PSI

Q3 results and estimate changes

Two steps forward one step back

Software & comp services

PSI's underwhelming financial performance and lower revenue guidance for FY16 reflect difficult trading conditions as well as retaining price discipline and moving away from lower-quality business lines. The transformation of the PSI's model should advance in FY17 with the migration of key Production Management modules to its new software platform. We still see significant upside potential if PSI can execute its plan and expand margins well into double digits, although this may be at the expense of organic top-line growth in the near term.

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/14	175.4	5.9	27.50	0.0	43.9	0.0
12/15	183.7	9.6	49.07	21.0	24.6	1.7
12/16e	181.1	10.8	56.77	25.0	21.2	2.1
12/17e	187.6	12.9	67.73	30.0	17.8	2.5

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

Trading reflects weak conditions, better discipline

Order intake for 9M16 declined 10% y-o-y at €134m, while revenues fell by 6% to €129m, with declines in each division but particularly Infrastructure Management where the weakness and restructuring of PSI InControl continues to drag on results. The reduction in group EBIT by 5% to €6.9m was entirely due to Infrastructure Management dropping to a loss. EBIT for Production Management grew 15% y-o-y and was flat in Energy Management against a strong comparator last year. Reflecting revised FY16 guidance of a slight decline in revenues (previously mid-single-digit growth) with EBIT of €11-13m (unchanged), we have reduced our FY16 revenue by 6% and EPS by 3% with respective downgrades of 7% and 9% for FY17.

Transition set to accelerate in FY17

Despite this, we believe there are signs that the company's transition to a more product-centric and ultimately higher-margin model is becoming more meaningful. Notably, the migration to the unified software platform looks set to accelerate, as key Production Management modules (specifically Automotive and Industry) are rolled out to existing and new customers over FY17. This transition will take time and may continue to suppress revenue growth in the near term, but the potential for earnings growth through margin expansion from the current level (6.2% for FY16) to mid to high teens enjoyed by more product-centric peers is significant.

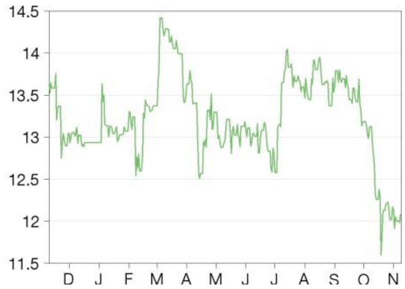
Valuation: Upside hinges on margin expansion

PSI's P/E rating of 21.2x for FY16, dropping to 17.8x in FY17 is towards the lower end of the company's broader peer group. The upside case hinges on PSI's scope to significantly expand margins and deliver above-average earnings growth. Our DCF analysis shows that with no revenue growth, expansion of operating margins to 12.5% should justify a share price of €15.5. Achieving 15% would justify a share price closer to €20.

10 November 2016

Price	**€12.06**
Market cap	**€189m**
	€1.13/£
Net cash (€m) at 30 September, excludes €47m pension provision	34.4
Shares in issue	15.6m
Free float	76%
Code	PSAN
Primary exchange	Frankfurt
Secondary exchange	Munich

Share price performance



%	1m	3m	12m
Abs	(7.9)	(11.4)	(11.7)
Rel (local)	(9.3)	(11.0)	(10.2)
52-week high/low		€14.42	€11.60

Business description

PSI develops and integrates software control systems for critical infrastructure across a range of end markets including Energy Management (electricity, gas and oil), Production Management (manufacturing, metal processing, mining) and Infrastructure (logistics, public transport).

Next events

German Equity Forum	21-23 November

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Edison profile page

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Investment summary

Difficult conditions, price discipline and corrective action

Group level declines in order intake (-10% y-o-y at €134m) and revenues (-6% to €129m) reflect both difficult market conditions in a number of segments and price discipline and efforts to transition the company to a more scalable, higher-margin, product-centric model.

We believe this is shown by the company's margin performance. Whereas group EBIT reduced by 5% y-o-y, factoring in operational gearing, this is smaller than what one would normally expect given the similar level of revenue decline.

Moreover, the reduction in EBIT was entirely due to the Infrastructure Management division dropping to a loss (sales down 16% to €16.5m, EBIT down €0.9m from break-even last year). This is primarily due to restructuring in the problematic South East Asia PSI (previously In Control), where the company is migrating to a software-centric model whereas previously revenues were boosted by hardware sales.

Margins expanded in both Energy Management, with sales down 2% to €43.3m and EBIT broadly flat at €5.8m on a strong comparator, and Production Management, where sales reduced by 4% y-o-y to €95.8m but EBIT increased 11% to €6.6m.

Estimate changes

Our estimate changes are shown in Exhibit 1. Management has reduced FY16 revenue growth guidance to slightly down year-on-year but maintained the €11-13m EBIT guidance range. We reduce our group EBIT forecast to the lower end of this range (€11.4m from €12.3m), although a lower finance charge reduced moderates the impact on EPS (down 3% to 56.7c).

Exhibit 1: Estimate changes

€m	2014 Actual	2015 Actual	2016e Old	2016e New	Change	2017 Old	2017e New	Change
Energy Management								
Revenue	64.1	67.2	68.6	68.6	0%	69.9	69.9	0%
Growth	5%	5%	2%	2%		2%	2%	
EBITDA	5.5	6.8	7.0	7.5	7%	7.3	7.3	0%
EBITDA margin	9%	10%	10%	11%		11%	11%	
Production Management						0.0		
Revenue	79.6	86.4	94.2	89.5	-5%	100.8	94.0	-7%
Growth	-5%	9%	9%	4%		7%	5%	
EBITDA	3.8	8.0	9.1	9.0	-1%	10.6	10.1	-5%
EBITDA margin	5%	9%	10%	10%		11%	11%	
Infrastructure Management								
Revenue	31.6	30.1	30.1	23.0	-23%	30.7	23.7	-23%
Growth	-5%	9%	9%	4%		7%	5%	
EBITDA	2.9	1.6	1.5	0.3	-80%	2.8	1.5	-44%
EBITDA margin	9%	5%	5%	1%		9%	7%	
Group								
Total sales	175.4	183.7	192.8	181.1	-6%	201.4	187.6	-7%
EBITDA	11.1	15.3	16.4	15.6	-5%	19.4	17.7	-9%
Operating profit (reported)	7.2	11.1	12.2	11.4	-6%	15.2	13.5	-11%
Operating margin	4.1%	6.0%	6.3%	6.3%		7.5%	7.2%	
Profit before tax (FRS 3)	5.7	9.4	11.0	10.6	-3%	14.0	12.7	-9%
EPS - normalised and fully diluted (c)	27.5	49.1	58.6	56.8	-3%	74.3	67.7	-9%
EPS - FRS 3 (c)	26.2	47.8	57.3	55.5	-3%	73.0	66.4	-9%
Dividend (c)	0.0	21.0	25.0	25.0	0%	30.0	30.0	0%
Net debt (cash)								

Source: Company data, Edison Investment Research

Valuation

PSI's P/E rating remains toward the lower end of its broader peer group, which is understandable given the company's growth profile is lower than most peers. The company's substantially lower EV/sales ratio highlights the potential upside if the company can bring margins closer to the level of its software peers. This transition is challenging and we need to bear in mind that this may be at the expense of organic top-line growth in the near term. However, with the restructuring of PSI South East Asia and the planned rollout of more of the new software platform across more of the Production Management business, we believe that this transition is starting to become more meaningful.

Exhibit 2: Peer valuation

	Share price currency	Share price	Market cap (m)	EV/sales (x)		P/E (x)		EBIT margin (%)	
				Current	Next	Current	Next	Current	Next
PSI	€	12.1	189	0.8	0.8	21.2	17.8	6.4	7.3
Local peers									
Init Innovation In Traffic Systems AG	€	15.6	157	1.5	1.4	19.6	16.2	11.2	12.3
Nemetschek SE	€	56.0	2,154	6.4	5.5	38.0	32.7	21.5	21.8
International industrial software									
ANSYS Inc	US$	91.4	7,967	7.2	6.7	25.2	23.4	47.6	48.2
Autodesk Inc	US$	72.3	16,038	7.3	6.5	neg.	2,492.4	-8.4	1.3
AVEVA Group PLC	£	1838.0	1,176	5.0	4.8	26.0	24.1	24.4	26.4
Constellation Software Inc/Canada	US$	628.4	13,316	4.8	4.2	25.6	21.4	15.6	16.3
Dassault Systemes	€	71.9	18,547	5.7	5.2	29.2	26.3	25.5	27.1
Emerson Electric Co	US$	50.7	32,614	1.8	2.1	17.4	18.7	14.6	16.0

Source: Edison Investment Research, Bloomberg. Note: Prices at 3 November 2016.

A discounted cash flow analysis suggests the current valuation is pricing in flat or low single-digit organic revenue growth with operating margins expanding – and plateauing – at 10% by 2022. In most circumstances, expansion of operating margins to 12.5% would justify a share price above €17. Operating margin expansion to 15% in the same timescale would justify a valuation well above €20.

In Exhibit 3, we show a DCF sensitivity analysis assuming the company reaches different operating margins by the year 2022 and differing organic revenue growth rates between now and 2022.

Exhibit 3: DCF share price (€) sensitivity analysis to revenue growth and EBIT margin

		EBIT margin attained by 2022				
		5.0%	7.5%	10.0%	12.5%	15.0%
Organic revenue growth rate to 2020	0%	4.8	8.3	11.9	15.4	18.9
	2%	4.6	8.6	12.5	16.5	20.5
	4%	4.4	8.8	13.3	17.7	22.1
	6%	4.2	9.1	14.1	19.0	23.9
	8%	3.9	9.4	14.9	20.4	25.9
	10%	3.7	9.8	15.9	22.0	28.1

Source: Edison Investment Research. Note: WACC = 10%, terminal growth rate = 2%. Analysis assumes that margins expand steadily from the 2016 forecast level to 2022 target. Valuation excludes the €47m (€3/share) pension provision from both the WACC calculation and the enterprise value.

Exhibit 4: Financial summary

€m	2013	2014	2015	2016e	2017e
Year end 31 December	IAS	IAS	IAS	IAS	IAS
PROFIT & LOSS					
Revenue	176.3	175.4	183.7	181.1	187.6
Cost of Sales	(34.8)	(33.1)	(31.6)	(31.1)	(32.3)
Gross Profit	141.5	142.3	152.1	149.9	155.3
EBITDA	8.0	11.1	15.3	15.6	17.7
Operating Profit (before aqu'd int amortisation.)	4.4	7.4	11.3	11.6	13.7
Amortisation of acquired intangibles	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)
Operating Profit	4.2	7.2	11.1	11.4	13.5
IFRS 2 charges	-	-	-	-	-
Net Interest	(1.6)	(1.5)	(1.7)	(0.8)	(0.8)
Profit Before Tax (norm)	3.3	5.9	9.6	10.8	12.9
Profit Before Tax (FRS 3)	3.1	5.7	9.4	10.6	12.7
Tax	(2.7)	(1.6)	(2.0)	(1.9)	(2.3)
Profit After Tax (norm)	1.7	4.3	7.7	8.9	10.6
Profit After Tax (FRS 3)	0.4	4.1	7.5	8.7	10.4
Average Number of Shares Outstanding (m)	15.7	15.7	15.6	15.7	15.7
EPS - normalised (c)	10.6	27.5	49.1	56.8	67.7
EPS - normalised fully diluted (c)	10.6	27.5	49.1	56.8	67.7
EPS - FRS 3 (c)	2.4	26.2	47.8	55.5	66.4
Dividend per share (c)	0.0	0.0	21.0	25.0	30.0
Gross Margin (%)	80%	81%	83%	83%	83%
EBITDA Margin (%)	4.5%	6.3%	8.3%	8.6%	9.5%
Operating Margin (before GW and except.) (%)	2.4%	4.1%	6.0%	6.3%	7.2%
BALANCE SHEET					
Fixed Assets	69.3	80.5	78.8	77.1	76.6
Intangible Assets	49.1	61.7	59.4	58.2	56.9
Tangible Assets	13.8	12.9	12.2	11.8	12.5
Goodwill	0.0	0.0	0.0	0.0	0.0
Other	6.4	5.8	7.1	7.1	7.1
Current Assets	108.8	111.8	120.7	125.4	134.1
Stocks	3.9	3.5	4.2	5.5	5.5
Receivables	77.8	73.6	72.5	74.0	75.2
Cash	21.8	29.3	38.8	40.7	48.3
Other	5.3	5.4	5.2	5.2	5.2
Current Liabilities	(64.8)	(75.7)	(79.0)	(69.8)	(71.2)
Trade & Tax Payable	(35.5)	(41.1)	(43.7)	(38.0)	(39.4)
Short term borrowings	(3.5)	(5.1)	(5.1)	(1.6)	(1.6)
Other creditors	(25.7)	(29.5)	(30.2)	(30.2)	(30.2)
Long Term Liabilities	(45.9)	(48.2)	(49.2)	(49.1)	(49.1)
Long term borrowings	(3.4)	(0.2)	(0.2)	(0.0)	(0.0)
Pension provision & other long term liabilities	(42.6)	(48.0)	(49.0)	(49.0)	(49.0)
Net Assets	67.4	68.3	71.3	83.5	90.5
CASH FLOW					
Operating Cash Flow	1.8	27.4	17.3	8.9	17.0
Net Interest	(0.2)	(0.2)	(1.7)	0.6	0.6
Tax	(1.6)	(1.3)	(2.6)	(1.9)	(2.3)
Capex	(5.0)	(3.0)	(3.0)	(2.5)	(3.8)
Acquisitions/disposals	1.0	(11.5)	0.7	0.0	0.0
Financing	(0.6)	(0.5)	0.0	0.0	0.0
Dividends	(4.7)	(1.2)	0.1	(3.3)	(3.9)
Net Cash Flow	(8.6)	9.7	10.9	1.8	7.6
Opening net debt/(cash)	(24.0)	(14.9)	(24.0)	(35.4)	(37.2)
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0
Other	(0.5)	(0.5)	0.4	0.0	0.0
Closing net debt/(cash)	(14.9)	(24.0)	(35.4)	(37.2)	(44.8)

Source: PSI data, Edison Investment Research

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