

Mandrakesoft

15 November 2004

A prosperous year ahead

Software & Computer Services

Current Price € 5.75

Outperform

France

Target Price € 7.00

Rating Unchanged

Performance over	1m	3m	12m
Absolute	-1%	0%	153%
Rel.SBF250	-4%	-9%	124%
Relative to sector	-8%	-15%	156%
12m Hi/Lo	€ 6.50/2.27		
Reuters	MAKE.PA		
Bloomberg	MLMAN FP		
Market Cap	€ 27m		
Next corporate event			

FY/e 09.30	2004	2005E	2006E
Sales (€m)	5.2	6.5	7.9
EBITDA (€m)	0.4	1.2	1.9
Net earnings (€m)	0.8	1.1	1.8
Current EPS (€)	0.08	0.24	0.37
Published EPS (€)	0.17	0.24	0.37
Dividend per share (€)			
P/E (x)	48.2	23.8	15.6
Dividend yield (%)			
EV/EBITDA (x)	46.5	21.2	12.9

Source: KBC Securities

*Adjusted for goodwill and exceptionals

Mandrakesoft has published revenue for the year-ended 30 September of €5.18m, an increase of 33% above our own estimate of €4.7m. Services made a slightly smaller contribution than we expected but should rise sharply in 2005, since orders in this field already stand at close to twice the 2004 level, thereby comforting our forecast of at least 25% growth next year. The Edge-IT acquisition was finalised on 4 October but is yet to be consolidated.

A return to growth

Mandrakesoft made a dramatic return to growth in 2003/04, with +21% in the first half and a spectacular +49% in the second. The group's efforts are bearing fruit and the quality of the revenue mix is improving, with 77% now coming from on-line sales, licences and the Users' Club, up from 66% last year. Sales in retail outlets now only contribute 15% of revenue while services have temporarily slipped to 8% from 11% in 2002/03.

Trends in half-yearly revenues

	30/09/00	30/09/01	30/09/02	30/09/03	30/09/04
1 st half	1.72	1.71	2.33	2.09	2.52
2 nd half	1.28	1.85	2.34	1.81	2.66
Total	3.00	3.56	4.67	3.90	5.18

Source: company

The acquisition of Edge-IT was announced on July 1 this year. The company has since posted billings of €0.27m, virtually triple that of the previous year, but it was not consolidated because the takeover was finalised after September 30. The strong growth nevertheless underlines the benefits of the merger with Mandrakesoft.

As expected, the group will post a profit for the year, although with significant help from one-off items, which will help to overshadow the net loss. Our projection for 2004 gross operating profit may be a little optimistic, particularly in light of some of the structural reorganisation that has taken place.

The press release states that anticipated revenues (Club subscriptions and services not yet rendered) came to €0.77m and that the order book for services stood at €0.87m at the end of the fiscal year.

Now Europe's only open source specialist

The last few months have seen much positive newsflow for the group. Many of the announcements refer to partnerships in fairly disparate and at times technologically advanced areas. Mandrakesoft's reputation for updating its Mandrakelinux software every six months (the new version 10.1 has just been released) reassures customers that they are buying a durable product backed up by a high-quality developer network.

Another important element in the group's favour is that since the takeover of Suse by Novell, it has become the only European player in open source software, making the company virtually unavoidable, and no doubt strengthening its hand in negotiations for public sector contracts. We feel that the steady flow of new partnerships and the company's participation in major projects reflect the quality of the products and the R&D teams that develop them.

Materials

The main developments in this field have been:

- The launch of Globe Trotter, consisting in a "LaCie Mobile Hard Drive" with Mandrakelinux pre-installed. ("Plug with an USB to a PC and power up to enjoy a full-featured Mandrakelinux desktop"),
- The launch of PCs targeted at the general public assembled by the French constructor Pérityle and pre-installed with the Mandrakelinux OS. The partners are Carrefour (the *Compubox* is sold on-line and in certain stores on a trial basis) and most importantly Planète Saturn, which has decided to raise the quality bar with a 3Ghz Pentium 4 costing €499 after the success of the budget models between €299 and €329.

The growing interest of the mass retailers in Linux is extremely promising. But the adoption rate will be slow without heavy investment in support and training, which are the main obstacles to growth. We nevertheless think that this segment will see steady growth.

Services

This is the activity with the strongest growth potential – and that motivated the Edge-IT acquisition. The offer of services is an essential complement to the product range and crucial to opening the door to contracts with companies and public bodies. Working hand in hand with industry partners helps to create durable commercial relations that can lead to joint bidding for tenders, thereby accumulating new references and reinforcing the company's reputation. Moreover, some developments can later be used in Mandrakesoft's own products. The most interesting recent contract gains are:

- A role in the creation of the French Ministry of Defence's high security operating system – a contract worth €7m of which €1m will go to Mandrakesoft. The project requires the highest level of expertise, reflected in the ultra-stringent 'EAL5' security standard demanded by the system, making it the most technically demanding contract undertaken by the group so far.
- Participation in an R&D project called GITAN for advanced mobility research for IT applications. Mandrakesoft will receive approximately one third of the €1m contract.

Conclusion

Revenue for the year-ended 30 September exceeded our estimates. The group will post a net profit, although it will include a number of exceptional items. Looking beyond the solid financial health, which should be enhanced by the upcoming capital increase and the transfer of the listing to a regulated market, the last year has underlined the strength and dynamism of the group.

In terms of the group's business environment, the Linux market is still growing strongly, as the recent Forrester study has demonstrated. Mandrakesoft's status as the sole European open source publisher, the growing list of clients in industry, commerce and government and the involvement in major projects confers a clear advantage on the group. This is why we think the capital increase is an essential step forward. Only then will Mandrakesoft have the financial strength to accelerate the current growth and fully exploit its commercial and technological momentum.

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