

SOPHEON

SOFTWARE & COMPUTER SERVICES

SPE.L

1147.5p

Market Cap: £118.5m

SHARE PRICE (p)


12m high/low

1370p/655p

Source: LSE Data

KEY INFORMATION

Enterprise value	£111.3m
Index/market	AIM
Next news	AGM, 13 June 2019
Gearing	N/A
Interest cover	N/A

**SOPHEON IS A RESEARCH CLIENT OF
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An excellent performance in FY 2018...

...provides a platform for future growth

Sopheon has reported full year results in line with its January trading update and a little ahead of our estimates which we upgraded at that time. Sopheon saw a strong finish to 2018 with a number of transactions further underlining the adaptability and flexibility of the Accolade platform. Overall, Sopheon won 18 new customers compared to 13 in 2017. Chairman Barry Mence says that Sopheon has 'a unique opportunity' to build on its category leader status by accelerating investment. Revenue visibility is already at \$20.6 million for FY 2019E and the announcement highlights a sales pipeline which includes a number of 'large opportunities'. Management continues to look at acquisition opportunities to augment organic growth. After an excellent FY 2018 which has enabled Sopheon to increase its dividend by 30%, we note the Board's intention to speed up investment during the year and we make changes to our FY 2019E estimates which leave Adj EBITDA a touch lower than our previous estimate. We introduce FY 2020E estimates which reflect a resumption of good growth in Adj EBITDA on the expectation of moderated investment spend.

- Sopheon reported a 19% increase in revenue to \$33.9m while reported EBITDA of \$8.9m was an increase even on the strong prior year comparator of \$8m. Profit after tax rose to \$6.9m (FY 2017: \$5.4m) with fully diluted EPS increasing by 16% to 65.0 cents from 55.9 cents in FY 2017. The dividend increased by 30% to 3.25p. The Group ended the year with net cash of \$16.7m, up from \$9.5m at the end of FY 2017.
- With a tailwind from 2018 and 'a few early-reported sales in 2019', current year revenue visibility is now an encouraging \$20.6m compared to \$19.3m at this time last year.
- While Sopheon's European business was particularly strong in FY 2017, both the Americas and Europe grew revenues further in FY 2018 with the emphasis moving back to North America.
- The outlook statement re-emphasises the opportunity that a strong business performance has brought to accelerate investment – in particular to hire more of the right people in FY 2019E. The Group also remains 'open to M&A opportunities' which align with its strategic priorities.
- Overall, we view Sopheon's upcoming acceleration in investment in organic initiatives as well-timed, with the group seeking to exploit a burgeoning market opportunity, the scale of which is only just beginning to show through in financial results.**

FYE DEC (\$M)	2016	2017	2018	2019E	2020E
Revenue	23.2	28.5	33.9	36.5	41.5
Adj EBITDA	5.3	8.2	9.4	9.0	10.5
Fully adj PBT	2.7	5.3	6.9	6.5	7.8
Fully adj dil EPS (c)	28.1	50.9	59.8	56.2	67.1
EV/Sales (x)	6.3	5.2	4.3	4.0	3.5
EV/EBITDA (x)	27.7	17.9	15.6	16.4	14.0
PER (x)	53.8	29.8	25.3	26.9	22.6

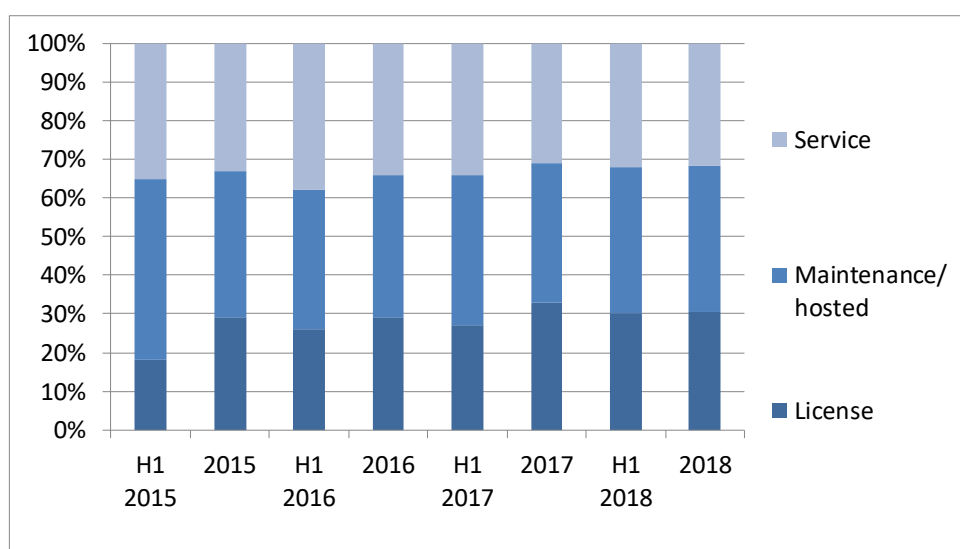
Source: Company Information and Progressive Equity Research estimates

FY 2018 results

A strong year brings the opportunity for accelerated investment

Sopheon's strong performance in FY 2018 included the addition of 18 new customers (of which 5 were SaaS) compared to 13 in FY 2017. Sopheon's blue chip customer base features increasingly enterprise-focused customer relationships and over two-thirds of its annual revenues come from existing customers. 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. With further increases in maintenance and hosting, Sopheon ended 2018 with a total recurring revenue run rate of \$15m (compared to \$12m the year before) of which approximately \$3m is SaaS and hosting. The evolution of Sopheon's revenue mix between licence, maintenance/hosting and service is shown in the chart below.

Revenue by type (%)



Source: Sopheon information

Revenue visibility

With a tailwind from 2018 and 'a few early-reported sales in 2019', current year revenue visibility is now an encouraging \$20.6m compared to \$19.3m at this time last year. As in the last couple of years, Sopheon saw a slight bias towards H2 in its results although it was the signing of a number of substantial transactions at the end of Q3 which had most influence compared to the notable impact of Q4 activity in previous years. In FY 2018, 53% of revenues came in the second half compared to 55% the year before.

Progress brings opportunities to invest in future growth

In his commentary, Chairman Barry Mence highlights the progress that Sopheon has made in broadening its offering from one that enabled its customers to improve innovation, to one that helps major enterprises achieve their strategic goals. We see the evolution of Sopheon and its recent strength of performance as providing an excellent platform from which to target further growth.

To that end, we view the upcoming investment in organic initiatives as well-timed, as it seeks to exploit a burgeoning market opportunity as Sopheon concentrates on its three areas of strategic focus:

- to extend the footprint in its existing customer base with an enterprise platform approach
 - “leverage blue chip references to extend Accolade as the digital platform of choice to digitalize corporate strategy and operational execution”
- to target new business with a vertical focus
 - “generate faster Net New logo growth in target industries through deeper specialization and domain-specific expertise.”
- to develop a partnership ecosystem
 - “multiply our growth through developing and monetizing an Accolade ecosystem of distribution partnerships – channel, strategic and geographical.”

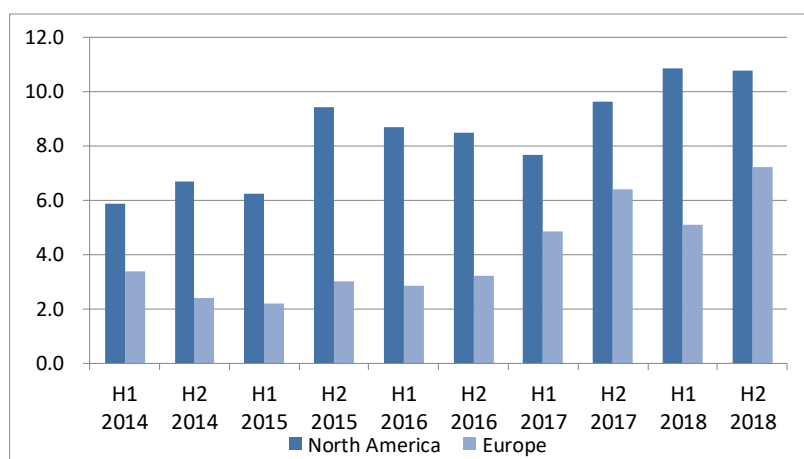
The announcement notes that there are significant market opportunities that are attuned to these strategies. For example, large companies need to follow digital transformation strategies and initiatives as quickly as possible and Sopheon sees this as a unique opportunity to help clients digitalise corporate strategic initiatives in a new emerging market of considerable potential size.

The outlook statement re-emphasises the opportunity that a strong business performance has brought to accelerate investment – in particular to hire more of the right people in FY 2019E. The Group also remains ‘open to M&A opportunities’ which align with its strategic priorities.

Numbers

All growth in FY 2018 was organic as Sopheon reported a 19% increase in revenue to \$33.9m from \$28.5m in 2017, split roughly half and half between software related revenues and service-related revenues. The Group’s base of recurring business rose to \$15m at the end of 2018, compared to \$12m the year before and the announcement says that maintenance has a run rate of \$12m, with an additional \$1.5m each in hosting services and SaaS subscriptions. Over a quarter of its active perpetual customers are hosted by Sopheon. Overall retention of recurring revenue increased to 97% by value (2017: 95%). As we note elsewhere, revenue visibility for the year stands at \$20.6m compared to \$19.3m at this time a year ago. While Sopheon’s European business was particularly strong in FY 2017, both the Americas and Europe grew revenues further in FY 2018 with the emphasis moving back to North America. The chart below shows the revenue of the two segments.

Revenue by segment (US\$m)



Source: Sopheon information

Gross margin was 71% compared to 73% in 2017 reflecting greater services intensity and an overall similar mix to that seen in FY 2016 when the margin was 70%.

R&D Expenditure

Expenditure in product development increased by \$0.9m to \$5.5m in FY 2018 with the income statement reflecting an increase from \$4.3m to \$5.1m following the recruitment of additional development resources during the year. It was in this area that Sopheon experienced a tight recruitment market - in particular for US software engineers – during FY 2018 which resulted in lower than anticipated investment costs.

Other Operating Costs

In line with revenue growth, headcount has expanded with staff numbers reaching 147 by the end of FY 2018 and the Group still expects to make 'a large number of hires' in 2019 to support further growth. Overall costs in the sales and marketing area increased by approximately \$0.8m, again mainly due to additional staff hires. Administration costs rose by approximately \$0.6m, also reflecting the pace with our growth in the business and includes the impact of the notional charge for share option grants.

Currency

Sopheon does not hedge currency cash holdings but maintains cash balances in local currency within an entity while aiming to incorporate a natural hedge through broadly matching revenues and costs within common currency entities, reducing the need for active currency management.

EBITDA and PBT

Sopheon reported strong growth in EBITDA in FY 2018 to \$8.9m from the already impressive comparator of \$8.0m in 2017 - a position which was aided by the lower than anticipated level of investment during the year just reported. A lower finance expense reflected the positive changes in the funding structure of the business to augment PBT growth to \$6.4m from \$5.1m in FY 2017.

Taxation

The net tax credit of \$0.5m (2017: \$0.2m) reflects the following:

- a current tax charge of approximately \$0.2m was incurred in 2018 (2017: \$0.4m) of which a third arose in Germany and the balance were state taxes in the United States
- the rising profit trend allows recognition of the substantial deferred tax asset which resulted in added recognition of a further \$0.5m in FY 2018 (FY 2017: \$0.7m) - out of a total potential asset of approximately \$13m
- reforms of the corporate alternative minimum tax regime in the US entitled Sopheon to refund producing a \$0.2m credit.

Earnings and dividend

Profit after tax rose to \$6.9m (FY 2017: \$5.4m) with fully diluted EPS increasing by 16% to 65.0 cents from 55.9 cents in FY 2017. The dividend increased by 30% to 3.25p. The Group ended the year with net cash of \$16.7m from \$9.5m at the end of FY 2017

Estimates

After a strong FY 2018 we note 1) current revenue visibility and 2) the Board's intention to speed up investment during the year. In addition, our adjusted numbers are now net of Share Based Payments which look set to remain at the higher level seen in FY 2018 of around \$0.5m. They also contain a nominal tax charge although we note Sopheon's substantial potential deferred tax asset. In combination, we make a minor upgrade to our FY 2019E revenue estimate but increase cost expectations further which leaves Adj EBITDA for FY 2019E a touch below our previous restated estimate and a little lower than the level reported for FY 2018. We introduce FY 2020E estimates which reflect a resumption of good growth in Adj EBITDA.

FY 2018 actuals, FY 2019E estimate changes and new FY 2020E numbers

\$m unless stated	FY 2018			FY 2019E			FY 2020E
	Est	Act	Diff. (%)	Old	New	Change (%)	New
Revenue	33.0	33.9	3%	36.0	36.5	1%	41.5
Adj EBITDA	9.2	9.4	3%	9.1	9.0	-1%	10.5
Fully adj PBT	6.4	6.9	8%	6.4	6.5	2%	7.8
Diluted EPS (c)	59.0	65.0	10%	59.0	56.4	-4%	68.3
Fully adj dil EPS (c)	58.0	59.8	3%	58.0	56.2	-3%	67.1

Source: *Progressive Equity Research*

Summary and conclusion

The 2018 results reported this morning represent another major step forward in financial performance – the group continues to expand its client base, to sell into ever more end use cases, and to evolve the reach of its offering. Sopheon has, for some time, been seeking to invest further in its teams, and we continue to forecast such investment – hopeful that 2019 will allow the group to hire a good number of new, high quality, members of its team. We expect further progress in terms of customers, projects and revenue, but we have structured our upgrades as shown above, to cater for the potential incremental hires – whose benefit will only likely be felt in later years. We remain believers in the Sopheon strategy, and look forward to further evidence of success during 2019 and beyond.

Financial Summary: Sopheon

Year end: December (\$m unless shown)

	2016	2017	2018	2019E	2020E
PROFIT & LOSS					
Revenue	23.2	28.5	33.9	36.5	41.5
Adj EBITDA	5.3	8.2	9.4	9.0	10.5
Adj EBIT	3.1	5.8	6.9	6.3	7.6
Reported PBT	3.1	5.1	6.4	6.0	7.3
Fully adj PBT	2.7	5.3	6.9	6.5	7.8
NOPAT	3.0	5.3	6.3	5.8	7.0
Reported Dil EPS (c)	42.8	55.9	65.0	56.4	68.3
Fully adj dil EPS (c)	28.1	50.9	59.8	56.2	67.1
Dividend per share (p)	0.0	2.5	3.3	3.9	4.6
CASH FLOW & BALANCE SHEET					
Operating cash flow	5.5	6.0	10.4	8.1	9.2
Free Cash flow	3.0	2.8	7.6	4.9	5.9
FCF per share (c)	29.1	27.1	73.3	47.5	57.6
Acquisitions	0.0	0.0	0.0	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0
Shares issued	0.1	0.0	0.2	0.0	0.0
Net cash flow	2.9	3.1	7.8	4.9	5.9
Overdrafts / borrowings	(5.8)	(3.2)	(0.4)	(0.4)	(0.4)
Cash & equivalents	10.1	12.7	17.1	22.0	27.9
Net (Debt)/Cash	4.2	9.5	16.7	21.6	27.6
NAV AND RETURNS					
Net asset value	10.4	18.6	25.6	31.3	38.2
NAV/share (c)	100.3	180.0	247.7	303.1	370.1
Net Tangible Asset Value	0.2	0.4	0.5	0.8	0.9
NTAV/share (c)	2.3	4.0	5.2	7.4	8.2
Average equity	7.9	14.5	22.1	28.5	34.8
Post-tax ROE (%)	37.7%	36.5%	28.7%	20.5%	20.2%
METRICS					
Revenue growth	11.1%	23.0%	18.9%	7.6%	13.6%
Adj EBITDA growth	28.9%	54.8%	14.7%	(4.6%)	16.9%
Adj EBIT growth	98.8%	87.5%	19.6%	(8.0%)	20.4%
Adj PBT growth	88.5%	95.1%	30.5%	(5.4%)	19.4%
Adj EPS growth	102.4%	80.7%	17.5%	(5.9%)	19.4%
Dividend growth	N/A	N/A	30.0%	18.5%	18.2%
Adj EBIT margins	13.2%	20.2%	20.3%	17.4%	18.4%
VALUATION					
EV/Sales (x)	6.3	5.2	4.3	4.0	3.5
EV/EBITDA (x)	27.7	17.9	15.6	16.4	14.0
EV/NOPAT (x)	49.0	27.8	23.2	25.2	20.9
PER (x)	53.8	29.8	25.3	26.9	22.6
Dividend yield	N/A	0.2%	0.2%	0.3%	0.3%
FCF yield	1.9%	1.8%	4.8%	3.1%	3.8%

Source: Company information and Progressive Equity Research estimates

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