

# SOPHEON

## SOFTWARE & COMPUTER SERVICES

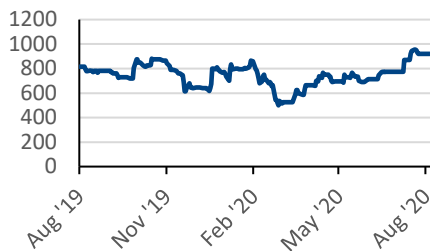
27 August 2020

### SPE.L

920p

Market Cap: £93.6m

### SHARE PRICE (p)



12m high/low 955p/500p

Source: LSE Data

### KEY DATA

|                     |                         |
|---------------------|-------------------------|
| Net (Debt)/Cash     | \$21.9m (at 30/06/20)   |
| Enterprise value    | £75.7m                  |
| Index/market        | AIM                     |
| Next news           | Trading update, Jan '21 |
| Shares in Issue (m) | 10.2                    |
| Chairman            | Barry Mence             |
| Chief Executive     | Andy Michuda            |
| Finance Director    | Arif Karimjee           |

### COMPANY DESCRIPTION

Sopheon is an international provider of software and services for product life cycle management

[www.sopheon.com](http://www.sopheon.com)

SOPHEON IS A RESEARCH CLIENT OF PROGRESSIVE

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## A resilient performance in H1 20

### Current trading and pipeline bode well for H2

Sopheon has reported interim results which reflect a resilient performance despite some impact from COVID-19 on its client retention and pace of growth. The Group still produced revenues slightly up on H1 19. Happily, its solutions continue to attract new customers, as evidenced by the Mondelez deal announced in July, a healthy sales pipeline and a doubling of the value of new customer sales bookings. With a historical Q4 weighting for revenues, and bearing in mind the uncertainties in the current operating environment, we do not reintroduce estimates at present. However, we would hope to revisit that in early 2021 in conjunction with trading or results news. Meanwhile, we note the good revenue visibility for the current financial year, the improving rate of Annual Recurring Revenue (ARR) and Sopheon's strong balance sheet position.

- H1 20 revenue was \$13.9m compared to \$13.7m in H1 19. Sopheon reported Adjusted EBITDA of \$2.6m in H1 20 (H1 19: \$2.8m) following increased R&D spending and the Group reported H1 20 PBT of \$0.4m (H1 19: \$0.9m). Basic and diluted EPS were 3.23c and 3.10c respectively (H1 19: 6.33c and 5.98c). It ended the period with cash of \$21.9m and no borrowings.
- Sopheon's transition to a SaaS model is well underway and the shift from traditional perpetual licences continues with all new customer licences in 2020 so far being SaaS.
- With further orders from new and existing customers booked so far in Q3, revenue visibility for FY 20E is currently \$25.5m compared to \$21.2m at the time of the FY 19 results announcement in March 2020. Sopheon's ARR currently stands at \$16.5m compared to \$15.9m at the start of this year.
- Sopheon's trading has historically been weighted towards Q4 and we expect this to be the case in FY 20E as well. While the operating environment remains uncertain, we note the Board's confidence in the outlook and the signing of four \$1m-plus orders so far this year.

Although COVID-19 affected its H1 20 results, we think that Sopheon has fared better than many. It is well-positioned with solutions which have proved to be highly appropriate for the need of businesses to innovate and digitalise at a faster pace. The Group continues to garner new contracts which affirm Accolade's qualities, displaying continuing sales traction.

| FYE DEC (\$M)         | 2016  | 2017  | 2018  | 2019  |
|-----------------------|-------|-------|-------|-------|
| Revenue               | 23.2  | 28.5  | 33.9  | 30.3  |
| Adj EBITDA            | 5.3   | 8.2   | 9.4   | 6.4   |
| Fully adj PBT         | 2.7   | 5.3   | 6.9   | 3.1   |
| Fully adj dil EPS (c) | 28.1  | 50.9  | 59.8  | 26.5  |
| EV/Sales (x)          | 4.0x  | 3.2x  | 2.7x  | 3.1x  |
| EV/EBITDA (x)         | 17.4x | 11.2x | 9.8x  | 14.3x |
| PER (x)               | 39.9x | 22.1x | 18.8x | 42.3x |

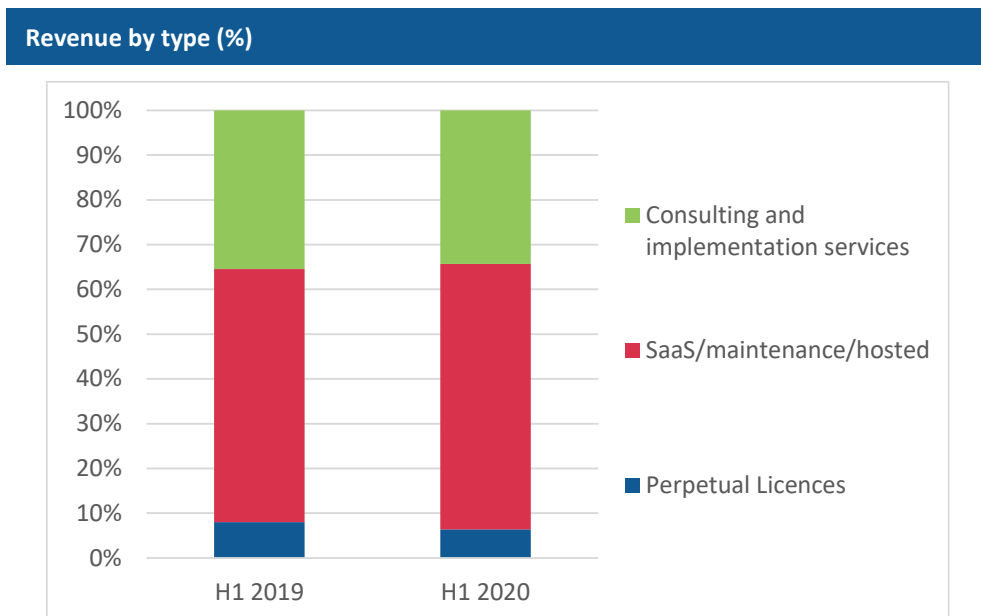
Source: Company Information and Progressive Equity Research estimates

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## H1 20 results

### Revenue



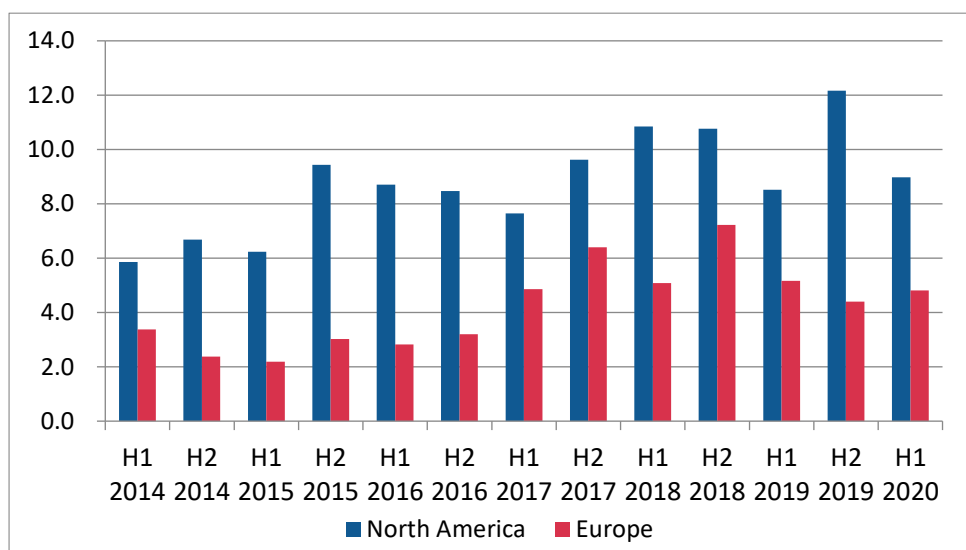
Source: Company information

First half revenue was \$13.9m compared to \$13.7m in H1 19. In its May trading update, Sopheon reported that, at that stage, retention levels for ARR had remained good. Subsequently, the Group has experienced some increase in customer non-renewal notices or user reduction notices. Consequently, its ARR retention rate is currently around 94% (on a gross basis). Lower retention rates reflect, inter alia, budget cuts and M&A. However, management notes that this has been more than offset by new license orders which have added some \$1.5m of new ARR. Sopheon’s ARR currently stands at \$16.5m compared to \$15.9m at the start of this year.

With further orders from new and existing customers booked so far in Q3, revenue visibility for FY 20E is currently \$25.5m compared to \$21.2m at the time of the FY 19 results announcement in March 2020.

The chart below shows that the geographical split of revenue continues to reflect a split of around two-thirds to one-third between North America and Europe respectively.

**Revenue by geographical segment (\$m)**



Source: Company information

**Margins**

Gross margin for the period reduced slightly to 67% compared with 69% in H1 19 due to slightly higher headcount (average headcount in H1 20 was 162 versus 156 in H1 19) and movement in indirect taxes.

**Expenses**

The increase in sales and marketing costs from \$4.3m to \$4.4m in H1 20 reflects the staff levels mentioned above, offset by lower costs in travel and commissions. Having held back recruitment in FY 20 so far, Sopheon has started to hire again, mainly in the development area. The net R&D expense in H1 20 rose to \$2.7m from \$2.5m in H1 19. Capitalisation of product development costs was \$1.7m compared to \$1.6m in H1 19 with amortisation of \$1.3m compared to \$1.1m in H1 19. COVID-19 related subsidies received in the Netherlands and exchange rate movements helped administrative expenses to reduce to \$1.8m from \$2.0m in H1 19. Sopheon continues to invest in its cloud conversion strategy.

**Profitability**

Sopheon reported Adjusted EBITDA of \$2.6m in H1 20 (H1 19: \$2.8m) and H1 20 PBT of \$0.4m (H1 19: \$0.9m). This result includes net interest, depreciation and amortization and share-based payment costs amounting to \$2.1m (2019: \$1.9m). There was no adjustment to the deferred tax asset in H1 20 although provision was made for c. \$0.1m in current tax for US state taxes and German corporation tax in the first half (H1 19: \$0.2m) with Sopheon recording basic and diluted EPS of 3.23c and 3.10c respectively (H1 19: 6.33c and 5.98c).

**Cash**

Sopheon had gross and net cash (excluding IFRS 16 lease liabilities) of \$21.9m at the end of June 2020, up from \$19.4m at the end of December 2019. Sopheon had no borrowings at either point. Of the June 2020 cash balance, around \$10.6m was held in US Dollars, \$8.8m in Euros and the balance of \$2.4m in Sterling.

## Trading

Sopheon's trading has historically been weighted towards the second half of the year and, in particular, towards Q4. With the first half having been impacted by COVID-19, we expect this to be the case in the current financial year as well. Clearly, uncertainty remains over how the rest of the year will pan out with regard to the further possible effects of COVID-19 on the operating environment. However, it is clear that the coronavirus pandemic has, in many cases, accelerated companies' needs to address digitalisation or the updating of strategies and innovation. In that respect, one can see the source of the resilience in the demand for Sopheon's solutions, while also acknowledging the effect of COVID-19 on momentum in its growth during the first half of the current financial year.

The Group had enjoyed a strong end to 2019 but, at 13, the number of software transactions in the first half of the current financial year was down on the 18 recorded in the comparator period last year. While Sopheon took on 7 new customers in H1 19, they were for smaller deal sizes. The transition to a cloud-based model is still at a relatively early stage for Sopheon so perpetual licences still currently represent a significant part of the existing customer base.

In March, the FY 19 results announcement highlighted that, on the deals where the pipeline already indicated a buying preference, approximately 45% of the software-related value represents SaaS opportunity as opposed to perpetual. It broadly expected that the majority of new customers will opt for SaaS while the majority of existing customers are expected to continue to opt for perpetual licensing as a natural extension of their existing licensed base – although the Group is looking to migrate existing customers where possible.

May's trading update confirmed that and that the Group had already instituted a number of revisions to its standard pricing models, service delivery models and commission plans.

The interim announcement notes that the 12-month forward sales pipeline is 'holding broadly steady' in terms of overall value since the start of the year, which had represented a strong start to the period. The new business pipeline continues to reflect a high proportion of (SaaS) opportunities. Sopheon has signed four \$1m plus orders since the start of the year. The value of new customer sales bookings has doubled year on year, and all new customer licenses were SaaS. With those trends expected to continue, as the transition progresses over the next two to three years, the proportion of SaaS contracts is expected to increase. The main caveat had been the speed with which deals are being closed in the current environment. However, the current trading comments look encouraging to us and, since the end of June, Sopheon has closed another 8 software deals, including a further 2 new customers.

## M&A

The Group has previously said that it would only engage in M&A if it improved its speed and competency in achieving its strategic goals. The interim results announcement notes that management is starting to 'take a more structured look at M&A opportunities' while continuing to invest elsewhere and maintaining the pace of new releases for the Accolade platform.

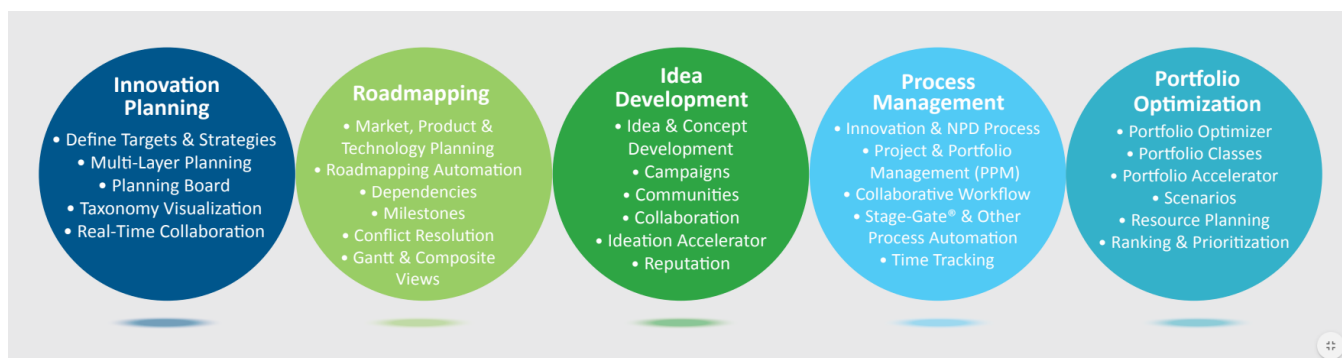
## Mondelez

The recent (end July) contract win for Accolade with global snack food giant, Mondelez, as well as being a material contract, was a useful reminder of the Group’s ability to win material deals despite the pressures of COVID-19. We also see it as another strong reference point for the business and an affirmation that Accolade’s innovation management platform is seen as a market-leading solution by blue-chip customers. The deal is also a SaaS implementation, in line with Sopheon’s strategy and will feature a rapid rollout of Accolade, which is targeted to go live before the end of 2020, to replace two different legacy platforms. We give a brief reminder of Accolade’s attributes below.

## Accolade

Sopheon’s Accolade solution provides its customers with complete enterprise innovation management solutions which provide fully integrated coverage for the entire innovation management and new product development lifecycle. Sopheon’s solutions have been implemented by over 250 customers with over 60,000 users in over 50 countries. Sopheon provides complete enterprise innovation management solutions including software, expertise, and best practices, that enable them to achieve exceptional long-term revenue growth and profitability. As we note earlier

### Accolade solution



Source: Company information

The Group has expanded Accolade’s target market by enabling customers to achieve their strategic goals as well as helping R&D organizations to improve innovation – particularly important as the digitalisation of organisations proceeds rapidly.

As well as extending the use cases of Accolade and deepening its specialisation and domain expertise to gather new customers, Sopheon is in the process of transforming into a cloud business – which management acknowledges may take several years – which will help grow recurring revenue. It is also encouraging existing perpetual customers to move into its hosting centres.

Sopheon continues to invest in the development of Accolade and it released Accolade version 13.1 in May which incorporated Accolade Connect for Microsoft® Teams, a cloud-only offering. The Group notes that it is ‘busy with the next release’.

**Financial Summary: Sopheon**

Year end: December (\$m unless shown)

|                                      | 2016   | 2017  | 2018  | 2019    |
|--------------------------------------|--------|-------|-------|---------|
| <b>PROFIT &amp; LOSS</b>             |        |       |       |         |
| Revenue                              | 23.2   | 28.5  | 33.9  | 30.3    |
| Adj EBITDA                           | 5.3    | 8.2   | 9.4   | 6.4     |
| Adj EBIT                             | 3.1    | 5.8   | 6.9   | 3.0     |
| Reported PBT                         | 3.1    | 5.1   | 6.4   | 2.5     |
| Fully adj PBT                        | 2.7    | 5.3   | 6.9   | 3.1     |
| NOPAT                                | 3.0    | 5.3   | 6.3   | 2.8     |
| Reported Dil EPS (c)                 | 42.8   | 55.9  | 65.0  | 19.2    |
| Fully adj dil EPS (c)                | 28.1   | 50.9  | 59.8  | 26.5    |
| Dividend per share (p)               | 0.0    | 2.5   | 3.25  | 3.25    |
| <b>CASH FLOW &amp; BALANCE SHEET</b> |        |       |       |         |
| Operating cash flow                  | 5.5    | 6.0   | 9.8   | 7.1     |
| Free Cash flow                       | 3.0    | 2.8   | 7.0   | 3.4     |
| FCF per share (c)                    | 29.5   | 27.1  | 65.6  | 31.6    |
| Acquisitions                         | 0.0    | 0.0   | 0.0   | 0.0     |
| Disposals                            | 0.0    | 0.0   | 0.0   | 0.0     |
| Shares issued                        | 0.1    | 0.0   | 0.2   | 0.1     |
| Net cash flow                        | 2.9    | 3.1   | 7.2   | 2.7     |
| Overdrafts / borrowings              | (5.8)  | (3.2) | (0.4) | 0.0     |
| Cash & equivalents                   | 10.1   | 12.7  | 17.1  | 19.4    |
| Net (Debt)/Cash                      | 4.2    | 9.5   | 16.7  | 19.4    |
| <b>NAV AND RETURNS</b>               |        |       |       |         |
| Net asset value                      | 10.4   | 18.6  | 25.6  | 27.9    |
| NAV/share (c)                        | 142.3  | 186.0 | 252.2 | 274.2   |
| Net Tangible Asset Value             | 0.2    | 0.4   | 0.5   | 0.5     |
| NTAV/share (c)                       | 3.3    | 4.1   | 5.2   | 5.0     |
| Average equity                       | 7.9    | 14.5  | 22.1  | 26.7    |
| Post-tax ROE (%)                     | 37.7%  | 36.5% | 28.7% | 10.5%   |
| <b>METRICS</b>                       |        |       |       |         |
| Revenue growth                       | 11.1%  | 23.0% | 18.9% | (10.8%) |
| Adj EBITDA growth                    | 28.9%  | 54.8% | 14.7% | (31.6%) |
| Adj EBIT growth                      | 98.8%  | 87.5% | 19.6% | (55.9%) |
| Adj PBT growth                       | 88.5%  | 95.1% | 30.5% | (55.5%) |
| Adj EPS growth                       | 102.4% | 80.7% | 17.5% | (55.6%) |
| Dividend growth                      | N/A    | N/A   | 30.0% | 0.0%    |
| Adj EBIT margins                     | 13.2%  | 20.2% | 20.3% | 10.0%   |
| <b>VALUATION</b>                     |        |       |       |         |
| EV/Sales (x)                         | 4.0    | 3.2   | 2.7   | 3.1     |
| EV/EBITDA (x)                        | 17.4   | 11.2  | 9.8   | 14.3    |
| EV/NOPAT (x)                         | 30.8   | 17.5  | 14.6  | 33.0    |
| PER (x)                              | 39.9   | 22.1  | 18.8  | 42.3    |
| Dividend yield                       | N/A    | 0.2%  | 0.3%  | 0.3%    |
| FCF yield                            | 2.6%   | 2.4%  | 5.8%  | 2.8%    |

Source: Company information and Progressive Equity Research estimates

**Disclaimers and Disclosures**

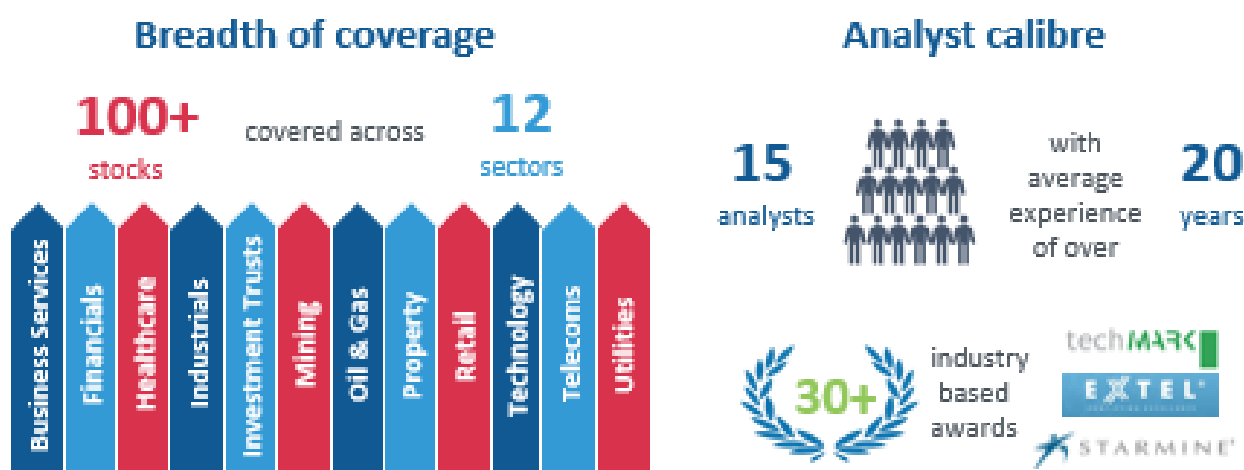
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