

Date 15/06/2015

**Recommendation:**

Buy (previous: Buy)  
PT: € 46.00 (previous: € 51.15)

**GK Software**

Industry: Software  
Segment: Prime Standard  
ISIN: DE0007571424  
Reuters: GKSG

**Price (12/06/2015): € 32.80**

Market Cap € 62 Mio.

EV € 72 Mio.

Ø-volume `000€ (100 days) 63.5

52W High 47.00

52W Low 32.20

**Financial Calendar**

AGM 29/06/2015

Q2 2015 28/08/2015

**Shareholder structure**

GK Software Hldg. 49.8%

SAP AG 5.3%

R.Gläß 3.3%

S.Kronmüller 2.3%

**Share performance**



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# GK SOFTWARE AG

## Progress of international expansion efforts temporarily putting pressure on EBIT margin

The sales figures for both FY 2014 and Q1 2015 have (slightly) exceeded our expectations, however the same cannot be said of the EBIT for 2014 (€ 0.2 million projected vs. € -3 million actually realised), with this discrepancy being attributable to a value adjustment (in the amount of € 0.87 million) and shifts in the sales mix: High-margin licensing revenue was approximately one third lower in 2014 than in the previous year. Personnel-related costs were generated in advance for important new customer projects which were not completed in 2014. However GK's current project opportunities should enable it to amortize these costs more effectively in 2015. However, we have significantly lowered our previous projected margins for 2015, while maintaining that an EBIT margin in a low positive amount remains likely in 2015. In terms of its EV-to-sales ratio, GK Software's performance will prove to be favourable on a peer group comparison if it succeeds in regaining its EBIT margin target (15%) over the medium term as planned.

- ✓ Q1 2015: All of the operating segments together realised an increase in sales of almost 40% in the first quarter, with licenses experiencing the greatest growth (+323%), on the basis of low figures for the previous year. Services also recorded strong growth of +49.3%, while the maintenance business, which experiences growth in line with that of the installed systems base, grew by +14.6%. We believe the fast pace of internationalisation and the resultant costs to be the primary reason for the negative amount of EBIT realised by GK in Q1. From a strategic perspective, we feel that it is appropriate and necessary to exploit the current window of opportunity (presented by the upcoming launch of omni-channel retailing strategies) in order to gain further market shares at the international level – even where this temporarily involves negative EBIT results.
- ✓ We are of the opinion that the market environment is stable and that GK is well positioned - among other things as a result of its partnership with SAP - to benefit from the strategic concept of omni-channel retailing and the ongoing internationalisation of the market. The company explicitly emphasises that the capturing of new target markets takes priority for it over short-term margin growth.

**Outlook:** GK plans to increase its GK/Retail sales (2014: € 31.7 million) by a not insignificant amount in 2015. It intends to increase the sales generated by this business division by 50% over a period of 3-4 years; this growth may well come on in leaps and bounds. It is expected that the sales generated by the Services business segment will be slightly higher than in the previous year (€ 11.92 million), while the small SQRS business division (2014: € 1.05 million) looks set to experience a further fall in sales. The company expects to achieve its (Group) EBIT margin target (15%) in three to four years, stating that EBIT in a low negative amount may be realised in 2015 in light of the priority currently being accorded to further growth.

### Key figures - GK Software AG

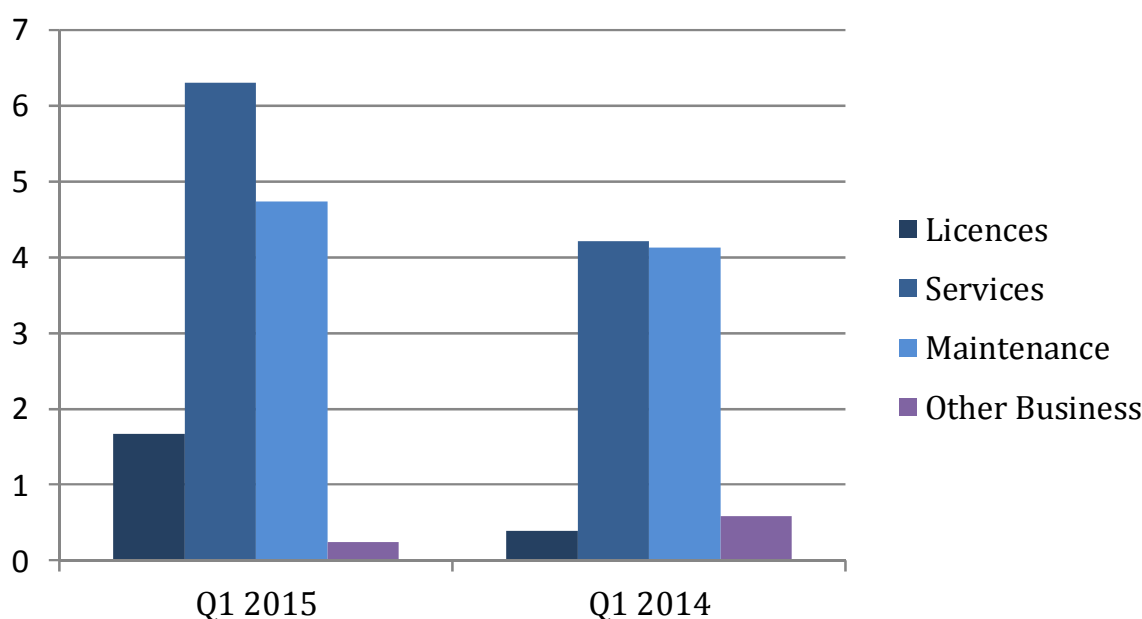
|        | Sales | EBITDA | EBIT | EPS (adj.) | EV/Sales | P/E    |
|--------|-------|--------|------|------------|----------|--------|
| 2013 a | 42.5  | 3.3    | 1.0  | 0.34       | 1.08     | 93.50  |
| 2014 a | 44.6  | 0.0    | -3.0 | -0.99      | 1.61     | -42.38 |
| 2015 e | 54.4  | 4.5    | 0.8  | 0.14       | 1.32     | 236.10 |
| 2016 e | 60.9  | 8.7    | 4.6  | 1.38       | 1.18     | 23.80  |
| 2017 e | 64.9  | 12.2   | 7.8  | 2.64       | 1.11     | 12.43  |

Source: Company Data, EQUI.TS GmbH

## 2014 and Q1 2015

The operating margin was primarily affected by the non-completion (contrary to expectations) of new projects in 2014, which had an adverse effect on the sales mix. Thus, there was a fall (-31.6%) in licensing revenue, which typically realises high margins, which could not be offset in overall earnings by growth in the services (+22%) and maintenance (+6.9%) business, particularly in light of GK's further expansion of its capacity in expectation of upcoming projects (increase personnel-related costs in 2014: 12.3%). Growth of approximately 40% was recorded in Q1, and overwhelmingly attributable to revenue from licenses (>+300%) and services (+49%).

**Chart 01: Sales mix Q1 2015 vs. Q1 2014**



Source: Company data, EQUITS GmbH

## Our expectations for 2015

We stand by our projections with regard to sales growth, which in 2015 will also receive inorganic impetus from the DBS asset deal. Some adverse factors experienced in 2014, such as project deferrals, are unlikely to be reoccur and the value adjustment on the goodwill of SQ IT-Services GmbH (in the amount of € 0.87 million) was also a one-time item. Nevertheless, we have significantly lowered our previous projected margins. The new customer business remains a project-related business in which the non-materialisation of individual projects has a major impact on overall earnings. In addition, GK will be assigning greater weight to the expansion of its international business into new target markets than to short-term margin-related considerations, an approach which makes good sense in strategic terms. The exploitation of new markets (for example in Asia) may involve considerable (initial) costs. However, the three US projects which have to date been announced for this year are in line with the company's plans. GK is thus well on track, although the year-end business will, typically, be of particular significance – due to the often large proportion of licensing revenue.

At present, GK relies on its new customer (licensing) business, which is volatile and does not lend itself to precise quantification, to generate positive earnings, and intends to gradually reduce its dependency on new business by building on its business relationships with existing customers and developing alternatives to constantly shifting sales opportunities. Over the medium term, GK hopes to position itself so as to be able to use revenue from project-related services, software maintenance and retail services to cover all of its ongoing expenses, however this process is likely to take approximately three years.

Given that the company has accorded priority to attaining its growth targets, we expect there to be a temporary suspension of dividend payments.

### **Omni-channel retailing – the retail trade in flux**

The omni-channel concept has gained a foothold in the retail trade, however the length of sales cycles has increased as a result of the strategic elements involved. There has been an increase in takeovers and mergers, or greater exploration of such possibilities (currently: Karstadt-Kaufhof), among retailers in the face of the new challenges presented by this development – something which is also resulting in protracted delays in strategic decision-making on the part of traders. However, competitive pressure alone is likely to leave (brick-and-mortar) retailers without any alternative to the integrative omni-channel approach. The same could prove to be the case for some online-only business models: In Q1 2015, the increase in the online revenue of multi-channel retailers, at just over 27%, was significantly higher than that of online-only retailers (+10%).

The trend towards the provision of a broader range of services, with a view to being able to supply customers with solutions from a single source is also evidenced by the performance of IT services providers with a retail focus. We believe that GK is well positioned, as a result of its partnership with SAP and hybris, to take an entirely integrative omni-channel approach to meeting its customers' needs. However, globally active hardware manufacturers (such as Wincor) are also increasingly attempting to establish a presence as universal suppliers by acquiring direct competitors of GK. With the takeover of Tomax by Demandware, a supplier previously focussed exclusively on ecommerce strategies, in January 2015 demonstrating that even pure ecommerce specialists are no longer able to ignore the movement towards omni-channel retailing (or store-based selling).

### **GK pipeline remains well-stocked**

At present, prime examples of real multichannel integration are few and far between in the market, with the result that there are currently many promising distribution options available, although these do involve long decision-making cycles. GK considers its own pipeline to be very well stocked – in terms of both direct and partner-facilitated sales. The company believes its position in a number of ongoing tenders to be strong.

- Please consider the disclaimer at the end of this document -

| <b>Income Statement</b>           | <b>2012</b>   | <b>2013</b>   | <b>2014</b>   | <b>2015e</b>  | <b>2016e</b>  | <b>2017e</b>  |
|-----------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| <b>Sales</b>                      | <b>28.426</b> | <b>42.458</b> | <b>44.634</b> | <b>54.426</b> | <b>60.906</b> | <b>64.920</b> |
| Change in finished goods          | -0.127        | 0.000         | 0.000         | 0.000         | 0.000         | 0.000         |
| Other own costs capitalized       | 0.748         | 0.376         | 0.512         | 0.398         | 0.445         | 0.474         |
| Other operating income            | 1.658         | 2.451         | 2.188         | 2.668         | 2.986         | 3.182         |
| <b>Total performance</b>          | <b>30.704</b> | <b>45.285</b> | <b>47.333</b> | <b>57.491</b> | <b>64.336</b> | <b>68.577</b> |
| Cost of material                  | -0.673        | -4.082        | -5.151        | -5.523        | -6.180        | -6.210        |
| <b>Gross profit</b>               | <b>30.031</b> | <b>41.202</b> | <b>42.182</b> | <b>51.969</b> | <b>58.156</b> | <b>62.367</b> |
| Personnel expenses                | -19.441       | -25.605       | -28.749       | -33.203       | -33.684       | -34.044       |
| Other operating expenses          | -7.290        | -12.258       | -13.397       | -14.228       | -15.739       | -16.094       |
| <b>EBITDA</b>                     | <b>3.301</b>  | <b>3.340</b>  | <b>0.037</b>  | <b>4.537</b>  | <b>8.733</b>  | <b>12.229</b> |
| Depreciation/amortisation         | -2.068        | -2.295        | -3.052        | -3.721        | -4.165        | -4.439        |
| <b>EBIT</b>                       | <b>1.233</b>  | <b>1.045</b>  | <b>-3.015</b> | <b>0.817</b>  | <b>4.568</b>  | <b>7.790</b>  |
| Financial result                  | 0.043         | -0.113        | 0.028         | -0.439        | -0.825        | -0.625        |
| Non operating result before taxes | 0.000         | 0.000         | 0.000         | 0.000         | 0.000         | 0.000         |
| EBT                               | 1.277         | 0.932         | -2.987        | 0.377         | 3.742         | 7.166         |
| Non operating result after taxes  | 0.000         | 0.000         | 0.000         | 0.000         | 0.000         | 0.000         |
| Taxes                             | -0.226        | -0.331        | 1.117         | -0.115        | -1.137        | -2.178        |
| Minority interest                 | 0.000         | 0.000         | 0.000         | 0.000         | 0.000         | 0.000         |
| <b>Net result</b>                 | <b>1.051</b>  | <b>0.601</b>  | <b>-1.870</b> | <b>0.263</b>  | <b>2.605</b>  | <b>4.988</b>  |
| Adjustments                       | 0.00          | 0.00          | 0.00          | 0.00          | 0.00          | 0.00          |
| <b>Adjusted net result</b>        | <b>1.051</b>  | <b>0.601</b>  | <b>-1.870</b> | <b>0.263</b>  | <b>2.605</b>  | <b>4.988</b>  |
| Average number of shares          | 1.79          | 1.79          | 1.89          | 1.89          | 1.89          | 1.89          |
| EPS                               | 0.59          | 0.34          | -0.99         | 0.14          | 1.38          | 2.64          |
| Adjusted EPS                      | 0.59          | 0.34          | -0.99         | 0.14          | 1.38          | 2.64          |
| DPS                               | 0.00          | 0.25          | 0.00          | 0.00          | 0.00          | 0.58          |

Source: EQUITS; company data

| <b>Cash Flow Statement</b>                | <b>2012</b> | <b>2013</b> | <b>2014</b> | <b>2015e</b> | <b>2016e</b> | <b>2017e</b> |
|---|-------------|-------------|-------------|--------------|--------------|--------------|
| Net cash provided by operating activities | 3.181       | 1.829       | -0.394      | 1.452        | 5.126        | 8.444        |
| Net cash used in investing activities     | -3.988      | -0.951      | -1.569      | -18.606      | -2.621       | -3.094       |
| Net cash provided by financing activities | -2.673      | 2.483       | -1.606      | 13.153       | -2.000       | -2.000       |
| Change in cash and securities             | -3.480      | 3.361       | -3.569      | -4.000       | 0.504        | 3.350        |
| Cash and secur. at the end of the period  | 10.382      | 13.742      | 10.173      | 6.173        | 6.677        | 10.027       |

Source: EQUITS; company data

- Please consider the disclaimer at the end of this document -

| <b>Balance Sheet</b>                   | <b>2012</b>   | <b>2013</b>   | <b>2014</b>   | <b>2015e</b>  | <b>2016e</b>  | <b>2017e</b>  |
|--|---------------|---------------|---------------|---------------|---------------|---------------|
| Long term assets                       | 15.810        | 14.718        | 13.445        | 28.330        | 26.787        | 25.442        |
| Intangible assets                      | 10.924        | 9.922         | 8.474         | 23.981        | 22.688        | 21.395        |
| Tangible assets                        | 4.884         | 4.794         | 4.970         | 4.348         | 4.098         | 4.046         |
| Financial assets                       | 0.002         | 0.002         | 0.002         | 0.002         | 0.002         | 0.002         |
| Current assets                         | 26.580        | 32.351        | 28.270        | 27.240        | 29.709        | 34.276        |
| Inventories                            | 1.019         | 1.043         | 1.159         | 1.414         | 1.582         | 1.686         |
| Accounts Receivables                   | 11.629        | 13.754        | 12.375        | 15.090        | 16.887        | 18.000        |
| Other current assets                   | 3.550         | 3.812         | 4.563         | 4.563         | 4.563         | 4.563         |
| Cash and securities                    | 10.382        | 13.742        | 10.173        | 6.173         | 6.677         | 10.027        |
| Other assets                           | 1.978         | 0.753         | 2.957         | 2.957         | 2.957         | 2.957         |
| <b>Total assets</b>                    | <b>44.367</b> | <b>47.821</b> | <b>44.673</b> | <b>58.527</b> | <b>59.453</b> | <b>62.675</b> |
| Equity                                 | 28.332        | 33.156        | 30.555        | 30.818        | 33.423        | 38.411        |
| Reserves                               | 28.332        | 33.156        | 30.555        | 30.818        | 33.423        | 38.411        |
| Minorities                             | 0.000         | 0.000         | 0.000         | 0.000         | 0.000         | 0.000         |
| Provisions                             | 4.271         | 2.540         | 3.321         | 3.401         | 3.485         | 3.572         |
| Liabilities                            | 10.114        | 10.196        | 8.600         | 22.112        | 20.350        | 18.497        |
| Interest bearing liabilities           | 3.475         | 2.290         | 1.132         | 14.285        | 12.285        | 10.285        |
| Accounts Payables                      | 0.843         | 1.421         | 1.634         | 1.992         | 2.230         | 2.377         |
| Other non-interest bearing liabilities | 5.795         | 6.485         | 5.835         | 5.835         | 5.835         | 5.835         |
| Other liabilities                      | 1.651         | 1.928         | 2.196         | 2.196         | 2.196         | 2.196         |
| <b>Total equity and liabilities</b>    | <b>44.367</b> | <b>47.821</b> | <b>44.673</b> | <b>58.527</b> | <b>59.453</b> | <b>62.675</b> |

Source: EQUITS; company data

| Key Ratios                             | 2012  | 2013   | 2014    | 2015e  | 2016e | 2017e |
|--|-------|--------|---------|--------|-------|-------|
| <b>Ratios for corporate valuation</b>  |       |        |         |        |       |       |
| EV/Sales                               | 2.39  | 1.08   | 1.61    | 1.32   | 1.18  | 1.11  |
| EV/EBITDA                              | 20.55 | 13.67  | 1969.16 | 15.83  | 8.23  | 5.88  |
| EV/EBIT                                | 54.99 | 43.68  | -23.84  | 87.98  | 15.73 | 9.22  |
| P/E reported                           | 64.73 | 93.50  | -42.38  | 236.10 | 23.80 | 12.43 |
| P/E clean                              | 64.73 | 93.50  | -42.38  | 236.10 | 23.80 | 12.43 |
| PCPS                                   | 14.40 | 48.20  | 41.00   | 15.26  | 9.05  | 6.52  |
| Price-to-book ratio                    | 2.40  | 1.70   | 2.59    | 2.01   | 1.85  | 1.61  |
| <b>Profitability ratios</b>            |       |        |         |        |       |       |
| EBITDA margin                          | 11.6% | 7.9%   | 0.1%    | 8.3%   | 14.3% | 18.8% |
| EBIT margin                            | 4.3%  | 2.5%   | -6.8%   | 1.5%   | 7.5%  | 12.0% |
| Pre tax margin                         | 4.5%  | 2.2%   | -6.7%   | 0.7%   | 6.1%  | 11.0% |
| Net margin                             | 3.7%  | 1.4%   | -4.2%   | 0.5%   | 4.3%  | 7.7%  |
| Free-cash-flow-margin                  | 9.4%  | n.m.   | 0.3%    | n.m.   | 6.9%  | 9.9%  |
| ROE                                    | 3.7%  | 2.0%   | -5.9%   | 0.9%   | 8.1%  | 13.9% |
| <b>Productivity ratios</b>             |       |        |         |        |       |       |
| Sales/employees (in EUR '000)          | 59.6  | 76.9   | 70.9    | 78.6   | 83.8  | 85.1  |
| Personnel expenses/employees (in '000) | 40.7  | 46.4   | 45.7    | 48.0   | 46.4  | 44.6  |
| Net result/employees (in '000)         | 2.2   | 1.1    | -3.0    | 0.4    | 3.6   | 6.5   |
| Number of employees                    | 477   | 552    | 629     | 692    | 727   | 763   |
| <b>Financial ratios</b>                |       |        |         |        |       |       |
| Equity ratio                           | 63.9% | 69.3%  | 68.4%   | 52.7%  | 56.2% | 61.3% |
| Gearing                                | -0.7% | -31.8% | -24.1%  | 32.0%  | 22.2% | 5.7%  |
| Dividend yield                         | 0.0%  | 0.8%   | 0.0%    | 0.0%   | 0.0%  | 1.8%  |
| <b>Cash-flow ratio</b>                 |       |        |         |        |       |       |
| Cash-flow per share                    | 2.64  | 0.65   | 1.02    | 2.15   | 3.63  | 5.03  |
| Free-Cash-flow per share               | 1.49  | -0.02  | 0.08    | -7.69  | 2.24  | 3.40  |
| <b>Other ratios</b>                    |       |        |         |        |       |       |
| Depreciation/Sales                     | 7.3%  | 5.4%   | 6.8%    | 6.8%   | 6.8%  | 6.8%  |
| Capex/Sales                            | 7.2%  | 2.8%   | 4.0%    | 34.2%  | 4.3%  | 4.8%  |
| Working Capital/Sales                  | 41.5% | 31.5%  | 26.7%   | 26.7%  | 26.7% | 26.7% |
| Tax rate                               | 17.7% | 35.5%  | 37.4%   | 30.4%  | 30.4% | 30.4% |

Source EQUITS

# DISCLAIMER

## A. Disclosures in accordance with § 34 b WpHG (German Securities Trading Act), Finanzanalyseverordnung (FinAnV) (Ordinance on the Analysis of Financial Instruments):

I. Disclosures on authorship, responsible company, regulatory authority:

**Company responsible for the publication: EQUI.TS GmbH**

**Authors of this financial analysis: Daniel Großjohann, Analyst, and Thomas Schießle, Analyst.**

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### Reference pursuant to section 4 subsection 4 point 4 FinAnV:

| Company        | Analyst                  |            | Rating | Price Target |
|----------------|--------------------------|------------|--------|--------------|
| GK SOFTWARE AG | D.Grossjohann/B.Ludacka  | 08/20/2014 | Buy    | € 55.80      |
| GK SOFTWARE AG | D.Grossjohann/B.Ludacka  | 12/11/2014 | Buy    | € 50.80      |
| GK SOFTWARE AG | D.Grossjohann/T.Schießle | 04/23/2015 | Buy    | € 51.15      |
| GK SOFTWARE AG | D.Grossjohann/T.Schießle | 06/15/2015 | Buy    | € 46.00      |

II. Additional information:

1. Information sources:

Material sources of information for preparing this document are publications in domestic and foreign media such as information services (including but not limited to Reuters, VWD, Bloomberg, DPA –AFX), business press (including but not limited to Börsenzeitung, Handelsblatt, Frankfurter Allgemeine Zeitung, Financial Times), professional publications, published statistics, rating agencies as well as publications of the analysed issuers.

Furthermore, discussions were held with the Management for the purpose of preparing the company study. The analysis was provided to the issuer prior to publication; no substantial changes were made afterwards.

2. Summary of the valuation principles and methods used in preparation of the analysis:  
EQUI.TS GmbH uses a 3-level absolute share rating system. The ratings pertain to a time horizon of up to 12 months.

BUY: the expected price trend of the share amounts to at least +15%. NEUTRAL: The expected price trend lies between -15% and +15%.

SELL: The expected price trend amounts to more than -15%.

The following valuation methods are used when valuing companies: Multiplier models (price/earnings, price/cash flow, price/book value, EV/revenues, EV/EBIT, EV/EBITA, EV/EBITDA), peer group comparisons, historical valuation approaches, discounting models (DCF, DDM), break-up value approaches or asset valuation approaches. The valuation models

are dependent upon macroeconomic measures such as interest, currencies, raw materials and assumptions concerning the economy. In addition, market moods influence the valuation of companies. Furthermore, the approaches are based on expectations that can change quickly and without warning, according to industry-specific developments. As a result, the results of the valuation and target prices derived from the models can change correspondingly. The results of the valuation are based on a period of 12 months. They are, however, subject to market conditions and represent a snapshot. They can be reached more quickly or more slowly or be revised upwards or downwards.

**3. Date of initial/original publication of the financial analysis:**

**(06/15/2015)**

**4. Date and time of the prices of financial instruments disclosed therein:**

**(Closing price on 06/12/2015)**

**5. Updates:**

We have currently not yet set a fixed date to provide a precise update of this analysis. EQUI.TS GmbH reserves the right to update the analysis unannounced.

III. Disclosure on possible conflicts-of-interest by the use of the following numeration as reference:

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3. the author has carried out sales/purchase transactions on the analysed contents,
4. there exists personnel ties between the author and the issuer,
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6. the author has an agreement with the issuer on the preparation of analysis (assignment),
7. the author receives payments from the issuer,
8. the author concluded an agreement on services in connection with investment banking transactions in the last 12 months, and he has received consideration or promise of consideration from such agreement

**In the present financial analysis the conflict-of-interest mentioned under 6. applies.**

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