

PSI AG

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

Q3 Results

RATING

PRICE TARGET

Return Potential
 Risk Rating

ADD

€ 20.00

13.6%
 Medium

ENERGY TRANSITION IS A GIFT WHICH KEEPS ON GIVING

PSI continues to benefit from a cyclical upturn in investment at its Production Management business and a structural increase in demand at Energy Management. Reorganisations and spin-offs at Energy Management's German utility customers are prompting increased readiness to invest in digitalised solutions. The third quarter report demonstrates once again the increasing business possibilities such as sector coupling and grid management as a service which the ongoing energy, mobility and heating transitions are creating. We have revised up our earnings forecasts and raised our price target from €17.00 to €20.00 to take account of the increasing momentum behind the adoption of the PSI's solutions in these areas. We maintain our Add recommendation.

Energy Management sales up 14.3% in Q3/17 PSI's Q3 results showed a 6.4% increase in sales to €45.5m (Q3/16: €42.8m, FBe: €45.2m). Group EBIT a €2.5m (Q3/16: €2.4m) was below our forecast of €2.8m due to exceptional items of €1m at Infrastructure Management. Energy Management was the fastest growing of PSI's three segments in the third quarter. Its sales were up 14.7% compared with the prior year quarter and were 5.3% ahead at the nine months stage. The increase was driven by strong growth in the electrical grid business which continues to benefit from increasing demand for energy transition-related software. Production Management sales rose 4.4% on Q3/16 and were up 6.7% after nine months with the logistics software and Metals subsegments leading the way. Q3/17 sales at Infrastructure Management fell 12.1% as business at the south east Asian unit, PSI Incontrol, continued to contract. Infrastructure Management has been lossmaking so far this year while the other two segments are clearly profitable. The order intake climbed 5.9% to €36m in Q3/17 (Q3/16: €34m) while the nine months figure was up 9.7% at €147m (9M/16: €134m). At the end of September the order backlog at €141m was 6.8% above the prior year level of €132m. (p.t.o.)

FINANCIAL HISTORY & PROJECTIONS

	2014	2015	2016	2017E	2018E	2019E
Revenue (€m)	175.39	183.68	176.85	187.77	202.13	216.35
Y-o-y growth	-0.5%	4.7%	-3.7%	6.2%	7.6%	7.0%
EBIT (€m)	7.66	11.11	11.84	14.41	17.59	20.32
EBIT margin	4.4%	6.0%	6.7%	7.7%	8.7%	9.4%
Net income (€m)	4.10	7.46	8.55	9.86	12.27	14.54
EPS (diluted) (€)	0.26	0.48	0.55	0.63	0.79	0.93
DPS (€)	0.00	0.21	0.22	0.24	0.25	0.27
FCF (€m)	9.74	11.78	10.42	4.83	10.96	12.99
Net gearing	33.7%	15.9%	12.0%	10.1%	1.2%	-7.9%
Liquid assets (€m)	29.31	38.83	43.01	44.35	51.54	60.60

RISKS

Risks include a renewed downturn in the prices of oil, gas and steel.

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 03 Nov 2017

Closing Price	€ 17.61
Shares outstanding	15.70m
Market Capitalisation	€ 276.45m
52-week Range	€ 10.91 / 19.93
Avg. Volume (12 Months)	11,926

Multiples	2016	2017E	2018E
P/E	32.2	27.9	22.4
EV/Sales	1.6	1.5	1.4
EV/EBIT	24.6	20.2	16.5
Div. Yield	1.2%	1.4%	1.4%

STOCK OVERVIEW



COMPANY DATA

As of 30 Sep 2017

Liquid Assets	€ 39.81m
Current Assets	€ 117.41m
Intangible Assets	€ 55.80m
Total Assets	€ 194.36m
Current Liabilities	€ 64.80m
Shareholders' Equity	€ 74.08m

SHAREHOLDERS

Innogy SE	17.8%
Harvinder Singh	8.1%
Free float	74.1%



Figure 1: Q3/2017 results versus our forecasts

€ 000s	Q3 17A	Q3 17E	Δ Q3 17A vs. vs. Q3 17E	Q3 16A	Δ Q3 17A vs. vs. Q3 16A
External sales	45,484	45,200	0.6%	42,759	6.4%
by division:					
Energy Management	18,631	18,000	3.5%	16,244	14.7%
Production Management	22,461	22,500	-0.2%	21,518	4.4%
Infrastructure Management	4,392	4,700	-6.6%	4,997	-12.1%
Total EBIT	2,502	2,750	-9.0%	2,386	4.9%
by division:					
Energy Management	1,155	1,200	-3.8%	854	35.2%
Production Management	2,018	2,000	0.9%	2,452	-17.7%
Infrastructure Management	-322	-100	n.a.	-575	n.a.
Reconciliation	-349	-350		-345	
EPS (€)	0.10	0.11	-9.0%	0.09	11.1%

Source: PSI AG; First Berlin Equity Research estimates

Energy Management won major sector coupling contract in Q3/17 Q3/17 sales at Energy Management rose 14.7% to €18.6m (Q3/16: €16.2m). Segment EBIT came in at €1.2m (Q3/16: €0.9m) equivalent to a margin of 5.6% (Q3/16: 5.2%). The electrical grid business won another major contract during the third quarter based on its capability in sector coupling (the integration of the electricity transition, the nascent shift towards electro-mobility and the heat transition). Further details of this contract have so far not yet been made public. PSI also notes increasing interest in its “multi-tenancy capability” which it demonstrated by winning a major contract from 13 Danish energy companies in 2013. Multi-tenancy capability has created new business potential for major network operators by allowing them to offer grid management as a service to smaller network operators.

Partnership with ACS in the U.S. has provided local references In late September PSI announced a strategic partnership with the American company, Advanced Control Systems (ACS). ACS is strong in Texas and California where the percentage of renewable electricity generation is relatively high. ACS has already executed two projects which incorporate PSI's energy management systems. PSI expects to be able to use these references to further expand its business in the U.S.

Gas and Oil business was weaker during the first nine months PSI's Gas and Oil business won an important new European customer in the field of gas transportation, but we gather from talking to management that the relative weakness in commodity prices pushed this business' sales and order intake lower during the first nine months of 2017. The energy trading business' sales grew in Q3/17. Its result improved on the Q3/16 level and was back in the black after a loss in Q2/17.

Important new contract in internet order logistics software in Q3/17 Production Management's sales climbed 4.4% to €22.5m (Q3/16: €21.5m). Segment EBIT was €2.0m (Q3/16: €2.5m). Nine months figures were stronger with sales up 6.7% at €67.2m (9M/16: €63.0m) and EBIT 5.8% ahead at €5.5m (Q3/16: €5.2m). The logistics business won a large contract from an important new client for its internet order logistics software. This contract helped boost logistics business sales by 20% in Q3/17. Sales at Metals grew at a high single digit rate during the quarter as stronger commodity prices promoted a recovery in investment. In Q3/17 this business also won contracts for supply chain planning and quality management systems from a longstanding Chinese steel industry client, MaGang. Automotive and Industry sales grew at a low single digit rate but the business area succeeded in winning an important reference contract for ERP software from e.GO Mobile AG, an emerging manufacturer of electric city cars.



Infrastructure Management sales fell in Q3/17... Q3/17 sales at Infrastructure Management declined 12.1% to €4.4m (Q3/16: €5.0m). Weakness in sales stemmed mainly from the southeast Asian business unit, PSI Incontrol, which last year accounted for around half of segment revenues. The order intake at PSI Incontrol has been under pressure from low commodity prices and political turbulence in Thailand and Malaysia over the past two to three years. In addition, management last year moved to reduce exposure to low margin, capital/hardware intensive lines of business. Performance at Infrastructure Management's other businesses has improved so far in 2017. PSI Transcom, which provides operational management software for public transport, has seen an increase in its order intake and the Polish subsidiary has made further progress in the energy market.

...but segment EBIT would have been in the black without exceptional costs Segment EBIT came in at €-0.3m (Q3/16: €-0.6m) but the Q3/17 number was burdened by a charge of almost €1m in connection with the out-of-court settlement of collection of key payments from major market entry projects. Closure costs of the Chennai site in connection with capacity adjustments of substation production also reduced the quarter's earnings. Management expects sales at Incontrol to stabilise in 2018 provided that upgrade contracts can be won from Malaysian utilities in an upcoming tender round. Additional smart city contracts following on from two recently completed projects could also boost the business' topline. Longer term, sales may be helped by the business created by the likely future unbundling of utilities in the region.

Net gearing remains modest at 19.5% Operating cash flow before expenditure on working capital climbed 8.1% to €3.5m in Q3 (Q3/16: €3.2m). But working capital yielded €4.0m in Q3/17 compared with €1.6m in the prior year quarter. Net cashflow from operations thus climbed 55% to €6.3m (Q3/16: €4.1m). Lower investment in fixed assets was the main driver of a 28% decline in the cash outflow from investing to €0.7m (Q3/16: an outflow of €1.0m). Free cashflow rose 81% to €5.6m (Q3/16: €3.1m). Debt and valuation changes of €-0.4m (Q3/16: €-1.9m) meant that cash rose €5.2m in Q3/16 to €39.8m (Q3/16: cash rose €1.2m to €35.9m). Net debt including pension liabilities amounted to €14.4m at the end of Q3/17 and net gearing including pension liabilities was 19.5% (Q3/16: €12.3m and 16.8%).

Add recommendation maintained and price target raised to €20.00 (previously: €17.00)

Following the Q3 results we have revised our forecasts as shown in table 2 below. The changes to our near term numbers are relatively minor but we have also altered our long term growth assumptions for the Energy Management division to reflect the increasing business possibilities which the energy, electric mobility and heating transitions are creating for PSI. We now see Energy Management sales growing at a CAGR of 8% (previously: 6.6%) during the period 2017-2022. We have also lowered our cost of debt estimate from 5% to a more realistic 3%. This in turn reduces our WACC estimate from 8.0% to 7.7%. We maintain our Add recommendation but raise the price target from €17.00 to €20.00.



Figure 2: Changes to our forecasts

€m	2017 NEW	2017 OLD	Δ %	2018 NEW	2018 OLD	Δ %	2019 NEW	2019 OLD	Δ %
External sales	187.77	186.37	0.8%	202.13	199.90	1.1%	216.35	213.94	1.1%
by division:									
Energy Management	72.70	71.29	2.0%	78.51	76.28	2.9%	84.79	82.38	2.9%
Production Management	90.90	90.90	0.0%	97.26	97.26	0.0%	103.10	103.10	0.0%
Infrastructure Management	24.18	24.18	0.0%	26.35	26.35	0.0%	28.46	28.46	0.0%
Total EBIT	14.41	14.42	0.0%	17.59	17.37	1.3%	20.32	20.06	1.3%
margin (%)	7.7%	7.7%		8.7%	8.7%		9.4%	9.4%	
by division:									
Energy Management	6.85	6.85	0.0%	8.34	8.10	2.9%	9.43	9.16	3.0%
margin (%)	9.3%	9.5%		10.5%	10.5%		11.0%	11.0%	
Production Management	7.92	7.92	0.0%	8.97	8.97	0.0%	10.57	10.57	0.0%
margin (%)	8.5%	8.5%		9.0%	9.0%		10.0%	10.0%	
Infrastructure Management	0.90	0.90	n.a.	1.63	1.63	0.2%	1.76	1.76	0.2%
margin (%)	3.0%	3.0%		5.0%	5.0%		5.0%	5.0%	
Reconciliation	-1.26	-1.25		-1.35	-1.34		-1.45	-1.43	
EPS (€)	0.63	0.64	-1.3%	0.79	0.80	-1.8%	0.93	0.95	-2.0%

Source: First Berlin Equity Research estimates

Figure 3: Valuation model

€000s	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E
Net sales	187,772	202,126	216,351	229,997	244,244	258,286	273,223	287,613
NOPLAT	10,090	12,313	14,221	16,555	17,953	19,015	20,147	21,242
+ Depreciation and amortisation	4,694	5,053	5,409	5,750	6,106	6,457	6,831	7,190
= net operating cash flow	14,784	17,366	19,630	22,305	24,059	25,472	26,977	28,433
- total investments (Capex and WC)	-9,564	-6,467	-7,061	-2,361	-1,864	-5,329	-8,489	-8,788
Capital expenditure	-5,298	-5,491	-6,094	-7,183	-7,358	-7,659	-8,369	-8,672
working capital	-4,266	-976	-967	4,822	5,493	2,330	-119	-115
= Free cash flow (FCF)	5,219	10,899	12,569	19,944	22,195	20,143	18,489	19,645
PV of FCF's	5,163	10,015	10,729	15,816	16,351	13,785	11,754	11,602

€000s	
PVs of FCFs explicit period (2017-30)*	161,588
PVs of FCFs in terminal period	164,430
Enterprise Value (EV)	326,018
(Net cash)/net debt	14,413
Shareholder value	311,605

Value per share (€)	19.95
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WACC	7.65%
Cost of equity	9.5%
Pre-tax cost of debt	3.0%
Normal tax rate	30.0%
After-tax cost of debt	2.1%
Share of equity	75.0%
Share of debt	25.0%
Terminal growth	2.0%

Sensitivity analysis

		Terminal growth rate (%)						Fair value per share
		0.5%	1.0%	1.5%	2.0%	2.5%	3.0%	
WACC	3.65%	43.93	49.74	58.26	71.96	97.62	163.00	676.80
	4.65%	32.64	35.44	39.13	44.22	51.69	63.68	86.15
	5.65%	25.76	27.31	29.24	31.70	34.94	39.40	45.94
	6.65%	21.13	22.07	23.20	24.56	26.25	28.41	31.25
	7.65%	17.82	18.42	19.12	19.95	20.94	22.13	23.62
	8.65%	15.33	15.73	16.19	16.73	17.34	18.07	18.94
	9.65%	13.39	13.67	13.99	14.35	14.75	15.22	15.76
	10.65%	11.85	12.05	12.27	12.52	12.79	13.11	13.47

*for layout purposes the model shows numbers only to 2024 but runs until 2030

Source: First Berlin Equity Research estimates



INCOME STATEMENT

All figures in €'000	2015	2016	2017E	2018E	2019E
Revenues	183,682	176,854	187,772	202,126	216,351
Change in inventories & capitalised production	0	0	0	0	0
Total output	183,682	176,854	187,772	202,126	216,351
Cost of materials	-31,596	-26,210	-27,227	-29,308	-31,371
Gross profit	152,086	150,644	160,545	172,818	184,980
Total personnel costs	-106,820	-109,269	-110,785	-119,254	-127,647
Net other operating costs	-29,871	-25,246	-30,651	-30,920	-31,608
Depreciation & amortisation	-4,286	-4,294	-4,694	-5,053	-5,409
EBIT	11,109	11,835	14,414	17,590	20,316
Net interest	-1,811	-749	-552	-291	220
Associates	140	147	160	160	168
Pretax profit	9,438	11,233	14,022	17,459	20,704
Income taxes	-1,979	-2,682	-4,159	-5,190	-6,161
Net income / loss	7,459	8,551	9,864	12,269	14,543
EPS (€)	0.48	0.55	0.63	0.79	0.93
EBITDA	15,395	16,129	19,108	22,643	25,725
Ratios					
Gross margin	82.8%	85.2%	85.5%	85.5%	85.5%
EBIT margin	6.0%	6.7%	7.7%	8.7%	9.4%
EBITDA margin	8.4%	9.1%	10.2%	11.2%	11.9%
Net income margin	4.1%	4.8%	5.3%	6.1%	6.7%
Tax rate	21.0%	23.9%	29.7%	29.7%	29.8%
Expenses as % of output					
Personnel	-58.2%	-61.8%	-59.0%	-59.0%	-59.0%
Net other operating income/expenses	-16.3%	-14.3%	-16.3%	-15.3%	-14.6%
Depreciation & amortisation	-2.3%	-2.4%	-2.5%	-2.5%	-2.5%
Y-o-y growth					
Total revenues	4.7%	-3.7%	6.2%	7.6%	7.0%
EBIT	45.1%	6.5%	21.8%	22.0%	15.5%
Net income / loss	82.0%	14.6%	15.3%	24.4%	18.5%



BALANCE SHEET

All figures in €'000	2015	2016	2017E	2018E	2019E
Assets					
Current assets, total	120,742	120,710	124,905	138,252	153,416
Cash and cash equivalents	38,831	43,008	44,351	51,540	60,602
Trade accounts and notes receivables	36,169	27,466	28,166	30,319	32,453
Inventories	4,184	6,421	7,323	7,883	8,438
Receivables relating to long term contracts	36,366	38,184	37,554	40,425	43,270
Other current assets	5,192	5,631	7,511	8,085	8,654
Non-current assets, total	78,780	78,717	77,202	78,288	79,625
Property, plant and equipment	12,214	12,153	13,144	13,542	14,496
Goodwill	49,559	48,914	48,914	48,914	48,914
Other intangible assets	9,859	8,837	8,450	8,489	8,221
Associates	149	150	310	470	638
Deferred tax assets	6,999	8,663	6,384	6,872	7,356
Other non-current assets	0	0	0	0	0
Total assets	199,522	199,427	202,107	216,540	233,041
Shareholders' equity & debt					
Current liabilities, total	77,343	69,200	67,786	72,967	78,103
Interest bearing debt	3,374	0	0	0	0
Trade accounts payable	14,929	12,553	13,332	14,351	15,361
Liabilities relating to long term contracts	28,819	25,728	22,533	24,255	25,962
Provisions	0	0	0	0	0
Other current liabilities	30,221	30,919	31,921	34,361	36,780
Non-current liabilities, total	49,027	54,953	55,959	56,500	57,040
Interest bearing debt	83	0	0	0	0
Pension provisions	46,981	52,037	52,297	52,559	52,821
Deferred tax liabilities	1,963	2,916	3,662	3,941	4,219
Consolidated equity	73,152	75,274	78,363	87,073	97,898
Shareholders' equity	73,152	75,274	78,363	87,073	97,898
Minorities	0	0	0	0	0
Total consolidated equity and debt	199,522	199,427	202,107	216,540	233,041
Ratios					
Current ratio (x)	1.56	1.74	1.84	1.89	1.96
Quick ratio (x)	1.51	1.65	1.73	1.79	1.86
Equity ratio	36.7%	37.7%	38.8%	40.2%	42.0%
Net gearing	15.9%	12.0%	10.1%	1.2%	-7.9%
Equity per share	4.66	4.80	4.99	5.55	6.24
Interest coverage ratio (x)	6.13	15.80	26.13	60.38	-92.45
Capital employed (CE)	88,045	84,531	85,306	87,200	89,104
Return on capital employed (ROCE)	9.7%	9.8%	11.8%	14.1%	16.0%



CASH FLOW STATEMENT

All figures in €'000	2015	2016	2017E	2018E	2019E
Pretax result	9,438	11,233	14,022	17,459	20,704
Depreciation and amortisation	4,286	4,294	4,694	5,053	5,409
Other	-1,685	-1,632	-4,319	-5,088	-6,066
Operating cash flow	12,039	13,895	14,398	17,424	20,047
Investment in working capital	1,971	-560	-4,266	-976	-967
Net operating cash flow	14,010	13,335	10,131	16,448	19,080
Cashflow from investing	-2,234	-2,912	-5,298	-5,491	-6,094
Free cash flow	11,776	10,423	4,833	10,956	12,986
Dividend paid	0	-3,277	-3,453	-3,767	-3,924
Share buy back	-303	0	-297	0	0
New share capital	0	0	0	0	0
Debt financing	-1,813	-3,457	0	0	0
Other	0	0	260	0	0
Cash flow from financing	-2,116	-6,734	-3,490	-3,767	-3,924
Other	-143	488	0	0	0
Change in cash	9,517	4,177	1,343	7,189	9,061
Cash, start of the year	29,314	38,831	43,008	44,351	51,540
Cash, end of the year	38,831	43,008	44,351	51,540	60,602
Free cash flow per share in €	0.75	0.67	0.31	0.70	0.83

Y-o-y growth					
Operating cash flow	28%	15%	4%	21%	15%
Net operating cash flow	-42%	-5%	-24%	62%	16%
Free cash flow	21%	-11%	-54%	127%	19%

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...59	↓	↓	↓	↓
60	30 March 2017	€12.71	Add	€14.00
61	2 May 2017	€12.91	Add	€14.00
62	31 July 2017	€15.74	Add	€17.00
63	Today	€17.61	Add	€20.00

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

ASSET RECOMMENDATION

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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%.

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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.

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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

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