

SOPHEON

SOFTWARE & COMPUTER SERVICES

30 January 2023

SPE.L

625p

Market Cap: £66.4m

SHARE PRICE (p)



12m high/low

915p/505p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (Debt)/Cash	\$21.0m (at 31/12/22)
Enterprise value	£51.3m
Index/market	AIM
Next news	FY22 results, 24 Mar '23
Shares in Issue (m)	10.6
Executive Chairman	Andy Michuda
Chief Executive	Greg Coticchia
Finance Director	Arif Karimjee

COMPANY DESCRIPTION

Sopheon is an international provider of software and services for product lifecycle management.

www.sopheon.com

SOPHEON IS A RESEARCH CLIENT OF PROGRESSIVE

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Getting in step for the SaaS jump forward

Sopheon's trading update for the year ended 31 December 2022, issued today, shows a strong performance at the revenue level, in line with market expectations, and adjusted EBITDA comfortably above expectations. Net cash of \$21m is in line with our estimate, down on last year principally because of the currency movements on Euro and Sterling deposits and the extended payment terms on the US Navy contract announced in July, as well as M&A payments. ARR at the year-end is expected to have been \$24.3m. With this strong growth in SaaS, Sopheon has announced that it is ceasing to sell perpetual licenses to new customers – a significant strategic and operational milestone on Sopheon's path to being a globally scaling SaaS business. We have adjusted our FY23 forecasts down to reflect this but introduce FY24 forecasts with a strong bounce back in revenue and profit.

- Good growth in revenue.** Revenue for FY22 is expected to have been c.\$36.5m, just ahead of our estimate of \$36.3m and 6% above FY21 (\$34.3m). On a constant currency basis, the revenue would have been comfortably ahead of these figures. Importantly for a SaaS business, ARR increased by an impressive and encouraging 17.5% (FY22 \$24.3m vs FY21 \$20.7m) at the year-end.
- Adjusted EBITDA outperformance.** The surprise is that, at approaching \$7m (FY21: \$6m), adjusted EBITDA is expected to comfortably exceed expectations and our estimate (\$4.9m). This is doubly impressive as it is after the \$1.6m write-down in capitalised development (see our note [New clients, channels, products – new rating?](#) 24 Aug 2022). The update records that this outperformance is due to several factors, including careful cost management.
- Forecasts – trimming FY23E, growth in FY24E.** The news that Sopheon is ceasing to sell perpetual licenses to new customers is not unexpected, but leads us to revise FY23 forecasts, in addition to revising FY22 numbers following the update. FY23E revenue growth is not as strong as we were previously forecasting and FY23E profits are now expected to decline in the short term. The FY24 forecasts reflect a growing fully SaaS business.
- Looking at the full value of SaaS.** While we do not forecast figures beyond FY24, it is then that we would expect the full benefits of the SaaS transition and recent acquisitions to show through, both in terms of growing revenues, growing profitability and, importantly, growing margins – growth that could, in turn, be reflected in the valuation.

FYE DEC (\$M)	2020	2021	2022E	2023E	2024E
Revenue	30.0	34.4	36.5	37.2	42.1
Adj EBITDA	5.9	6.2	6.8	5.4	7.5
Fully adj PBT	2.2	2.1	2.5	1.0	2.9
Fully adj dil EPS (c)	18.3	15.5	19.7	6.6	23.1
EV/Sales (x)	2.4x	2.1x	2.0x	1.9x	1.7x
EV/EBITDA (x)	12.0x	11.5x	10.4x	13.1x	9.5x
PER (x)	47.6x	56.0x	44.1x	132.2x	37.6x

Source: Company Information and Progressive Equity Research estimates.

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Please refer to important disclosures at the end of the document.

Accounting and Annual Recurring Revenues (ARR) building well

The year-end trading update reports that revenue for FY22 is expected to have been c.\$36.5m, just ahead of our estimate of \$36.3m and 6% above FY21 (\$34.3m). Much of Sopheon's business is in Sterling and Euro, and on a constant currency basis the revenues would have been comfortably ahead of these figures.

As a software business transitioning to a Software as a Service (SaaS) model, Sopheon targets Annual Recurring Revenue (ARR) as a key metric. In what management describes as a challenging market, Sopheon managed to increase ARR by an impressive and encouraging 17.5% (FY22 \$24.3m vs FY21 \$20.7m) at the year-end.

Strong adjusted EBITDA outperformance

The surprise in the announcement is that, at approaching \$7m (FY21: \$6m), Adjusted EBITDA is expected to comfortably exceed the board's expectations and our forecast (\$4.9m). This is doubly impressive as it is after the \$1.6m write-down in capitalised development spend made because two recent acquisitions have led to the company following a slightly different technology development path (see our note *New clients, channels, products – new rating?* 24 Aug 2022).

The update shows that this outperformance is due to several factors, including careful cost management.

Balance sheet in-line – still strong

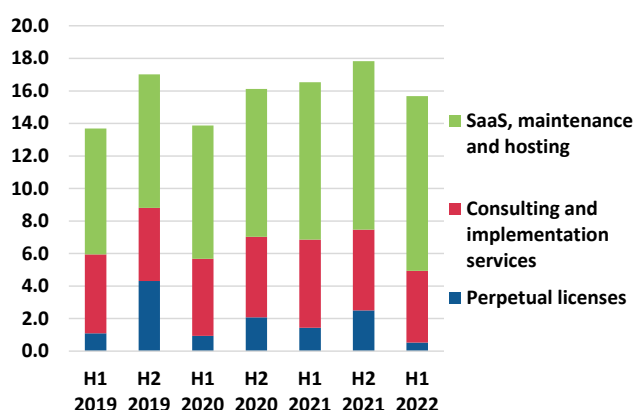
The year-end net cash of \$21m was in line with our expectations. The decline from last year is mainly due to the impact of currency moves on Euro and Sterling cash balances, M&A payments and the extended payment terms in the significant US Navy contract announced in July.

Final steps in the SaaS transition – step back to jump forward

Following its strong progress with building ARR and evolving the SaaS offering, the news that Sopheon is ceasing to sell perpetual licenses to new customers is not unexpected, but it does lead us to revise our FY23 forecasts, in addition to revising our FY22 numbers following the trading update.

The way that software companies manage the transition from perpetual license sales to a SaaS model is something of a balancing act. Sopheon's management has delivered a relatively smooth transition.

SaaS transition – revenue mix / balance (\$m)



Source: Sopheon

With ARR at the end of December 2022 of \$24.3m, management has taken one of the final steps on the path to being a fully scaling SaaS business. The statement suggests that the final step, when perpetual license sales cease, is expected to happen in FY24. We have adjusted our forecasts to reflect the impact on FY23 revenue and profits, as shown in the table below. FY23 estimated revenue growth is not as strong as we were previously forecasting and FY23 profits are now expected to decline in the short term.

We are introducing forecasts for FY24 in this note. The FY24 forecasts reflect a fully SaaS business. They also reflect the benefits of Sopheon’s two recent acquisitions, Solverboard (May 2022) and ROI Blueprint (December 2021), along with the gains from Sopheon’s two-pronged individual (Acclaim) and corporate (Accolade) product/sales approach.

Revised and new estimates

	2022E			2023E			2024E
	New \$m	Old \$m	Change %	New \$m	Old \$m	Change %	New \$m
Revenue	36.5	36.3	1%	37.2	39.8	-7%	42.1
Adj EBITDA	6.8	4.9	39%	5.4	5.7	-5%	7.5
Adj PBT	2.5	0.6	317%	1.0	1.3	-23%	2.9
Adj EPS (c)	19.7	5.9	234%	6.6	11.9	-45%	23.1
Cash	21.0	21.0	0%	21.7	24.2	-10%	22.3

Source: Progressive Equity Research

Conclusion

While we do not forecast figures beyond FY24, it is then that we would expect the full benefits of the now almost complete SaaS transition and recent acquisitions to show through, both in terms of growing revenues, growing profitability and, importantly, growing margins – growth that could, in turn, be reflected in the valuation.

Financial Summary: Sopheon

Year end: December (\$m unless shown)

	2020	2021	2022E	2023E	2024E
PROFIT & LOSS					
Revenue	30.0	34.4	36.5	37.2	42.1
Adj EBITDA	5.9	6.2	6.8	5.4	7.5
Adj EBIT	2.2	2.2	2.5	1.1	2.9
Reported PBT	1.7	1.2	1.1	(0.3)	1.5
Fully adj PBT	2.2	2.1	2.5	1.0	2.9
NOPAT	1.9	1.7	2.2	0.7	2.6
Reported Dil EPS (c)	14.1	7.5	7.4	(5.7)	10.9
Fully adj dil EPS (c)	18.3	15.5	19.7	6.6	23.1
Dividend per share (p)	3.25	3.25	3.25	3.25	3.25
CASH FLOW & BALANCE SHEET					
Operating cash flow	6.6	10.1	5.0	6.8	7.0
Free Cash flow	2.6	3.9	(1.4)	1.1	1.1
FCF per share (c)	25.3	37.6	(13.1)	10.6	10.2
Acquisitions	0.0	(1.5)	(0.7)	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0
Shares issued	0.1	0.6	0.0	0.0	0.0
Net cash flow	2.3	2.5	(3.1)	0.7	0.6
Overdrafts / borrowings	0.0	0.0	0.0	0.0	0.0
Cash & equivalents	21.7	24.2	21.0	21.7	22.3
Net (Debt)/Cash	21.7	24.2	21.0	21.7	22.3
NAV AND RETURNS					
Net asset value	30.2	31.3	31.2	31.0	32.6
NAV/share (c)	295.6	297.8	294.0	292.0	307.2
Net Tangible Asset Value	22.3	19.4	18.0	16.6	16.9
NTAV/share (c)	218.5	184.1	169.9	156.2	159.3
Average equity	29.0	30.7	31.3	31.1	31.8
Post-tax ROE (%)	6.7%	5.5%	7.0%	2.3%	8.1%
METRICS					
Revenue growth		14.5%	6.3%	2.0%	13.0%
Adj EBITDA growth		4.3%	10.5%	(20.5%)	37.5%
Adj EBIT growth		(0.7%)	14.5%	(57.3%)	169.9%
Adj PBT growth		(2.2%)	17.6%	(58.4%)	178.1%
Adj EPS growth		(15.1%)	26.9%	(66.6%)	251.2%
Dividend growth		0.0%	0.0%	0.0%	0.0%
Adj EBIT margins		6.4%	6.9%	2.9%	6.9%
VALUATION					
EV/Sales (x)	2.4	2.1	2.0	1.9	1.7
EV/EBITDA (x)	12.0	11.5	10.4	13.1	9.5
EV/NOPAT (x)	36.7	42.0	32.7	97.6	27.8
PER (x)	47.6	56.0	44.1	132.2	37.6
Dividend yield	0.4%	0.4%	0.4%	0.4%	0.4%
FCF yield	2.9%	4.3%	(1.5%)	1.2%	1.2%

Source: Company information and Progressive Equity Research estimates

Disclaimers and Disclosures

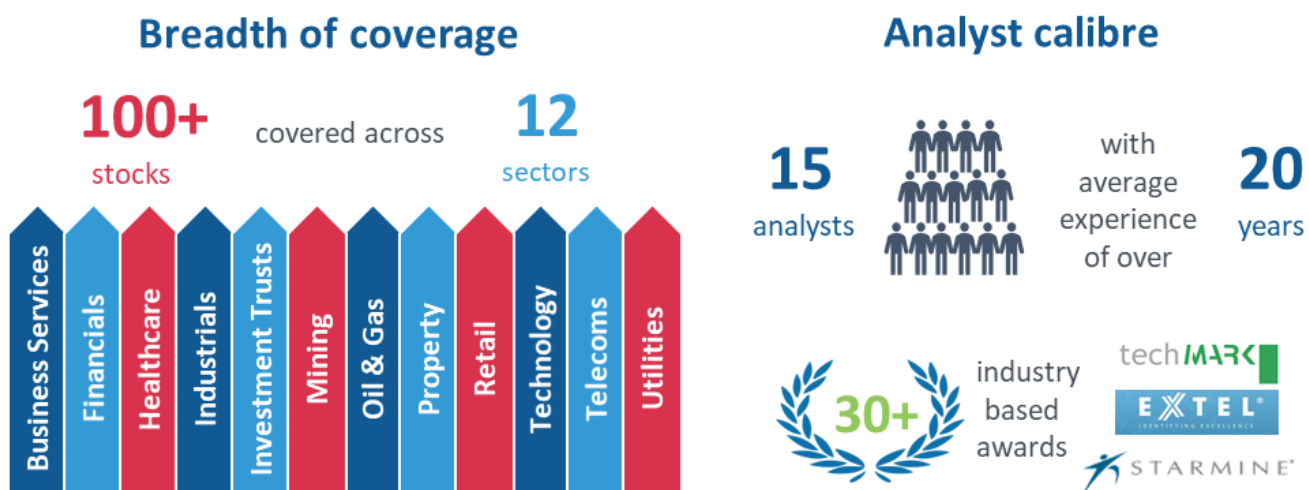
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