# Axway – Web Audio Conference

## Summary

# Axway Half-Year 2013 Results

Christophe FABRE

*CEO, Axway*

Hello, good afternoon, good morning, welcome to this conference. So we are going to cover the results of half-year 2013. The content of this presentation will be first some comment and analysis on the activity, then my colleague Patrick Donovan, CFO of Axway, will comment on the accounting and financial results. I will then take over on the positioning and the strategy of the company, then we will enter the Q&A session.

First we need to comment on the revenue breakdown by region. Our first region, America, had a growth of 5.1% for this first semester. After a good start in Q1 with 15.7% we have a slower quarter at minus 2.5%. I think some slippage and lack of execution on the closing explains that in Q2, but it is not something which is really significant. I think the momentum in this zone is still strong, and we should catch up in Q3 on the slippage.

The second region is France, with 6.2% organic growth in this semester. After a good start of 6.8% we have a Q2 of 5.7%, which is a showing a rebound of the activity; there are now three quarters where we are back in positive organic growth, and that is really a good sign.

The rest of Europe is at 1.2% organic growth at the end of this semester, which is a very contrasting landscape, with the second quarter at minus 9%, the third quarter at 12%. Here we have some countries where we do not have a lot of customer base, and so we can have some ups and downs quarter to quarter; it is really linked to large deals.

Asia-Pac, to end the region list, is at 17% or 18% organic growth. There is consistent growth in Asia-Pac, a smaller number, but it is adjusting in a region which is used to leap-frogging technology.

Going to the analysis by business line, the licences end up at 1.6% for the first semester, the first quarter at 5.5%, the second quarter at minus 0.9%, explained by some slippage in the US and a little bit in Germany, but this kind of flat plus resulting from the semester includes trends that are not flat at all. We can say that the traditional business of a single-product solution appears to be slowing down, and we see an increase of coverage of business with multiple products combined, so a traditional trend integration with convergence of technology. We also see a very positive trend on API server mobile technology, where the growth was around 40% in the first semester, so the flat result is not at all flat, and I think it is good for the future, where the emerging part of the business is going to take over in terms size.

The maintenance is strong at 9.5% organic growth in the first semester. Two quarters were very solid. Here is mentioned a very proactive effort by the teams to propose to enterprise customers additional levels of service to handle their mission-critical implementation, and it has been very welcome.

Regarding services, the activity is flat, following the licence momentum in the last quarters. It should catch up when the project we signed in Q4 last year will start becoming active.

Regarding the balance of Axway's business model by region, you see that America is growing and becoming the first region, with France and the rest of Europe getting further business in the quarter. Asia-Pac is up 3%, but in fact it is probably more important than that, because a lot of deals we do in the US and Europe are conditioned because of our presence in Asia, so we sign large accounts because we are also present in Asia-Pac.

The split between maintenance, licence and services is not representative of the full year because we have more licences in H2, but you can see the nice portion of recurring business through maintenance.

The headcount at the end of this first semester is rising to 1,798 compared to 1,774 in 2012 at the same period. France is flat, as well the hirings that happen outside France, especially in the US.

Going now to the cost analysis and cost of sales, product revenues, which are maintenance costs and OEMs, were flat as a percentage of the revenues, contained to 9.9%. Services are flat in terms of absolute value, at 25.4% in 2012 and 25.7% in 2013, with a better margin compared to the volume of business, which is slightly up. Here there is a shift of activity; after the services activity we are focusing more on emerging technology, where we help our customers to really leverage emerging technologies like API servers. We also have investment in cloud which we are boosting and which is starting to take off. Regarding services, we kept the headcount and focused the staff on the coming growth. Therefore, gross profit is up from 64.1 to 65.9.

Regarding operating expenses, the differences between 2012 and 2013 are mainly coming from the integration of the Vordel business we achieved in Q4 last year. Sales and marketing is at the same level as last year. Resource and development are the same, G&A is the same. Therefore, this is exactly the same effect; we are repositioning and refocusing, for instance, R&D resources to the emerging technologies, we are briefing our key sales and marketing staff on the emerging solutions, and they are focusing on them now.

The profit on the operating activity, in the end, is rising from 5.6% to 6.7%, so you will have understood that mainly as an attempt to manage cost; efficiency improvements may come later.

Summarising the first semester, in France there has been an issue in 2012, but a rebound is now confirmed, which is really good news, and we are really working on our customer base, and they are buying new products and also opening new accounts. I will comment more on that later in the deal analysis for S1. Regarding the rest of Europe, it is a disparate landscape from one quarter to another and one region to another. Aside from Germany, we do not really have a strong customer base in these countries. Q2 was slow in the US, but the momentum is real, and I think we will see that later in the year. There are a lot of opportunities to be leveraged in Asia-Pac.

Regarding the licence side, a transformation of the activities is ongoing, and we are seeding for the future on where we think the market is going. Maintenance showed a strong performance, which is stabilising the financials of the company, and services is still linked to licence performance, so we are doing the same shift on the licence regarding where we are focusing our teams.

Regarding some deals in H1, I did not organise them by account or size; I tried to take some deals that were representative of the low-level signals we see in this transformation of the business. You will see that our new version of the suite called Axway 5, the fifth generation of Axway technology, is taking off. The first reference here is a company that is processing a lot of payment on the Internet especially, and they acquired Axway 5 to handle the flow of this financial data and meet stringent SLAs.

The second example is a company which is managing health records in the state of Washington, and they already owned our suite and had the API server, which is opening to mobile integration. This is to show the cross-selling potential we have with the Vordel acquisition we made last year and will leverage in the future.

The last one is an interesting one, because this company, which is a competitor of Intel on mobile, has chosen Axway as their sponsor technology to allow enterprise to connect internal resources and sensitive data to their own system. That is one we are very proud of, because here we are working with people on the edge of a mobile trend.

Going to France, as I mentioned the first project is a brand new opportunity where we are selling Axway 5 to govern all the data allowing the collection of a tax the government has set up for vehicles, depending on how much they pollute the atmosphere. Castorama is a company that has acquired Axway 5 to govern store-to-corporate data, which is another example of the flow of data. Around 300 stores will be effectively using our suite. The last one is two ministries in France, the Ministry of Defence and Ministry of Economy, that are exchanging data on expenditures for a workforce of nearly 300,000 people.

Regarding the rest of the world and an example of a shift at BMW, BMW is not shifting, they are a very important reference of ours in B2B, but they are now also a reference in the API server in their attempt to implement the connected car, all these new services that you can get in your car that are connecting and using data through mobile technology. BMW chose us especially for our secure authentication features. Porsche was a traditional B2B customer but now is starting to use MFT; it is also an example of cross-selling in the existing portfolio. The last is in Australia, an electricity network which is using their API server to connect cloud and mobile, especially smart meters, so that is another example of what people were using and how they now use our technology to keep in touch with the state of the art.

Now I will pass over to my colleague Patrick on the financial results.

# Accounting and Financial Results

## Patrick DONOVAN

*CFO, Axway*

Total revenue for the first half of 2013 ended at EUR106.4 million, which represented 8.1% growth over the first half of 2012. Gross profit, as Christophe mentioned, increased to 65.9% for the first half of 2013 over 2012. Because we were able to keep our overall costs in line, growing only 6.8% in the first half of 2013, we had a profit on our operating activities of EUR7.1 million, which represents 6.7% of our revenue. This is in comparison to 5.6% for the first half of 2012.

Our operating profit in the first half of 2013 was impacted by, first, an increase in our amortisation of intangible assets. This is coming from the Vordel acquisition we did in November of 2012. Second, we took a EUR4.7 million provision, which was recorded in the US, on the GSA matter. Our income tax benefit resulted from a first-half 2013 release of the tax valuation reserve of the US subsidiary's different tax assets of EUR9 million. Our net profit for the first half of 2013 was EUR9.8 million, or 9.2% of our revenue, versus EUR2.6 million or 2.6% of our 2012 first-half revenue.

Total assets for June 2013 ended at EUR398 million. Our cash balance ended at EUR54 million, and our accounts receivable at EUR58 million. Our accounts receivable outstanding for the first half of 2013 was 80 days versus 102 days at the end of 2012. Our total liabilities for June 2013 ended at EUR159 million; this includes EUR40 million of bank debt coming from the Vordel acquisition, with EUR58 million of deferred revenue. Our shareholder equity at the end of June ended at EUR239 million, which includes the EUR7.1 million dividend which was paid in June 2013.

We increased our cash balance for the first half of 2013 by EUR18.7 million, and as usual in the first half of the year, we had positive changes to our operating working capital requirements of EUR19.8 million coming from our collections of our maintenance accounts, as well as our good selection of our Q4 activity from 2012. This compares to an EUR18 million change in operating working capital requirements for the first half of 2012. Now, a reminder that the income tax paid net accrual includes the EUR9 million valuation release I mentioned previously.

Our financial structure remains strong, and we are in line with all our bank covenants for the first semester end of June 2013, as well as all other periods measured. Now back to Christophe.

# Positioning and Strategy

## Christophe FABRE

*CEO, Axway*

Regarding positioning and strategy, we are in the market of middleware, which is a huge market, EUR20 billion in 2012, forecasted at EUR29 billion in 2017. We are a segment of that, but this is just to show that this world is growing. What those numbers and that survey does not say is that there is a cloud impact, which is not measured here, as the cloud is growing outside of that, but the habits of buyers are evolving through this cloud growth. Where you are able to consume technology in pieces in an open structure, when you are buying software on licences you may also want to buy that piece by piece, and I think the habits are changing here, and that is an impact from cloud.

Our business is not really cannibalised by cloud – we are not really selling cloud where we are selling licences – but we have to take that change of habits into account. This market is also made of ups and downs. Some traditional middleware is seeing their adoption stabilised, because a lot of enterprise companies have already equipped their systems, and you see other segments growing a lot, so there is a balance here that has to be taken into account.

We have invested in the convergence of these segments. The Magic Quadrant, which is applicable to us, which is the on-premises integration application suite, has been released and Axway, for the first time in its history, has taken a leadership position. There are very different companies in this quadrant. The two generalists which are giants, Oracle and IBM, are selling the old style to everybody but for standard usage, as you would buy Honda, GM, Peugeot or Fiat as a family car, and then you will find some specialists, such as Tibco for real-time software for processes, and Axway for governing the flow of data. Microsoft is there because their operating system is still one of the best choices.

Therefore, that shows that in our attempts to match with demand for convergence offerings, our investment in Axway 5 last year is being recognised, and that is good for the future. However, this quadrant also shows the static vision of the market, so the market is going to evolve. Regarding the three major architectures we have seen in the past, in the 1980s, architecture number one, you would have a few applications, not very well integrated, in the centre, back office, front office and middle office, an ecosystem that was quite small. Regarding the 2000s, with the need to reuse technology and have an IT system that was more flexible, IT was really trying to capitalise on their efforts, and SOA was born, and that was the beginning of middleware.

Now, the architecture of 2020 will effectively live at the edge, a bigger ecosystem to feed with data and to get data from, this ecosystem being based on cloud and mobile technology and also just classical information systems interacting with others. The technology that is going to be delivered to govern these flows and to manage the volumes which are increasing exponentially is API, and we are really investing to leverage that change in Axway because it is central to what we do, B2B in a way becoming B2B and B2C.

One of the key points, if you have a lot of flows and the number is exploding, is how you govern them, and that is what we worked on in our Axway 5 suite. The key word in governing the flow of data is governing, so the main preoccupation of IT and even business is how I govern that flow, how I bring new partners and clients on board, how I manage this community, how I guarantee them SLAs, and also how I guarantee they will only use what they are supposed to use. How do I guarantee that, as I open my system, my system is secure? How do I integrate these flows to my internal applications? That is the whole spectrum of governance.

Therefore, we are really focusing on managing two kinds of flows, ones that are mature and are converging, files, MFT, ADI and B2B, and the new flows, which are covered by APIs. We have invested in a unique platform that will be able to manage both the mature flows and the emerging flows with a very strong governance tool. That technology, which we started to release in February this year, will also be recognised as the equivalent of a governor on application services governance, and we will take a very nice position there in a new Magic Quadrant..

Therefore, this Axway 5 technology and this positioning on governing the flow of data will strengthen our strategy. Regarding the market, at the bottom of the middleware market you find the giants, Oracle, IBM, SAP, and Microsoft, and we are trying to give everybody a standard solution. Some specialists have also emerged, as in all big markets, so we already have a track record of some successful companies that went in that direction; Informatica, specialising in data integration, Software AG, specialising in processes and SOA, Tibco on SOA and real time, GXS on B2B outsourced, and Axway which is also making a path as an emerging specialist here.

How we differentiate compared to these guys is that we have the best solution to govern the flow of data at the edge of the enterprise, and whatever is crossing the edge, we can manage. We have some competition from niche players, but the niche players are not covering the breadth of what we cover; they do not cover all the edge. These people do not have the breadth to be a single solution in order to sit at the table of a CEO, and that is really key for us.

That tells us that the change in vision we made last year is really in line with the market evolution. Governing the flow of data in this position enables the EUR500 million target we want to reach in 2015, and maybe we will go beyond EUR500 million if we are able to accelerate that momentum with acquisitions, and that is something we are working strongly on. There is nothing to announce in the short term, but now that we have a strong technology, we will be able to deliver value to customers that might now be working with vendors who did not invest in the breadth of that.

It is a business model we also used in the past, because in the early 2000s we invested in a platform, Generation 4, (Synchrony platform) and then we acquired Cyclone, Tumbleweed, then Actis, then Vordel. We are going to deliver the value of that synchrony platform to our customer base, and with Axway 5 we have a vehicle for consolidation that will be very strong.

This transformation is taking time but is executing well. We have strengthened our operating structure, we have strengthened our processes, we have strengthened our management capabilities, we have finalised and completed the Vordel integration, and this is starting to impact the pipe. I think the pipe of Axway 5 is strengthening and growing, and as I was saying before, 1.8% of growth in this semester hides a deep evolution in our positioning. It is also penalised by cloud investment, because this platform, which is mainly on premises, is also set up to be used in the cloud. This Axway 5 suite can also be consumed in the cloud, for people who would like to start slowly, or to have some sort of extension in the cloud, with an infrastructure which has pieces on frames and pieces in the cloud.

Services are working to make this happen, and we are working on the first reference and have some good first signatures. Further, to be a specialist and to be present in the market, targeting the large enterprises, we invested a lot in our maintenance services to be able to commit on some mission-critical resellers for our large customers, and that translates to a strong growth in maintenance.

We confirm our outlook for the full year, but we have to take into account some different points of view. Firstly, on the market there is a technology shift happening, and we also have to recognise that the economic situation is not great in Europe; we are still in a crisis, the US is not growing as much as we saw in the last decade. All the software vendors are impacted, and we are in that trend. The good point is that we have started and are continuing our transformation to leverage that landscape, and I think that we have some low-level signals of that.

Looking more closely at the second semester, we have an encouraging commercial pipe for the third quarter, maybe involving some slippage from Q2 but also some new deals that were not signed in Q2. However, we are in July, and we still have a lot of work to secure Q4, so all in all, we are not changing our guidance. We are staying in positive organic growth for the year, and the operating margin should be maintained.

I think we are done with the presentation, and now we are going to take your questions.

# Questions and Answers

**Operator**

(Sound very low)

Profit from operating activities has increased compared to first-half 2012. What are the reasons for this (structural shift in activities or controlled cost pressure)? What can we expect for S2?

**Christophe FABRE**

I think the question is on the first semester. Is the improvement in the operational margin coming from efficiency improvement or management of cost? I think the answer is that we have managed our cost efficiently by really being careful about where we are investing, shifting our resources from areas with flat growth to areas with better growth. The efficiency may come later, and we have started positioning to help support the growth.

**Operator**

Regarding the second question, (sound very low)].

US deferred tax assets: what is the amount of the provision reversed in your accounts? How much still remains?

**Christophe FABRE**

That is a question for Patrick.

**Patrick DONOVAN**

Yes; in the first half of 2013 we released EUR9 million worth of the deferred tax assets in the US market. Remaining at the end of June 2013 is another EUR27 million worth of deferred tax assets not recognised on the books.

**Operator**

Regarding our next question, (Sound very low)

For several quarters, to explain a slow performance in licences, you have mentioned that a number of contracts have been deferred. Why is this slippage not increasing the following quarter's figures?

**Christophe FABRE**

That is part of why we think we can have a good Q3, and we have an encouraging commercial pipe, even if Q3 is not only based on slippage from Q2.

**From the floor**/telephone

Thank you for taking my question. I have four questions, if I may. The first one is probably for Patrick. Can you help us to assess what will be the impact of CICE and research tax credits you may benefit from this year? That is my first question. My second question relates to the cloud. What will be your best expectation at this point in time in terms of EBIT margin for this business? I know that you will answer that today it is at break-even or slightly loss-making, but I am just wondering if you can help us to understand how the economic model of this activity will work three years from now, i.e. gross margin and OPEX you have to put through the P&L of this activity.

My third question is again – sorry about that – whether you can remind us what is the variable compensation of your sales quota carrying people?. Asking the question differently, what are the variable costs you may have in the EUR65 million sales and marketing spending per year. The first question is again for Patrick.

**Christophe FABRE**

Yes, I think Patrick is going to answer you on the credit for research and CICE.

**Patrick DONOVAN**

The CICE tax rate for the year is not overly important; I would say it will give us about EUR200,000-300,000 of benefits. Regarding the credit on research, we actually pick up a little bit this year with the acquisition of Vordel, as they actually have a similar system as the credit for research in France, so I would estimate that at around EUR6.5 million.

**Christophe FABRE**

Regarding the second question on the cloud and the best expected margin, the thing to understand is that the cloud opportunities, where usually you have a consolidation of the cloud or some asset the customer has, or where the customer wants to move some products from an area to the cloud, usually starts with a settled period. You have a project in this settled period to take his configuration and set it up in the cloud. Therefore, the purpose is not to do that with a lot of margin; that is something you want to decrease to really protect the recurrent part, which could be three, four, five years.

Therefore, we are starting to bring on board some new customers, but we are making the effort not to penalise their investment on the first part. That does not give us a very good margin right now on cloud.

Secondly, we are building our infrastructure, and even if we let third parties manage the hardware, such as Amazon or our people in Europe, we are setting up our operations, people that are going to take care of our cloud solution for our customers, maintain them, make them evolve, support them 24/7, so here we are investing in cost.

What could be the margin for cloud in nominal mode? I think I would answer not with a number but by saying that it is something that should not impact the margin too negatively in the end. The key point is that it is an area of growth, and we have to take it. The real model for us is not to be on premises or in the cloud, because what we are selling are not utilities, but it is true that some customers may want some part in the cloud and others on premise, so we have to be aboard. I think that is a model that has been pursued by some successful companies, and I think that is right for us.

Regarding the last question on the variable compensation and how much we have, I would not answer on how much that impacts our cost line, but I would say that we are on par with the industry. Our compensation is benchmarked correctly in all the countries compared to the market, so we have the same latitude as the others to act on that.

**From the floor**

Can you repeat the CICE impact? I did not catch the number.

**Patrick DONOVAN**

It is EUR200,000-300,000.

**From the floor**

3.3?

**Christophe FABRE**

No, it is 200k.

**From the floor**

300k.

**Christophe FABRE**

300k. It is limited.

**From the floor**

Thank you.

**Christophe FABRE**

Thank you for being with us tonight. I think if there are no more questions, it is time to end this call.