24 August 2017

SOPHEON

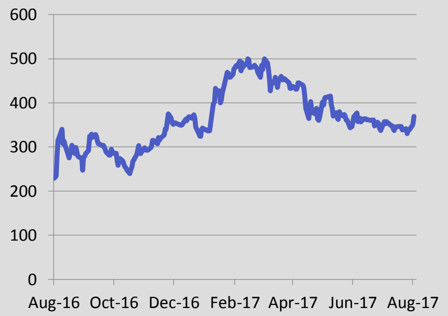
SOFTWARE AND COMPUTER SERVICES

SPE.L

369.0p

Market Cap: £27.5m

SHARE PRICE (p)



12m high/low	500.0p/229.0p

Source: LSE Data

KEY INFORMATION

Enterprise value	£24.2m
Index/market	AIM
Next results	Prelims – Mar '18
Gearing	n.a.
Interest cover	8.6x

SOPHEON IS A RESEARCH CLIENT OF PROGRESSIVE

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Solid interims show good momentum

Investment bearing fruit

Sopheon has reported good interim results with revenues just below half of our full year estimate and adjusted EBITDA just above. The announcement highlights a growing sales pipeline and good revenue visibility for the full year. Higher first half licence revenue was spread across a broad customer profile while maintenance and hosting revenues also increased. Annualised recurring revenues (ARR) improved to U$10.5 million at the end of H1. The outlook statement is positive and the Group says that it is considering the introduction of a formal dividend policy. We note the positive momentum in the business with a broad range of customers adopting Accolade for an increasingly wide range of applications. Although we leave estimates unchanged for now, the balance of risk appears to be on the upside, and we see the results as a clear and positive step in the right direction. We will revert with further analysis on the back of the company's upcoming customer event.

- Revenue visibility for full-year 2017 currently stands at $20.3 million compared to $18.4 million at this time last year and U$17.5 million in early June 2017. This includes closed license orders, contracted services business and recurring maintenance, hosting and rental streams. It does not include revenues from new sales opportunities expected to close during the remainder of 2017.
- Sopheon booked 28 licence orders in H1 2017 compared to 20 during H1 2016 (which had included one very substantial order). H1 2017 licence revenue was higher than the prior year was and more broadly spread across Sopheon's growing customer base - including several larger deals.
- Maintenance and hosting revenues increased, reflecting the long-term benefit of several license closings in 2016, as well as new business this year. Services revenues were relatively stable, reflecting continued delivery of implementation projects at a similar pace to the prior year.
- Sopheon notes that its inclusion in Gartner's Magic Quadrant for Project Portfolio Management makes it the only vendor referenced in both that and the Market Guide for Strategy Execution Software.

FYE DEC (US$M)	2015	2016	2017E	2018E	2019E
Revenue	20.9	23.2	26.0	29.0	32.0
Adjusted EBITDA	4.3	5.2	5.3	6.1	7.3
Adjusted PBT	1.6	2.7	2.7	3.5	4.6
Adjusted EPS (₵)	13.9	28.1	28.5	36.8	45.1
EV/Adj. EBITDA	7.6x	6.0x	5.9x	5.1x	4.3x
P/E	34.2x	16.9x	16.7x	12.9x	10.6x
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%

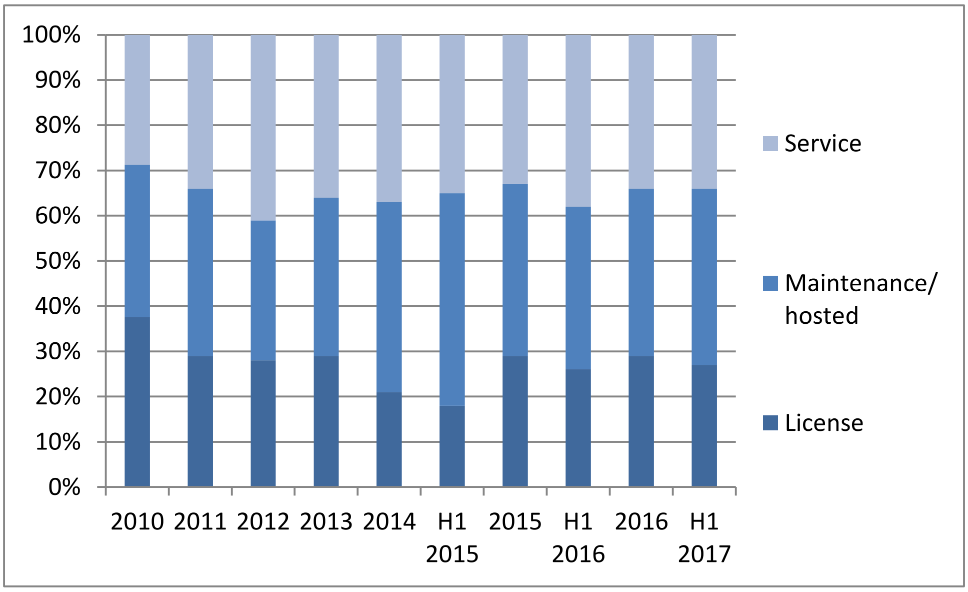
Source: Company Information and Progressive Equity Research estimates

Revenue

H1 2017E revenues of U$12.5 million represented a good performance against a strong U$11.5 million comparator in H1 2016. Sopheon saw 28 licence orders booked in H1, compared to 20 during H1 2016 – the comparator period containing a very substantial order from an existing enterprise-tier customer. Consequently, while H1 2017E licence revenue was higher than the prior year, it also contained a more even profile across several larger deals and a wider range of customers. Maintenance and hosting revenues reflected the long-term benefit of several licence closings in 2016 and new business closed in the first half. Services revenues were 'relatively stable'.

The evolution of Sopheon's revenue mix between licence, maintenance/hosting and service is shown in the chart below. Sopheon sells Accolade predominantly on perpetual licences with annual maintenance and hosting fees. Few deals are pure SaaS although there is a good level of recurring income. The recurring base of maintenance, hosting and SaaS contracts is now above U$10.5 million annually, compared to around U$9 million a year ago and US$9.9 million at the end of 2016, reflecting the momentum across the business. Sopheon has delivered the planned two new releases (Accolade 11.1 and Accolade 11.2) in February and July 2017.

Revenue by type (%)



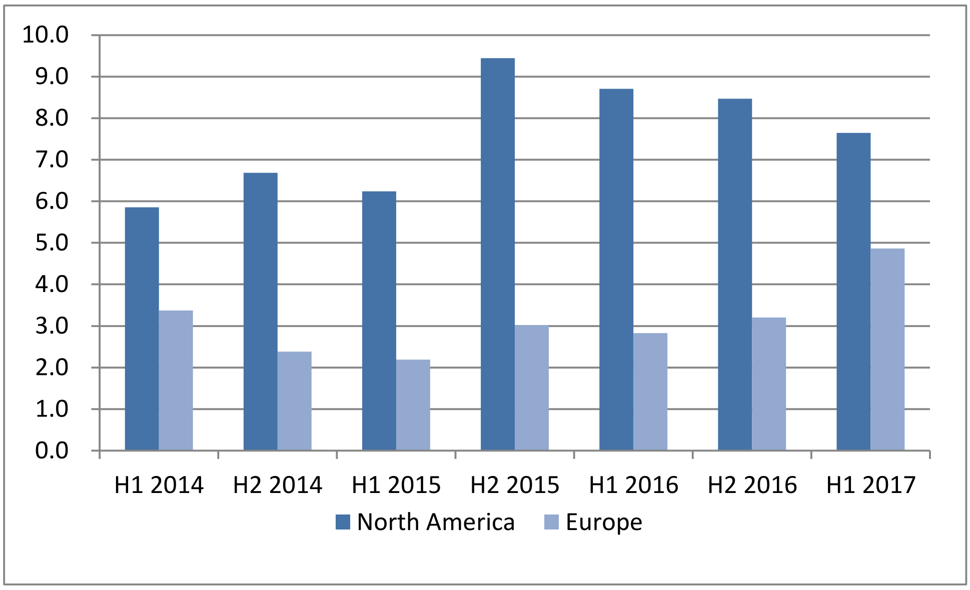
Source: Sopheon information

Revenue visibility for full-year 2017 currently stands at $20.3 million compared to $18.4 million at this time last year and U$17.5 million in early June 2017. It is worth noting that activity was particularly strong in Europe during the first half.

Sopheon continues to work with clients such as Electrolux, Honeywell, PepsiCo, Proctor & Gamble and Merck, to realise its growth strategy of increasing the "lifetime value" of its customer relationships through an expanded partnership model. We note that the Company has derived increased awareness of its solutions from, inter alia, being named a representative vendor in Gartner's 2016 Market Guide for Strategy Execution Software; voted a top provider of NPDI solutions by CGT magazine and receiving recognition in Gartner's new 2017 Magic Quadrant for Project Portfolio Management. Sopheon is the only vendor referenced in both the Gartner publications.

North America represented the majority of revenues once again – although at 61% of the total (H1 2016: 75%), the balance shifted considerably towards Europe and small contributions from Asia, Australia and the Middle East. The chart below shows the segmental reporting for the two main geographic areas for the last seven half year periods.

Revenue by segment (US$m)



Source: Sopheon information

Expenses

In terms of costs, we recall that Sopheon was slower in hiring people than it intended during 2016, so 2017 costs were likely to reflect this additional recruitment (which is why our estimate for Adjusted EBITDA in FY 2017E is broadly unchanged from the figure reported in FY 2016 despite the higher revenue estimate). The interim announcement says that several of these recruits are now in place or under offer, and that total headcount at 30 June was 123, resulting in an increase in staff costs of around U$0.4 million compared to the first half of 2016. Non-staff costs were up by almost U$0.4 million (U$0.2 million when excluding the effect of exchange rates following the Brexit vote which took place at the end of H1 2016). Overall, administrative costs increased from U$1.2 million to U$1.6 million. There were capitalised development costs of U$1 million compared to U$0.9 million last year, offset by U$1.1 million of amortization (2016: U$1 million). Sales and marketing costs reflected the investment in distribution made at the end of 2016, rising from U$3.3 million to U$3.5 million.

Sopheon continues to invest in its vertical industry focus areas of chemical, consumer goods, food & and beverage, aerospace and defence, and high-tech. Having signed customers in the insurance, services and automobile industries, it is also researching those sectors to assess new growth opportunities.

Profitability

Adjusted EBITDA in the first half of the current financial year was U$3.0 million (H1 2016: U$2.9 million). Reported PBT was U$1.8 million (H1 2016: U$1.6 million or U$1.4 million excluding the U$0.2 million exchange gain). Adjusted profit before tax was $1.8m (2016: $1.4m). Sopheon has reported fully diluted EPS of 18.01 cents (H1 2016, 17.16 cents). We continue to assume a 0% effective tax rate for our forecast horizon – this drives our lower reported EPS estimate for 2017 than 2016, which saw the benefit of the recognition of a U$1.3m deferred tax asset.

Net cash position

Sopheon ended the first half with net cash of U$6.6 million and the Company continues to repay its facility with Silicon Valley Bank.

The Company's convertible unsecured loan stock instrument has a current maturity date of January 2019 with a conversion price of 76.5p per share. Although we have diluted our EPS estimates assuming conversion of the convertible loan notes, we have also left the associated debt within our forecast balance sheet, both for prudence and to allow like-for-like comparison of the 2016 net cash figure (which was reduced by the convertible debt) with the equivalent figures for later years within our forecasts.

Outlook statement

The outlook statement notes that Sopheon continues to execute its strategy of building momentum and delivering on its main initiatives to generate faster growth through extending the reach of its solutions, growing the value of its customer relationships and expanding the benefits of its partnerships. Given the solid first half numbers, good momentum, increased market recognition and a healthy level of revenue visibility, the Board says that it is confident about meeting its goals for the full year and is 'actively considering the introduction of a dividend policy'. We see this as an indication of the Board's longer term confidence in Sopheon's future performance, the maturity of the business and future cash generation.

Sopheon has delivered a strong H1 performance, the group is seeing a broad range of customers adopting Accolade for an increasingly wide range of applications – the balance of risk within forecasts appears to be on the upside, and we see the H1 announcement as a clear and positive step in the right direction for the group. We will revert with further analysis on the back of the company's upcoming customer event.

Financial Summary

FINANCIAL SUMMARY

PROFIT & LOSS (US$m)	FY-14A	FY-15A	FY-16	FY-17E	FY-18E	FY-19E
Revenue	**18.3**	**20.9**	**23.2**	**26.0**	**29.0**	**32.0**
Adj EBITDA	1.4	4.1	5.2	5.3	6.1	7.3
Adj EBIT	**(0.9)**	**1.5**	**3.0**	**2.9**	**3.9**	**5.1**
Reported PBT	(1.3)	1.2	3.0	2.7	3.5	4.6
Fully adj PBT	**(1.3)**	**1.4**	**2.7**	**2.7**	**3.5**	**4.6**
NOPAT	(0.9)	1.5	3.0	2.9	3.9	5.1
Reported EPS (₵)	(18.4)	11.4	42.2	26.1	34.4	45.1
Fully adj EPS (₵)	**(18.4)**	**13.9**	**28.1**	**28.5**	**36.8**	**45.1**
Dividend per share (₵)	0.0	0.0	0.0	0.0	0.0	0.0

CASH FLOW & BALANCE SHEET	FY-14A	FY-15A	FY-16	FY-17E	FY-18E	FY-19E
Operating cash flow	3.2	4.3	5.4	5.3	5.6	6.8
Free Cash flow (US$m)	0.3	1.7	2.9	3.0	3.1	4.3
FCF per share (₵)	4.2	16.9	28.9	29.1	30.7	41.9
Acquisitions	0.0	0.0	0.0	0.0	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0	0.0
Shares issued	0.0	0.0	0.1	0.0	0.0	0.0
Net cash flow	**0.1**	**1.5**	**2.8**	**2.8**	**3.0**	**4.1**
Overdrafts / borrowings	(5.4)	(6.1)	(5.8)	(5.9)	(6.0)	(6.1)
Cash & equivalents	4.7	7.0	10.1	12.9	15.8	19.9
Net (Debt)/Cash	**(0.7)**	**0.9**	**4.2**	**6.9**	**9.8**	**13.8**

NAV AND RETURNS	FY-14A	FY-15A	FY-16	FY-17E	FY-18E	FY-19E
Net asset value	4.2	5.5	10.4	13.0	16.5	21.1
NAV/share (₵)	**58.3**	**76.0**	**142.3**	**174.6**	**221.8**	**283.5**
Net Tangible Asset Value	(1.6)	(0.0)	4.9	7.6	11.1	15.6
NTAV/share (₵)	**(22.6)**	**(0.7)**	**67.2**	**102.3**	**148.3**	**209.7**
Average equity	2.1	4.9	7.9	11.7	14.8	18.8
Post-tax ROE (%)	**-63.0%**	**23.1%**	**54.2%**	**22.8%**	**23.8%**	**24.4%**

METRICS	FY-14A	FY-15A	FY-16	FY-17E	FY-18E	FY-19E
Revenue growth	*n.a*	*14.2%*	*11.1%*	*12.0%*	*11.5%*	*10.3%*
Adj EBITDA growth	*n.a.*	*197.3%*	*27.4%*	*0.6%*	*15.5%*	*20.0%*
Adj EBIT growth	*n.a.*	*-268.2%*	*94.8%*	*-2.9%*	*33.0%*	*29.9%*
Adj PBT growth	*n.a.*	*-207.9%*	*84.2%*	*0.2%*	*32.1%*	*31.0%*
Adj EPS growth	*n.a.*	*-175.7%*	*102.4%*	*1.1%*	*29.4%*	*22.4%*
Dividend growth	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*
Adj EBIT margins	*-5.0%*	*7.4%*	*13.0%*	*11.2%*	*13.4%*	*15.8%*

VALUATION	FY-14A	FY-15A	FY-16	FY-17E	FY-18E	FY-19E
EV/Sales	1.7	1.5	1.3	1.2	1.1	1.0
EV/EBITDA	22.6	7.6	6.0	5.9	5.1	4.3
EV/NOPAT	(34.0)	20.2	10.4	10.7	8.0	6.2
PER	n.a.	34.2	16.9	16.7	12.9	10.6
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
FCF yield	0.9%	3.5%	6.1%	6.1%	6.4%	8.8%

Source: Company information, Progressive Equity Research estimates

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