Axway
Web Audio Conférence
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1st Half Year 2016 Results

Introduction

Jean-Marc Lazzari
Axway CEO

Thank you. Good morning, good afternoon, ladies and gentlemen, and again, welcome to this half-year web conference around the Axway results. Let me first go through the traditional forward-looking statement disclaimer; you are absolutely used to it, so I will not spend too long on that.

Here is the agenda I suggest we will cover. Patrick Donovan will cover details around the accounting and financial results. I will conclude, prior to the Q&A session, with the mid-term plan, the status, and our strategy as regards new positioning and transformation. I will start by giving you a few highlights on the overall results of the first six months of the year.

First of all, I want to give you a summary, using a single word, of what we did in the past six months. As you can see, this has been a solid semester. Combined significant growth as well as profit improvement has resulted in a total growth in revenue of 7.1%, rising to EUR 144.7 million, compared to EUR 135.1 in 2015. As you can see, the ROA profit from business activity reached EUR 16.3 million with 11.3% of the revenue in the net profit, EUR 11 million with 7.6% of revenue. As you can see, both the profit from business activity and the net profit increased from last year, respectively two points for the business activity and close to six points for the net profit.

If you now look at what this revenue is made of and look at the revenue line, obviously you can see licence accounts for EUR 37.4 on the first half of the year, representing a 10.3% organic growth, which is extremely significant. The last time we had a double-digit growth in Axway was in 2010, so we had a very good first half as far as licence is concerned.

Maintenance revenue was EUR 70.2. This is also extremely solid. You see a 4% organic growth, and of course maintenance revenue, being recurrent, is one of those indicators that we watch carefully; combining licence growth and maintenance is really the essence of the game. Maintenance revenue accounts for 49% of the total revenue, and then you see services accounts for USD 37.1 million, with a 4.4% organic growth. This area also showed significant and encouraging signs. By way of reminder, services in Axway are going through a pretty significant transformation; we announced at the beginning of the year that we want to focus the services activity of Axway on added-value services, and work on a strategy with partners around integration. We are taking the first step in that direction and, as you can see, it did not have an impact on the potential revenue that we made.

Therefore, if you now look at revenue by region, you can see the four regions in which we operate: France, Rest of Europe, Americas, and Asia Pacific. As you can see, the significant growth that we have been enjoying for the first half of the year was mainly driven by the Americas; our US business grew

18.1% at EUR 61.5 million, significant growth. There was 20.1% growth in Asia Pacific also, with EUR 7.4 million in revenue, and you will notice that our French business tended to stabilise, preparing for the second half of the year where our objective is to get a balanced business position by Q4 in France.

If you look now at sequential quarters, Q1 and Q2, you can see in most cases an acceleration in the right direction. It starts with France where you can see that the decrease in organic revenue slowed to 6.1% in Q2; that was my observation in preparing Q3 and Q4. You can see here the acceleration in growth in our North American business; 23.8% growth, reaching EUR 34.1 million in revenue for Q2, and of course our very fast-growing business in Asia Pacific, here again accelerating in Q1 and Q2 to reach close to 30% of growth. Even though the number is small in Asia Pacific, the vast majority of that growth is achieved in the digital business, which is Australia-driven, where we see an extremely active business, specifically in the banking area.

If you now look at the same view of the sequential quarters, Q1 and Q2, but this time concentrating on revenue breakdown, you will also see a significant acceleration in Q2 with licence reaching EUR 25.1 million, which is 22.9% growth. This is, without doubt, one of the best Q2 quarters in the history of Axway. Maintenance has also showed a to 4.5% growth, with services on the whole showing a stabilisation in revenue, including a little growth as we do the transformation that we mentioned.

Therefore, there has been significant growth in licence revenue and extremely solid overall growth in revenue, as well as a turn-around situation in our US business, which is now basically showing growth across three consecutive quarters.

If you look at the balance of the different ratios and indicators, I would say that is an extremely resilient business. We do not depend on one single source of revenue, and you can also see that licence and services are pretty balanced, with 49% of maintenance.

An alternative view shows a 6% growth in services, cloud business, which is also a recurrent business. This takes recurrent business, including subscription in the cloud, to over 50% actually to 55%.

If you look at the balance between the different geographical locations, we still have a pretty solid 30% coming out of France, and you can see now that our US business represents one of the biggest businesses that we have got in terms of geographical breakdown, but also showing over 40%. By way of reminder, last year we were balancing 37/35 during a certain number of quarters, so, overall, it is an extremely resilient business which does not depend on one single source of revenue, be it geographic or by a type of activity.

If you look at the head count, we have had a slight increase in the head count, reaching 1 957 people in the company. The vast majority of that increase is driven by the acquisition of Appcelerator that we made in January. Underlying trends also show some growth in the US, and, potentially, a small reduction in France.

These are the overall generic comments that I would make in terms of the first half-yearly results. Patrick Donovan, our CFO, will now take you through the detail of the financial results. Patrick?

Patrick DONOVAN

Directeur Administratif et Financier / Chief Financial Officer, Axway

Thank you, Jean-Marc. I will go through, in more detail, the accounting and financial results for the first half of 2016 and make a few comments as I go through them. First, you will see the top level of our income statement, and as Jean-Marc mentioned, total revenues grew to EUR 144.7 million, up from the EUR 131.1 million in the first half of 2015. That represents a total growth of 7.1%, or 5.7% organic, driven by strong licence growth, primarily in our North American market. However, we were happy to see that all lines of business presented here grew over the first half of 2015.

Our growth margin finished at 69.3% versus 67.3% in the first half of 2015. Our growth margin was EUR 100 million in the first half of 2016 versus EUR 91 million in the first half of 2015. The improvement in growth margin as a percentage of revenue was driven by our services business, which includes our cloud business. During the budgeting cycle for 2016 we took a hard look at where we were spending all our costs, and held back our costs to allow the margin to drop from our services business, and we are pleased to say that our services margin for the first half of 2016 was over 10%.

For our operating expenses, they increased to EUR 84 million from EUR 78.3 million in the first half of 2015. This increase was primarily from the additional costs through the Appcelerator acquisition done in January 2016. We experienced very little foreign currency exchange effect in the first half of 2016, principally due to the fact that the US dollar to euro conversion rate was stable between 2015, first half, and 2016, first half.

Our profit on operating activities improved to EUR 16.3 million from EUR 12.7 million in the first half of 2015. This represents 11.3% ROA as a percentage of revenue, versus 9.4% in the first half of 2015. As mentioned, with the growing revenue and the costs control we were able to have an increase in our result from operating activities.

You will notice the amortisation of intangible assets increased from EUR 3 million in 2015 to EUR 3.8 million in the first half of 2016, and this is due to the intangible assets acquired from Appcelerator.

Our profit from recurring operations finished at EUR 12.3 million versus EUR 9.4 million in the first half of 2015.

Other income and expenses, this, as a reminder, for the first half of 2015 was EUR 8.1 million of restructuring charges. We took those charges to restructure our R&D and sales areas that were misaligned with the business activities due to years of acquisitions. In the first half of 2016 the EUR 1.5 million represents acquisition-related charges.

Overall, therefore, our net profit finished for the first half of 2016 at EUR 11 million, or 7.6% of our revenues, versus EUR 2.3 million, or 1.7% of our revenues in 2015, first half.

Now, onto the balance sheet. Total assets finished at EUR 529.4 million, up from the EUR 488.6 million at the fiscal year end 31 December 2015. Primarily, the change was due to the Appcelerator acquisition, which grew both our good will and intangible assets. Our cash and cash equivalents was stable across all periods presented, and we finished at EUR 41.7 million.

In our trade receivables, we remained strong at 78 days versus 80 days DSO in the first half of 2015, representing a two-day improvement.

Our shareholders' equity finished at EUR 338.4 million. The change from the fiscal year end was insignificant, as we really did not have any movement in the foreign currency, as previously mentioned. Our financial debt included EUR 20 million of borrowings under our revolving credit facility. By way of reminder, this revolving credit facility has a total capacity of EUR 125 million. Other current liabilities include EUR 86.9 million of deferred income in the first half of 2016 versus EUR 81.8 million in the first half of 2015.

Now, onto our cash flows. Our working capital requirements have a strong positive improvement in 2015, which drove the EUR 27.8 million improvement in cash in the first half of 2015. As a reminder, this was due to a very strong French licence business in Q4 of 2014, which was able to be collected in the first half of 2015. Additionally, by way of reminder, in the fourth quarter of 2015 we had a weaker licence revenue, and so that dragged that same amount down to EUR 8.7 million for the first half of 2016.

Our free cash flow for the first half of 2016 was EUR 17.4 million, and to note, our change in loan represents the payback of the money borrowed to perform the Systar acquisition in 2014, which was paid back in 2015, in the first half. Then in the first half of 2016 we took out the EUR 20 million to execute the Appcelerator acquisition.

Our financial covenants remained strong in all periods. Our net treasury for the first half of 2016 was EUR 10.5 million. As a reminder, our net treasury is calculated by our net treasury of EUR 41.7 million, and deducting our bank debt.

Our main covenant is our leverage ratio, which we must maintain under three times, and we are easily well within the range as we have a net treasury versus are net debt. We have our EUR 125 million credit line available to us, and we have extended that out to mid-2021.

Our shareholders' structure remains strong, and our concerted action holds 58% of the shares and 65% of the voting rights.

Therefore, in summary, our total revenue grew 7.1%. We were able to grow our operating profit to 11.3% in the first half of 2016, and we had a solid cash balance of EUR 42 million.

Now, I will pass it back over to Jean-Marc.

Jean-Marc LAZZARI

Thank you, Patrick, thank you for all those details. I will now move away from examining pure numbers and talk about the status of our transformation and the first results in the execution of our new strategy. By way of reminder, we joined the company a little over a year ago, and we began working on the new positioning, the new strategy with the team. We presented that new positioning and that new strategy in early 2016, so we are approximately six to seven months into that new strategy. For me, there is no new strategy or new positioning without the support of a strong execution behind it. Furthermore, there is no strong execution without a set of indicators that are reported on a regular basis, demonstrating that this execution is a reality.

In February we presented, for the first time, what I call 'the strategic ambition', which basically means that we want to double the size of Axway. We are talking here of doubling the revenue of EUR 262 million, which was the 2014 revenue, within a three-year time period. An integral part of our business plan is to double that revenue. Of course, I will examine what doubling that revenue implies in terms of growth, but we also want to preserve the margin before acquisition; as you saw in some of the results, we have been doing pretty well on that specific indicator, but I will comment further.

I also mentioned that our US business was out of proportion with the potential of the market. In February, we presented the US business as being close to 65% of the addressable market that Axway can go after, and it is our ambition to grow our licence and cloud revenue by of 20% in the US over the next three years.

Basically, we also talked about the new articulation of the offerings that we have got, and you may remember that we talked about having a foundation which is a collection of all the products in which we have been market leaders that take the product in the fine transfer area in the B2B area. Then we have developed and positioned the company around the digital transformation, which is the area that we call Ecosystem Engagement, where you have all the products around API management, and you have all the products around Analytics. This is important when you are positioning the company towards a new strategy, and for us this means absolutely combining a strong business in the Foundation, where we have got a lot of customers, with a strong growth in the digital business. Therefore, we have come to the conclusion that we need to grow that digital business by over 30% in the course of 2018.

Of course, as our French business is the cornerstone and the historical flagship of the company, everything that we have just mentioned should not be done at its expense. I will comment on that further in a moment. Doubling the size of the company is going to be a combination of external growth as well as organic growth.

Taking that ambition to double the size of Axway as our strategic intention, you can see here a summary of all the acquisitions that we have made, including the latest one, Appcelerator in 2016. Appcelerator was an acquisition in terms of technology; the company developed an extremely powerful market-leading technology that we are now combining with our product, and we have said from the outset that it is going to be something of a balance between external and organic growth. We envisage a 50/50 balance. Of course, this is not a scientific calculation and, depending on when the acquisition is made, and depending on the size of those acquisitions, the 50/50 ratio may de-balance over time, but it remains our clear intention to keep our significant organic growth evident in the first half year, and to combine it with external growth.

The only further comment I would make is that we are actively on the lookout in the market, both in terms of the digital ecosystem environment as well as in reinforcing some of our client positions in the foundation, we are actively looking at technology acquisition, as well as our cloud business and customer base, and, during the next two or three years, we will be extremely active on that front.

If you now look at the preserve margins, obviously you can see that we have improved the margin. We actually have a new statement that we are going to put into that strategic ambition set of indicators. We want to move from preserve the margin before acquisition to improve the margin for acquisition. It is a focus of ours; the company is extremely well-managed. Patrick Donovan made a comment on how we manage costs. The protection of profit obviously is driven by top-line growth but it is also driven by a very strict and focused management of costs, which we did pretty well on in the first half of the year.

Turning now to the other strategic intentions that we have got in terms of the US, growing our licence and cloud by over 20%. You have got the growth of licence and cloud in the US, which accounts for 76%. I would love to be able to tell you it is going to be like that every quarter. These growths are significant growths, and are obviously made up of a lot of deals in the US, and, as a result of the huge transformation in the sales force that has taken place in the US, we are now having a third consecutive growth quarter. Remember, we have had several quarters, 15 quarters of consecutive decrease in our overall business in the US on the licence and cloud front.

Accounting in that 76%, another extremely important indicator is the capacity to sign large deals in the US. We have signed an extremely significant deal with a customer called Fannie Mae. That deal accounts for several millions, and it is also an extremely positive sign, not only that we have got an extremely motivated and extremely efficient sales force focusing on growing licence revenue, which is the first indicator in the time of the transformation of the business, but also because we are able to sign large deals in the US.

The second growth indicator demonstrating the execution of our strategy is around the digital end. We want to develop our business with a lot of digital growth via our product in API but also analytics, and clearly here you can see that the numbers speak for themselves: 68% growth in the digital and ecosystem engagement. That licence growth is extremely significant in the sense that we have, on the first half, balanced our foundation business with the ecosystem engagement with the digital business at the 50/50 range. Part of that 68% is also made up of one of the deals that I mentioned, the Fannie Mae deal. This is an analytic deal on Decision Insight which, by way of reminder, was the leading product of Systar, the most recent acquisition we made, just prior to Appcelerator, but even putting that deal to one side, growth in North America and in the digital business is well in excess of 20% and over 30%, which is in line with our strategic intent.

Turing to the French side of the business, obviously you saw that we have had a smaller decrease of our revenue in the second quarter versus the first quarter. Our strategic intent is to get that business balanced and stop the decrease. The French business has always been the flagship of the company. We have got a significant market share in the French business; it is close to 40%, and, of course, being attacked versus being the attacker, with regard to the US, makes that situation extremely tough in terms of making new logos and getting new deals.

There are encouraging signs in the pipeline; we have encouraging signs in the business itself with a smaller decrease in the second quarter, and the significance of that development is that 30% is there to remain. The beauty of that market, and being a leader in that market, is that we have got an extremely solid customer base, which, for the vast majority, is made up of foundation business, and we are actually upselling that to digital. Actually, if I were to report digital business growth, it would be close to 100% in a little over a year. Therefore, it is an extremely active market pipeline trending towards getting the third and fourth quarter back to a balanced position by the end of the year.

Now, a few comments on the M&A front. As I said, one, we are going to keep doing some acquisitions. We do not have a reputation for buying stupidly, so we have got a lot of choices, both in the technical portfolio, in the digital portfolio, as well as the foundation. We are actively studying some potential targets and, as a matter of fact, I am happy to report some progress we have made on the Appcelerator front. As I said, Appcelerator did develop the fantastic, market-leading technology with a product called Arrow, as well as Titanium. We are working hard to combine these offers in the API management field. We are going to launch an offer which will be an end-to-end API management offer, combining Appcelerator products as well as API products that we have had in our portfolio. This is going very well. The products are going to be available by year end, and we already have a significant signature of the combined offer in most of the countries where we have launched the products.

Therefore, pretty significant progress. We are learning a lot with our colleagues from Appcelerator, specifically on the development side, and actually things are profiling pretty well. Therefore, I would conclude, again, that those are the strategic intents that we have got. They are there to demonstrate that we are executing our strategy, to demonstrate our aim to position ourselves as the partner of choice along the digital journey for our customer, to demonstrate that this strategy is working, and that we are moving back to significant growth, both in the US, and in the digital world, and everywhere on the planet. In summary, we have moved from preserved to increased margin. Before acquisition, we have been doing very well, and Patrick and the team have taken a specific focus on making savings. As a reminder, all the profit improvement that we have shown includes the potential dilutive of the Appcelerator acquisition that we have made.

In short, this is what we are going to work on for the second half of the year, and now I suggest that we open up the floor for questions and answers.

Questions and Answers

Johannes RIES

Apus Capital

Yes, good afternoon. Congratulations, great figures. Like always, maybe a question to the weaker parts of the French business, can you explain, or repeat again what has been the problem or the reasons for the slow start in the year? Is it maybe a change in the sales team, or is it maybe some other reasons which caused this for the time being weaker development? Otherwise, you mentioned that the pipeline looks good and it should improve. Could we also maybe expect a return to growth in France next year?

A second question, you mentioned this large order in the US. Is it right, even without this large order, the US has been showing good growth in Q2? Also, how strong was the growth in Appcelerator in the first half? You mentioned the pipeline in France – maybe a little bit more to the pipeline of the whole company, maybe how it looks for the second half, how it may be increased since the beginning of the year for example? I hope it increased.

Jean-Marc LAZZARI

I will answer the first half of your question on the French business. I will leave Patrick answer on the US performance, without the big deal, Fannie Mae, that I mentioned, but let me start with the French business. You have got several effects combining in the French business. The first one, as I mentioned, is that we are the leader, we are the incumbent in a lot of cases with our large customers, so, we are attacked on those positions very aggressively by some of the new entrants in that market, and they change the trends of the business a little bit.

The other important factor is that our very mature French business has been reaching a stage of maturity where a lot of our large customers have decided to go to what we call ELA, which is basically an unlimited usage of a licence in a specific area of the portfolio, and that ELA practice would show a difficult comparison, year on year, depending on if you are in a period of renewal, depending on the length of those ELAs. Therefore, the French reading of the results is sometimes a little more difficult. Now, the reality of what we have here is that we have got a very solid foundation base of customers to whom we go and sell API. This is working extremely well.

Now, the other reality is that you may have noticed in the past quarter that the average size of the digital business, even though it is increasing significantly lately, is still not reaching the size of the traditional foundation business, which basically would change the whole infrastructure of the customer, and by nature, would trigger a much bigger deal as its maturity level. Therefore, the French business is basically looking good as far as the pipeline is concerned, and it is extremely well-positioned as far as the strategic intent of going digital. As I mentioned, we have 100% growth in digital, and the maturity of the market is also evolving. We are forced to look at, country by country, varying maturity in term of digital, and are forced to see that, clearly, a country like Australia or the US would absolutely lead the charge in terms of the digital transformation of the customer we serve. It took a little longer in France, which may explain that when you have got a significant market share in a position, gaining the last additional point is always more difficult; but, again, a very encouraging pipeline, an extremely positive trend and encouraging momentum on the deal. Therefore, we look forward to entering Q3 and Q4, which will take us back to a balanced approach, year over year.

Patrick, maybe you want to comment on the growth of the US without the Fannie Mae deal and give a little bit of perspective?

Patrick DONOVAN

Sure. For our US licence growth, without the Fannie Mae deal, so for the first quarter we were over 20% licence growth in North America, and without Fannie Mae in the second quarter, we also would have been over 20%, so we had strong core business growth, more the transactional, and then Fannie Mae just really kicked it up a notch and made it a super-growth for the second quarter.

I will also try to address your Appcelerator question. We had a small organic growth on Appcelerator but that was not surprising. I remind you that when we announced the Appcelerator acquisition at year end this was an investment in technology, and so where we are going on our digital journey, the Appcelerator technology was necessary, but it will take about nine months for us to fully develop where we see the technology going, hooked into our current products. Therefore, really, the impact we are expecting from the Appcelerator revenue is to come next year, and this year will be a year of continued investment to get the product where we need it with our technologies.

I believe that was all, if my memory serves? I do not know if you had one more question? Oh, pipeline.

Jean-Marc LAZZARI

Well, as I said, the overall pipeline is for France, but also for the US, globally, significantly improved year over year. I look at two things in particular in the pipeline: first, the overall size, and do we have the proper coverage to make the deal that we want to make, and the answer is yes. The second aspect that I look at is the nature of the pipeline, which basically would reflect the foundation pipeline and the digital pipeline, and there also we have got a very balanced business pipeline between the two layers of the offering. Therefore, the pipeline is encouraging.

Now, I am a tough CEO in the sense that when it comes to pipeline, for me, there is never enough, right? The more pipeline you have the more deals you can pull forward and replace, potentially, slippage, so it is an encouraging, good situation for the year, but never enough.

Participant

What is the tax rate for the first semester, and what do you expect for the second semester?

Jean-Marc LAZZARI

I would love to be able to answer but I will leave Patrick answer that question.

Patrick DONOVAN

That is a difficult one. Our tax rate, we had a tax expense for the first semester of 2015, but that is a blended tax rate that includes the release of some tax assets, so we release about EUR 3.1 million worth of tax assets in the first half of 2016, which benefitted and lowered our effective tax rate in the first half. Our income tax charge was roughly EUR 500 000 in the first half on EUR 144 million of revenue, so the effective tax rate is near zero, but we benefit from the release of some tax assets which lowered what we would expect, without any tax assets, an effective tax rate of about 34%. With our tax strategies and benefits we knock that down and we target more of a 20% to 23% effective tax rate, but in the first half we were able to release enough reserves so it was close to zero.

Participant

In your services strategy, how do you involve partner relationship?

Jean-Marc LAZZARI

In the long-term transformation, services is not the type of business you can turn around in one quarter, because of course it does involve people and projects. Therefore, the strategy is very simple, we want to move to added value services in order to leave room for a services partner integrator to help our customer on their digital transformation, or deploying some of the offers. Therefore, we have been working a lot, specifically in Europe, with Sopra Steria to regularly go and deploy the product and the service together. That partnership is working well. Obviously, in the US we had to diversify and find some other partner. We were actually working extremely well with a lot of boutique players as well as strategic players, and it is going in the right direction. We are looking at improving our business through partnership from a current situation of around 25% of our business, driven with and through partnership, closer to 35%, and potentially 40%.

The service part of it is obviously extremely driven by the customer on a lot of occasions. We see the reaction of the customer is, ‘Please work with my current service provider and get that deployment together’. Therefore, in the US, more specifically, we also work a lot with the customer service provider.

Well, it was a short conference, and it must have been very clear because we do not have a lot of questions. I want to thank you for attending this conference. Our next discussion and conference will most likely be early in February, early next year, to report on the full result, and I wish you a very nice afternoon. Thank you.