Axway
Web Audio Conference

February 19, 2014 - Paris

Contents

2013 Annual Results

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Chief Executive Officer, Axway

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Welcome to this 2013 results web conference. I will start by commenting on 2013, and then Patrick will comment on our continuing financial results. Then I will talk about our positioning and strategy, and we will do a Q&A.

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I think 2013 was a solid year. Our numbers were in line with our initial guidance, despite a Q4 that has been a bit low. We have worked a lot during the last 2-3 years to strengthen our offering, with the new version of our suite being well received by the market.

It integrates the API technology that we acquired from Vordel at the end of 2012 and we are seeing good traction from the market, leveraging the drivers which we see in the digital economy. At the same time, this suite is providing new governance components in the last quarter to strengthen the offering on management transfer and business-to-business integration technology, which are Axway's core and historical offer.

This new positioning and offering have been recognised by Gartner in two magic quadrants where we took leadership positions. The first one was the global integration suite, including much more than just what we do, so that was a good result, and applications service for governance which we took from Vordel. We also started to expand our sales network again, acquiring Brazilian resellers to directly support customers in Brazil and Latin America. We did a small acquisition to acquire the assets of our Australian distributor who was working with us for a long time. These two acquisitions are not so significant, but they show the premise of what we will do in the next few years to expand our reach to customers.

Last but not least, we also on-boarded new managers; the executive team is now composed of people who already made the trip to USD500 million in other companies, and we on-boarded people from worldwide leaders in software that developed solutions in our space for big companies. The executive team is also composed of people who constitute the DNA of our company, who are experts and gurus on governing the flow of data.

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Regarding results by region, France delivered strong performance five quarters in a row, and it is showing a rebound compared to 2012 with organic growth of 8.4%. The rest of Europe and Asia-Pac are flat or a little positive; their presence is not so big, so we have ups and downs depending on the deals we can find. The first big region is America, with organic growth of 3.3%; we are hoping to do more, and I will go into that, but nothing serious for Axway's medium term.

Total organic growth was 3.7%, and total growth was 5.9%; when you compare that to what traditional players of the middleware market are delivering, it is a solid performance, where we also demonstrated good integration of Vordel.

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Regarding business lines, maintenance has done pretty well, and this trend has been ongoing for two or three years, with organic growth of 8.2%. Licence is flat, and I will discuss that in the analysis of Q4. Flat does not mean that everything was flat; some business lines and business segments showed strong growth and others were really flat. We have seen good traction and good success on the suite deals, the B2B deals and the API deals. But the MFT deals decreased a little bit, but as we released some major new products in Q4 last year, we think we will be able to increase that business segment again.

Services grew slowly at 0.4%; the offering there is also in a transformation stage, following the trend on API and new services, so all in all it was good.

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What happened in Q4? We had a big Q4 in 2012, so the comparison effect was difficult. Our goal was to do in France what we did in 2012, when we reached 2.9% organic growth. The rest of Europe and Asia-Pac was a little below our vision, and the US did minus 10%, mainly because of licences.

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Regarding licences in Q4, we missed EUR5-6 million, coming especially from the US. There were two main things: we had a plan over 18 months to deliver compliance solutions to enable our healthcare clients to comply with new regulations in the State of California.

Those involved pushing all drug manufacturers to implement ways to track and trace their product lines at factory level and retail level. The idea was to make sure that the pill you buy is really the one that has been produced, so there are no counterfeits in the supply chain. This was a good measure, as sometimes people try to buy pills in a country where the price is lower and try to sell them in a country where the price is higher. In Thanksgiving, the Federal Government oversaw the regulation and implemented a country-wide act called the Drug Quality and Safety Act. A milestone of 2014-2015 was put in place, and the criteria were also smoothed a little, so that automatically pushed out some important deals from our pipeline to 2014, as well as some deals in MFT.

Therefore, healthcare is not only based on this track-and-trace business, but also the traditional MFT and B2B businesses, which went well, so that compensate the problem for 2013. We are catching up and are focusing on delivering for 2014.

Maintenance is steady and services are a little up at 2.3% organic growth, which was a good sign for 2014. We are starting to see a demand for services around API in product consulting and B2B and MFT around managed services.

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All in all, if I look at the different regions, we have the same balance. The US and North America is the first region for Axway at 38% of total revenues. France is second at 35%, and the rest of Europe is at 24%. I just want to remind you here that we have some presence in Asia, at just 3% of our total revenues, but it is key to helping the big accounts we are serving in the US and Europe, as they operate globally. By activity the business model is the same in terms of balance as in previous years. Maintenance, which is a recurring part of the activity, was at 45%, licences at 32% and services at 23%.

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Now I would like to illustrate a few success stories that will show you what we do, how we serve our customers, and what kind of value proposition we have. First customer, the “T car” was one of the first to be produced automatically, so this big automotive manufacturer in North America and worldwide had a tender to refresh and consolidate their B2B infrastructure, to integrate some applications, to connect better to suppliers, to connect better to dealers and smoothen the supply chain, and also to integrate and send information to government agencies. Therefore, they tried to develop their offering for their partners with a self-service on-boarding technology that permits them to connect automatically to the information system and provide end-to-end control and visibility. We are pretty proud of that deal, because as you can imagine, IBM and others were trying to win this deal.

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This is an example of governing the flow of data in an MFT world, here in terms of the finance sector, regarding on-boarding partners and data.

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The third was another partner in the life insurance sector same kind of ROI.

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Here we had the pharmaceutical supply chain with traditional partner on-boarding and integration.

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Regarding the insurance world, the problem was how to deliver new services to increase the turnover by 30% in three years around a new mobile offering; that was the mandate from that company. The key point was how to integrate some internal services with the outside, securing web services, and improving the governance of the SOA architecture. Our technology is product-based, is secure and is much faster than doing in-house development. That is an example of a company which had to redefine its business model to leverage utilisation.

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This one is Telstra a telco company which is the leader in Australia. The challenge was to integrate new services, because they have a huge network but do not really monetise it. The way to do that is to create APIs on top of it, so people would pay to access the network and exchange data. Here, using products from Axway, they reduced the time to market, will reduce development and maintenance costs, and will leverage the security access we have.

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The next example is also about leveraging the digital economy, but here for internal use. This big pharmaceutical company based in Europe, with its headquarters in Switzerland, has a project to deliver new applications to their workforce – salespeople, R&D, HR – all around the world, so that means about 65,000 devices all around the world running on iOS, with 49 applications and 500,000 transactions daily. The same thing arose here in terms of how to set up an infrastructure very quickly and make the data secure, so they chose Axway's API technology.

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This one is a little more traditional; this was a subsidiary of a world leader in luxury, and their challenge was to govern the flow of data which was not so typical for their business, as they are mainly selling products that are not so much impacted by digitalisation, so they wanted a provider who would only manage their internal and external flows for 2,400 stores and 84,000 employees. They wanted someone to roll out the infrastructure and deliver the maintenance evolution, with very demanding SLAs, at 99.99% availability. That was also a win against some strong competition, and it was also in France and delivered in the cloud. That shows we can win market share in the cloud, targeting the premium side of businesses, and can be a good and reliable partner for a large account.

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The last one was an International bank which is also present in France. Here the point was to do some business activity monitoring on top of financial applications, also monitoring some of our components, like an accounting integrator and CFT. That solution provided visibility to business lines and has been implemented very quickly. Therefore, you see through these examples that we are providing value in traditional business cases MFT/B2B and also emerging ones like digitalization economy. Our positioning is around governing the flow of data, because in two cases we also provided governance on top of moving data is really the governance and this is what there are looking for.

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I will give some metrics on the business, starting with the licences. The number of deals was relatively stable, but Tier 1, where business was over EUR250,000, went up, and our strategy is to deliver more business to the biggest customers. Indirect business has decreased a little, moving from 12-10%. The new business went from 10-8%, which is not surprising, because our strategy was to cross-sale our customer base after the acquisition, so we did not go for new names but tried for new references on additional product lines in the existing accounts, still 8% of new business is a good number for a company like Axway. The average sale price went up in all segments.

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The FSI vertical did not grow so much, remaining stable compared to last year. Supply chain and healthcare grew significantly through the A5 push and B2B push. Public sector was down. However, in all these areas the Suite has been a success, and we have seen a move from single component sales to suite-level sales. You might say that if suite levels are going up component levels are going down, which is true; that means that people today are not really interested in deploying technology but to set up new infrastructures to refresh their business model.

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Regarding maintenance, the total contribution was EUR106 million or 45%. The two main factors were the attachment rate, how much maintenance you sell when you sell licences. We improved that attachment rate, and it reached 19.4%; it is a good number. We are not trying to be aggressive but to provide good value to our customer base, and to reach around 20%, so we may have to improve a little and then keep it at that level. Regarding the renewal rate, how much we are renewing revenues from one year to another, we reached 93%; above 90% you are in the good part of the market, so 93% is a good result. This is the result of a new level of services, meaning people going from standard to premium offerings with more services and more 24/7 consulting. It is also about consolidation of maintenance, where two companies which merge also merge their maintenance contracts, so this takes into account non-renewal of maintenance.

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Regarding headcount, staff has been stable in number from 2012 and 2013. Regarding quality, we did a good job in strengthening the management structure, and also on-boarding people who could be meaningful at suite level in terms of product development, marketing and management, as well as the salespeople who have a Tier 1 profile, able to sell to large accounts and understand Axway's value proposition.

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In terms of the cost analysis, the gross margin has been improved a little to 69.6%. Further sales, marketing and operating expenses have also grown; if you want to grow your top line and have good efficiencies you need more salespeople, so we are investing there. We also had to invest around Vordel to make technology known. Research and development grew slightly, but we have more to worry about in terms of the next steps in integrating Vordel. We are not making a big push in terms of staffing, but we are going to grow the investments in R&D, and we have a strategy to invest year on year in the product line and to keep it smooth. G&A and other costs grew through the effect of the acquisition. The operating margin went from 15.6% to 15.8%. I will now let Patrick comment on the accounting and financial results.

Accounting and Financial Results

Patrick DONOVAN
Chief Financial Officer, Axway

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I will present the 2013 financial results and give some commentary. As Christophe mentioned, we grew our total revenue to EUR237.5 million, a growth of 5.9% over the EUR224.3 million for the end of 2012. We saw all our product lines grow, in licence, maintenance and services. Our gross profit finished 2013 at almost 70%, an improvement from the 68% we experienced in 2012. This was the result of controlling our cost of sales, both in product revenue and services, while growing our total revenue.

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Our profit on operating activity ended the year at EUR37.5 million, or 15.8% of total revenue, versus EUR35 million or 15.6% for 2012. When you look at 2013, you see the full effect of the Vordel acquisition and the amortisation of intangible assets, which reached EUR3.7 million for the year. As I discussed in the first semester results presentation, our other income and expenses take the effect of the Dollar6.2 million settlements in the GSA matter with the US Department of Justice.

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Additionally, in the first semester presentation I discussed the impact of the valuation release on the US tax assets based on the US operating performance over the past several years. That had a positive impact of approximately EUR13.7 million on our income tax line for 2013. Our net profit ended at EUR35.6 million, or 15% of our revenue, while in 2012 it was EUR34.7 or 11%. Our basic earning per share ended at EUR1.75, versus EUR1.22 in 2012. If you remove the effects of the GSA matter and the income tax valuation release in the US, our basic earnings per share would be approximately EUR1.33 for 2013.

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Our balance sheet is quite stable, improving to total assets of EUR392 million for the end of 2013. We improved our DSOs, our day sales outstanding, to 90 days from 102 at the end of 2012. Additionally, we were able to improve our cash to EUR49.2 million for the end of 2013, versus EUR35.4 million for 2012. Our total shareholder equity ended the year at EUR258 million, while our bank debt outstanding at the end of 2013 was related to the Vordel acquisition at the end of 2012, at EUR35.1 million.

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Our changes in equity were quite normal for the year, improving to EUR35.6 million for the period, and also showing dividends paid of EUR7.1 million resulting from the 2012 operating results. We were able to generate EUR28.3 million from our net cash from operating activities, and our free cash flow was EUR24.7 million for 2013, while we invested roughly EUR4 million back into general equipment and other operating activities. For 2013 we were able to improve cash by EUR13.8 million.

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All our bank covenants for all three years presented have been clearly and comfortably met, and we continue to have EUR50 million under our revolving line of credit available to us through to 2016. We had no change on our shareholder structure during 2013; that remained quite stable, and our shareholders continued to own approximately 60% of the group shares outstanding.

Positioning and Strategy

Christophe FABRE
Chief Executive Officer, Axway

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On the positioning and the strategy, first let us look at the global economy. Regarding expected growth for major countries, Europe is forecasting roughly 1% for France, 1.7% for Germany, 2.4% for the UK, with the US reaching 3% and above in 2015. The emerging markets slowed a bit compared to what we have seen at the beginning of the decade. That means an economy which is pushing between 2-3%.

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The middleware market, which is our market, has a lot of players with a lot of different offerings and represents roughly USD22 million. That should reach EUR28-29 million in 2017, which is good growth, but this market is subject to a big transformation, with cloud, mobile, social networks and big data being big drivers generating growth. At the same time we should look at the performance of IBM or Oracle, Software-AG and others, which are not at 7%, so it is about trying to understand the emerging needs of the customer side and adapting their offerings to leverage these opportunities.

Therefore, adaptation and transformation are the terms we hear from customers. They have to become adaptable enterprises, changing scale and speed, leveraging data to offer new services and operating much more efficiently. These is why enterprises are not investing so much in traditional technologies and are really thinking about how they can evolve in their business models and what kinds of tools will help them do that.

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I think, given the quality of the deals we have closed lately, that we are on the way to serving these needs. The market is diverging and people are not buying a lot at the moment, and it is still a market of early adopters, but when it becomes mainstream, people will not be talking about it so much and that is when the big orders will come. So in the integration middleware space, you have a lot of technologies, and you basically have three kinds of players. You have the players who are focusing on internal integration; their revenues are not going so much to the ESB people or those working on analytics, but rather to big data. If we look at what they are doing, a lot of them are taking positions in big data and trying to update their technology.

Then you have the people in edge integration, B2B integrating applications between ecosystems between the inside and outside, and that is where we are, and the revolution is in API. It is about connecting people and cloud, mobile, and social networks are just additional sources of data we have to cover. Then you have outsourced integration, people who do not really care about owning the technology, like the deal we did in France, where they ask their provider to manage everything for them, and it is usually in the cloud.

Regarding internal integration, there is also an emerging trend for providing that technology in the cloud, but you do not see all this technology moving to the cloud for a simple reason. We are serving big customers with big volumes, who have flows with other entities that need to be secure because of liability issues, regarding credit card numbers, patient X-rays, etc., so they do not want to put them in the cloud in case something happens. We think the cloud is secure now, but you still have to trust your partner to handle things that are very important to you, which is not always the case.

Finally, if you are in integration, which is the case with most of our customers, it is a way to differentiate yourself the market because your customers are so varied. Then you want to run it, because you want the ability to invest and to customise, especially because you want to deliver new data abilities, and most of our customers expect that from us.

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Regarding the trend to B2B, cloud, mobile and social, these are exploding. We made two predictions last year and the year before, that there would be an explosion of investment by 2017, and that over two-thirds of all new integration flows would go outside the enterprise side, so most of them would be at the edge, not inside. By 2016, companies will spend 33% more on application integration technology, so that sub-segment of the middleware market will grow significantly, and by 2016 the integration of mobile devices will represent 20% of these two-thirds of additional flows. This means a new distribution channel for each company, a new way to reach customers which you need to take care of.

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How are we doing? Digital strategy; what tools are we proposing to help people do this digital strategy? By the way, we are seeing customers going in this direction now, and when you want to connect mobile, cloud and also the Internet, you feed information to a company with an API, which is a kind of data plug you expose to the outside world. That plug is new, because it is a technology which deals with huge volumes, because the flows you have with mobile or cloud is phenomenal, and you need security. It has to be hacker proof, and it has to be governed, meaning it needs not just a new standard but all the know-how we have developed in B2B. You need to apply the same techniques and methods as in the traditional way to govern a relationship with a business partner with the B2C world.

The first thing is monitoring SLAs. You have a commitment to your partner that you will deliver this application that fast by so much every day; you want to monitor that relationship in terms of how much it is consuming, what is going well and what is going wrong. One of the key problems with B2B has been how to on-board new users and developers very quickly, not in two months but in two weeks. You need to apply policies to make sure the right data is going out and it is encrypted. There needs to be security to protect from outside interference, but you must also make sure an inside party is not able to read the data on a hard drive. You need to integrate this into your internal applications, and that is what we do in governance.

We do that for the API world, the emerging world of digitalisation, and also for the existing business we have. We see that the new components we released in Q4 in particular are going to help people to operate better, to be more efficient, because to open your system and make it adaptable, it must also be more efficient inside. A lot of companies already have tools to handle files internally, and a lot of them use open source or free technology. The flows powered by this free technology have failure rates that average 6%; 6% of the flows are in error, so a lot of people are trying to fix the flows, and there is liability in terms of auditing. Our tools, from managed transfer space, and the tools of that industry in general, is have a failure rate close to 0.02%, you understand that there are fewer problems with the units, fewer people to handle the technology and to correct it, and fewer people to on-board, which definitely helps the bottom line. It also provides a good system internally to feed your digital strategy.

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Our positioning and new offering have been recognised by Gartner. It is interesting that this is the first time we entered the leader quadrant, even if we do not compete face-to-face with all the offerings, so Gartner confirms that we are specialists in this business like Tibco or Software AG. Regarding application service governance, with Vordel we took a very interesting place at the top of the right quadrant, and that is good news, because analysts and customers can see the value of the new Axway.

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The landscape is wide, so you have the generalists who try to deliver everything to everybody, like Honda or Ford in the car industry. Then you have the specialists who are targeting niches, which can be very big, so if you want a fast car or a four wheel drive car you go to a specialist like BMW or Range Rover. Our positioning is unique, more and more differentiated by the governing data flow approach, which has two legs, MFT and B2B, where we are expanding, and the API world, where we took a leadership position with Vordel. The second pioneer, the first mover in the API market was Layer7, acquired nine months after we acquired Vordel buy by Computer Associates, which is not really a specialist, as they are a specialist in computer security and web applications, so that was good news for us. Therefore, we have a big opportunity to grow here without facing the big guys.

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Therefore, we confirm our project. We confirm that we have an opportunity in the digital economy; we have the right positioning, and we have the right offering to help the customers who have already invested in Axway to go to the next level through the strategy of governing the flow of data. Our Suite, which mixes API and governance tools, has been pretty successful, and this vision can take us to our 500 million we are targeting. We will work on new acquisitions to reinforce that target.

The last point I would like to make is that we have strengthened our operating structure to grow the company to 500 million, with new management pillars and a strong internal programme to help people buy and implement our technology. That is the trend of our good news. You can see that in the years 2002, 2003 and 2004 we also went through a major transformation of our market, and that is where our middleware was really born; in 2012, 2013 and 2014 there is another transformation, but here it was more on the customer side than in the IT department. However, the opportunity for the middleware world is real.

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Regarding the outlook for 2014, the economic environment is getting better, but not very quickly. The IT context is evolving through the evolution and transformation of our customers, but we are also evolving and continuing our transformation. We are trying to leverage all of that with a better offering and better positioning. We will work on some acquisitions to develop the features in the Suite, with new tools to govern the flow of data, but we will also work to expand our distribution network, for which we have the customer base, most probably through the verticals, in order to see where there are flows which are valuable and where we can help people govern them better.

The guidance is significant total growth in 2014, meaning organic and probably external combined. If we have good growth on the top line, the operating margin should be improved; at minimum at should be maintained. In summary, we have a rebound; we can see that things are getter better, more in line with vertical investing. I am confident in our offering, I am confident in our position and I am confident in the team we have, and in the medium term I think we will get to our target for organic growth and margin.

Questions and Answers

Operator

We have three questions on the web. The first one is: What was the size of the API in terms of the growth in actual revenues in 2013?

Christophe FABRE

We did around EUR10 million in 2012 (size of Vordel); we expected growth greater than 20% in 2013, just for the API business by itself, but the real growth around API was bigger, because we had some combined deals, where we combine API and MFT or API and B2B, and the size of these has made us more competitive. We wanted some deals on MFT or B2B because we have API in the portfolio and we connected all the components together. So, it is significant, and it can be repeated in 2014.

Operator

Thank you. Our next question is: When you mentioned the cloud as a foundation, what is Axway's share in terms of the cloud for the coming years?

Christophe FABRE

It is not only cloud as a foundation. I think the point concerned governance, API and cloud. API is a foundation, because any information or any process must be exposed through a mobile or something like that, so you have to API everything. So even if you are moving a file, you might be able to tell from the mobile where that file is. Governance is really the added value we can bring to a customer as a specialist, and regarding cloud, because some of them want to consume that technology from the cloud, we are now ready to deliver our suite from the cloud. It is not a shift of our business from on-premises to the cloud, because the large customers still want some on-premises, but it is an opportunity for us also to deliver in the cloud for people where it is less strategic. The revenue in the cloud is still not too significant; we are coming close to 10%, but we had a good growth year and we are investing, and we are building some references for the future.

Operator

The last one is: For the last two years, licence revenue was flat. How will Axway change this trend to obtain significant growth in licences?

Christophe FABRE

So, the first thing is to sell what customers want. It sounds straightforward, but we have seen the demand evolving, and for a while that made licence flat. In 2013 in the US, for the reasons I have explained, we did not grow our licence numbers, but we saw quality growing. I will mention, regarding the first question that the API growth is significant, so the size of API is going to grow in terms of sales. We just released some new products at the end of the year for governing MFT and B2B more effectively, so we are also working here to find growth in our traditional business.

Therefore, I think that this should help us. Our ability to execute has also been strengthened in order to find growth on the licences again. I would also say something on API; a lot of people are thinking about their digital strategy, they are thinking about buying, but it is not yet a mainstream market. I hope we will reach a point soon where it becomes mainstream and everyone understands what are the problem and the solution, and then buy the solution. At the moment a lot of people are still trying to understand what the problem is, and then they start to discuss the solutions. So I still think we will see some growth in the future in MFT and B2B, but API and governance are going to pull Axway forward step by step.

Operator

Our next question comes from DSF Markets. Could you give some details on your acquisition strategy?

Christophe FABRE

Our acquisition strategy has multiple axes. The first two ones are really of equal importance for us. The first one is obviously trying to do the same thing we did with Vordel, finding a technology that can broaden our reach to customers and the scope of our offering, and to govern a middleware that has to do with a lot of complex problems. We are not yet at the point where we have the product for the problem, so we can still enrich it. Governance is a big thing, and integration is a big problem. It is also just as important for us to get a bigger customer base, an ecosystem for each ecosystem and a vertical for each vertical, to be more present and to grow the business. It is always much quicker to buy a relationship with a customer than to attract new customers; it takes a year to two years to do this, to penetrate. When the market is mainstream in API, we should take in a lot of customers, but it is still not there.

Therefore, vertical innovation and differentiation are the two main axes. The third one is geo-presence, but for me it is a second priority. We can still be bigger in the US. We are still not at a critical mass in the UK – you have seen the numbers. The rest of Europe and Asia are up and down because we do not have a critical mass there, so if we had more critical mass in the UK it would be better. We can still strengthen Germany and we can still strengthen France; the market is there and there are still opportunities. However, in B2B it is a fragmented market and we have a lot of small players in verticals and geos, so you cannot just have an organic strategy – you have to add consolidation to that, so that is what we want to do.