April 24th, 2018
Research update

SMC Research
Small and Mid Cap Research

THOMSON REUTERS ANALYST AWARDS 2017 WINNER

Mensch und Maschine SE

As expected, a good start to the year

Rating: Buy (unchanged) | **Price:** 22.40 Euro | **Price target:** 26.70 Euro

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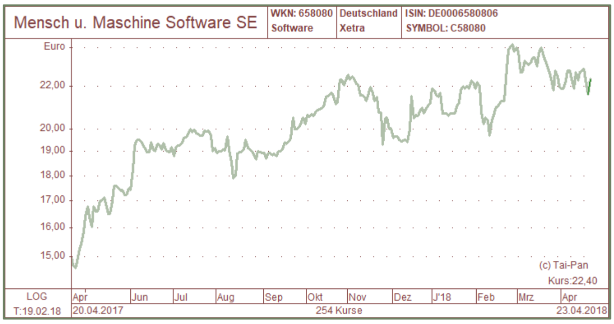
Recent business development



Basic data

Based in:	Wessling
Sector:	CAD/CAM software
Headcount:	794
Accounting:	IFRS
ISIN:	DE0006580806
Price:	22.40 Euro
Market segment:	Scale / m:access
Number of shares:	16.7 m
Market Cap:	373.7 m Euro
Enterprise Value:	398.9 m Euro
Free Float:	46.8 %
Price high/low (12M):	24.50 / 14.61 Euro
Ø turnover (Xetra, 12 M):	170,400 Euro / day

In the first quarter, Mensch und Maschine increased sales by 6.8 percent to EUR 48.6 m. This growth was driven primarily by the software segment, but the VAR business, which had suffered last year from the conversion of the Autodesk license model, also confirmed the turnaround from the fourth quarter and achieved sales growth of 5.9 percent. M+M is forecasting further growth acceleration for the second and third quarters, pointing to the weaker basis and a small exceptional boom because of numerous Autodesk maintenance contracts due for renewal. This puts the company on track to meet its annual forecast. It also applies to earnings, which rose disproportionately in the first quarter and climbed to new quarterly highs in EBITDA and EBIT.

Against this background, we consider our estimates to be confirmed and have therefore left them largely unchanged. Consequently, we still assume that M+M will continue the extremely reliable course of recent years in the future and double its profit by 2020. On this basis, the price target is now EUR 26.70, indicating a further potential of almost 20 percent for the share. Our rating remains "Buy".

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	19.4	22.6	26.6
Net profit	3.9	6.6	9.4	11.5	13.7	16.5
EpS	0.24	0.39	0.56	0.71	0.84	1.01
Dividend per share	0.25	0.35	0.50	0.66	0.80	0.95
Sales growth	14.5%	4.2%	-3.7%	10.0%	10.5%	10.5%
Profit growth	4.0%	70.4%	42.9%	22.2%	18.8%	20.6%
PSR	2.28	2.19	2.27	2.06	1.87	1.69
PER	94.5	55.5	38.8	31.8	26.7	22.2
PCR	24.81	24.96	24.01	22.45	19.61	17.14
EV / EBIT	46.1	31.3	25.7	20.1	17.3	14.7
Dividend yield	1.1%	1.6%	2.2%	2.9%	3.6%	4.2%

Software segment drives growth

In the first quarter of the current year, Mensch und Maschine increased sales by 6.8 percent to EUR 48.6 m, benefiting above all from the continuing momentum of the software division, whose revenues increased by 9.3 percent to EUR 14.0 m. However, the VAR segment, which in the previous year had been impacted by the effects of the license model change at Autodesk, also achieved a 5.9 percent sales increase in the first three months.

Slight increase in gross margin

Due to the disproportionate growth of the higher-margin software segment, the Group's gross margin increased slightly (by 0.2 percentage points) to 55.1 percent, so that the Group's gross profit rose by 7.2 percent to EUR 26.8 m. By contrast, the gross margin of the VAR business declined (from 38.0 to 37.8 percent), which is likely to be attributable to the increase in trading business.

EBITDA and EBIT with new records

Since personnel expenses rose by 5.3 percent and thus only disproportionately less than gross profit, and other operating expenses even fell again (-5.2 percent), EBITDA rose by 22.3 percent, a significant disproportionate increase. At EUR 6.6 m, the highest quarterly figure in the company's history was generated; the EBITDA margin improved by 1.7 percentage points year-on-year. Growth was achieved in both segments, although the percentage increase in the VAR business was significantly higher at 32.6 percent due to base effects. By contrast, the operating result in the software segment increased "only" by 16.8 percent. An even higher rise was prevented by a disproportionate increase in segment personnel expenses, which resulted in part from the completion of a capitalized software development in autumn 2017. As a result of the completion of the work, the salaries of the employees concerned are no longer capitalized but processed directly in expenses. At the same time, the completed development triggered the depreciation cycle, so that depreciation in the software segment increased by 27 percent. However, in absolute figures it is still at a very low level of just under EUR 0.4 m. The same applies to the figure across the Group, which increased by 11.2 percent to EUR 0.8 m. Group EBIT thus increased by 23.9 percent to EUR 5.9 m, with the 41.3 percent increase in the VAR business being significantly higher here as well.

Business figures	Q1 2017	Q1 2018	*Change*
Sales	45.47	48.58	*+6.8%*
VAR business	32.64	34.56	*+5.9%*
Software	12.83	14.02	*+9.3%*
Gross profit	24.98	26.79	*+7.2%*
VAR business	12.42	13.05	*+5.1%*
Software	12.56	13.74	*+9.3%*
Gross margin	*54.9%*	*55.1%*	
EBITDA	5.42	6.62	*+22.3%*
VAR business	1.87	2.48	*+32.6%*
Software	3.54	4.14	*+16.8%*
EBITDA margin	*11.9%*	*13.6%*	
EBIT	4.73	5.86	*+23.9%*
VAR business	1.48	2.09	*+41.3%*
Software	3.26	3.78	*+16.0%*
EBIT margin	*10.4%*	*12.1%*	
EBT	4.22	5.43	*+28.6%*
EBT margin	*9.3%*	*11.2%*	
Net profit	2.62	3.40	*+29.8%*
Net margin	*5.8%*	*7.0%*	

Source: company

Quarterly profit increases by 30 percent

Earnings were also boosted by financial expenses, which fell by 15 percent year-on-year to EUR 0.4 m in the first quarter. As a result, pre-tax profit and net profit (after minority interests) both improved by almost 30 percent to EUR 5.4 and 3.4 m respectively.

Cash flows remain very strong

The strong earning power was once again reflected in a high operating cash flows surplus, which, at EUR 6.8 m, did not quite reach the previous year's figure (EUR 7.7 m), but nevertheless amounted to over 14 percent of revenues. As payments for investments were, in addition, two-thirds lower than in the previous year (mainly due to the concluded development project mentioned above), free cash flows remained virtually unchanged at EUR 6.5 m. However, the cash flows at the beginning of the year seem always slightly too positive due to the payments of the annual maintenance contracts (the opposite item is deferred revenues, which increased from EUR 1.4 m to 7.6 m compared to the turn of the year), so that more moderate inflows are to be expected in the next quarters.

Further increase in equity ratio

The quarterly profit also caused a rise in equity by more than 9 percent to EUR 47.2 m, bringing the equity ratio to the new record level of 44.9 percent (previous year: 41.5 percent). Even though this figure will fall again temporarily in the second quarter due to the forthcoming dividend payment, M+M has thus shown a steady upward trend since 2013.

Forecasts confirmed

The company describes the development of the first quarter as fully on target and has therefore confirmed its forecast for the current year. With planned gross profit growth of 10 to 12 percent, EBITDA is expected to increase by 22 to 28 percent and to enable a net profit growth by 30 to 40 percent and a further dividend increase to 62 to 68 cents. Compared to these targets, Q1 growth rates were at the lower end (EBITDA, net income) or below the forecast, but M+M points to an expected increase in growth figures especially in the next two quarters, which were rather weaker last year. In addition, an above-average number of three-year maintenance contracts are due for renewal in the second quarter, which should be reflected in an intermediate spurt in the Autodesk trading business. In this respect, the Management Board is very relaxed about the achievement of the targets and has also confirmed the medium-term forecast according to which net profit is to double to more than one euro per share by 2020.

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	11.0%	11.6%	12.3%	13.0%	13.6%	14.0%	14.2%	14.4%
EBIT	**19.4**	**22.6**	**26.6**	**31.0**	**35.9**	**40.9**	**45.9**	**51.2**
Tax rate	34.0%	33.5%	33.0%	32.5%	32.0%	31.5%	31.0%	30.5%
Adjusted tax payments	6.6	7.6	8.8	10.1	11.5	12.9	14.2	15.6
NOPAT	**12.8**	**15.0**	**17.8**	**20.9**	**24.4**	**28.0**	**31.7**	**35.6**
+ 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	16.0	18.1	20.6	23.6	27.0	30.6	34.3	38.2
- 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	**15.3**	**17.6**	**20.0**	**23.0**	**26.4**	**29.9**	**33.5**	**37.4**

SMC estimation model

Sales and earnings estimates unchanged

We also see no reason to change our estimates based on the Q1 figures. Consequently, we continue to expect sales of EUR 177.0 m, gross profit of EUR 105.4 m and EBITDA of EUR 22.6 m for 2018. We have also left our estimates for the next few years unchanged. However, we have made an adjustment with regard to the investments which the company expects to be significantly below last year's value for the foreseeable future due to the completion of the software development project mentioned above. As the time series of depreciation has also changed due to the modified assumptions regarding investments, there is a slight upward shift in EBIT margins and net profit. Our estimate for net profit in 2018 has thus increased by one cent to EUR 0.71. An overview over the data underlying our valuation is to be found in the table above; a detailed presentation of the model business development up to 2025 is shown in the tables in the Annex.

Framework data unchanged

We subsequently expect "perpetual" cash flows growth of 1 percent p.a. and an EBIT margin of 10.8 percent, which is also slightly above the figure of our last update due to modified assumptions regarding investments. We have left the discount rate unchanged: Based on the assumption of a beta factor of 1.2, a risk-free interest rate of 2.5 percent, a risk premium of 5.4 percent, a target debt ratio of 40 percent and an interest rate on borrowed capital of 4.0 percent, the weighted average cost of capital (WACC) of our model is 6.5 percent.

Target price: EUR 26.70

These assumptions result in a market value of equity of EUR 436.0 m or EUR 26.72 per share, from which we derive the new price target of EUR 26.70. The increase over our last update (EUR 25.90) is due to changes in assumptions regarding investments and to the discounting effect. The estimation risk, however, remains unchanged at three out of six possible points.

Sensitivity analysis

When the input parameters are varied for our sensitivity analysis (WACC between 5.5 and 7.5 percent and perpetual cash flows growth between 0 and 2 percent), the fair value of the share lies between EUR 20.55 and EUR 39.69.

Sensitivity analysis	Perpetual cash flows growth				
WACC	**2.0%**	**1.5%**	**1.0%**	**0.5%**	**0.0%**
5.5%	39.69	35.85	32.86	30.47	28.51
6.0%	34.67	31.79	29.49	27.60	26.03
6.5%	30.76	28.54	**26.72**	25.21	23.92
7.0%	27.63	25.88	24.41	23.18	22.11
7.5%	25.06	23.65	22.46	21.43	20.55

Conclusion

In the first quarter of 2018, Mensch und Maschine achieved sales growth of just under seven percent and thus returned to growth in the top line as well, after the change in the license model at Autodesk had led to lower sales last year.

Earnings developed very positively, rising disproportionately due to the higher gross margin and ongoing cost discipline and reaching new quarterly highs at the EBITDA and EBIT levels.

We consider it important that the VAR business is now showing an above-average profit dynamic and is therefore apparently on the right track to increase its still disproportionately low earnings contribution. The continuation of this trend is a central prerequisite for achieving the doubling of profits M+M promised by 2020.

The dynamic development and increasing profitability are also in line with our expectations, which is why we have left our estimates largely unchanged with the exception of the somewhat reduced investments. On this basis, we now see the fair value at EUR 26.70 and confirm our "Buy" rating.

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 as-	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	41.4	44.4	48.0	51.6	61.6	73.4	86.0	99.7
LIABILITIES									
I. Equity	43.9	47.6	50.8	55.5	60.8	68.1	75.8	84.2	93.4
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	18.7	15.0	10.7	5.7	4.6	4.6	4.6	4.6
2. Short-term liabilities	25.2	26.4	27.8	29.4	31.1	33.5	36.4	39.5	43.0
TOTAL	**101.8**	**102.9**	**104.7**	**107.5**	**110.5**	**120.0**	**131.4**	**143.8**	**157.4**

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	22.6	25.7	29.4	33.7	38.5	43.5	48.5	53.8
EBIT	15.2	19.4	22.6	26.6	31.0	35.9	40.9	45.9	51.2
EBT	13.6	18.2	21.4	25.6	30.2	35.7	40.9	46.0	51.4
EAT (before minorities)	9.0	12.0	14.2	17.2	20.4	24.3	28.0	31.7	35.8
EAT	9.4	11.5	13.7	16.5	19.6	23.3	26.9	30.5	34.3
EPS	0.56	0.71	0.84	1.01	1.20	1.43	1.65	1.87	2.10

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	16.3	18.6	21.3	24.5	28.4	32.2	36.0	40.1
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	-13.4	-15.2	-17.3	-20.7	-18.3	-20.3	-23.4	-26.5
Liquidity beginning of year.	6.4	7.7	8.8	10.4	12.4	14.2	22.2	31.8	42.0
Liquidity end of year	7.7	8.8	10.4	12.4	14.2	22.2	31.8	42.0	53.1

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%	12.8%	13.2%	13.6%	14.1%	14.6%	14.9%	15.0%	15.1%
EBIT margin	9.5%	11.0%	11.6%	12.3%	13.0%	13.6%	14.0%	14.2%	14.4%
EBT margin	8.5%	10.3%	10.9%	11.9%	12.7%	13.5%	14.0%	14.3%	14.4%
Net margin (after minorities)	5.9%	6.5%	7.0%	7.6%	8.2%	8.8%	9.2%	9.5%	9.6%

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 24.04.2018 at 13:45 and published on 24.04.2018 at 14:15.

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Date	Rating	Target price	Conflict of interests
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)
29.07.2016	Hold	14.90 Euro	1), 3), 4)
28.04.2016	Hold	12.90 Euro	1), 3)

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