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Research report

SMC Research
Small and Mid Cap Research

THOMSON REUTERS ANALYST AWARDS 2018 WINNER
THOMSON REUTERS ANALYST AWARDS 2017 WINNER

Mensch und Maschine SE

Excellent figures and a convincing outlook

Rating: Buy (unchanged) | **Price:** 26.70 Euro | **Price target:** 31.30 Euro

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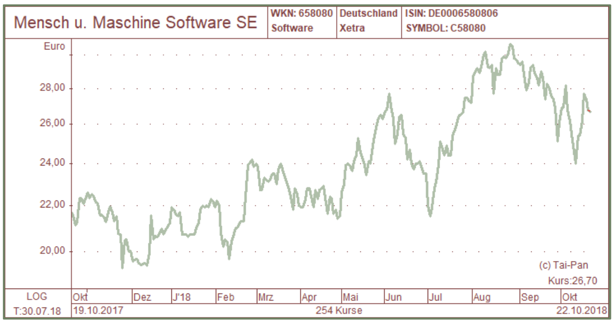
Recent business development



Basic data

Based in:	Wessling
Sector:	CAD/CAM software
Headcount:	818
Accounting:	IFRS
ISIN:	DE0006580806
Price:	26.70 Euro
Market segment:	Scale / m:access
Number of shares:	16.7 m
Market Cap:	445.4 m Euro
Enterprise Value:	469.0 m Euro
Free float:	46.7 %
Price high/low (12M):	30.90 / 19.00 Euro
Ø turnover (Xetra, 12 M):	165,900 Euro / day

Mensch und Maschine continued its dynamic growth in the third quarter and increased its pace even further. In total for the first nine months of the year, this represents an increase in sales of almost 16 percent. EBITDA improved by more than a third, with the EBITDA margin reaching a double-digit figure at 11.5 percent for the first time in a nine-month period. Net income increased even more strongly, rising by 41 percent year-on-year to EUR 7.6 m. On the basis of these strong figures, the Management Board has confirmed its forecasts for the full year and subsequent years and intends to increase EBITDA this year by up to EUR 5 m to EUR 22 to 23 m. We even consider it probable that this target will be exceeded and continue to estimate EBITDA at EUR 23.5 million. Since we also assume that M+M will be able to continue the dynamic upward trend in its key earnings figures in the coming years, we see further significant price potential for the M+M share as well. With a new price target of EUR 31.30, we confirm our "Buy" rating and see this positive assessment also supported by the dividend yield of an estimated 2.6 percent.

FY ends: 31.12.	2015	2016	2017	2018e	2019e	2020e
Sales (m Euro)	160.4	167.1	160.9	177.0	195.6	216.1
EBIT (m Euro)	8.5	12.5	15.2	20.3	23.6	27.6
Net profit	3.9	6.6	9.4	12.1	14.3	17.2
EpS	0.24	0.39	0.56	0.74	0.87	1.05
Dividend per share	0.25	0.35	0.50	0.69	0.85	1.00
Sales growth	14.5%	4.2%	-3.7%	10.0%	10.5%	10.5%
Profit growth	4.0%	70.4%	42.9%	28.1%	18.5%	20.2%
PSR	2.72	2.62	2.72	2.47	2.23	2.02
PER	113.0	66.3	46.4	36.2	30.6	25.4
PCR	29.7	29.8	28.7	25.9	22.7	19.8
EV / EBIT	54.3	36.9	30.3	22.7	19.5	16.7
Dividend yield	0.9%	1.3%	1.9%	2.6%	3.2%	3.7%

Growth rate increases again

After +7 and +20 percent in the first two quarters, the pace of growth accelerated again in the months from July to September. Overall, quarterly sales increased by 23.0 percent to EUR 39.1 m, with the acceleration being visible in both segments. The growth rate in the software segment increased from 9.3 and 12.0 percent in Q1 and Q2 respectively to 13.0 percent, while the VAR business recorded an increase to 28.0 percent (Q1: 5.9 percent, Q2: 24.0 percent). In total for the first nine months, M+M reported sales of EUR 133.6 m (+15.7 percent). With this momentum, M+M continues to benefit from the buoyant demand for its CAM software and the completed change of pricing model at the supplier Autodesk. The company reports that customers are very willing to switch to the new subscription model, which implies a significant price increase over previous maintenance and support contracts. But even apart from this price effect, M+M is experiencing high demand, especially in the BIM field.

Double-digit gross profit growth

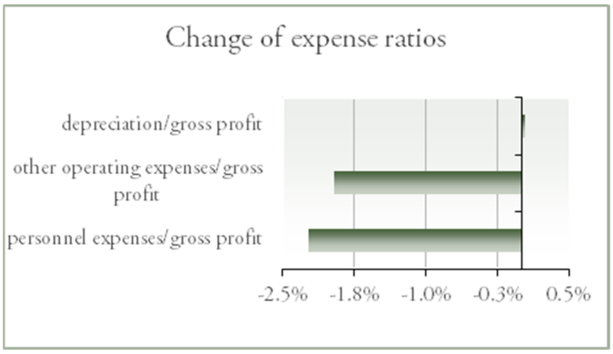
The increase in gross profit, which rose by 14 percent in the third quarter (Q1: 7 percent, Q2: 10 percent), accelerated as well. Cumulated over the three quarters, gross profit grew by 10.2 percent to EUR 75.5 m. In relation to sales, this corresponds to a gross margin of 56.5 percent. The decline compared to the previous year (59.4 percent) is attributable to the increased dynamics in the trading business with Autodesk licenses, whose gross margin is naturally lower than in the services sector or in business with proprietary software. After the Autodesk business was still burdened last year by the change of license model at Autodesk, the weak prior-year basis and the positive effects of this measure are noticeable in the current year. As a result, the gross margin in the VAR business fell from 42.3 percent to 38.9 percent, while in the software segment the already very high level increased again to 97.8 percent (previous year: 97.1 percent).

Business figures	9M 2017	9M 2018	*Change*
Sales	115.47	133.55	*+15.7%*
VAR business	79.48	93.48	*+17.6%*
Software	36.00	40.08	*+11.3%*
Gross profit	68.56	75.52	*+10.2%*
VAR business	33.59	36.34	*+8.2%*
Software	34.97	39.18	*+12.0%*
Gross margin	*59.4%*	*56.5%*	
EBITDA	11.44	15.32	*+34.0%*
VAR business	3.13	5.23	*+67.2%*
Software	8.31	10.09	*+21.5%*
EBITDA margin	*9.9%*	*11.5%*	
EBIT	9.37	13.02	*+38.9%*
VAR business	1.95	4.03	*+107.0%*
Software	7.43	9.00	*+21.1%*
EBIT margin	*8.1%*	*9.8%*	
Pre-tax result	8.63	12.01	*+39.2%*
Pre-tax margin	*7.5%*	*9.0%*	
Net profit	5.40	7.62	*+41.0%*
Net margin	*4.7%*	*5.7%*	

In m Euro and percent, source: company

EBITDA increases by one third

As in the previous quarters, M+M was able to convert the gross profit growth in the third quarter into a disproportionately high increase in profits. Quarterly EBITDA increased by more than half to EUR 3.5 m, resulting in EBITDA growth of 34 percent to EUR 15.3 m in the first nine months. As a result, the EBITDA margin improved from 9.9 percent to 11.5 percent. This was not only due to gross profit growth, but also – again – to continued cost discipline, which resulted in a disproportionately low increase in personnel expenses (+6.4 percent) and almost unchanged other operating expenses (+0.1 percent). The ratios of these two types of expenses to gross profit fell by 2.2 (personnel expenses) and 2.0 (other operating expenses) percentage points respectively. The operating progress is even somewhat understated by these figures, since personnel expenses in the software segment include a sum of around EUR 1.2 m that was capitalized in the previous year as development costs for a software development project that has since been completed.



Source: company

Profit increase by 40 percent

The completed software development project also made itself felt in the form of higher depreciation, which increased by 11.4 percent as a result. Due to the base effect, however, EBIT recorded a disproportionately high increase by 38.9 percent to EUR 13.0 m. In the VAR business, earnings before interest and taxes even more than doubled to EUR 4.0 m, with the software segment still contributing more than two thirds of earnings. After interest, taxes and minority interests, a profit for the period of EUR 7.6 m was reported, an increase of 41 percent on the same period last year.

Cash flows slightly weaker

In contrast to profit, the operating cash flows could not be increased and, at EUR 11.0 m, fell short of the previous year's figure of EUR 13.0 m. The company attributes this primarily to last year's exceptionally high figure. The aforementioned software development project, completed in the fourth quarter of 2017, also had a dampening effect on operating cash flows, because the related personnel costs are now included in cash flows from operating activities and not, as in the previous year, in investment cash flows. These improved accordingly from EUR -2.8 m to EUR -1.4 m, resulting in a free cash flows of EUR 9.7 m. M+M used these funds mainly to pay last year's dividend, so that the net change in cash and cash equivalents of EUR 2.9 m was considerably more moderate.

Equity ratio improved further

As of September 30, liquidity amounted to EUR 10.6 m, which corresponds to net debt of EUR 13.6 m with financial liabilities of EUR 24.2 m (including the secured real estate loan). In relation to last year's EBITDA, the multiple of net debt is thus only 0.8. The healthy balance sheet situation can also be seen in the equity item, which amounts to 45 percent of the balance sheet total at EUR 45.2 m. At the turn of the year, the figure was 43.1 percent.

Forecasts confirmed

On the basis of the very strong nine-month figures, M+M has confirmed its forecast for the current year and describes the target of increasing EBITDA to EUR 22 to 23 m and net income to 67 to 73 cents per share as "very well backed". The forecast for the next few years was also confirmed. M+M intends to increase EBITDA by EUR 4 to 5 m per year and net profit by 18 to 24 cents per share p.a. As a result, the dividend is to rise by 15 to 20 cents per year.

Estimates unchanged

The nine-month figures were in line with our expectations, so we see no reason to change our estimates. We are still assuming that M+M will slightly exceed its forecast this year and calculate with sales of EUR 177.0 m, EBITDA of EUR 23.5 m, EBIT of EUR 20.3 m and net income of EUR 12.1 m. We have also left the estimates for subsequent years unchanged and consequently expect sales to grow to EUR 356 m and margins to improve further to 16.1 percent (EBITDA) and 15.3 percent (EBIT) by 2025. This requires in particular that the profitability of the VAR business can gradually be brought closer to the target level of more than 10 percent EBITDA margin, which we continue to regard as probable. The model business performance for the next eight years, which we assume for determining the fair value, is summarized in the table on the next page; further details can also be found in the Annex.

m Euro	12 2018	12 2019	12 2020	12 2021	12 2022	12 2023	12 2024	12 2025
Sales	177.0	195.6	216.1	238.8	263.9	291.6	322.2	356.0
Sales growth		10.5%	10.5%	10.5%	10.5%	10.5%	10.5%	10.5%
EBIT margin	11.5%	12.1%	12.8%	13.5%	14.1%	14.7%	15.0%	15.3%
EBIT	**20.3**	**23.6**	**27.6**	**32.1**	**37.1**	**42.7**	**48.5**	**54.6**
Tax rate	34.0%	33.5%	33.0%	32.5%	32.0%	31.5%	31.0%	30.5%
Adjusted tax payments	6.9	7.9	9.1	10.4	11.9	13.5	15.0	16.7
NOPAT	**13.4**	**15.7**	**18.5**	**21.7**	**25.3**	**29.3**	**33.4**	**38.0**
+ Depreciation & Amortisation	3.2	3.1	2.8	2.7	2.6	2.6	2.6	2.6
+ Increase long-term accruals	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
+ Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross operating Cash Flows	16.6	18.8	21.3	24.4	27.9	31.9	36.0	40.6
- Increase Net Working Capital	1.1	1.3	1.4	1.4	1.5	1.6	1.6	1.7
- Investments in fixed assets	-1.8	-1.9	-2.0	-2.0	-2.1	-2.3	-2.4	-2.5
Free Cash Flows	**15.9**	**18.2**	**20.7**	**23.8**	**27.2**	**31.2**	**35.3**	**39.8**

SMC estimation model

Framework data unchanged

We have also left the basic data of the model unchanged. We continue to discount the cash flows resulting from our estimates at a WACC rate of 6.1 percent, based on a cost of equity of 9.0 percent (consisting of: beta factor: 1.2, risk-free interest rate: 2.5 percent, risk premium 5.4 percent), borrowing costs of 4.0 percent and a target debt ratio of 45 percent. The assumptions used to determine the terminal value have also remained unchanged. In order to reduce risk, we continue to work with a 25 percent safety discount on the target margin of the detailed forecast period and, on this basis, are targeting "perpetual" cash flows growth of 1.0 percent.

Target price: EUR 31.30 per share

The model results in a market value of equity of EUR 512.2 m or EUR 31.30 per share, which also equals our new price target. The slight increase in the price target compared to our last report (EUR 30.80) is mainly due to the discounting effect. The assessment of the forecast risk of our estimations remains unchanged at three out of six possible points.

Sensitivity analysis

When the input parameters are varied for our sensitivity analysis (WACC between 5.1 and 7.1 percent and perpetual cash flows growth between 0 and 2 percent), the fair value of the share lies between EUR 23.73 and EUR 48.21.

Sensitivity analysis	Perpetual cash flows growth				
WACC	**2.0%**	**1.5%**	**1.0%**	**0.5%**	**0.0%**
5.1%	48.21	42.93	38.93	35.79	33.26
5.6%	41.61	37.74	34.70	32.26	30.25
6.1%	36.59	33.66	**31.30**	29.35	27.72
6.6%	32.65	30.37	28.49	26.92	25.58
7.1%	29.47	27.66	26.14	24.85	23.73

Conclusion

Mensch und Maschine's positive trend is continuing, even in a more uncertain environment. Supported by the unbroken strong demand for its own software products and services and the positive effects of the licence model change at Autodesk that are now becoming apparent, M+M increased its growth rate in the third quarter even further. With revenue growth of almost 23 percent, EBITDA improved by more than half and EBIT even by almost 70 percent. In total for the first nine months, this resulted in sales growth of 16 percent and a profit increase of more than 40 percent.

The company is also very confident about the coming months and years and, on this basis, has confirmed its forecasts indicating very high profit growth. With regard to the current year, we even consider it probable that the forecast range will be exceeded and have therefore left our estimates above the corporate guidance. On this basis, we now see the fair value at EUR 31.30 per share, which indicates an upside potential of 17 percent compared with the current share price. The attractive valuation is also supported by the estimated dividend yield of 2.6 percent. Since M+M has oriented itself in the past at the 2 percent mark for share buybacks, we also believe that the share price is well hedged at the current level. Our rating remains therefore "Buy".

Annex I: Balance sheet and P&L estimation

Balance sheet estimation

m Euro	12 2017	12 2018	12 2019	12 2020	12 2021	12 2022	12 2023	12 2024	12 2025
ASSETS									
I. Total non-current	63.0	61.6	60.3	59.5	58.9	58.4	58.0	57.8	57.7
1. Intangible assets	43.8	42.7	41.7	40.9	40.2	39.6	39.0	38.5	38.1
2. Tangible assets	13.2	12.9	12.7	12.6	12.6	12.8	13.0	13.3	13.6
II. Total current assets	38.8	41.7	44.7	47.4	49.8	57.7	67.4	77.6	88.7
LIABILITIES									
I. Equity	43.9	48.1	51.5	55.4	59.8	65.0	70.6	76.6	83.2
II. Accruals	9.4	10.3	11.1	12.0	12.9	13.7	14.6	15.5	16.4
III. Liabilities									
1. Long-term liabilities	23.2	18.6	14.7	10.2	5.1	3.9	3.9	3.9	3.9
2. Short-term liabilities	25.2	26.3	27.8	29.3	31.0	33.4	36.3	39.4	42.9
TOTAL	**101.8**	**103.3**	**105.0**	**106.9**	**108.7**	**116.0**	**125.4**	**135.4**	**146.4**

P&L estimation

m Euro	12 2017	12 2018	12 2019	12 2020	12 2021	12 2022	12 2023	12 2024	12 2025
Sales	160.9	177.0	195.6	216.1	238.8	263.9	291.6	322.2	356.0
Gross profit	94.8	105.4	115.8	127.3	139.9	153.8	169.0	185.7	204.1
EBITDA	18.0	23.5	26.7	30.4	34.8	39.8	45.4	51.1	57.2
EBIT	15.2	20.3	23.6	27.6	32.1	37.1	42.7	48.5	54.6
EBT	13.6	19.0	22.4	26.7	31.4	37.0	42.8	48.6	54.8
EAT (before minorities)	9.0	12.6	14.9	17.9	21.2	25.2	29.3	33.5	38.1
EAT	9.4	12.1	14.3	17.2	20.4	24.2	28.1	32.2	36.6
EPS	0.56	0.74	0.87	1.05	1.24	1.48	1.72	1.97	2.24

Annex II: Cash flows estimation and key figures

Cash flows estimation

m Euro	12 2017	12 2018	12 2019	12 2020	12 2021	12 2022	12 2023	12 2024	12 2025
CF operating	15.2	16.9	19.3	22.0	25.3	29.3	33.5	37.8	42.4
CF from investments	-3.8	-1.8	-1.9	-2.0	-2.0	-2.1	-2.3	-2.4	-2.5
CF financing	-10.1	-13.6	-15.9	-19.0	-22.6	-21.3	-23.7	-27.5	-31.5
Liquidity beginning of year	6.4	7.7	9.2	10.7	11.8	12.4	18.3	25.8	33.7
Liquidity end of year	7.7	9.2	10.7	11.8	12.4	18.3	25.8	33.7	42.1

Key figures

m Euro	12 2017	12 2018	12 2019	12 2020	12 2021	12 2022	12 2023	12 2024	12 2025
Sales growth	-3.7%	10.0%	10.5%	10.5%	10.5%	10.5%	10.5%	10.5%	10.5%
Gross profit growth	3.7%	11.2%	9.8%	9.9%	9.9%	9.9%	9.9%	9.9%	9.9%
Gross margin	59.0%	59.6%	59.2%	58.9%	58.6%	58.3%	58.0%	57.6%	57.3%
EBITDA margin	11.2%	13.3%	13.6%	14.1%	14.6%	15.1%	15.6%	15.8%	16.1%
EBIT margin	9.5%	11.5%	12.1%	12.8%	13.5%	14.1%	14.7%	15.0%	15.3%
EBT margin	8.5%	10.8%	11.4%	12.4%	13.2%	14.0%	14.7%	15.1%	15.4%
Net margin (after minorities)	5.9%	6.8%	7.3%	8.0%	8.5%	9.2%	9.6%	10.0%	10.3%

Disclaimer

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Charts
The charts were made with Tai-Pan (www.lp-software.de).

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II) Preparation and updating

The present financial analysis was prepared by: Dipl. Volkswirt Dr. Adam Jakubowski

Participants in the preparation of the present financial analysis: -

The present analysis was finished on 23.10.2018 at 13:25 and published on 23.10.2018 at 13:40.

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Hold	We expect that the price of the analyzed financial instrument will remain stable (between -10 and +10 percent). The forecast risk (1 to 6 points) has no further impact on the rating.
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The expected change in price refers to the current share price of the analyzed company. This price and any other share prices used in this analysis are XETRA closing prices as of the last trading day before publication. If the share is not traded on XETRA, the closing price of another public stock exchange is used with a separate note to that effect.

The price targets published within the assessment are calculated with common methods of financial mathematics, especially with the DCF (discounted cash flow) method, the sum of the parts valuation and a peer group analysis. The valuation methods are affected by economic framework conditions, especially by the development of the interest rates.

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Date	Rating	Target price	Conflict of interests
30.07.2018	Buy	30.80 Euro	1), 3), 4)
24.04.2018	Buy	26.70 Euro	1), 3)
19.02.2018	Buy	25.90 Euro	1), 3), 4)
26.10.2017	Hold	21.80 Euro	1), 3), 4)
17.08.2017	Hold	19.80 Euro	1), 3), 4)
25.04.2017	Buy	17.80 Euro	1), 3), 4)
16.02.2017	Buy	16.20 Euro	1), 3)
27.10.2016	Buy	14.80 Euro	1), 3), 4)

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The publishing dates for the financial analyses are not yet fixed at the present moment.

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