

Axway

Presentation of H1 2013 results

1 August 2013

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Presentation

Christophe FABRE

Hello all, Thank you for attending this presentation of Axway's results for first-half of 2013. Before I start, I would ask you please to turn off your mobile phones. In the first part of the presentation, we present an analysis of business during the first half of the year. Patrick Donovan, our Chief Administrative and Financial Officer, will then move on to the financial results, after which I will talk about Axway's strategy and positioning, before taking your questions.

I) Business analysis

By region, the United States posted organic growth of 5.1% in H1 2013. On the heels of an excellent first quarter, Q2 lagged somewhat, but not enough to stem the strong acceleration in our business growth. Some deals were simply postponed until the third quarter.

France reported organic growth of 6.2% in the first half of the year. The company performed well in Q4 last year and the first two quarters of this year have been positive. The rebound in France is confirmed. This is a very good sign for us.

In Europe, organic growth was 1.2%, the result of two very contrasting quarters, with a decline of 9% in the first quarter and growth of 12% in the second. The impacts varied substantially between countries and quarters. We do not have a strong installed base outside Germany, and are therefore very exposed to large contracts. The recovery in Europe has yet to be confirmed, but we are hopeful.

Although the figure is a little lower, growth remained strong in the Asia-Pacific region at 18%.

Looked at by type of activity, licences rose 1.6% over the period, with the pace in the second quarter a little slower than in the first. A number of contracts were deferred in both the United States and Germany. Profound changes are taking place in the business. The economic situation remains an issue, but new opportunities are emerging -convergence opportunities or opportunities related to new market trends, such as mobile and cloud-which we are monitoring. Overall, business expanded at a rate of 1.8%, but some sectors contracted 5%, while others rose 15% or 20%.

Maintenance grew 9.5% in the first half, 10% of which was in the second quarter. Axway takes a proactive approach to developing its offering, with more mission-critical support contracts offered to our key accounts in response to continued demand.

Services contracted 0.4% in the first half, with growth of 0.9% in the first quarter and a 1.8% contraction in the second. This was related to licences. Some agreements signed in the fourth quarter of last year are not yet active.

Axway's business model remains well balanced. Growth continues to be driven by the United States, while France remains key, accounting for one-third of business. By type of activity, this pie chart for the first half is not truly representative, since licences are not equal between the first and second quarters; however it does show very strong recurrent business, with maintenance set to remain fairly close to 50% over the year.

Axway increased its workforce to 1,798 at the end of the first half, from 1,774 last year. Headcount was stable in France, while there were some new hires in other countries. In all, the workforce ensures we have the resources to benefit from future growth.

Licence sales management costs are primarily associated with maintenance and on-board products. They remained stable year-on-year as a proportion of revenue. The percentage represented by services declined. Personnel costs remained constant for services. We undertook rationalisation measures. The business is in transition, with cloud projects starting and not yet generating much revenue. Technology consulting work is under way for new solutions based on API Server technology. The lack of new projects translates into weak growth. However costs are under control, which is also true for sales and marketing, where the increase in the cost structure is mainly due to the integration of Vordel. The same comment holds for research and development and G&A costs.

In brief, our operating margin improved in the first half, primarily reflecting a reduction in the costs of reassigning personnel to new offerings, rather than improved efficiency.

The recovery in France is confirmed, while the picture is more contrasted in Europe, where a larger installed base would help to stabilise activity. Growth accelerated in the United States, despite a somewhat slower second quarter, while opportunities must be optimised in Asia.

The transformation of the licence business is under way. Our proactive approach to recurrent business is starting to pay dividends in maintenance. Activity in services remains tied to licences and is therefore lacking momentum.

A number of deals concluded in the first half illustrate the positive reaction to our new Axway 5 offering. We concluded a major deal with a company in the banking sector in the United States - that I cannot name - which chose Axway 5 to govern the flow of financial data and SLAs. A contract with a health economic interest group in the state of Washington is an example of upselling the API Server to the rest of the commercial portfolio. The third deal is also very beneficial. A competitor of Intel in mobile hardware selected Axway's API Server to enable companies to access sensitive information from their mobile devices.

I would also point to illustrations of new projects/clients in France. A new eco-tax project selected Axway 5 to govern data flows. Castorama selected Axway for data flows between headquarters and its retail outlets. Finally, the French Ministry of Defence uses Axway 5 for the secure management of very large data flows between ministries, in a project covering 285,000 employees.

In the rest of the world, Vordel's contract with BMW was extended. Axway is now BMW's partner for all its in-car solutions, which are activated using mobile technologies (the connected car). Porsche, which was also an Axway customer in the B-to-B segment, acquired a new MFT solution. A major Australian utility company (the equivalent to EDF in France) chose Axway to manage the integration of all cloud and mobile flows, and particularly for the connection of smart meters to the information system.

All of these examples show that Axway 5 has had a flying start. They are often convergence projects, with several functionalities in the same offer, or new cloud or mobile projects.

II) Financial results

Patrick DONOVAN

As Christophe mentioned, the first half revenue for 2013 ended at EUR106.4 million, which was an increase on the first half of 2012 by 8%. Gross margin increased to 65.9% thanks to increased product revenue in the first half. We were able to keep our total costs in line, with costs growing by just 6.8%, helping us to generate a profit of EUR7.1 million on operating activities, or 6.7% of total revenues versus 5.6% in the first half of 2012.

In the first half of 2013, our operating profit was impacted by two main items. Firstly, the intangible asset amortisation from the Vordel acquisition in November of last year is having an impact. Secondly, we took a EUR4.7 million provision on the GSA matter in the

United States. Additionally, in the first half of 2013 our income tax benefited from the release of our tax valuation reserve on a deferred tax asset of EUR9 million in the United States. This all amounted to a net profit of EUR9.8 million or EUR0.48 per share, compared with EUR2.6 million or EUR0.13 per share in the first half of 2012.

Total assets at the end of June 2013 were EUR398 million. Our cash improved to EUR54 million and trade receivables closed at EUR58 million. This represents a metric of 80 days' sales outstanding, compared with 102 days on the balance at the end of 2012. This is standard for Axway as we do a lot of Quarter 4 (Q4) billings, and a lot of maintenance accounts are also billed at the end of the year. We select those in the first half 2013. Total liabilities closed at EUR159 million and for 2013 these include the EUR40 million of bank debt that came from the Vordel acquisition as well as approximately EUR58 million in deferred revenue. Our total equity ended at EUR239 million, and this includes the dividend payment of EUR7 million made in June 2013.

We generated almost EUR19 million of cash in the first half of 2013. As is usual for Axway, changes in operating working capital [inaudible] benefited from the previously mentioned cash collection on maintenance and Q4 activities, which amounted to EUR20 million for the first half of 2013 compared with EUR18 million in 2012. Our income tax paid net of accrual reflects an impact of the release of the deferred tax asset mentioned earlier. All of our bank financial covenants are in line and have been in line for all the periods that have been measured.

III) Axway's market positioning and strategy

Christophe FABRE

There have been many changes since 2012.

In a recent study examining the potential of the middleware market, Gartner announced growth of close to 9 billion in the period between 2012 and 2016, out of a total target market of 30 billion. In other words, the software market is expanding, not including the cloud, which is growing around it. The impact of the cloud is greater on some software segments than on ours. Clients want middleware in the cloud. This is an emerging market and we intend to position ourselves in this segment. If clients have a larger cloud component in what they buy, this will automatically have an impact on how software is purchased. Large traditional software deals could be broken down over time. Clients will shift to purchasing gradually as needed. We must therefore offer them an alternative method for acquiring our products.

Mobile, big data and social networks will also have an impact, requiring changes to traditional integration technologies. Most companies develop their applications based on the technologies used by their employees. Changes are being led by the mobile world with its very light technologies. Companies need to develop applications for their clients to use on mobile devices. Company standards are changing and these developments will also have an impact on middleware, the software that connects applications. Mobile technologies generate many flows and interactions. Whereas, before, middleware connected a few thousand applications. The scale has now increased from thousands to millions.

The effects of this growth on on-premises software will vary. Standard technologies are flat or declining, in contrast to the rapid growth in technologies that meet new needs. Axway is moving in the right direction. The company is known and recognised in the market, underscored by its position as a Gartner magic quadrant leader in on-premise integration technologies (generalists Oracle and IBM, specialists Software AG for processes, TIBCO for real-time, Microsoft for PCs, and Axway for governing data flows). You can see that convergence is included in the integration criteria for the magic quadrant. Messaging, B to B and APIs are needed, alongside traditional integration technologies. Our

Axway 5 suite positions us as a leader in the magic quadrant. However, the quadrant represents the current state of the market rather than the outlook for the future.

The development of information systems since the 1980s has been dramatic. Systems were fairly simple initially, before the applications incorporated in them started to multiply. SOA developed from the need to integrate these applications. Then came the Internet. Now there is a need to connect more people and provide greater data flows at the frontiers of companies. This is the challenge of the future.

Governing these data flows is absolutely essential to this development. More and more users download and are connected to applications and services are increasingly in the cloud. This is the challenge addressed by Axway 5.

Emerging cloud and mobile connection technologies are the basis of new API technologies. At the same time, we have to continue to manage existing interfaces (MFT, B2B). Our approach is to provide major business clients with a solution to manage both these modes. Governance is the key. Everybody knows how to manage information, but not necessarily how to govern these exchanges - adding a new customer, blocking, permissions, security, etc. - although these are critical issues for companies.

An updated magic quadrant on application service governance will soon be available, showing Axway and Vordel as leaders.

All of these developments reinforce our positioning and strategy. In a middleware world of huge generalist companies aiming to create software for "average man", the specialists also play a role. For example, Informatica is the specialist data integration provider, Software AG for process management, Tipco for real time, GXS for conventional B to B, and Axway for governance of data flows. We stand out as the only player in this landscape truly working at the frontiers of companies and the only provider to offer mature and emerging technologies in the same line-up. Our competitors are smaller and more specialised on sub-components. API: Computer Associate, Intel/Mashery, Apigee, SOA Software. Here, Axway is the only company to focus on all technologies. We have growth drivers with these new technologies, as well as consolidation factors with applications in place, which are not going to disappear.

This allows us to confirm our business plan. Axway's vision is aligned with market developments. We could set a target of \$500 million or more. In addition to the continued development of the Axway 5 technology, one of our key drivers is targeting acquisitions to accelerate the growth of our market share. We are working very hard on this, although we do not intend to complete any during the second half. Through this market screening we intend to do what we achieved in this past, after the creation of Synchrony in 2003, and with the Cyclone, Tumbleweed and Actis acquisitions we have expanded the range of functions offered to clients. We are following the same schema at present, as we have just created a platform, are the leader in a number of areas and are set to very soon become the leader in emerging technologies. This platform will be capable of delivering added value for the clients who joined us through acquisitions. We will follow the same pattern.

While not complete, the change from Synchrony to Axway 5 is progressing. Integration of Vordel is complete. We are working on the operating structure, processes, systems and management. We are reinforcing the Axway 5 pipeline. Change in demand is qualitative, rather than quantitative, but it should increase in the Axway portfolio.

Services, penalised by investments in the cloud, should develop. New offerings will enable us to increase the value-added component of our software development services. Maintenance is interesting because flows show that we have a presence in the value chain of clients who want our operating systems to be continuously available. They purchase support services to ensure continuous readiness.

We are confirming our guidance for 2013, with some positive points and others that are a little less so. Profound technological changes are taking place in the market. Clients are wondering what they will do in response. The economy is not particularly rosy and no

software developer has escaped the impact, including Axway. We are working to adapt to this changed landscape and to leverage its benefits.

Our commercial portfolio is encouraging for the third quarter, while we still have work to do for Q4, since our sales cycles are from six to nine months.

We are therefore maintaining our guidance for positive organic growth with a stable operating margin. With regard to this last point, we mentioned a slight improvement in the second quarter. For us, this means the same thing. We should have been consistent in our vocabulary, what we mean is we will maintain our margin.

That is the end of the presentation. We will now move on to the Q & A.

Q&A

From the floor

The Services business has been flat for almost two years. What is that due to? Do you use third-party integration services? Are there other factors?

What is the scale of the signature deferrals you observed in Q2?

Christophe FABRE

With respect to services, the business has changed and licences did not grow at the same pace as before. Licences activity changed during the first three quarters of 2012 especially, with a shift from creation projects to consolidation or rationalisation projects, which generated less demand for services. We could have downsized, but we retained our headcount to ensure we had the resources to position the company in emerging segments, such as the cloud. Investments in the cloud are included in the Services P&L. We are aiming for growth, and the cloud is one way of obtaining services.

As regards deferrals, the scale is not huge. A few major deals were deferred in the United States and Germany. The response is included in our information on the Q3 pipeline, which we think is well positioned.

From the floor

How is the integration of Vordel progressing, in terms of human resources and technologies? How did your own and Vordel's clients react?

Christophe FABRE

The integration is progressing well. This is strategically important and we have paid very close attention to its execution. The entire Axway sales network was trained in API Server technology and is working on it. It is a key point. The same can be said for the R&D component. Axway 5 will be one of the first platforms to fully leverage API technologies. Rather than simply working on developing Vordel's functionalities, we want to enable people to connect B to B, MFT and mobile. All existing B-to-B processes will need to use API Server technology to either provide data or retrieve data on a mobile device. We are working hard on it. The integration of Vordel is extremely important strategically.

Vordel was the closest company to our positioning in API Server technologies. Generally speaking, Vordel's clients are very satisfied with this acquisition. By comparison, Layer 7 is moving in another direction after being bought out by Computer Associates. This gives us a fairly good market opportunity as the pure middleware leader. If all goes well, this will be confirmed in Gartner's next magic quadrant.

From the floor

With the emergence of the cloud, will integration services not be a little weaker at Axway in the medium term?

Christophe FABRE

When I refer to the cloud, it is in the area of Axway's B-to-B integration. Companies with a long track record in this area have strong services business. Once in the cloud, solutions have a life of their own. Changes are necessary, because data flows are linked to business processes. In addition to placing these products in the cloud, clients want us to develop them, which generates recurrent services business.

In addition, API Servers and mobile technology are new. Many clients demand value-added services to understand how to build the architecture for these solutions. Security is critical. Information leaks can be very damaging for companies. API Servers are in the upward phase, since, having developed them specifically, companies realised that the problem was very complicated. They are therefore turning to software developers with experience in security to propose the architectures. We can offer advice around our products upstream. Change is taking place in the services business. It will take off again in time, but it won't be the same as it is now. There is a relation to be built with the client, in the long term.

From the floor

I didn't fully understand the GSA dispute and the activation of fiscal losses brought forward in the US.

Where do you stand with your objective of developing the share of indirect sales? What is the position of MNA?

Christophe FABRE

The dispute with GSA dates back to 2011. GSA is a US government agency in charge of federal contracts. It challenged activities carried out by Tumbleweed prior to 2008; Tumbleweed is a company we acquired in 2008. We worked on the matter for two years, and in principle have now reached a settlement out of court, which is currently being finalised. We set aside a provision in the amount of this agreement. It is being finalised and therefore I am unable to release any more details. The issue is a sensitive one. In any case, we have moved on and come to an agreement. We have now reinforced the security of our activities with the US government.

Patrick DONOVAN

We acquired several companies in the US that had a history of losing money and a high amount of net operating losses. However, when we made these acquisitions we had no reliable forecasts that indicated that we would be profitable. In 2010, you may remember, we put in place all the cost savings and mechanics to forecast profitability. Therefore we were not profitable before but in 2010 we then became able to forecast.

However, we were conservative and had never proved this previously. We therefore took a two-year view in 2010 and released two years' worth of valuation reserves. Now, in 2013, we have achieved what we forecast and with a couple of years having now passed I am forecasting profitability in the US. Additionally, we have settled the GSA matter, which was slightly impacting my ability to produce clear forecasts for the future. We now have all the elements in place and are able to forecast up to five years. After this, we will be releasing one year until we recognise [inaudible].

From the floor

Could you have started this earlier in France?

Participant

We follow International Financial Reporting Standards (IFRS).

Christophe FABRE

When we acquired these companies, which had tax credits, our business in North America was not profitable enough to activate five years of credits. We therefore only activated two. The measures undertaken to improve the profitability of the Vordel subsidiary paid off in earnings and we have just reached a settlement with the GSA. We can now make more reliable profit forecasts and have therefore recognised more tax

credits. This is a once-off and we will return to our normal system in the next half-year periods.

We are working on identifying acquisition targets. At this stage, nothing will be finalised in the short term, in the second half.

From the floor

What is the total cloud revenue for the first half? What is your target for the year? What method do you use to recognise revenue from the cloud? What happens when a client purchases your cloud solution via a third-party supplier for the cloud platform? Does he have a direct contract with this platform, or do you post the revenue?

What is the variable component in your cost base in the second half? For example, by how much would the cost base be adjusted in the case of a €10 million decline in your licences?

Lastly, core banking platforms are emerging in the banking sector. Is there a risk for the business, which used to be called the "règles du jeu" (the rules of the game, in English) and used to connect different banking applications?

Christophe FABRE

I won't go into too much detail on the figures. We do not give the revenue for the cloud in the first half. The qualitative part is more interesting and we have had a few resounding successes. The cloud is not cannibalising our on-premises activity. Key accounts on the lookout for value are not interested in a basic offer. Our cloud products will appeal to clients who do not take a strategic approach to the cloud. It is more a development area than a change in our current client contracts. There is no pass through. Clients with licensing agreements with us are not asking us to switch them to the cloud. However, there is demand from new clients for an on-premises offer and a cloud offer, and they only use one in general. There is no break through. Therefore, we are not going to review our installed base. There is growth in cloud solutions on which we are not positioned, and we are working on this.

From the floor

There is a slight confusion. By pass through, I meant purchase-resale.

Christophe FABRE

The Axway cloud solution client's contract is only with Axway. We use two subcontractors for our offering, Amazon and Atos. The contract with Amazon guarantees us infrastructure SLAs. We manage the software in the cloud, and the related service. When a client pays €100, we pay out a percentage of this to Amazon, but Axway is the contact point and has responsibility for everything.

Sopra provides core banking platforms. Its line-up could include "règles du jeu" and other Axway products to govern data flows inside the core banking platform. Sopra Banking clients are interested in an API Server to open up their processes to mobile devices. Therefore, it is not a risk. Basically, all these ERP or application platform projects include many data flows with frequent and high-volume data exchanges. Generally, it is possible to include a project for Axway alongside these consolidation or application platform projects. It's more like a working space for us.

From the floor

You didn't answer my question about the adjustment to the cost base if, theoretically, you had a fall of €10 million in licences in the second half.

Christophe FABRE

We are very pragmatic in our approach to costs and rationalisation. We will do as we always do, we will be very pragmatic when it comes to our cost base. Licences in Q4 are the real issue. We have the ability to manage our cost base. We must secure the fourth quarter and are stepping up our efforts to generate growth. We will not prune the foundations of the company and are protecting our investment in R&D, services and sales.

One more question? No?

Thank you.

Document prepared by Ubiquis – Tel: + 33 (0)1.44.14.15.16 – <http://www.ubiquis.fr> – infofrance@ubiquis.com