PSI

Eigenkapitalforum

Structural margin expansion initiatives

Software & comp services

While near-term visibility is limited, key structural initiatives to build on PSI's strengths, consolidate products onto a single platform and move towards a standard software revenue model should improve competitiveness and margins. PSI's ability to execute will be key, but success should drive sustained double-digit earnings growth. This is not factored into PSI's current valuation.

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/13	176.3	3.3	10.64	0.0	103.5	N/A
12/14e	176.2	7.3	38.72	10.0	28.4	0.9
12/15e	196.9	12.4	65.50	30.0	16.8	2.7
12/16e	206.8	16.6	87.27	40.0	12.6	3.6

Note: *PBT and EPS exclude acquired intangible amortisation, but not exceptional items or share-based payments.

Geopolitical risk – some more clarity emerging

PSI has endured a difficult two years, with execution issues severely damaging earnings in 2013 and into H1. More recently, rising geopolitical/economic risk has prompted the company to withdraw full year profit guidance. However, there are also more encouraging signs. Order intake increased 29% y-o-y to €44m in Q3. Demand from the German electrical energy market is recovering, the Logistics operations appear on a recovery path, and the crisis in Ukraine could eventually drive demand in gas and oil as new pipelines are built to mitigate risk.

Structural initiatives

A number of key initiatives are being implemented to add resilience and put the business back on a margin expansion trajectory. A shift towards a more product-led vs project-based model should reduce exposure to cost overruns. The progressive migration of customers and products onto a unified technology platform should improve development, product maintenance and implementation efficiency. We also expect the company to build around its core strengths, as exemplified by the recent acquisition of Broner Metals, and potentially rationalise non-core operations.

Substantial margin expansion potential

While near-term earnings visibility is low, with good execution on the strategic initiatives highlighted above, we believe that margins have the potential to expand to the mid-teens level on a four- to six-year view. This is substantially above our 8.5% EBIT margin estimate for 2016. Hence this dynamic opens up the potential for sustained double-digit earnings growth, although execution is absolutely key.

Valuation: Margin expansion key to upside

PSI's investment case hinges on its ability to expand margins. We believe that only modest expansion beyond our forecasts is priced in. Our DCF analysis suggests that if margins can be expanded to a very achievable 12% by 2020, this would justify a share price above €15. Achieving 15% operating margins in the same timescale would justify a share price above €20.

24 November 2014

Price	**€11.01**
Market cap	**€173m**

Net cash (€m) 31 September 2014	15.7
Shares in issue	15.7m
Free float	76%
Code	PSAN
Primary exchange	Frankfurt
Secondary exchange	Munich

Share price performance

%	1m	3m	12m
Abs	2.3	(11.4)	(10.3)
Rel (local)	(6.6)	(14.4)	(15.3)
52-week high/low		€14.77	€10.60

Business description

PSI develops and integrates software control systems: (1) solutions for electricity, gas, oil and water; (2) software for production planning, control and logistics; and (3) solutions for monitoring and operating critical transport, public safety, environmental and disaster prevention.

Next events

Eigenkapitalforum	25-26 November 2014
Full year results	Mid-March 2014

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Edison profile page

PSI is a research client of Edison Investment Research Limited

Investment summary: Critical infrastructure recovery

Control software for critical infrastructure

PSI (Gesellschaft Fuer Produkte und Systeme der Informationstechnologie) develops, sells and integrates software for controlling complex systems, networks and infrastructures. Its systems are crucial components within these systems, enabling them to run efficiently, improving flexibility and avoiding failure. The company has three key divisions: **Energy Management**, where the company's systems are used to ensure a stable and dependable supply of electricity, gas, oil, heat or water. **Production Management** – solutions for optimising metal processing, automotive production, mechanical engineering and mining processes. **Infrastructure Management** – highly available control systems for managing and monitoring road, rail and other public transport systems. The company transacts business across the globe, but holds a particularly strong position in in Germany, which accounts for circa 50% of sales.

Visibility low, but structural margin enhancement initiatives

A five-year track record of revenue growth and EBIT margin expansion was interrupted in 2013, largely due to a combination of execution issues and accelerated product investment. The hangover from this lasted into H114, but order intake (+29% y-o-y) and revenues (+4% y-o-y) both moved forwards again in Q3. Demand from the German energy market is recovering and the logistics division now looks set to move forward following last year' troubles. However, with geopolitical risk in overseas markets (Russia, Thailand and the Middle East) and the Chinese economic slowdown clouding visibility, no guidance has been offered for the full year.

Looking through this uncertainty, two key initiatives are being implemented to add resilience and put the business back on a margin expansion trajectory. Firstly, the shift towards a product-led vs project-based model should reduce exposure to cost overruns. Secondly, the progressive migration of customers and products onto a unified technology platform (Eclipse) should help improve development and implementation efficiency and reduce overheads. Through the acquisition of Broner, the company has also shown its wiliness to build out in domains of key strength. Rationalisation of non-core business would help de-fragment the business.

We bring back FY14 EPS by 13% to reflect a more cautious stance on year-end trading. However, our earnings estimates for FY15 take a small nudge upwards reflecting the positive order intake in Q3 and subsiding risks to the Oil and Gas business related to the Ukrainian crisis. Our FY16 estimates are new. We also incorporate the Broner acquisition, which adds €10m to revenue in FY15 but no profit. Broner synergies along with the other structural improvement initiatives help drive the expansion in operating margin from 7.2% in FY15 to 8.6% in FY16. On a four- to six-year view, we believe mid-teens margins should be achievable, with good execution on the structural improvement initiatives listed above. This should open up the potential for sustained double-digit earnings growth.

Valuation: Upside all about margin expansion

PSI's shares trade on typical recovery multiples, with a low EV/sales ratio but relatively high P/E. The latter is not out of kilter with peers however and we believe justified by the potential for more significant margin expansion beyond our forecast period (and potentially within it).

PSI's success at expanding margins is the key sensitivity to the investment case. Our DCF sensitivity analysis suggests that expanding margins to a very achievable 12% by 2020 should justify a share price above €15, while achieving 15% operating margins in the same timescale would justify a share price above €20.

Mission critical infrastructure control software

PSI's software solutions control, monitor and optimise mission critical infrastructure for utility companies, industrial manufacturers and processors and the transport industry. The company's solutions enable customers to control highly complex business processes, minimising the risk of potentially catastrophic failure, improve operational efficiency and reduce environmental impact.

Founded in Berlin, in 1969, the company has been built up through organic development supplemented by a number of acquisitions. As a result, PSI now operates in a diverse spread of geographical and vertical markets, served with a still disparate range of specialist software products.

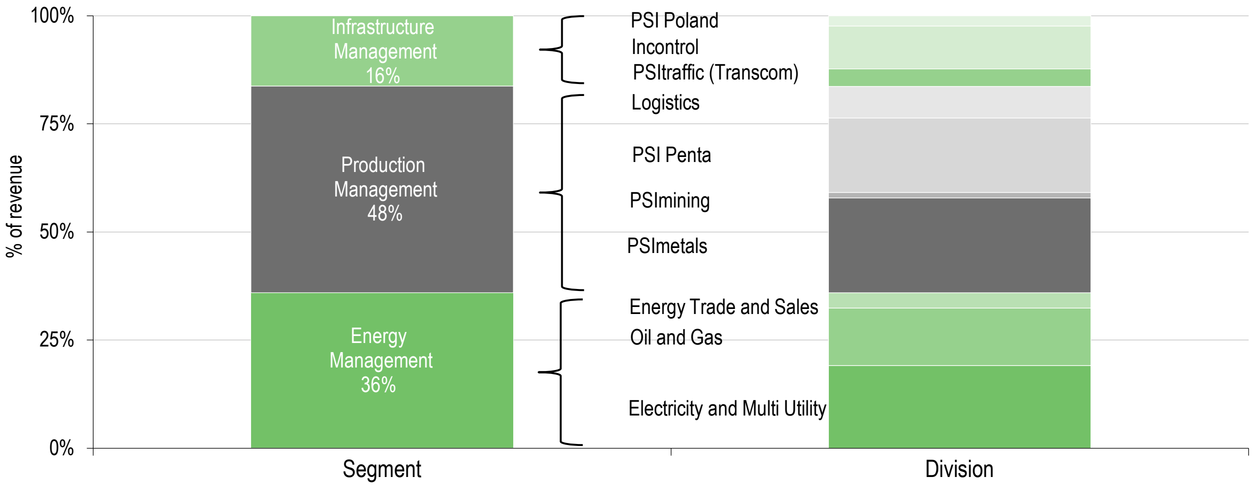
Management is now looking to consolidate the business, building on its key strengths, in vertical markets where the company has a strong competitive position or promising market opportunity while de-emphasising and potentially disposing of non-core operations. The company is also progressively migrating its operations onto a single product platform, which should ultimately improve R&D efficiency and competitiveness.

Divisional split

Disparate businesses within each division

The company segments its business into three divisions: Energy management, Production management and Infrastructure management, each addressing a broader collection of end markets. However, to better understand the dynamics of the business, it is important to note that each of these three divisions is made up of a number of more focused businesses, each offering optimised solutions and expertise to address more specific industry verticals, as shown in Exhibit 1. Consequently, each reporting segment consists of a number of businesses with differing maturities and margin profiles and each is exposed to different end market and competitive dynamics. Looking at the business from this perspective, the three largest businesses in terms of revenue contribution are PSI Metals (22%, which will increase with the acquisition of Broner), Electricity and Multi-Utility (19%) PSI Penta (17%), followed by Oil and Gas (13%) and PSI Incontrol (10%) (figures estimated on trading for the nine months to September).

Exhibit 1: Revenue split by segment and by division (Q1-Q314)



Source: Company data, Edison Investment Research

Production management (c 48% of sales)

The production segment consists of two of PSI's larger but relatively mature businesses, PSI Metals and PSI Penta with PSImining being much smaller, but with good growth potential, and the Logistics division, which has good growth potential and appears to be recovering from execution issues that marred performance in H113 and H114.

PSI Metals – (c 22% of sales) steel cycle maturing, aluminium may offset

PSI Metals has been one of the company's star performers over the past few years, growing at a robust double-digit rate driven by the resurgence of the global production steel industry. This cycle now appears to have weakened, although rising investment in the aluminium production industry could offset this. Consequently, on an organic basis, we expect flat revenue performance in 2014 and 2015.

Broner acquisition looks a good fit, and should improve pricing power

PSI has a market leadership position in the segment, but the recently completed (12 November 2014) acquisition of Broner, from Hyperion Systems Engineering Ltd, should strengthen this further. Broner is essentially a direct competitor to PSI, but with a complementary customer/geographical footprint, being strong in the UK, India and Brazil, where PSI has little presence, and with an operation in Japan, where PSI Metals does not yet operate. Investment in product development had suffered as Hyperion focused on the oil and gas, refining and petrochemical markets, and in the longer term customers are likely to be migrated onto the PSI platform. In the near term, the consolidation of two competitors should improve pricing power.

Broner is being acquired for €15m of which €4m is being held in escrow (€1.5m for transaction risk, €2.5m for project risks). We estimate that it will contribute €10m to revenue in FY15, but cautiously little to profitability until synergies start coming in FY16, where we add €0.8m to EBIT. Ultimately, however, the key benefit is likely to come through in improved geographical reach and pricing power for incumbent PSI Metals business. With combined annualised sales of c €46m PSI Metals will account for c 26% of group revenues at the current run rate.

PSI Penta (c 22% of sales) – automotive growth offset by Mittelstand challenges

PSI Penta stands somewhat apart from the rest of the group in that it supplies enterprise resource planning (ERP) and manufacturing execution systems (MES) rather than control software. Operating primarily in Germany, the division supplies into two key verticals, the automotive manufacturing supply chain and German Mittelstand manufacturers. The automotive manufacturing industry presents solid growth opportunities driven by investment in just in time and just in sequence methodologies and helped by a new software platform release. However, the economics of addressing the Mittelstand are hampered by the fragmentation of the customer base (over 400 customers) and competition with SAP. Until a solution can be found for the latter, growth is likely to remain lacklustre (zero to low single digits) and operating margins are low (low to mid single digit).

Mining (c 1% of sales) – Potential for strong growth

PSImining is still only a small business in terms of sales contribution but has the potential to grow strongly. The company is implementing its software at two initial customers, both in China, one of which was frozen earlier this year due to the cash shortages but has now been unfrozen. Once these reference sites go live, a substantial opportunity should open up for the business, which should be a catalyst for robust growth in the 2016 timeframe.

Logistics (c 7% of sales) – recovering from execution issues

A $6m project overrun significantly hurt group earnings in 2013, running into H114, especially given the relatively small size of the division. However, following a complete re-write, the software – an integrated transport management control system – is now operational at the pilot customer, Swiss Post. Other opportunities are now starting to open up. Management believes there is an opportunity to cross sell the product into other groups, eg metals. Consequently we expect robust 5-10% growth this year, with margins expanding to the c 7% level, which they were before the issues transpired.

Energy management

Electricity and Multi Utility (c 19% of sales) – recovery underway

Trading in this segment has been severely depressed in recent years as the German government's policy to eliminate nuclear power generation and to migrate from conventional energy sources to renewables starved PSI's customer base of cash. (Around two-thirds of division's revenues come from the domestic market.) However, the group looks set to enjoy a period of stronger growth and margin expansion. The drivers behind this are in part cyclical and in part structural. The cyclical element comes from Germany's five-year energy tariff setting cycle, which tends to drive investment in the grid in the years running up to the 'photo year' when the tariffs are set. For electricity this is in 2016. More structurally, investment into the grid to adapt it to a more volatile, renewables-based supply is now finally increasing. PSI has also invested into its solution set to meet these requirements and in productising its software to enable more rapid deployment and reduce costs. The growing threat from cyber-attacks is also driving the switch towards newer, productised software to facilitate the rapid application of security software patches. Outside of Germany, through its partners, the company is also seeing some promising developments in Russia.

Gas and Oil (c 13% of sales) – some promise amidst the uncertainty

The company's Gas and Oil business supplies control software primarily for gas distribution grids (mainly domestic) and pipelines (mainly overseas). Uncertainty around the potential for the fallout over the Russian/Ukrainian situation to disrupt business supplying to pipeline operators was one of the reasons management withdrew sales and earnings guidance for 2014. However, those risks appear to have subsided somewhat and opportunities may emerge as a result, as the construction of at least three new pipelines is being considered to mitigate the Ukrainian risk. Domestically (c 50% of sales), business has likely benefited to an extent from investment ahead of Germany's gas distribution 'photo year' in 2015, although not to the same extent expected within electrical energy.

Energy Trade and sales (c 4% of sales)

This is a small division, which supplies software for enterprises working in the liberalised energy market to allow them to manage all sales and trade related processes. The launch of updated software may prompt some faster growth (mid-single digits), but being small the division is not particularly material to the investment case.

Infrastructure management

Transcom (c 4% of sales) – competitive domestic market, opportunities in Asia

PSI Transcom provides software for controlling public transport infrastructure – metro, buses, trams, regional trains, etc – and also has a depot management system. The domestic market is competitive, particularly for public transport infrastructure systems, where the company competes with Init and IVU Traffic Technologies, but traction in South-East Asia is helping to drive growth; we estimate around 5% next year.

Incontrol (10% of sales) – not an obvious fit

PSI Incontrol differs from the rest of the group, in that it was PSI's implementation partner in South-East Asia, which the company acquired in 2009. As such its revenues are more project than product based and it also has a more significant hardware component to its revenue mix than the rest of the group. This said, the division's margins are relatively healthy (circa 10%), although the revenues and particularly earnings are strongly Q4 weighted. At some stage a disposal of the business looks likely.

Structural margin improvement initiatives

Three key structural initiatives underpin management's drive to improve PSI's margins: consolidating much of the business onto a single technology platform, migrating to a standard software business model and de-fragmenting the business, through building around key strengths and potentially rationalising non-core operations.

Consolidating operations onto a single technology platform

PSI introduced a new product platform, Eclipse 4, in 2010, and is currently around 50% of the way through a migration that will eventually consolidate 25 individual solutions onto the one core architecture. The platform has four layers, described below, with the lower layers holding core standard features, while the upper layers allow for increasing configuration according the industry or customer.

Exhibit 2: Eclipse 4 architecture

Source: PSI

Exhibit 3: Role of the key layers in Eclipse 4

- **Industry solutions:** Contains industry-specific or customer-specific functions and algorithms and interfaces to existing enterprise software or machinery.
- **Application layer:** Provides ready to use applications for solving operational tasks. Includes algorithms for optimisation, production control and logistics.
- **Framework layer**: Provides the basic interfaces and tools to enable rapid, cost-effective application development.
- **Infrastructure layer:** Contains the key elements common to all components and services. Key elements include the operating system, databases and networks.

Source: PSI, Edison Investment Research

The key benefits of this migration to the company's margin profile are as follows:

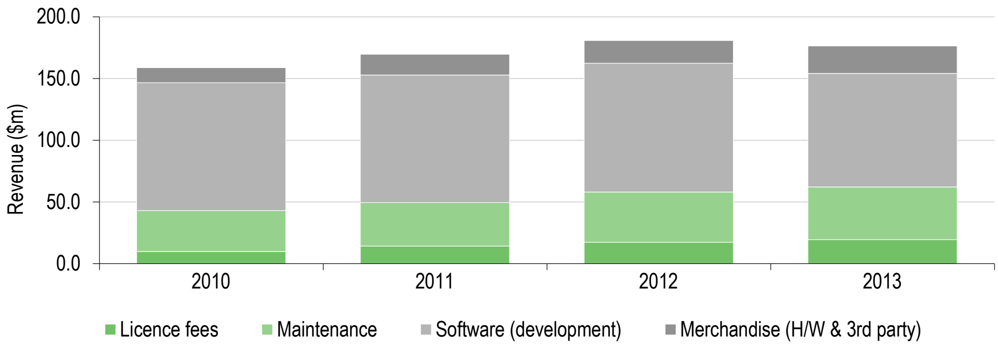
- Reduced replication of work, through the use of a common platform. For example if an infrastructure software provider changes an interface, the modification can be implemented just once across all applications rather than once for each legacy platform.
- Efficiency gains through using a more modern, user-friendly platform.
- Access to a larger pool of developers, enabling reduced dependence on (typically expensive) niche skillsets and increased ease of near shoring or offshoring.

Ultimately, the potential for this platform consolidation to proportionately reduce R&D costs and raise margins could be significant. In the transition period, however, margins are being compressed by an element of double costs being incurred, as the company still supports a number of disparate legacy solutions while it further develops the Eclipse platform. This is a factor in R&D costs almost doubling, from €10.5m (8% of sales) in 2008 to €19.8m (11% of sales) in 2013.

Shift towards a more product-based model

Historically, PSI operated a solutions based model, whereby the licensing component of a customer engagement was relatively low, with revenues weighted towards the implementation project, which involved customising and then integrating the solution, often on a fixed-price basis. Facilitated by the move towards a standard software platform, the company is now shifting its model whereby the licensing component (for a more modern, flexible product) will be higher, while the implementation work will be carried out on a time and materials basis, and should proportionately reduce with the improved configurability of the new platform. The standardisation of the platform should also support growth in maintenance and upgrade revenues, through enhancing the company's ability to sell standard software upgrades and security patches often bundled into a full upgrade and maintenance contract. Historically the typical value of a standard maintenance contract was 15-16% of sales, whereas under the new model a full upgrade and maintenance contract may be worth as much as 20-25% of the initial license fee.

Exhibit 4: Revenue progression by type (strategic growth areas in green)



Source: PSI, Edison Investment Research

Improving margins and earnings predictability

Ultimately, this shift in model should help drive up margins and improve earnings predictability. The shift should drive growth in licensing (high margin but volatile) and maintenance and upgrade revenue (high margin and recurring), while software development and integration revenues are likely to decline, although the shift towards time and materials contracts should reduce exposure to cost overruns. Hardware revenues, a significant proportion of which are generated by Incontrol, are unpredictable and low margin. The shift will also suppress growth in the order book in the near term as multi-year fixed price implementation projects (where the whole value would be recognised in the order book) give way to time and materials, upgrade and maintenance revenues, which enter the order book more progressively.

Building on strengths, potential rationalisation of non-core

PSI is a fragmented business and while the company has a strong competitive position in its key markets, there are others that are sub-scale (eg PSI Penta's Mittelstand business or Transcom) or which do not fit particularly well with the rest of the business (eg Incontrol).

The Broner acquisition shows PSI's ambition to build upon its core strengths, consolidating the market to improve pricing power and grow the company's customer and geographic footprint. Further acquisitions are possible, although the company is selective and we do not necessarily expect any acceleration in activity. Equally, the disposals or rationalisation of non-core businesses should help improve focus and expand margins.

Sensitivities

- Geopolitical/economic risk – PSI has a diverse geographical footprint and investment in mission critical infrastructure can be negatively affected by geopolitical or economic instability. Guidance for the full year has been withdrawn due to geopolitical/economic risks in Russia, Thailand and China.
- Fragmentation of the business – While the breadth of PSI's industry and geographical footprint helps diversify risk, some operations are sub scale. In addition, as we have seen with logistics, execution issues event in a relatively small business can have a negative impact on profitability.
- Conservative accounting – Compared to some international peers, PSI's accounting policies look conservative. Legacy and one-time costs are not stripped out as exceptional. All R&D is expensed, meaning this year's P&L bears the brunt of the accelerated development work, whereas some other companies would likely capitalise this investment and spread the cost over a longer time.
- Low margins, operational gearing – While margins are low, relatively small variations in operational performance have a large percentage impact on earnings. Equally the scope to expand margins is central to the long-term investment case. Executing this transition is not a trivial task and will take time.
- Strategic attractiveness – PSI is often mentioned as a potential takeover target, and compared to its largest competitors (ABB and Siemens) PSI is a small company with limited resources. The current situation, with the share price depressed and benefits from initiatives such as the move to a single product platform and product based model yet to come through in any meaningful way, could attract attention. However, we believe that management is not seeking such a scenario. We also note that RWE (a German utility) owns approximately 18% of the shares, with employees and management owning 25%. Together these represent a reasonable blocking holding.

Financials

Estimate changes

Our estimate changes are shown in Exhibit 5 and reflect a more cautious stance on year-end trading in FY14, due to geopolitical and economic uncertainty. However, our PBT estimates for FY15 take a small nudge upwards, reflecting the positive order intake in Q3 and subsiding risks to the Oil and Gas business related to the Ukrainian crisis. Our FY16 estimates are new. We also incorporate the Broner acquisition, which adds €10m to revenue in FY15 but at no profit. Broner synergies, along with the other structural improvement initiatives, help drive the expansion in operating margin from 7.2% in FY15 to 8.6% in FY16.

Exhibit 5: Estimate changes

€m	2012	2013	2014e	2014e		2015e	2015e		2016e
	Actual	Actual	Old	New	Variance	Old	New	Variance	New
Energy Management	62.3	61.0	63.3	64.3	2%	68.4	69.47	2%	72.9
Production Management	89.4	84.1	82.1	81.1	-1%	86.2	95.16	10%	99.9
Infrastructure Management	29.2	31.3	32.3	30.8	-5%	33.9	32.32	-5%	33.9
Total Sales	180.9	176.3	177.7	176.2	-1%	188.5	196.9	4%	206.8
EBITDA	17.0	8.0	13.6	12.4	-9%	17.0	17.7	4%	21.3
Operating profit (reported)	13.0	4.2	9.9	8.7	-12%	13.4	14.0	5%	17.6
Margin	7%	2%	5.6%	5.0%		7.1%	7.1%		8.5%
Profit before tax (FRS 3)	11.4	3.1	8.5	7.1	-16%	11.9	12.2	2%	16.4
EPS - normalised and fully diluted (c)	63.6	10.6	44.8	38.7	-13%	62.9	65.5	4%	87.3
EPS - FRS 3 (c)	60.4	2.4	43.4	37.4	-14%	61.6	64.2	4%	86.0
Dividend (c)	30.0	0.0	13.0	10.0	-23%	30.8	30.0	-3%	40.0
Net debt/(cash)	(24.0)	(14.9)	(16.94)	(1.5)	-91%	(22.8)	(4.3)	-81%	(9.3)

Source: PSI, Edison Investment Research

We expect a return to growth

Following a 3% decline in FY13 and estimated flat revenue performance this year, our estimates assume 6% and 5% organic revenue growth at group level in FY15 and FY16 respectively. With Broner, revenue growth in FY15 is 12%. With such a diverse footprint there is generally part of the business that is performing well, offset by others going through more difficult times. However, with good execution and no significant geopolitical/economic shocks, we believe our estimates may turn out to be cautious.

Margin expansion the key value driver

Our estimated 5% operating margin for FY14 is meaningfully up on the 2013 nadir of 2%, but still below the 7% reached in 2012. It is worth noting that this year's profitability is encumbered by €1.5m of adjustment and restructuring costs in logistics, which are not stripped out as exceptionals. Stripping this out, the EBIT margin this year would be 5.8%, which makes our forecast expansion to 7.2% in FY15 and then 8.6% in FY16 look less demanding.

Looking longer term, with the shift to a standard software model, consolidation onto a shared software platform and rationalisation of non-core business, we believe that margin expansion to the mid-teens level should be achievable, on a four- to six-year view. The elimination of double costs while Eclipse 4 migration is ongoing, but other product suites are maintained will also be an important factor in this regard. Looking at PSI's peer group in Exhibit 6, successful companies with pure software models and a (more or less) consolidated software platform can generate operating margins well north of 20%. Achieving such margins would take time and/or more aggressive restructuring, but is not out of the realms of possibility.

Balance sheet and cash flow

The company had net cash of €15.7m at end Q314, comprising of €22.7m cash and €7m debt. Following the Broner acquisition we expect this to drop to €1.5m at year-end. Cash flows have suffered over the past two years along with profitability, and the company did not pay a dividend last year.

While the business has a considerable amount of cash tied up in working capital (average 37% of sales over the past two years), mainly in receivables and accrued income, this looks relatively stable, and there may be room to reduce these levels. Expanding margins should also help cash conversion. Consequently we expect positive free cash generation over our forecast period and believe that there should be room reinstate the dividend towards historic levels (30c per share estimated) in FY15.

Valuation: Margin expansion should drive upside

PSI remains rated at typical recovery multiples, with a low EV/sales ratio but a relatively high P/E, although the latter is actually not out of kilter with its broader peer group. PSI's margins, however, are substantially below the majority of its peers, which reflects the fragmentation of the current product set and project-based business model.

Typical recovery multiples

While the very high margins enjoyed by the likes of Aveva and Dassault are likely to be out of reach, with some rationalisation, broader roll out of the Eclipse 4 software platform and a successful shift to a standard software model, we believe that expansion to the mid-teens level should be achievable with a five-year view. This would open up the potential for sustained double-digit earnings growth, which we do not believe is priced in.

Exhibit 6: Peer multiple comparison

				EV/sales		Price earnings		EBIT margin	
	Currency	Share price	Market cap	Current	Next	Current	Next	Current	Next
PSI	€	11.0	173	1.0x	0.9x	28.4x	16.8x	5%	7%
Local peers									
Init Innovation In Traffic Systems AG	€	21.3	214	1.9x	1.8x	16.9x	15.5x	17.6%	17.9%
IVU Traffic Technologies AG	€	2.9	51	.8x	0.8x	12.5x	11.5x	8.6%	8.9%
Nemetschek AG	€	79.2	762	3.3x	2.8x	23.3x	19.4x	21.2%	21.1%
International industrial software									
PTC Inc	US$	37.9	4,446	3.5x	3.3x	15.9x	14.3x	25.8%	27.1%
ANSYS Inc	US$	79.8	7,333	7.0x	6.5x	24.0x	22.2x	42.1%	43.1%
Autodesk Inc	US$	59.7	13,557	4.8x	4.5x	49.9x	40.7x	15.3%	18.4%
AVEVA Group PLC	£	1,535.0	982	4.2x	3.9x	19.9x	18.0x	31.2%	33.0%
Constellation Software Inc/Canada	US$	322.4	6,832	3.9x	3.4x	23.0x	19.0x	9.7%	11.2%
Dassault Systemes	€	50.7	12,978	5.0x	4.4x	28.4x	25.2x	28.0%	28.8%

Source: Bloomberg consensus, Edison Investment Research. Note: Priced as at 20 November.

DCF: Operating margin expansion beyond 10% should generate upside

A discounted cash flow analysis suggests that the current valuation is pricing in minimal operating margin expansion beyond our 8.6% FY16 estimate. In Exhibit 7, we show a DCF sensitivity analysis assuming that the company reaches different operating margins by the year 2020 and differing organic growth rates between now and 2020. The analysis suggests that a share price of €20+ should be justifiable if operating margins can be expanded to 15% and of €15+ if margins reach 12%. The valuation is much less sensitive to variations in growth rate.

Exhibit 7: DCF – sensitivity to differing long term margin and medium term growth rates

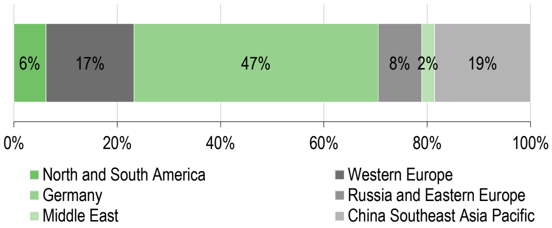
Value per share	€		EBIT margin attained by 2020			
		8%	10%	12%	14%	16%
Organic growth rate to 2020	0%	8.4	11.8	15.2	18.5	21.9
	2%	8.7	12.3	16.0	19.6	23.3
	4%	9.0	12.9	16.9	20.8	24.7
	6%	9.3	13.5	17.8	22.0	26.3

Source: Edison Investment Research. Note: WACC = 10%, Terminal growth rate 2.5%.

Exhibit 8: Financial summary

€m	2012	2013	2014e	2015e	2016e
Year end 31 December	IAS	IAS	IAS	IAS	IAS
PROFIT & LOSS					
Revenue	180.9	176.3	176.2	196.9	206.8
Cost of Sales	(36.1)	(34.8)	(33.5)	(37.4)	(39.3)
Gross Profit	144.8	141.5	142.7	159.5	167.5
EBITDA	17.0	8.0	12.4	17.7	21.3
Operating Profit (before aqu'd int amortisation.)	13.5	4.4	8.9	14.2	17.8
Amortisation of acquired intangibles	(.5)	(.2)	(.2)	(.2)	(.2)
Operating Profit	13.0	4.2	8.7	14.0	17.6
IFRS 2 charges	0.2	-	-	-	-
Net Interest	(1.7)	(1.6)	(1.7)	(1.8)	(1.2)
Profit Before Tax (norm)	11.9	3.3	7.3	12.4	16.6
Profit Before Tax (FRS 3)	11.4	3.1	7.1	12.2	16.4
Tax	(2.0)	(2.7)	(1.2)	(2.1)	(3.0)
Profit After Tax (norm)	10.0	1.7	6.1	10.3	13.7
Profit After Tax (FRS 3)	9.5	0.4	5.9	10.1	13.5
Average Number of Shares Outstanding (m)	15.7	15.7	15.7	15.7	15.7
EPS - normalised (c)	63.6	10.6	38.7	65.5	87.3
EPS - normalised fully diluted (c)	63.6	10.6	38.7	65.5	87.3
EPS - FRS 3 (c)	60.4	2.4	37.4	64.2	86.0
Dividend per share (c)	30.0	0.0	10.0	30.0	40.0
Gross Margin (%)	80%	80%	81%	81%	81%
EBITDA Margin (%)	9.4%	4.5%	7.0%	9.0%	10.3%
Operating Margin (before GW and except.) (%)	7.5%	2.5%	5.1%	7.2%	8.6%
BALANCE SHEET					
Fixed Assets	68.1	69.3	85.2	85.4	85.9
Intangible Assets	47.5	49.1	54.1	53.1	52.1
Tangible Assets	14.2	13.8	17.2	18.5	20.0
Goodwill	0.0	0.0	7.5	7.5	7.5
Other	6.4	6.4	6.4	6.4	6.4
Current Assets	118.3	108.8	101.7	113.2	122.7
Stocks	4.0	3.9	6.0	5.0	5.0
Receivables	76.3	77.8	81.9	91.5	96.1
Cash	33.3	21.8	8.5	11.3	16.3
Other	4.6	5.3	5.3	5.3	5.3
Current Liabilities	(67.8)	(64.8)	(65.9)	(69.6)	(71.3)
Trade & Tax Payable	(34.2)	(35.5)	(31.5)	(35.2)	(37.0)
Short term borrowings	(5.4)	(3.5)	(3.8)	(3.8)	(3.8)
Other creditors	(28.2)	(25.7)	(30.6)	(30.6)	(30.6)
Long Term Liabilities	(45.0)	(45.9)	(45.8)	(45.8)	(45.8)
Long term borrowings	(3.9)	(3.4)	(3.3)	(3.3)	(3.3)
Other long term liabilities	(41.1)	(42.6)	(42.6)	(42.6)	(42.6)
Net Assets	73.6	67.3	75.2	83.2	91.5
CASH FLOW					
Operating Cash Flow	3.3	1.8	7.8	10.8	16.6
Net Interest	(.3)	(.2)	(.3)	(.4)	0.2
Tax	(2.1)	(1.6)	(1.2)	(2.1)	(3.0)
Capex	(4.0)	(5.0)	(4.6)	(3.9)	(4.1)
Acquisitions/disposals	0.3	1.0	(15.0)	0.0	0.0
Financing	0.0	(.6)	0.0	0.0	0.0
Dividends	(3.9)	(4.7)	0.0	(1.6)	(4.7)
Net Cash Flow	(6.6)	(8.6)	(13.3)	2.8	5.0
Opening net debt/(cash)	(30.7)	(24.0)	(14.9)	(1.5)	(4.3)
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0
Other	(.1)	(.5)	(.1)	0.0	0.0
Closing net debt/(cash)	(24.0)	(14.9)	(1.5)	(4.3)	(9.3)

Source: Edison Investment Research, PSI accounts

Contact details	Revenue by geography (FY13)
PSI AG Headquarter Dircksenstrase 42-44 Berlin 10178 Germany +49 302801-0 www.psi.de	

CAGR metrics		Profitability metrics		Balance sheet metrics		Sensitivities evaluation	
EPS 2013-16e	8.2%	ROCE 15e	10.8%	Gearing 15e	N/A	Litigation/regulatory	◖
EPS 2014-16e	50.1%	Avg ROCE 2013-16e	9.7%	Interest cover 15e	N/A	Pensions	○
EBITDA 2013-16e	5.7%	ROE 15e	12.3%	CA/CL 15e	1.6x	Currency	◖
EBITDA 2014-16e	31.0%	Gross margin 15e	81.0%	Stock days 15e	9.3	Stock overhang	◖
Sales 2013-16e	3.4%	Operating margin 15e	7.2%	Debtor days 15e	170	Interest rates	○
Sales 2014-16e	8.3%	Gr mgn / Op mgn 15e	11.2x	Creditor days 15e	32	Oil/commodity prices	◖

Management team

CEO: Dr Harald Schrimpf

Dr-Ing Harald Schrimpf became a member of PSI's executive board in July 2002. Since 1995, the graduate electrical engineer has held different management positions at DaimlerChrylser, EADS and Volkswagen subsidiary gedas, with responsibility for major IT projects.

CFO: Harald Fuchs

Harald Fuchs, as the head of finances and controlling, has been active in the Electrical Energy business unit of PSI since 2011. Prior to that he held a number of senior commercial positions in RWE, Continental and Alpine Energy Group within Germany, the US and Austria. He studied business management in Germany, the UK and US.

Chairman of the Supervisory Board: Prof Dr-Ing Rolf Windmöller

Professor Dr-Ing Rolf Windmöller has held a variety of positions at Vereinigte Elektrizitätswerke Westfalen (VEW AG) since 1978. In 2003 he was appointed an honorary professor for his teaching at the Bochum Technical University of Applied Sciences Georg Agricola. He also worked for the international management consultancy Management Engineers GmbH & Co. KG from April 2004 to September 2006.

Principal shareholders	(%)
RWE Deutschland	17.8
Harvinder Singh	8.1
Employee Consortium	9.4
Sterling Strategic Value	5.0
Baden-Württembergische Versorgungsanstalt für Ärzte, Zahnärzte und Tierärzte	3.1
Investmentaktiengesellschaft für langfristige Investoren TGV	3.0

Companies named in this report

Init Innovation In Traffic Systems AG (IXX GR), IVU Traffic Technologies AG (IVU GR), Nemetschek AG (NEM GY), PTC Inc (PTC US), Ansys Inc (ANSS US), Autodesk Inc (ADSK US), Aveva Group PLC (AVV LN), Constellation Software Inc (CSU CN), Dassault Systemes (DSY FP)