

PSI AG

Germany / Software
 Primary exchange: Frankfurt
 Bloomberg: PSAN GR
 ISIN: DE000A0Z1JH9

Q3 results

RATING	ADD
PRICE TARGET	€13.00
Return Potential	8.0%
Risk Rating	Medium

COMMODITY DOWNTURN, PRICE PRESSURE, RESTRUCTURING CRIMP Q3

PSI's Q3 numbers were weaker than we expected due mainly to a further downturn in performance at the southeast Asian business unit, PSI Incontrol. Management has also identified increasing price competition as a factor in the decision to lower 2016 sales guidance from "a mid-single-digit percentage increase" to "slightly below the prior year level." The company has left 2016 EBIT guidance unchanged at €11-13m, but given the reduction in our sales forecast and management statements on price competition, we have lowered our 2016 EBIT forecast from €12.8m to €11.0m. We have also lowered our forecasts for 2017, 2018 and subsequent years. We assume that the price competition which PSI is currently experiencing is mainly cyclical in nature and will gradually ease as commodity prices continue their recovery from the lows reached in the early part of this year. For this reason the reductions in our forecasts for 2018 and subsequent years are smaller than for 2017. In the light of the reductions to our numbers, we now see fair value for the PSI share at €13.00 (previously: €14.00). We maintain our Add recommendation.

PSI Incontrol/Energy Management pushed Q3 EBIT below our forecast
 PSI's Q3/16 results showed a 7.2% decline in sales to €42.8m (FBe: €43.9m Q3/15: €46.1m) while EBIT came in at €2.4m (FBe: €2.8m; Q3/15: €3.2m). As figure 1 overleaf shows, sales were below our forecast mainly because of weaker performance at the Infrastructure Management segment's southeast Asian business, PSI Incontrol. Low raw materials prices and the aftermath of the 2014 coup in Thailand continue to depress PSI Incontrol's order intake. In addition, PSI has taken steps to reduce the unit's exposure to low margin but capital intensive hardware business. EBIT was below our expectation because of the above-mentioned weakness in sales at PSI Incontrol, but also because EBIT at Energy Management dipped below €1m for the first quarter since Q2/15 due in part to a small loss at the energy trading business. (p.t.o.)

FINANCIAL HISTORY & PROJECTIONS

	2013	2014	2015	2016E	2017E	2018E
Revenue (€m)	176.33	175.39	183.68	175.36	180.87	190.17
Y-o-y growth	-2.5%	-0.5%	4.7%	-4.5%	3.1%	5.1%
EBIT (€m)	4.17	7.66	11.11	11.00	13.39	15.56
EBIT margin	2.4%	4.4%	6.0%	6.3%	7.4%	8.2%
Net income (€m)	0.37	4.10	7.46	7.19	9.16	10.74
EPS (diluted) (€)	0.02	0.26	0.48	0.46	0.59	0.69
DPS (€)	0.00	0.00	0.21	0.21	0.25	0.28
FCF (€m)	-3.85	9.74	11.78	6.03	4.77	5.15
Net gearing	36.6%	33.7%	15.9%	11.9%	9.2%	7.1%
Liquid assets (€m)	21.80	29.31	38.83	36.83	39.25	43.74

RISKS

Risks include an interruption in the current upturn in German electricity distribution network investment

COMPANY PROFILE

PSI makes software control systems, primarily for energy, utility companies and metals producers. Customers also include manufacturers and the operators of transportation networks. The company's control system products are widespread in its core German market.

MARKET DATA

As of 02 Nov 2016

Closing Price	€ 12.04
Shares outstanding	15.70m
Market Capitalisation	€ 188.92m
52-week Range	€ 11.90 / 14.43
Avg. Volume (12 Months)	8,487

Multiples	2015	2016E	2017E
P/E	25.2	26.1	20.5
EV/Sales	1.1	1.1	1.1
EV/EBIT	18.1	18.2	15.0
Div. Yield	1.7%	1.7%	2.1%

STOCK OVERVIEW



COMPANY DATA

As of 30 Sep 2016

Liquid Assets	€ 35.93m
Current Assets	€ 117.33m
Intangible Assets	€ 59.13m
Total Assets	€ 194.44m
Current Liabilities	€ 71.55m
Shareholders' Equity	€ 73.16m

SHAREHOLDERS

RWE Deutschland AG	17.8%
Harvinder Singh	8.1%
Free float	74.1%



End September order backlog equivalent to over nine months sales The group order intake was down 10% at €134m (9M/15: €149m) at the nine months stage. Among PSI's three segments, we gather that in absolute terms, the biggest order intake decline came at Infrastructure Management. Orders at Energy Management also fell after very strong bookings in 2015 which included a €10m order from E.ON. Management tells us that the order intake at Production Management was flat. The group order backlog at the end of September was €132m, 3% above the prior year figure of €128m and equivalent to 1.03x 9M/16 sales of €127.9m. PSI has maintained the 2016 EBIT guidance of €11-13m given in the 2015 annual report. However, unwillingness to lower prices in response to price pressure from larger competitors and sluggish business development/restructuring measures at PSI Incontrol have caused PSI to lower 2016 sales guidance from "a mid-single-digit percentage increase" to "slightly below the prior year level."

Figure 1: H1 results versus our forecasts

€ 000s	Q3 16A	Q3 16E	Δ Q3 16A vs. vs. Q3 16E	Q3 15A	Δ Q3 16A vs. vs. Q3 15A
External sales	42,759	43,900	-2.6%	46,092	-7.2%
by division:					
Energy Management	16,244	16,400	-1.0%	17,274	-6.0%
Production Management	21,518	21,500	0.1%	21,416	0.5%
Infrastructure Management	4,997	6,000	-16.7%	7,402	-32.5%
Total EBIT	2,386	2,800	-14.8%	3,222	-25.9%
by division:					
Energy Management	854	1,200	-28.8%	1,951	-56.2%
Production Management	2,452	2,300	6.6%	1,854	32.3%
Infrastructure Management	-575	-400	43.8%	-327	75.8%
Reconciliation	-345	-300		-256	
EPS (€)	0.09	0.11	-14.8%	0.09	0.0%

Source: PSI AG; First Berlin Equity Research estimates

The electrical energy business is the largest component of the order backlog The Energy Management segment showed a 6% decline in sales to €16.2m (Q3/15: €17.3m). Segmental EBIT came in at €0.9m (Q3/16: €2.0m). We gather that the decline in sales was due to the vagaries of revenue booking dates, as the electrical energy business within Energy Management is the single largest component of the group's order backlog. Sales and EBIT in the electrical energy business were both higher at the nine months stage than a year ago. The oil and gas business is recovering from the oil price low seen during the first quarter of this year. We gather that the business' order intake during the first nine months of this year was not far below the prior year level with orders from Russia up slightly and bookings in Germany down. After breaking even in Q1/16 and recording a small profit in the second quarter, the energy trading business booked a small loss in Q3/16. However, an important license order from a gas and hydro power operator should push this unit's result into the black again in the fourth quarter.

PSI Metals improved its margin despite lower steel prices Production Management's sales were flat at €21.5m (Q3/15: €21.4m) while EBIT jumped to €2.5m (Q3/15: €1.9m), equivalent to an EBIT margin of 11.1% (Q3/15: 8.5%). The largest business within the segment - PSI Metals - has won additional rollout contracts so far this year. Sales have fallen slightly as low steel prices have dampened customer investment activity, but the unit has nevertheless succeeded in improving its margins. Q3/16 profitability at Production Management also benefited from a license contract awarded to the Automotive & Industry business unit by the Chinese rolling stock manufacturer, CRRC Sifang Co. Profitability at the Mines and Roads business unit also improved due to the absence of costs in connection with Chinese mining projects which burdened prior years' numbers. An upgrade order for the



Austrian motorway operator, ASFINAG, and a follow-on order from a UK/Netherlands road project also helped profitability.

PSI Incontrol reduces its exposure to capital/hardware intensive lines of business

Q3/16 sales at the Infrastructure Management business unit fell 32.5% to €5.0m (Q3/15: €7.4m). The operating loss widened to €0.6m (Q3/15: a loss of €0.3m). The largest operation within Infrastructure Management is the southeast Asian business unit, PSI Incontrol. Low raw materials prices and the aftermath of the 2014 coup in Thailand continue to depress PSI Incontrol's order intake. Meanwhile PSI has moved to reduce exposure to low margin, capital/hardware intensive lines of business.

Figure 2: Changes to our forecasts

€m	2016 NEW	2016 OLD	Δ %	2017 NEW	2017 OLD	Δ %	2018 NEW	2018 OLD	Δ %
External sales	175.36	194.48	-9.8%	180.87	208.22	-13.1%	190.17	222.65	-14.6%
by division:									
Energy Management	66.78	74.17	-10.0%	70.12	81.59	-14.1%	74.33	88.93	-16.4%
Production Management	86.54	90.51	-4.4%	88.27	95.94	-8.0%	92.69	101.81	-9.0%
Infrastructure Management	22.04	29.79	-26.0%	22.48	30.69	-26.8%	23.15	31.91	-27.4%
Total EBIT	11.00	12.76	-13.8%	13.39	15.68	-14.6%	15.56	17.82	-12.7%
margin (%)	6.3%	6.6%		7.4%	7.5%		8.2%	8.0%	
by division:									
Energy Management	5.68	6.51	-12.8%	6.41	8.43	-23.9%	7.18	9.64	-25.6%
margin (%)	8.4%	8.5%		9.0%	10.0%		9.5%	10.5%	
Production Management	7.55	6.44	17.2%	8.14	7.31	11.4%	9.02	8.27	9.1%
margin (%)	8.5%	7.0%		9.0%	7.5%		9.5%	8.0%	
Infrastructure Management	-1.07	0.90		0.00	1.11	-100.0%	0.59	1.16	-49.5%
margin (%)	-3.8%	2.5%		0.0%	3.0%		2.0%	3.0%	
Reconciliation	-1.16	-1.09		-1.17	-1.17		-1.23	-1.25	
EPS (€)	0.46	0.58	-20.6%	0.59	0.70	-16.2%	0.69	0.81	-15.1%

Source: First Berlin Equity Research estimates

Net gearing now at modest 17.3%; management examining acquisitions Q3/16's net cash flow from operations of €4.1m was 5.1% below last year's figure of €4.3m. An €0.5m increase in spending on tangible and intangible assets was the main reason for a €0.7m decrease in free cash flow to €3.1m (Q3/15: €3.8m). Net debt (including pension liabilities) decreased during the quarter from €15.7m at the end of June to €12.7m by the end of September, equivalent to net gearing of 17.3% (Q3/15: net debt of €23.2m and net gearing of 32.3%). The modest level of balance sheet gearing means that PSI is well placed to make acquisitions. Management repeated the statement from the Q2 report that it is examining takeover targets in the areas of power distribution and discrete production.

We maintain our Add recommendation but lower the price target to €13.00 (previously: €14.00) The reduction in 2016 sales guidance reflects restructuring at PSI Incontrol and increased price competition in several areas of the business including electrical energy, metals, and gas and oil. Management has left 2016 EBIT guidance unchanged at €11-13m, but given the reduction in our sales forecast and management statements on price competition, we have lowered our EBIT forecast from €12.8m to €11.0m. We have also reduced our forecasts for 2017 and 2018 as shown in figure 2. We assume that the price competition which PSI is currently experiencing is mainly cyclical in nature and will ease as commodity prices continue to recover from the lows reached in the early part of this year. For this reason the reductions in our forecasts for 2018 and subsequent years are not as large as for 2017. In the light of the reductions in our numbers, we now see fair value for the PSI share at €13.00 (previously: €14.00). We maintain our Add recommendation.



Figure 3: Valuation model

€000s	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
Net sales	175,361	180,872	190,167	200,235	210,873	221,265	231,286	241,766
NOPLAT	7,700	9,370	10,890	11,967	14,124	14,517	15,176	15,866
+ Depreciation and amortisation	3,858	3,979	4,184	4,405	4,639	4,868	5,088	5,319
= net operating cash flow	11,558	13,349	15,073	16,372	18,763	19,385	20,265	21,185
- total investments (Capex and WC)	-4,882	-8,210	-9,609	-7,361	-5,061	-7,040	-7,183	-7,509
Capital expenditure	-2,653	-4,635	-5,290	-6,604	-5,958	-6,156	-6,331	-6,618
working capital	-2,229	-3,575	-4,320	-756	898	-883	-852	-891
+/- others (incl. adj. on net int., provisions, etc)	0	0	0	0	0	0	0	0
= Free cash flow (FCF)	6,676	5,139	5,464	9,012	13,702	12,345	13,082	13,676
PV of FCF's	6,596	4,702	4,629	7,069	9,953	8,303	8,147	7,887

€000s	
PVs of FCFs explicit period (2016-30)*	111,482
PVs of FCFs in terminal period	104,852
Enterprise Value (EV)	216,334
(Net cash)/net debt	12,671
Shareholder value	203,663

Value per share (€) 13.04

WACC	8.00%
Cost of equity	9.5%
Pre-tax cost of debt	5.0%
Normal tax rate	30.0%
After-tax cost of debt	3.5%
Share of equity	75.0%
Share of debt	25.0%
Terminal growth	2.0%

Sensitivity analysis

		Terminal growth rate (%)						
		0.5%	1.0%	1.5%	2.0%	2.5%	3.0%	3.5%
WACC	4.00%	28.53	31.77	36.30	43.11	54.47	77.23	145.89
	5.00%	21.48	23.12	25.22	28.03	31.97	37.87	47.73
	6.00%	17.03	17.96	19.10	20.52	22.35	24.79	28.21
	7.00%	13.97	14.54	15.21	16.02	17.01	18.25	19.84
	8.00%	11.75	12.12	12.54	13.04	13.63	14.33	15.19
	9.00%	10.06	10.31	10.59	10.91	11.29	11.72	12.23
	10.00%	8.75	8.92	9.11	9.33	9.57	9.86	10.18
	11.00%	7.69	7.81	7.95	8.10	8.27	8.46	8.67

Fair value per share

*for layout purposes the model shows numbers only to 2023 but runs until 2030

Source: First Berlin Equity Research estimates



INCOME STATEMENT

All figures in €'000	2014	2015	2016E	2017E	2018E
Revenues	175,386	183,682	175,361	180,872	190,167
Change in inventories & capitalised production	0	0	0	0	0
Total output	175,386	183,682	175,361	180,872	190,167
Cost of materials	-33,101	-31,596	-29,636	-29,844	-30,807
Gross profit	142,285	152,086	145,725	151,028	159,360
Total personnel costs	-103,604	-106,820	-107,924	-110,874	-116,002
Net other operating costs	-27,142	-29,871	-22,943	-22,788	-23,618
Depreciation & amortisation	-3,882	-4,286	-3,858	-3,979	-4,184
EBIT	7,657	11,109	11,000	13,386	15,557
Net interest	-2,047	-1,811	-922	-529	-441
Associates	54	140	140	160	160
Pretax profit	5,664	9,438	10,218	13,017	15,276
Income taxes	-1,565	-1,979	-3,024	-3,857	-4,535
Net income / loss	4,099	7,459	7,195	9,160	10,741
EPS (€)	0.26	0.48	0.46	0.59	0.69
EBITDA	11,539	15,395	14,858	17,365	19,740
Ratios					
Gross margin	81.1%	82.8%	83.1%	83.5%	83.8%
EBIT margin	4.4%	6.0%	6.3%	7.4%	8.2%
EBITDA margin	6.6%	8.4%	8.5%	9.6%	10.4%
Net income margin	2.3%	4.1%	4.1%	5.1%	5.6%
Tax rate	27.6%	21.0%	29.6%	29.6%	29.7%
Expenses as % of output					
Personnel	-59.1%	-58.2%	-61.5%	-61.3%	-61.0%
Net other operating income/expenses	-15.5%	-16.3%	-13.1%	-12.6%	-12.4%
Depreciation & amortisation	-2.2%	-2.3%	-2.2%	-2.2%	-2.2%
Y-o-y growth					
Total revenues	-0.5%	4.7%	-4.5%	3.1%	5.1%
EBIT	83.7%	45.1%	-1.0%	21.7%	16.2%
Net income / loss	1004.9%	82.0%	-3.5%	27.3%	17.3%



BALANCE SHEET

All figures in €'000	2014	2015	2016E	2017E	2018E
Assets					
Current assets, total	112,016	120,742	118,018	127,515	138,251
Cash and cash equivalents	29,314	38,831	36,826	39,249	43,738
Trade accounts and notes receivables	33,708	36,169	26,304	32,557	36,132
Inventories	3,468	4,184	6,664	6,873	7,036
Receivables relating to long term contracts	39,865	36,366	40,333	41,600	43,738
Other current assets	5,661	5,192	7,891	7,235	7,607
Non-current assets, total	80,257	78,780	76,678	77,681	79,264
Property, plant and equipment	12,949	12,214	11,398	11,757	12,361
Goodwill	51,000	49,559	49,559	49,559	49,559
Other intangible assets	10,502	9,859	9,469	9,767	10,269
Associates	149	149	289	449	609
Deferred tax assets	5,657	6,999	5,962	6,150	6,466
Other non-current assets	0	0	0	0	0
Total assets	192,273	199,522	194,696	205,196	217,515
Shareholders' equity & debt					
Current liabilities, total	75,695	77,343	69,540	73,735	78,612
Interest bearing debt	5,082	3,374	-1,481	-784	2,165
Trade accounts payable	15,113	14,929	11,048	12,661	14,263
Liabilities relating to long term contracts	26,011	28,819	27,532	28,397	29,856
Provisions	0	0	0	0	0
Other current liabilities	29,489	30,221	32,442	33,461	32,328
Non-current liabilities, total	48,284	49,027	50,599	50,960	51,451
Interest bearing debt	188	83	-36	-19	53
Pension provisions	47,080	46,981	47,216	47,452	47,689
Deferred tax liabilities	1,016	1,963	3,420	3,527	3,708
Consolidated equity	68,294	73,152	74,557	80,501	87,452
Shareholders' equity	68,294	73,152	74,557	80,501	87,452
Minorities	0	0	0	0	0
Total consolidated equity and debt	192,273	199,522	194,696	205,196	217,515
Ratios					
Current ratio (x)	1.48	1.56	1.70	1.73	1.76
Quick ratio (x)	1.43	1.51	1.60	1.64	1.67
Equity ratio	35.5%	36.7%	38.3%	39.2%	40.2%
Net gearing	33.7%	15.9%	11.9%	9.2%	7.1%
Equity per share	4.35	4.66	4.75	5.13	5.57
Net debt	23,036	11,607	8,872	7,400	6,169
Interest coverage ratio (x)	3.74	6.13	11.94	25.31	35.28
Capital employed (CE)	92,685	88,045	84,094	85,665	90,761
Return on capital employed (ROCE)	5.8%	9.7%	9.2%	10.9%	12.0%



CASH FLOW STATEMENT

All figures in €'000	2014	2015	2016E	2017E	2018E
Pretax result	5,664	9,438	10,218	13,017	15,276
Depreciation and amortisation	3,882	4,286	3,858	3,979	4,184
Other	-143	-1,685	-3,164	-4,017	-4,695
Operating cash flow	9,403	12,039	10,913	12,979	14,765
Investment in working capital	14,674	1,971	-2,229	-3,575	-4,320
Net operating cash flow	24,077	14,010	8,684	9,404	10,445
Cashflow from investing	-14,341	-2,234	-2,653	-4,635	-5,290
Free cash flow	9,736	11,776	6,031	4,769	5,155
Dividend paid	0	0	-3,296	-3,296	-3,924
Share buy back	-488	-303	0	0	0
New share capital	0	0	0	0	0
Debt financing	-1,220	-1,813	-4,740	951	3,258
Other	0	0	0	0	0
Cash flow from financing	-1,708	-2,116	-8,036	-2,346	-666
Other	-514	-143	0	0	0
Change in cash	7,514	9,517	-2,005	2,423	4,489
Cash, start of the year	21,800	29,314	38,831	36,826	39,249
Cash, end of the year	29,314	38,831	36,826	39,249	43,738
Free cash flow per share in €	0.62	0.75	0.39	0.31	0.33
Y-o-y growth					
Operating cash flow	105%	28%	-9%	19%	14%
Net operating cash flow	n.a.	-42%	-38%	8%	11%
Free cash flow	n.a.	21%	-49%	-21%	8%

FIRST BERLIN RECOMMENDATION & PRICE TARGET HISTORY

Report No.:	Date of publication	Previous day closing price	Recommendation	Price target
Initial Report	15 July 2003	€4.96	Market Perform	€5.00
2...56	↓	↓	↓	↓
57	29 March 2016	€13.41	Add	€14.00
58	3 May 2016	€13.16	Add	€14.00
59	2 August 2016	€13.39	Add	€14.00
60	Today	€12.04	Add	€13.00

Authored by: Simon Scholes, Analyst

Company responsible for preparation:

First Berlin Equity Research GmbH

Mohrenstraße 34
10117 Berlin

Tel. +49 (0)30 - 80 93 96 94 Fax +49 (0)30 - 80 93 96 87

info@firstberlin.com

www.firstberlin.com

Person responsible for forwarding or distributing this financial analysis: Martin Bailey

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PRICE TARGET DATES

Unless otherwise indicated, current prices refer to the closing prices of the previous trading day.

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The present financial analysis is based on the author's own knowledge and research. The author prepared this study without any direct or indirect influence exerted on the part of the analysed company. Parts of the financial analysis were possibly provided to the analysed company prior to publication in order to avoid inaccuracies in the representation of facts. However, no substantial changes were made at the request of the analysed company following any such provision.

ASSET VALUATION SYSTEM

First Berlin's system for asset valuation is divided into an asset recommendation and a risk assessment.

ASSET RECOMMENDATION

The recommendations determined in accordance with the share price trend anticipated by First Berlin in the respectively indicated investment period are as follows:

STRONG BUY: An expected favourable price trend of more than 50% combined with sizeable confidence in the quality and forecast security of management.

BUY: An expected favourable price trend of more than 25% percent.

ADD: An expected favourable price trend of between 0% and 25%.

REDUCE: An expected negative price trend of between 0% and -15%.

SELL: An expected negative price trend of more than -15%.

RISK ASSESSMENT

The First Berlin categories for risk assessment are low, average, high and speculative. They are determined by ten factors: Corporate governance, quality of earnings, management strength, balance sheet and financial risk, competitive position, standard of financial disclosure, regulatory and political uncertainty, strength of brandname, market capitalisation and free float. These risk factors are incorporated into the First Berlin valuation models and are thus included in the target prices. First Berlin customers may request the models.

INVESTMENT HORIZON

Unless otherwise stated in the financial analysis, the ratings refer to an investment period of twelve months.

UPDATES

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Legally required information regarding

- key sources of information in the preparation of this research report
- valuation methods and principles
- sensitivity of valuation parameters

can be accessed through the following internet link: <http://firstberlin.com/disclaimer-english-link/>

SUPERVISORY AUTHORITY: Bundesanstalt für Finanzdienstleistungsaufsicht (German Federal Financial Supervisory Authority) [BaFin], Graurheindorferstraße 108, 53117 Bonn and Lurgiallee 12, 60439 Frankfurt

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