

Axway

Presentation of 2013 results

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Business analysis

Christophe FABRE
CEO

Hello. Welcome to this conference on the results for 2013. I will handle the first part, Patrick Donovan will present the financial and accounting results to you, then I will talk about Axway's positioning and strategy. Lastly, along with Patrick Gouffran, our corporate secretary, we will answer your questions.

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The figures for 2013 are in line with our annual guidance, even if Q4 was weak. Our new version of Axway 5 Suite was very well received by the market. That's an important point. The API resulting from the acquisition of Vordel at the end of 2012 also has great appeal.

In the fourth quarter, we launched two major new components for Axway's traditional business with managed file transfer and B2B – management of flows between the ecosystems of professional partners. These two business cases are part of the same offering. They consolidate each other. We have worked hard on the offering over the past two or three years. This new strategic positioning has been recognized by analysts, particularly Gartner, and customers. We were well positioned in the two new magic quadrants.

We worked on extending the distribution network, particularly in Brazil and Australia. In this way, we are beginning to work on getting to market and extending our distribution network.

Lastly, a key point: we have strengthened Axway's management and workforce to move towards the target of 500 million dollars that we set ourselves.

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Now for revenue in 2013 by region. France, at 8.4% growth, confirms the recovery in the fourth quarter of 2012. That makes five quarters in a row that France has performed well. We have worked extensively on getting new offerings to market and on accounts. The partnership with SopraBanking is being built and strengthened. It's a very good sign for Axway's future.

The Rest of Europe and Asia experienced highs and lows, depending on the deals that could be completed. There is not yet a critical mass of customers enabling us to develop substantively, as we can in France and the US.

The US posted growth of 3.3%, with a minor setback in the fourth quarter.

Organic growth was 3.7% in total, for overall growth of 5.9%, which is well positioned as regards the middleware market.

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By business line, despite the first three quarters being good, licenses were hit in the fourth, posting a flat performance over the year. Nevertheless, there are two ways of posting a flat performance: either everything is flat or some things grow and others decline. In analyzing Axway's business, you have to understand that there are emerging product lines – the Suite business, the digital-economy business. This marked improvement, in terms of quality, is promising for the future.

Maintenance is excellent, at 8.2%. We're up there with the best of our comparable companies.

Lastly, services are being transformed. We've done good work on the offering. We are continuing to work on the services offering to accompany these new software offerings. That doesn't show just yet.

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We had a very strong Q4 2012. So achieving the same figures in Q4 2013 was a great performance. That's what France did, with organic growth of 2.9%. The Rest of Europe and Asia dipped slightly, while the US posted a rather disappointing performance.

I should first explain track and trace – pharmaceutical companies are equipping themselves with solutions to guarantee that the medicines bought at points of sale are indeed those produced in the factories. In doing this, they are guarding against counterfeiting and ensuring that the correct prices are applied. In 2013, we based our business on a regulatory driver: the state of California had forced vendors to equip themselves with these tools. The regulatory constraint was pretty strong. But, at Thanksgiving, the federal government voted in the Drug Quality and Security Act, which pushed back the deadlines by one year and changed the criteria, making them less harsh. So part of our business, equivalent to four or five million, has been pushed back. It will be postponed to 2014, or even 2015. We have repositioned on other things. So it won't have too much of an impact for 2014.

In addition, some more traditional business concerning MFT was also pushed back. So in the end, the situation in the US is just temporary. Structurally, there's no cause for alarm.

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Revenue from licenses was 28.5 million euros in Q4, with negative organic growth of 17%. Maintenance posted organic growth of 7.3% while services got a jolt in Q4, which is a good omen for 2014 even if there's still a lot to do to get back to the levels of 5%, or even 7 to 8%.

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Structurally, Axway's business model is still stable, with maintenance representing 45% of revenue, compared to one third for licenses and 23% for services. By region, the US is still our biggest market, at 38%, ahead of France at 35%, the Rest of Europe at 24% and Asia, where we support our key accounts, at 3%.

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Now let's look at a few case studies to illustrate what I was saying about the quality of contracts which are developing. There are two categories.

The first represents what we are used to doing, but at another level. It's an American car manufacturer, whose name I can't mention, which wanted to review its B to B infrastructure – internal exchanges, exchanges with parts manufacturers, exchanges with retailers, regulatory exchanges with the government, integration problems with existing applications, problems with monitoring and visibility on transactions. For a contract like this, all the competition was involved. We won it with the help of a partner systems integrator. It's a great contract in which the effort we put in on the offering's governance tools set us apart.

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A similar contract concerned management of partner committees, with file exchanges, for an American institution.

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In the world of insurance here, these problems with governance, onboarding and partners are truly critical.

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Here in the world of pharmaceuticals.

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I'll spend more time on a French contract relating to a mutual company which wanted to reward its users' loyalty. The challenge for this company lay in delivering a program to improve revenue by 30%. To do this it had to connect the services available internally in order to make them available to mobile applications and, in so doing, improve the governance of the system. So it was an API strategy, with extension of the existing SOA. This is a very interesting case because it's a typical example of digitalization of the economy, in other words, a company which transforms its business model to take advantage of technological developments.

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We closed a deal which was similar in terms of technology, but which had different drivers. This concerned the leading telecoms operator in Australia, Telstra, and the issue was with monetizing the network. IT networks are vast, with lots of bandwidth. With the number of users increasing, the network has to be monetized: it must be accessed with tools which make it possible to bill and to ensure that a partner can only use a certain part of the bandwidth. That is done using API. There are also problems relating to governance and reducing development and maintenance costs. It's a great contract for Axway concerning API technologies.

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Another example of API use, but internally this time, concerns a big pharmaceutical laboratory, headquartered in Switzerland, which wanted to provide its employees – sales, engineers – with tools on their smartphones and cell phones. 65,000 devices had to be connected, for 500,000 transactions a day with peaks of 500 million, all with global geographic coverage, and all the security problems that you can imagine (cell phone stolen, not accessible, secure data, etc.). We were competing with everyone else on the market. In the end, the laboratory chose Axway's platform.

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A more typical example concerns a prestigious champagne and spirits company, which thought that exchanges on its supply chain didn't really set it apart. It was looking for a partner to host its internal and external flows in the cloud 24/7. This partner also had to undertake to develop its services and maintain the solution. Axway won it. This contract is in progress. It's one of our major customers in the cloud, and I think that we will win others.

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Now let's look at data-flow governance from another angle. A major global bank, present in France, bought supervision tools from us so as to ensure that closing times and risks, on this business application, were at the level of their internal SLA. One of the ROI was that our solution was four times cheaper.

Ultimately, these really are great contracts. Admittedly, revenue from licenses is flat, but we can see very interesting deals in the pipeline which prove that we are well positioned.

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In licenses, the number of deals was virtually the same in 2013 and 2012. However, the tier ones – major deals on major accounts – gained ground. The portion of indirect and new accounts is down slightly, but after the acquisition of Vordel, our goal was to cross-sell. Average prices increased. Conversely, very simple, middleware-type uses are down.

In the past, five or ten years ago, components rolled out virally. Now customers are concentrating on flow governance in order to go digital and to gain operational efficiency. MFT and B to B will enable us to find new *drivers* of traditional business.

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All sectors are affected by the Axway wave. They all have problems with transformation, digitalization and operational efficiency. The Suite and the B to B part increased our revenue in healthcare, pharmaceuticals and the supply chain. The public sector was down slightly, particularly after what happened in the US, while banking is stable, but with a change in demand.

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Maintenance makes a big contribution to revenue, worth 45%. The attachment rate for sales of licenses increased to 19.4%, up one point. For 100 euros of licenses, we sell 19.40 euros of maintenance. That's the recurring part. We've made good progress. We started at 15%. Publishers which aren't too aggressive, *i.e.* which pay attention to their sales relationships, sit at 20%. We'll allow ourselves another point of growth, then it'll be about remaining stable.

The renewal rate measures customers who, year after year, renew maintenance contracts. We're at 93%, up there with the best. This rate is stable. It's very good. It shows the level of loyalty. What's more, if customers take maintenance, it's because it's critical for their projects, which can be seen from the examples I mentioned.

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At the end of 2013 the workforce was stable overall, at 1,783 employees. I would like to emphasize the quality of this workforce. Management was strengthened, and the Executive Committee has welcomed industry heavyweights from major publishers. It is interesting to welcome people who have made it as far as 500 million and who have other ideas. Obviously, we continue to rely on all those who know our business, who are passionate and who have been with us for ten to fifteen years.

We've done a lot of work on the sales network. We have to be capable of speaking to major accounts. We have progressed in this respect.

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Cost analysis: the gross margin increased, from 68 to 69.6%. We made efforts in the sales and marketing network, which totaled 70.7 million euros. That supports growth. If you don't have more vendors, you don't grow any more. It's a basic equation that shouldn't be forgotten. R&D progressed a little. There will certainly be acceleration now that we have new customers and the Suite has moved into production. There will be requests for developments. So we can expect progression, but not a peak. I don't think there will be a drastic increase. It will simply be in line with activities.

G&A, simply the fact that we merged with Vordel. In the end, EBIT stood at 15.8%.

Financial results

Patrick DONOVAN

Administration and Finance Director

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I will make a few additional comments on the financial results and go through them in a little more detail. As Christophe mentioned, total revenue for the year finished at EUR237.5 million, a 5.9% total increase. We saw revenue increase in all our lines of business, licence, maintenance and services. For 2013 our gross margin increased to 70% of our revenue. We were able to keep our costs under control and build our product revenue, and our service revenue lines of business continued to improve our gross margin level to 68%, an improvement on last year.

Our profit on operating activities was EUR37.5 million, an improvement on the EUR35 million from last year, or 15.8% of our revenues, also an improvement on 15.6% we presented last year. We were able to do this as a result of continuing to invest in our distribution network and our R&D activities.

For 2013 we took the full effect of the Vordel acquisition, and our amortization increased to EUR3.7 million annually, which represents a full year's worth of amortization. During the first semester analysts' briefing, we mentioned our settlement with the GSA for EUR60.2 million. Those charges make up the entire EUR5.3 million EST and other entailment expense. Additionally, during our first semester discussions, we presented that, due to the profit building in our US market, we were able to avail from allowances on the income tax valuation reserve we had on the assets available in the US. (micro issue) That benefited our results for 2013 by EUR11.7 million.

Therefore, in total our net profit was EUR35.6 million or 15% of our revenues, versus EUR24.7 million or 11% of our revenues in 2012. Our base of net earnings per share was EUR1.75 per share for 2013. Without the GSA charges and the tax valuation release, those would have been approximately EUR1.33 for 2013. Our balance sheet did not change much in 2013, with just normal operating activities. We were able to improve our cash balance, at EUR49.2 million over the EUR35.4 million in 2012, and our DSOs improved to 90 days versus the 102 at the end of 2012. Our shareholders' equity ended the year at EUR258.4 million, and our bank debt outstanding at the end of the year was just over EUR35 million. Our changes in equity are quite standard, with the increase from the EUR35.6 million worth of profit, and this also reflects EUR7.1 million of dividends paid out in the 2013 year on the 2012 results.

Our cash flow statement will strongly generate EUR28.3 million of cash from operating activities, or EUR24.7 million of free cash flow. We had traditional investments in our equipment and facilities of EUR3.6 million, and we were able to generate EUR13.8 million of cash improvement for the year. All our banking covenants are quite comfortable and strong; they are all well below the limit in all three periods presented, and we continue to have EUR50 million available to us under the revolving bank lines we have available. Our shareholder structure is quite stable, and we had no real change since 2012. The pact of shareholders continues to maintain about 60% of the shares outstanding.

Axway's market positioning and strategy

Christophe FABRE
CEO

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In terms of macro-economics, European countries are heading for growth of 2%, the US 3 or 3.5% and emerging countries a little less. We have space in Brazil and Asia.

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The middleware market is Axway's market. It's a big market worth 20 billion dollars. It's here to stay because information technology needs tools to connect applications and new digital technologies. Gartner predicts annual growth of 7% by 2017. However, the results of companies like SAP, IBM, Oracle or Software AG show that a shift is taking place. Growth figures are pretty weak. Everyone in this industry is trying to adapt their offerings to follow customers.

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Forrester mentions this development of *all business* models and all companies. Digital technologies, social networks, the cloud and cell phones have an impact on these business models. In the first decade of the century, middleware was driven by IT problems. Now our customers' business departments are analyzing themselves. All business models can be reassessed or take advantage of opportunities.

Companies must put in place services so that their customers and their partners can take advantage of their IT capital. That's something which challenges traditional middleware players.

There are three categories of vendors. For those which do internal integration, the drivers of the digital economy are mainly big data. Others position themselves at the frontier to connect with ecosystems. These are internal or external frontiers. Lastly, for a third category, integration is not strategic. So these vendors look to outsource. We are in the second category.

By 2017, two thirds of all new application-to-application integrations will be going outside the company. They will be turned towards B to C. Companies including this will spend 33% more on middleware technologies, which includes big data and the cloud. By 2016, 20% of these integrations going outside will be based on mobile connection, which is the future driver of the market.

In traditional business, we will need speed and operational efficiency. For cell phone calls, you have to be sure that all the applications inside the information systems which are called will give results in good time and in the required form. Today there are still major problems with operational efficiency, particularly in file flows. The error rate with open sources is 6%. In other words, 6% of all flows exchanged are erroneous: that's huge. Axway technologies achieve rates of 0.02%. So the ROI/service level for the customer requesting information is direct.

We have operational efficiency business cases. We also have the digital economy and APIs. To connect cell phones, the cloud, smart meters or cars with internet services, flows pass through software sockets which make it possible to give or retrieve information. These standardized sockets are APIs. In themselves, these APIs are not very complicated. They are standardized. However, they come up against the same problem as the classic B to B: when you have a major account and you want to give a service, you have to manage that. Additional tools are needed to trace, see what's happening, detect trends or improve

offerings, manage new user tools, onboard them or connect them very quickly. That generally takes three months. It needs to take two weeks. We also need policies to ensure that people are allowed to do what they are doing. Security is essential, as theft of credit card numbers, social security numbers, etc., is on the increase. It is absolutely vital that these sockets be extremely secure.

That's Axway's emerging business. As usual, everyone's talking about it, so not many people are selling it. But once we know what we're talking about, we start to sell. We're in the middle of the wave. It's coming.

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Gartner's two magic quadrants show us that we are moving in the right direction.

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Everyone in our competitive landscape is faced with the same developments. Everyone chooses their own path. Generalists try to provide a solution for everyone, unlike specialists: Software AG is working on processes, Tibco on real time, OpenText on information management – low level B to B –, while Informatica is pulling out all the stops on big data. Faced with this, Axway is positioning itself on flow governance. Niche competitors, API vendors and MFT and B-to-B players try to gather up the crumbs left behind by Axway and IBM.

We pioneered API with the acquisition of Vordel. We were nine points ahead of the others. Since then, Computer Associate has acquired the second biggest player in this market, which was Layer Seven. Apigee, Mashery and Apiphany are situated in the world of developer portals. When APIs are made available to an ecosystem, that ecosystem develops new services. This is a specific business case. We are situated more on corporate business cases.

In this competitive arena, we have set ourselves apart over the past few years. We're moving in the right direction. For the moment, we have nothing to fear from the competition.

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We confirm our project. We have an answer to give our existing customers to ensure they take advantage of our investments in governance. We have this reaction to APIs. To govern these flows, you need lots of products. We made a Suite. We packaged it. It's good quality. This vision must be able to take us to 500 million dollars. To speed up, it is important to make acquisitions. We're working on that.

The strengthening of management and operational processes is one of the key points of Axway's success, in addition to a good offering and good positioning.

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We are adapting to reach 500 million. We are constantly honing our offerings. A first transformation took place at the start of the noughties. It was the start of middleware and SOA. Today, we have reached another turning point in the market. I think that we are handling it well.

Outlook for 2014

In 2014, the economic environment, even if it is recovering, is not growing rapidly. The IT landscape is reconfiguring because the competitive landscape of customers is reconfiguring. We must bring them the right solutions. We are continuing our transformation based on digitalization and operational efficiency. We have good fundamentals with API, governance and the cloud. The time has come to consider new acquisitions in order to strengthen the Suite's tools. For example, we could add more value to the data which are exchanged. We must also develop the commercial network and the customer base. There are regions and verticals where we can develop a lot.

Our orientation for 2014: we will work on significant, organic and, if possible, external growth, with an operational margin kept to a minimum. If growth goes well, there is no reason why we shouldn't improve the margin.

To recap, after a dip in 2012, Axway is back on track. We are confident in our offerings, our positions and our ability to manage the transformation. We must adapt well to demand and develop our sales abilities and our ability to get to market.

Q&A

From the floor

Grégory Ramirez, Bryan Garnier

What would be a reasonable level of growth for this year, while for the medium term, you mentioned a figure of 8 to 10%? By what proportion could the margin increase in 2014 in the current scope?

Christophe FABRE

For the short term, I'll stick to the target. We will be positive. In the medium term, it's entirely possible to reach 7 or 8%, and I hope as quickly as possible. The transformation in customer demand, the interest in our offerings and the transfer of activities have led us to not quantify exactly the degree of positive growth that we will achieve in 2014. That's prudent. In 2013 we had three good quarters, then the fourth was down. Big contracts are hard to predict. So I prefer just to say that the trend looks good, without going any further.

The acquisitions and synergies which arise will help us to speed up the growth of the margin. There's no doubt that the greater our growth, the better the improvement in the margin. The important thing is to harness trends, take positions on new offerings and set ourselves apart. Recent years have shown that Axway knows how to work the bottom line, whether the top line is there or not.

From the floor

Mr De Fels

There has been very strong organic growth in maintenance over the past two years. Will this continue in 2014? For what margin level?

The maintenance margin.

Sales of licenses have not been so good for the past two years. I assume that the bonuses paid to vendors have been decreased to improve the margin. What can we expect for this year?

Christophe FABRE

Maintenance is fed by the renewal of embedded solutions and, globally, by 20% of sales for the year. If we are still delivering a good level of service, and if licenses are also growing, there's no reason why we shouldn't post growth of 7 to 8%, as in recent years. We don't have any warning signals on this subject. The maintenance margin is excellent. We are working on new offerings and on improving contact with customers to anticipate renewals.

As regards licenses, we can obviously sell lots more with the same number of sales staff, but we are working instead on developing our distribution network. We are not hiring huge numbers of sales staff, but we are working at a reasonable rate. With good growth in licenses and revenue, we will have more expenses - commissions and bonuses. I doubt whether our margin would be fundamentally different if we had 3, 5 or 10% growth in licenses.

From the floor,

Derric Marcon, Société Générale

Is the share of new business (8%) in line with your targets? Will you need to significantly improve it to reach your goal of 500 million dollars in revenue?

I am astonished by what you have announced regarding R&D. We might have expected a drop after the efforts made to integrate Vordel and now that Axway 5 has been released.

You have an advantage in API Servers, but your competitors will try to develop products to meet customers' demands. How do you intend to keep your competitive advantage over the leaders in integration over the next two or three years?

Historical Gartner magic quadrants prove that you have made lots of progress in governance thanks to Vordel, but less in integration. Shouldn't you take action in this area?

Lastly, you don't really have any in-memory technology in your offering. Is this an area for development in coming years?

Christophe FABRE

We're not too bad, with 8% of revenue made from new customers. This will obviously be a significant element of our growth, even though we don't count new sales made to historic customers. The acquisition of Vordel allowed us to record new names, while also working on our base. New customers are an important element, which will accelerate when we move from an early-adopter market to a mainstream market. It's when the market has matured that the penetration rates will be very big. At the moment it's about honing offerings, understanding what is happening and adapting to it.

No, we couldn't expect a drop in R&D this year because we have long-term investment plans. Developing a new offering generally takes three years. We are in an offer-driven market. With the digital economy, customers have new needs. On existing markets, some problems are very difficult to resolve. Publishers must continuously improve their solutions. The important thing is to smooth out expenditure, make the right choices and have a good overview of the market. From this perspective, we have managed our R&D investment pretty well. The Axway 5 offering has just been put on the market. There are lots of evolutions still to come.

Regarding the API Server, we will stick to the approach we have had over the past ten to fifteen years. On paper, companies like IBM, SAP or Oracle have got it all. For all that, specialists always have the possibility of doing a lot better. B to B is our specialty. The majors are barely present there. We really have what it takes to stand out in this respect. Our customer relations really set us apart. Our successes in 2013 are reassuring us in that position. It's true that there are API offerings in virtually all middleware offerings, but we will remain well positioned to provide the best governance offering in complex situations.

We have progressed in governance thanks to Vordel and thanks to our vision of integration. Vordel had never reached that level in the magic quadrant. We have also progressed well in integration since we had never been among the leaders. This quadrant groups together everyone in the field, even generalists. It's recognition of our positioning as a specialist. The leader of integration can only be a generalist. Our position is very good. I doubt we could do much better.

Lastly, in-memory technologies are mainly big data. But we aren't involved in big data. So in-memory isn't strategic in the short term. Perhaps in the medium term. We don't do in-memory managed file transfer or in memory B to B. There wouldn't be any competitive advantage.

From the floor

Sébastien SZTABOWICZ

What growth drivers do you see for the different markets or different verticals of healthcare in the US in 2014?

What kind of acquisition, in terms of size, can we expect for 2014?

Christophe FABRE

In addition to track and trace, there is also traditional business and the B-to-B activity in the US in healthcare. We will be able to find drivers.

As regards acquisitions, we are working hard. I won't comment further.

Thank you for your attention.

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