

Date 07/05/2018

Recommendation:

Buy (previous: Buy)
PT: € 155.80 (prev.: € 136.00)

GK Software

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

Price (04/05/2018): € 115.00
Market Cap € 217m
EV € 221m
Ø-volume `000€ 180
52W High € 135.50
52W Low € 71.31

Financial Calendar

Q1 Report 30/05/2018
AGM 2018 21/06/2018

Shareholder structure

GK Software Hldg. 49.8%
SAP SE 5.3%
R.Gläß 3.3%
S.Kronmüller 2.3%

Share performance



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GK SOFTWARE SE

Medium-term goals up to 2020 announced, SaaS transition underway

In 2017, GK Software recorded a 17% sales growth to € 90.5 million. EBIT (+26.6%) and annual net profit (+37.4%) rose disproportionately. Since the transition from the classic license to a SaaS (Software-as-a-Service) business model is underway and a large new customer already decided on a SaaS contract of several years in Q4/17 (instead of the classic license model), our expectations for Q4/17 were missed, at first glance at least. The transition is however to be seen positively as a whole because in the medium-term it will pay off not only with better predictability of sales. With the submission of the 2017 figures and the premature attainment of the old medium-term forecast (aimed for 2018), a new outlook was also provided (up to 2020). This implicitly provides annual growth rates of an average of about 14.5% - which is significantly above the expected growth rate of most peer companies. Both the DCF and the peer review imply further upside potential for the GK shares.

✓ **Look back at 2017:** The past fiscal year was a successful one, and not only because the **medium-term aims were attained ahead of time**. The acquisition of **14 new customers from four continents** together with SAP (including 3 "Global Top50" retailers) and the intensification of the accounts for existing customers were the substantial drivers of growth. **Internationalisation** has progressed further, and so it was possible to win customers from France, Italy and Spain, among others, which in the future represent important references in these markets. Already 47.5% (2016: 35.9%) of annual sales were achieved with customers whose decision-making headquarters are located outside of Germany.

✓ **License/SaaS Transition.** Unlike with the classic license business, which starts with the initial payment of the license fee (and then brings annual maintenance fees of 17% of the license fee), the SaaS model stands out with constant payment flows for the useful life. In the conversion year, the sales development reported therefore does not reflect the underlying market success. In the long term, the conversion brings significantly better predictability and **broadens the base in recurring sales**.

Company outlook: Based on 2017 (€ 90 million), sales should increase by a factor of 1.5 up to 2020, which would correspond with sales of € 135 million in 2020. Another significant expansion in sales is planned for 2018. The operative margin in the core segment GK/Retail should be increased to 15% in 2018 and kept at this level in the coming years. The exploitation of new markets will continue to enjoy high priority.

Key figures - GK Software SE

	Sales	EBITDA	EBIT	EPS (adj.)	EV/Sales	P/E
2016 a	77.3	7.8	3.9	1.50	1.28	31.3
2017 a	90.5	8.8	5.0	2.05	2.03	46.2
2018 e	106.8	16.5	12.3	4.32	2.07	26.6
2019 e	122.0	19.4	14.9	5.05	1.81	22.8
2020 e	137.3	22.4	17.6	6.09	1.61	18.9

Source: Company Data, EQUITS

Development of license sales - Individually programmed software...

In 2017, **license revenues** were at € 16.2 million and therefore about € 3.8 million over the previous year's value. On this occasion, software programmed individually for the customer could be considered **for the first time**, which contributed € 6.35 million to the portfolio of software requiring maintenance. Specifically, it concerns programs requested by customers which add to/expand upon the GK standard solutions (without affecting the standard). The IP (intellectual property) of these solutions remains with GK and, as with product licenses, maintenance revenues will be received. Since the solutions are individual (but can in principle be re-used elsewhere), the margin of the individually developed solution could remain below that from product licenses, but be far more attractive than individual adaptations, which are only remunerated according to expenditure (and implicitly must be maintained by GK).

... and SaaS transition

Apart from the software programmed individually for customers, pure product licensing (about € 9 million) remained below the previous year's value (€ 11.5 million); the reason for this was the effect from a subscription in a significant OmniPOS project with several years of Cloud-related operating scenario. While the sales in the classic model are split into license and maintenance, the subscription payments at GK are allocated to **maintenance**.

Background: Classic license model vs subscription model

Instead of the initial license payment and following payments for the maintenance, a customer who decides on a subscription/SaaS model pays (constant) subscription payments for the entire useful life. In the first year of a new customer relationship, the classic license model leads to significantly higher revenues (and results) than the subscription model, but then the annual subscriptions overtake the classic maintenance revenues. To put it simply, it can be assumed that the accumulated revenues from both models are roughly the same in the third year of use - such a price calculation is common of the market. i.e. from the fourth year of a customer relationship, the SaaS model is more beneficial for the software provider in the accumulated revenue figures. But there are also benefits for the customer from the subscription model, such as a lower capital commitment and, if operating as a full service offer from the Cloud, there are also savings in hardware and own staff. (The general technical benefits of a Cloud solution are open to GK customers in both calculation models)

Smooth transition

In spite of the temporarily detrimental effects on revenues of the SaaS transition, GK also showed a slight increase in revenue in Q4 2017 against the same quarter in the previous year. In the case of large software companies like Adobe and Autodesk, the ultimately successful conversion to a subscription model was accompanied with declines in revenue in several consecutive quarters. We do not see this risk at GK because there is a "smooth" transition, i.e. **the customer decides** whether he wants a subscription model or the classic licensing. Moreover, the increasing internationalisation and the growth in business with existing customers could also contribute to the fact that the company can also continue dynamic growth in 2018. From 2020, the subscriptions could therefore also push-start margin growth.

Revenue quality

Maintenance revenues (sales volumes 2017: € 29.2 million; +38.7%) have become a very reliable source of revenue with high growth and, besides classic **maintenance**, also include **subscription revenues**. Both are recurring and in the medium term could level out sales development further. Regarding the **performance of IT services for existing customers**, in 2017, with software developed individually for customers, GK Software created for the first time a sales category (derived from IT services) which also generates recurring sales through mandatory maintenance. The adoption of prudsys, implemented in 11/2017, assimilates well in the GK range of solutions (there is also a number of joint customers) and opens up cross-selling potential. The core product **rde** (Realtime Decisioning Engine) especially delivers high

added value for retailers with regard to “**Dynamic Pricing**”: Optimal price-demand functions and price elasticities can be calculated observing all available influencing factors in real time. In this way, significant profit potentials for the retailers can be exploited, especially in the online sector.

Positive macro-environment

In 2017, commerce also profited from positive framework conditions. German retail achieved record sales and throughout Europe **sales growth adjusted for inflation** was also recorded. The investment environment in commerce was also able to remain favourable: According to the EHI Retail Institute, 66% of the chains surveyed stated that they wanted to renew their POS systems by 2020. With regard to IT, 95% assumed steady or increasing budgets. 39% see Cloud services advancing in commerce as well, **54% give the highest priority to omni-channel projects**. This is a development which could have also been benefited by the fact that omni-channel retailers were also able to increase their revenues disproportionately in 2017 and also grew faster than purely online marketplaces.

Assessment

We have revised our estimates after the submission of the 2017 financial report. The transition from a license to SaaS business model implemented levelled out growth, which we see as being well about 10% p.a. in the coming years, but lengthened the dynamic growth phase overall. A big unknown here is the speed of the transition, a very strong preference for the subscription model would lessen growth in the short term more. With regard to the margins, we are proceeding on the basis of a clear increase for 2018, also driven by process efficiency in the markets outside of Europe and one-off effects no longer applying, which squeezed results in 2017. A very high proportion of SaaS in new projects, the exploitation of new regional markets (where initially the same efficiency cannot be achieved as in Europe), as well as project postponements could have an opposite effect on the results. On the basis of the new estimates, the **DCF valuation** delivers a fair value of € 150.60 per share. Based on the current year, the **peer analysis** also implies a clear share price potential. What is noteworthy is that GK is, according to market expectations, the peer company with the highest growth (in the period 2017a to 2020e), behind Shopify. When the same weight is given to both assessment methods, the fair value per share is € 155.80.

Table 01: Peer analysis

Company	Market capitalisation in € m	P/E (2018e)	EV/Sales (2018e)	EV/EBITDA (2018e)	EV/EBIT (2018e)	CAGR (Sales) 2017e-20e (in %)
Zebra Technologies Corp	5,025.5	14.5	2.36	12.1	13.6	3.1
NCR Corp	2,291.6	8.3	1.00	5.0	7.7	1.5
Manhattan Associates Inc	2,018.7	28.7	4.94	19.1	20.3	-3.5
Vectron Systems AG	177.2	49.6	5.13	176.6	264.8	11.5
Diebold Nixdorf Inc	624.2	11.6	0.62	7.3	12.9	1.2
Mettler-Toledo Inc	9,819.7	27.3	5.21	19.9	21.7	6.4
Atoss Software AG	351.5	32.3	5.25	18.7	19.7	11.8
Shopify Inc	10,055.8	1208.4	11.76	329.6	2223.7	39.6
Intershop Communications AG	53.7	99.7	1.30	n.a.	72.3	11.6
MEDIAN	2,018.7	28.7	4.9	18.9	20.3	
GK Software AG	220.8	26.6	2.1	13.4	18.0	14.9
Discount/premium		-7.2%	-58.1%	-29.3%	-11.4%	
<i>Implied Fair Value</i>		<i>144.76</i>	<i>313.05</i>	<i>190.28</i>	<i>156.65</i>	
<i>Discount (size/market capitalisation)</i>					20.0%	
Fair Value					160.95	

Source: Thomson Reuters (peer estimates); EQUITS

Appendix

Income Statement	2015	2016	2017	2018e	2019e	2020e
Sales	62.602	77.333	90.452	106.750	121.978	137.346
Change in finished goods	0.000	0.000	0.000	0.000	0.000	0.000
Other own costs capitalized	0.525	0.382	0.000	0.000	0.000	0.000
Other operating income	1.726	1.769	5.197	6.133	7.008	7.891
Total performance	64.853	79.483	95.649	112.884	128.987	145.237
Cost of material	-8.266	-7.681	-8.530	-9.266	-10.027	-10.731
Gross profit	56.587	71.802	87.119	103.618	118.959	134.507
Personnel expenses	-39.668	-47.669	-57.809	-64.773	-74.232	-83.803
Other operating expenses	-14.742	-16.330	-20.537	-22.305	-25.304	-28.309
EBITDA	2.177	7.803	8.773	16.540	19.423	22.395
Depreciation/amortisation	-3.453	-3.861	-3.780	-4.264	-4.536	-4.771
EBIT	-1.276	3.942	4.993	12.276	14.888	17.623
Financial result	-0.107	-0.491	-0.653	-1.207	-1.110	-1.010
Non operating result before taxes	0.000	0.000	0.000	0.000	0.000	0.000
EBT	-1.383	3.452	4.340	11.070	13.778	16.614
Non operating result after taxes	0.000	0.000	0.000	0.000	0.000	0.000
Taxes	-0.117	-0.626	-0.456	-2.823	-4.134	-4.985
Minority interest	0.000	0.000	0.002	0.052	0.052	0.052
Net result	-1.500	2.826	3.885	8.298	9.696	11.681
Adjustments	0.00	0.00	0.00	0.00	0.00	0.00
Adjusted net result	-1.500	2.826	3.885	8.298	9.696	11.681
Average number of shares	1.89	1.89	1.90	1.92	1.92	1.92
Average number of shares (dil.)	1.97	2.00	1.95	1.95	1.95	1.95
EPS	-0.79	1.50	2.05	4.32	5.05	6.09
Adjusted EPS	-0.79	1.50	2.05	4.32	5.05	6.09
Adjusted EPS (diluted)	-0.76	1.41	2.00	4.25	4.96	5.98
DPS	0.00	0.00	0.00	0.00	0.76	1.22

Source: EQUI.TS; company data

Cash Flow Statement	2015	2016	2017	2018e	2019e	2020e
Net cash provided by operating activities	2.196	3.699	15.224	8.637	10.572	12.762
Net cash used in investing activities	-18.583	-5.099	-9.278	-5.129	-3.361	-3.706
Net cash provided by financing activities	12.574	-2.119	19.121	-2.000	-2.000	-3.454
Change in cash and securities	-3.813	-3.519	25.067	1.508	5.211	5.602
Cash and secur. at the end of the period	7.377	6.017	30.479	31.987	37.198	42.800

Source: EQUI.TS; company data

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

Balance Sheet	2015	2016	2017	2018e	2019e	2020e
Long term assets	30.944	32.736	39.575	40.441	39.266	38.201
Intangible assets	25.190	23.828	25.359	23.409	21.609	20.109
Tangible assets	5.753	8.902	14.183	16.999	17.624	18.058
Financial assets	0.002	0.007	0.033	0.033	0.033	0.033
Current assets	33.074	33.963	61.424	67.226	76.449	86.100
Inventories	1.655	1.180	0.990	1.169	1.336	1.504
Accounts Receivables	19.100	21.512	22.839	26.955	30.800	34.680
Other current assets	4.943	5.254	7.116	7.116	7.116	7.116
Cash and securities	7.377	6.017	30.479	31.987	37.198	42.800
Other assets	3.742	4.915	5.599	5.599	5.599	5.599
Total assets	67.760	71.615	106.598	113.266	121.313	129.899
Equity	28.967	31.654	38.669	46.915	56.559	66.734
Reserves	28.967	31.654	37.598	45.831	55.462	65.623
Minorities	0.000	0.000	1.071	1.084	1.098	1.111
Provisions	4.081	3.222	3.226	3.316	3.411	3.510
Liabilities	32.085	33.183	59.364	57.695	56.004	54.316
Interest bearing liabilities	14.723	14.763	32.323	30.323	28.323	26.323
Accounts Payables	2.091	2.187	1.835	2.166	2.475	2.787
Other non-interest bearing liabilities	15.271	16.233	25.206	25.206	25.206	25.206
Other liabilities	2.628	3.555	5.340	5.340	5.340	5.340
Total equity and liabilities	67.760	71.615	106.598	113.266	121.313	129.899

Source: EQUITS; company data

Key Ratios	2015	2016	2017	2018e	2019e	2020e
Ratios for corporate valuation						
EV/Sales	1.19	1.28	2.03	2.07	1.81	1.61
EV/EBITDA	34.17	12.67	20.90	13.37	11.38	9.87
EV/EBIT	-58.32	25.08	36.72	18.01	14.85	12.54
P/E reported	-43.72	31.27	46.22	26.59	22.76	18.89
P/E clean	-43.72	31.27	46.22	26.59	22.76	18.89
PCPS	24.45	15.24	23.50	17.44	15.40	13.33
Price-to-book ratio	2.26	2.79	4.78	4.82	3.98	3.36
Profitability ratios						
EBITDA margin	3.5%	10.1%	9.7%	15.5%	15.9%	16.3%
EBIT margin	-2.0%	5.1%	5.5%	11.5%	12.2%	12.8%
Pre tax margin	-2.2%	4.5%	4.8%	10.4%	11.3%	12.1%
Net margin	-2.4%	3.7%	4.3%	7.8%	7.9%	8.5%
Free-cash-flow-margin	n.m.	0.7%	n.m.	7.0%	9.0%	9.4%
ROE	-5.0%	9.3%	11.0%	19.3%	18.6%	18.9%
Productivity ratios						
Sales/employees (in EUR '000)	84.7	94.4	94.1	102.7	111.8	119.9
Personnel expenses/employees (in '000)	53.7	58.2	60.2	62.3	68.0	73.2
Net result/employees (in '000)	-2.0	3.5	4.0	8.0	8.9	10.2
Number of employees	739	819	961	1039	1091	1146
Financial ratios						
Equity ratio	42.7%	44.2%	36.3%	41.4%	46.6%	51.4%
Gearing	133.9%	126.2%	175.7%	141.4%	114.5%	94.7%
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.7%	1.1%
Cash-flow ratio						
Cash-flow per share	1.42	3.07	4.02	6.59	7.47	8.62
Free-Cash-flow per share	-8.45	0.27	-0.27	3.92	5.71	6.69
Other ratios						
Depreciation/Sales	5.5%	5.0%	4.2%	4.0%	3.7%	3.5%
Capex/Sales	29.8%	6.8%	9.0%	4.8%	2.8%	2.7%
Working Capital/Sales	29.8%	26.5%	24.3%	24.3%	24.3%	24.3%
Tax rate	-8.5%	18.1%	10.5%	25.5%	30.0%	30.0%

Source EQUITS

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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/T.Schießle	22/05/2017	Hold	€ 80.40
GK SOFTWARE AG	D.Grossjohann/T.Schießle	08/06/2017	Hold	€ 84.70
GK SOFTWARE AG	D.Grossjohann/T.Schießle	12/09/2017	Hold	€ 135.00
GK SOFTWARE AG	D.Grossjohann/T.Schießle	07/11/2017	Hold	€ 135.70
GK SOFTWARE AG	D.Grossjohann/T.Schießle	21/11/2017	Buy	€ 135.70
GK SOFTWARE AG	D.Grossjohann/T.Schießle	06/12/2017	Buy	€ 136.00
GK SOFTWARE AG	D.Grossjohann/T.Schießle	07/05/2018	Buy	€ 155.80

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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: EQUITS GmbH uses a 3-level absolute share rating system. The ratings pertain to a time horizon of up to 12 months.

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

(07/05/2018)

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

(Closing price on 04/05/2018)

5. Updates:

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

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