July 24th, 2020
Research update

SMC Research
Small and Mid Cap Research

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

Mensch und Maschine SE

On a record course despite Covid-19

Rating: Hold (prev.: Buy) | **Price:** 47.50 € | **Price target:** 50.50 € (prev.: 50.00 €)

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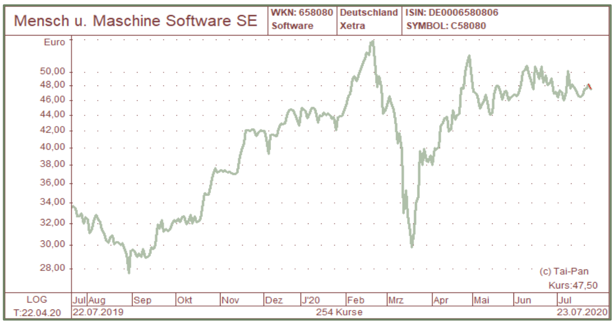
Recent business development



Basic data

Based in:	Wessling
Sector:	CAD/CAM software
Headcount:	964
Accounting:	IFRS
ISIN:	DE0006580806
Ticker:	MUM:GR
Price:	47.50 Euro
Market segment:	Scale / m:access
Number of shares:	17.2 m
Market Cap:	814.6 m Euro
Enterprise Value:	906.1 m Euro
Free Float:	44.5%
Price high/low (12M):	55.80 / 26.50 Euro
Ø turnover (Xetra, 12 M):	412,900 Euro / day

Mensch und Maschine has felt the effects of the expected Covid-19 dip in the second quarter. Its extent, however, remained satisfactorily moderate, particularly in terms of earnings. While consolidated sales and gross profit fell by 9 percent, the effect on quarterly earnings was limited to 4 percent. As a result, the half-year figures were dominated by the positive changes of the first quarter, so that overall sales growth of 9 percent and double-digit earnings growth to new record levels were reported. The free cash flow developed very impressively, improving by over 170 percent to EUR 21.2 m, mainly due to strict working capital management. Based on the half-year figures and, especially, the great cost elasticity expressed therein, the Management Board has confirmed its profit forecast for the year as a whole and continues to aim for earnings growth of 18 to 24 percent to EUR 1.17 to 1.23 per share.

We have also left our profit estimate for 2020 unchanged and have used the positive cost development as an opportunity to make our profitability assumptions for the future a little more assertive.

FY ends: 31.12.	**2017**	**2018**	**2019**	**2020e**	**2021e**	**2022e**
Sales (m Euro)	160.9	185.4	245.9	258.2	289.2	321.0
EBIT (m Euro)	15.2	19.7	27.2	31.1	40.5	47.2
Net Profit	9.4	11.7	16.7	19.5	25.1	29.5
EPS	0.56	0.71	0.99	1.17	1.50	1.76
Dividend per share	0.50	0.65	0.85	1.01	1.24	1.45
Sales growth	-3.7%	15.3%	32.7%	5.0%	12.0%	11.0%
Profit growth	42.9%	24.1%	42.6%	17.0%	28.9%	17.4%
PSR	4.94	4.28	3.23	3.08	2.75	2.47
PER	84.3	68.0	47.6	40.7	31.6	26.9
PCR	52.2	52.2	30.1	26.6	22.6	20.3
EV / EBIT	58.1	45.0	32.5	28.5	21.8	18.7
Dividend yield	1.1%	1.4%	1.8%	2.1%	2.6%	3.0%

Covid-19 dip in the second quarter

Following high growth rates in sales and profits in the first quarter, Mensch und Maschine's business development in the months April to June showed visible dampening effects from the Covid-19 pandemic, as announced and expected. Consolidated sales and gross profit each fell by around 9 percent, affecting both segments equally. Thanks to strict cost discipline, which in some areas (such as travel expenses or variable salary components) benefited from the crisis itself, as well as the use of short-time working arrangements for parts of the workforce (especially at Open Mind), the drop in sales was partially offset in terms of earnings. As a result, the impact on the profit figures remained moderate: EBITDA fell by 8 percent (to EUR 7.8 m) and EBIT and the quarterly profit after taxes and minorities fell by only 4 percent (to EUR 5.6 m and EUR 3.4 m respectively).

Solid growth in the first half-year

In conjunction with the very strong first quarter, M+M was able to achieve revenue growth of 8.5 percent to EUR 130.4 m in the first half of the year. The software segment, which, according to the company, has felt the Covid-19 effects more strongly due to its global presence, remained almost at the previous year's level (+1.0 percent) at EUR 37.9 m, while the VAR business grew by 11.9 percent to EUR 92.5 m, primarily thanks to Autodesk customers switching from maintenance to the subscription model. As this growth was thus driven by the comparatively low-margin trade in Autodesk licences, the average gross margin both in the VAR business and in the Group fell to 33.5 and 50.4 percent respectively (previous year: 34.9 and 53.3 percent). The gross margin in the Software segment was also down on the previous year (91.6 percent vs. 93.9 percent), mainly due to the shift in sales between the CAM business and SOFiSTiK. Unlike the other software subsidiaries, SOFiSTiK uses a higher proportion of third-party products (primarily Autodesk), which increased further in the first half of the year in the wake of the Autodesk exceptional boom. In absolute figures, the gross profit in the VAR business and in the Group increased by 7.2 and 2.4 percent respectively in the first half of the year, while the software segment suffered a slight decline of 1.5 percent.

Business figures	HY 2019	HY 2020	*Change*
Sales	120.22	130.39	*+8.5%*
VAR business	82.70	92.51	*+11.9%*
Software	37.51	37.87	*+1.0%*
Gross profit	64.12	65.68	*+2.4%*
VAR business	28.90	30.99	*+7.2%*
Software	35.22	34.69	*-1.5%*
Gross margin	*53.3%*	*50.4%*	
EBITDA	18.44	21.21	*+15.0%*
VAR business	6.90	8.82	*+27.9%*
Software	11.54	12.38	*+7.3%*
EBITDA margin	*15.3%*	*16.3%*	
EBIT	14.01	16.72	*+19.4%*
VAR business	4.77	6.77	*+41.8%*
Software	9.23	9.95	*+7.8%*
EBIT margin	*11.6%*	*12.8%*	
EBT	13.53	15.96	*+18.0%*
EBT margin	*11.3%*	*12.2%*	
Net profit	8.44	9.99	*+18.4%*
Net margin	*7.0%*	*7.7%*	
Free cash flow	7.76	21.21	*+173.5%*

In m Euro and percent, source: Company

Other expenses decrease by EUR 2 m

The development of gross profit, already remarkable in view of the general conditions, is still outshone by the key earnings figures, all of which M+M was able to increase significantly. This was made possible by a very beneficial change in key expense items, which M+M sees as a reflection of the strong cost elasticity of its business model. However, the cost trend in many areas, such as travel expenses and attendance events, which together were largely responsible for a decline in other operating expenses of EUR 2.0 m or 23 percent, was specific to the Covid-19 crisis (e.g. a consequence of travel and contact restrictions) and therefore cannot be readily transferred to "normal" economic crises. This is rather more true for the elasticity of personnel expenses, in which the variable salary components and in particular the performance-related bonuses for sales staff have had a dampening effect. Together with the only moderate growth in personnel (+3.7 percent), this resulted in a below-average increase in personnel expenses of 4.2 percent compared with the dynamic growth of previous years. The earnings-improving effect of the use of the short-time working scheme is also rather Covid-19-specific, particularly in view of the generosity of the scheme. This effect was reflected in a doubling of other operating income to EUR 1.6 m in the second quarter. Over the whole first half of the year, this item increased by almost 50 percent to EUR 2.4 m.

New profit records

The moderate growth in gross profit and the favourable cost development resulted in new half-yearly records for key profit figures. EBITDA increased by 15 percent to EUR 21.2 m, EBIT by 19 percent to EUR 16.7 m and EBT by 18 percent to EUR 16.0 m. After taxes and minority interests, a half-year profit of EUR 10.0 m was reported, exceeding the previous year's figure by 18 percent. Of the two segments, the VAR business stood particularly out with a high level of earnings momentum, which reflected not only revenue growth but also the discipline in personnel growth tightened for around a year now. The number of employees in the segment at the end of June was 461 and thus 1.5 percent down on the previous year's figure, which, together with the higher gross profit, resulted in an improvement in employee productivity (measured in terms of gross profit per employee) of almost 9 percent to EUR 67,000.

Excellent cash flow figures

The already very positive cash flow development in the first quarter continued in the second quarter as well, so that an operating cash inflow of EUR 24.5 m was recorded in the first six months. This figure, with which almost 19 percent of revenues remained as operating cash flow in the cash register, is by far the highest half-year figure, as the previous record from last year was "only" EUR 13.6 m. A small part of the increase was due to the Covid-19 relief measures (tax deferrals, short-time working compensation), but for the most part it was due to the change in current assets. While it had burdened the operating cash flow by almost EUR 4 m in the first half of 2019, in the reporting period it had a positive impact of EUR 6.2 m. As investment outflows were simultaneously reduced from EUR 5.9 m to EUR 3.2 m, the improvement in free cash flow was even more impressive at 174 percent, or from EUR 13.5 m to EUR 21.2 m. After deducting the payments for interest, repayments, leasing instalments and the buyback of own shares (with which M+M took advantage of the temporary fall in the share price in March), which together totalled a financing cash flow of EUR -7.8 m, liquidity increased by EUR 13.4 m to EUR 26.4 m since the beginning of the year.

Equity ratio over 50 percent

However, this figure is only a snapshot because the dividend payment, which was not made until July due to the Covid-19-related delay of the Annual General Meeting, has meanwhile caused a cash outflow of EUR 10.1 m. The same applies to equity, which climbed to EUR 80.9 m or more than 50 percent of the balance sheet total as of the half-year reporting date, despite the reduction by the share buyback (EUR -2.7 m). However, the dampening effect of the dividend payment on equity is offset by the heavy use of the stock dividend, for which M+M has reissued treasury shares worth EUR 4.1 m. As in previous years, the CEO and major shareholder has again exchanged a large part of his dividend entitlement for new shares.

Earnings forecast confirmed

Based on the half-year figures, M+M has confirmed the earnings forecast for profit growth of 18 to 24 percent to EUR 1.17 to 1.23 per share, as well as the goal of increasing the dividend from 85 cents to 100 to 105 cents. However, the previous revenue and gross profit forecast, which had so far envisaged growth of 10 to 12 percent, was no longer confirmed. Instead, M+M emphasises that the sales and gross profit targets are to play only a subordinate role in the second half of the year and stresses the great importance of cost management for achieving the earnings targets. These, too, are subject to a demand that improves at least moderately compared to the second quarter. According to the company, current observations do support these expectations.

2020 estimates slightly reduced

The shift in the focus of the forecast to earnings shows that this year's earnings growth is to be achieved less by increasing business volume than by efficiency gains and savings, which M+M also explicitly emphasises by referring to the strong cost elasticity. However, since we too had previously expected the earnings-driving effect of continued gross profit growth, we have now also adjusted our estimates. To make them sufficiently cautious in the current environment, we have decided to halve this year's sales growth to 5 percent. At the same time, in response to the half-year figures and the unequal impact on the segments, we have reduced the gross margin for this year to 50 percent, resulting in only minimal growth of 1.0 percent in gross profit for the whole year. Up to now, we had calculated with the same pace as in the sales (10 percent). In absolute figures, we therefore expect sales of EUR 258 m and gross profit of EUR 129 m (previously: EUR 271 and 141 m respectively). Broken down to the second half of the year, this means a moderate sales growth of 2 percent and a stable gross profit (in each case compared to the previous year), which we consider sufficiently conservative. As a result of the negative base effect of the reduced sales estimate for 2020, which we have only partially compensated for in subsequent years, the revenue estimates for the remaining periods of the detailed forecast period are also somewhat lower; the target revenue for 2027 is now EUR 529 m (previously: EUR 552 m).

Margins increased

On the other hand, the cost development in the first half of the year was even better than we had expected, which is partly due to Covid-19-specific effects, but partly also reflects the very good cost management. We have therefore reduced the expense ratios for 2020 and subsequent years, which has resulted in a somewhat higher margin level. For the current year, we are now expecting an EBITDA margin of 15.5 percent and an EBIT margin of 12.0 percent (previously: 15.2 and 11.8 percent), which will increase to 17.4 and 16.5 percent respectively by 2027 (previously: 17.1 and 16.2 percent). However, we remain more cautious than the M+M management, which is confident

m Euro	12 2020	12 2021	12 2022	12 2023	12 2024	12 2025	12 2026	12 2027
Sales	258.2	289.2	321.0	354.7	392.0	433.2	478.6	528.9
Sales growth		12.0%	11.0%	10.5%	10.5%	10.5%	10.5%	10.5%
EBIT margin	12.0%	14.0%	14.7%	15.3%	15.7%	16.0%	16.2%	16.5%
EBIT	**31.1**	**40.5**	**47.2**	**54.2**	**61.5**	**69.5**	**77.7**	**87.0**
Tax rate	30.0%	31.0%	31.0%	31.0%	31.0%	31.0%	31.0%	31.0%
Adjusted tax payments	9.3	12.6	14.6	16.8	19.1	21.5	24.1	27.0
NOPAT	**21.7**	**27.9**	**32.6**	**37.4**	**42.4**	**47.9**	**53.6**	**60.1**
+ Depreciation & Amortisation	8.9	8.0	7.2	6.2	5.6	5.0	5.1	5.1
+ 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	30.6	35.9	39.8	43.6	48.0	52.9	58.7	65.2
- Increase Net Working Capital	-0.2	-0.3	-0.4	-0.5	-0.6	-0.7	-0.8	-0.9
- Investments in fixed assets	-3.5	-2.5	-2.6	-2.7	-2.9	-3.0	-3.2	-3.3
Free Cash Flows	**26.9**	**33.1**	**36.8**	**40.4**	**44.5**	**49.2**	**54.7**	**60.9**

SMC estimation model

of achieving a margin level (EBITDA) above 18 percent in the longer term. The combination of the reduced sales estimate and the increased profitability assumptions has resulted in a profit expectation for 2020 that is unchanged from our previous estimate. At EUR 1.17 per share, it is at the lower end of the company's guidance and 17 percent above the actual value from 2019. The overall resulting model business performance for the next eight years, which we assume for determining the fair value, is summarized in the table above; further details can also be found in the Annex.

Framework data unchanged

We left unchanged the model's framework data as well as the assumptions used to determine the terminal value. To this end, we continue to apply a security discount of 15 percent on the target EBIT margin, resulting in a calculation margin of 14.0 percent. The estimate for the "perpetual" cash flow growth remains at one percent p.a. We discount the free cash flows resulting from these assumptions with WACC (Weighted Average Cost of Capital) at an interest rate on borrowed capital of 4.0 percent. The cost of equity is determined using the Capital Asset Pricing Model (CAPM). Our risk-free interest rate is – at 1.0 percent – the long-term average of the German current yield and for the market risk premium we use an above-average value of 6.5 percent (the past-based average market risk premium used for Germany in 2019 was 5.7 percent, source: Pablo Fernandez, Mar Martinez and Isabel F. Acin: Market Risk Premium and Risk-free Rate used for 69 countries in 2019: a survey). Combined with a beta of 1.2 and a target debt ratio of 40 percent, this results in a WACC rate of 6.4 percent.

Target price: EUR 50.50 per share

The model results in a market value of equity of EUR 844.6 million or EUR 50.51 per share, from which we derive the slightly higher price target of EUR 50.50 (previously: EUR 50.00). 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 5.4 and 7.4 percent and perpetual cash flows growth between 0 and 2 percent), the fair value of the share lies between EUR 38.35 and EUR 76.82.

Sensitivity analysis	Perpetual cash flows growth				
WACC	**2.0%**	**1.5%**	**1.0%**	**0.5%**	**0.0%**
5.4%	76.82	68.83	62.67	57.78	53.80
5.9%	66.63	60.68	55.96	52.13	48.94
6.4%	58.77	54.22	**50.51**	47.44	44.85
6.9%	52.54	48.96	45.99	43.50	41.36
7.4%	47.46	44.60	42.19	40.13	38.35

Conclusion

The very strong start to the year was followed in the second quarter by the expected Covid-19 dip, which was reflected in a 9 percent drop in sales. Thanks to automatic cost stabilisers (especially variable salary components), active cost management and some Covid-19-specific effects, however, the impact of this development on earnings was significantly limited, with the result that EBIT and quarterly profit shrank by only 4 percent each.

Thus, M+M was able to achieve double-digit growth and new records at all earnings levels in the first six months of the year, making it more likely that the earnings targets for the whole year will be achieved as well. M+M has also confirmed these targets and is still aiming for an EpS increase of 18 to 24 percent to 117 to 123 cents. However, the emphasis here was on the decisive role of the very good cost elasticity for the achievement of targets, while the previous growth target for sales and gross profit was not confirmed.

From this, we infer that M+M is now assessing the pace of demand recovery somewhat more cautiously than before. Accordingly, we have also modified our estimates and halved the previously assumed sales growth. At the same time, we have lowered the expense estimates, so that we continue to expect earnings per share of EUR 1.17, which is at the lower end of the M+M guidance. Our dividend estimate for the current year is also unchanged at EUR 1.01.

These changes, which have also affected the subsequent years, result in our valuation model in a new price target of EUR 50.50 that is slightly above the old figure. However, since the share price has risen even more since our last update, the resulting upside potential of around 6 percent is only moderate, which is why we are changing our rating from previously "Buy" to "Hold".

Annex I: Balance sheet and P&L estimation

Balance sheet estimation

m Euro	12 2019	12 2020	12 2021	12 2022	12 2023	12 2024	12 2025	12 2026	12 2027
ASSETS									
I. Total non-current assets	98.7	93.3	87.9	84.3	82.8	82.1	82.1	82.2	82.4
1. Intangible assets	54.1	61.0	60.4	59.7	59.2	58.6	58.1	57.6	57.1
2. Tangible assets	34.0	28.8	24.0	21.0	20.1	19.9	20.5	21.1	21.8
II. Total current assets	60.8	71.5	79.2	93.1	108.8	125.6	143.4	160.3	179.0
LIABILITIES									
I. Equity	73.5	84.5	93.7	103.6	114.6	127.4	141.8	155.3	170.5
II. Accruals	12.2	12.7	13.2	13.8	14.3	14.8	15.4	15.9	16.5
III. Liabilities									
1. Long-term liabilities	34.0	28.9	22.6	21.2	21.2	21.2	21.2	21.2	21.2
2. Short-term liabilities	39.9	38.9	37.6	38.8	41.5	44.3	47.2	50.1	53.2
TOTAL	**159.5**	**164.9**	**167.1**	**177.4**	**191.6**	**207.7**	**225.5**	**242.5**	**261.4**

P&L estimation

m Euro	12 2019	12 2020	12 2021	12 2022	12 2023	12 2024	12 2025	12 2026	12 2027
Sales	245.9	258.2	289.2	321.0	354.7	392.0	433.2	478.6	528.9
Gross profit	127.9	129.1	150.7	167.6	185.7	205.6	227.7	252.2	279.3
EBITDA	36.5	39.9	48.5	54.4	60.4	67.0	74.5	82.8	92.2
EBIT	27.2	31.1	40.5	47.2	54.2	61.5	69.5	77.7	87.0
EBT	26.3	30.3	39.7	46.7	53.8	61.1	69.1	77.4	86.8
EAT (before minorities)	18.3	21.2	27.4	32.2	37.1	42.2	47.7	53.4	59.9
EAT	16.7	19.5	25.1	29.5	33.8	38.4	43.3	48.3	54.0
EPS	0.99	1.17	1.50	1.76	2.02	2.29	2.59	2.89	3.23

Annex II: Cash flows estimation and key figures

Cash flows estimation

m Euro	12 2019	12 2020	12 2021	12 2022	12 2023	12 2024	12 2025	12 2026	12 2027
CF operating	26.4	29.9	35.1	39.1	42.9	47.2	52.0	57.7	64.1
CF from investments	-8.6	-3.5	-2.5	-2.6	-2.7	-2.9	-3.0	-3.2	-3.3
CF financing	-14.5	-16.8	-26.3	-24.1	-26.1	-29.3	-33.4	-39.9	-44.6
Liquidity beginning of year	9.6	12.9	22.4	28.7	41.1	55.1	70.0	85.7	100.3
Liquidity end of year	12.9	22.4	28.7	41.1	55.1	70.0	85.7	100.3	116.4

Key figures

percent	12 2019	12 2020	12 2021	12 2022	12 2023	12 2024	12 2025	12 2026	12 2027
Sales growth	32.7%	5.0%	12.0%	11.0%	10.5%	10.5%	10.5%	10.5%	10.5%
Gross profit growth	23.1%	1.0%	16.7%	11.3%	10.8%	10.8%	10.8%	10.7%	10.7%
Gross margin	52.0%	50.0%	52.1%	52.2%	52.3%	52.5%	52.6%	52.7%	52.8%
EBITDA margin	14.9%	15.5%	16.8%	17.0%	17.0%	17.1%	17.2%	17.3%	17.4%
EBIT margin	11.1%	12.0%	14.0%	14.7%	15.3%	15.7%	16.0%	16.2%	16.5%
EBT margin	10.7%	11.7%	13.7%	14.6%	15.2%	15.6%	16.0%	16.2%	16.4%
Net margin (after minorities)	6.8%	7.6%	8.7%	9.2%	9.5%	9.8%	10.0%	10.1%	10.2%

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 24.07.2020 at 8:00 and published on 24.07.2020 at 8:30.

For the preparation of its financial analyses, the sc-consult GmbH uses a five-tier rating scheme with regard to price expectation in the next twelve months. Additionally, estimation risk is quantified on a scale from 1 (low) to 6 (high). The ratings are as follows:

Strong Buy	We expect an increase in price for the analysed financial instrument by at least 10 percent. We assess the estimation risk as below average (1 to 2 points).
Buy	We expect an increase in price for the analysed financial instrument by at least 10 percent. We assess the estimation risk as average (3 to 4 points).
Speculative Buy	We expect an increase in price for the analysed financial instrument by at least 10 percent. We assess the estimation risk as above average (5 to 6 points).

Hold	We expect that the price of the analysed financial instrument will remain stable (between -10 and +10 percent). The forecast risk (1 to 6 points) has no further impact on the rating. The rating "hold" is also used in cases where we perceive a price potential of more than 10 percent, but explicitly mentioned temporary factors prevent a short-term realisation of the price potential.
Sell	We expect that the price of the analysed financial instrument will drop by at least 10 percent. The forecast risk (1 to 6 points) has no further impact on the rating.

The expected change in price refers to the current share price of the analysed 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.

The rating resulting from these methods reflects current expectations and can change anytime subject to company-specific or economic changes.

More detailed explanations of the models used by SMC Research can be found at:
http://www.smc-research.com/impressum/modellerlaeuterungen

An overview of the recommendations prepared and distributed by SMC Research in the last 12 months can be found at: http://www.smc-research.com/publikationsuebersicht

In the past 24 months, sc-consult GmbH has published the following financial analyses for the company:

Date	Rating	Target price	Conflict of interests
22.04.2020	Buy	50.00 Euro	1), 3), 4)
17.03.2020	Buy	50.00 Euro	1), 3)
17.02.2020	Hold	50.50 Euro	1), 3), 4)
23.10.2019	Buy	38.50 Euro	1), 3)
06.08.2019	Buy	37.10 Euro	1), 3)
02.05.2019	Hold	35.80 Euro	1), 3), 4)
19.02.2019	Buy	35.00 Euro	1), 3), 4)
17.12.2018	Buy	33.70 Euro	1), 3), 4)
23.10.2018	Buy	31.30 Euro	1), 3)
30.07.2018	Buy	30.80 Euro	1), 3), 4)

In the course of the next twelve months, sc-consult GmbH will presumably prepare the following financial analyses for the company: one report, two updates

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

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