

Mandrakesoft

6 December 2004

Back in profit

Software & Computer Services

Current Price € 6.00

Outperform

France

Target Price € 7.00

Rating Unchanged

Performance over	1m	3m	12m
Absolute	0%	5%	164%
Rel.SBF250	-1%	0%	140%
Relative to sector	-1%	-7%	171%
12m Hi/Lo	€ 6.50/2.27		
Reuters	MAKE.PA		
Bloomberg	MLMAN FP		
Market Cap	€ 29m		
Next corporate event			

FY/e 09.30	2003	2004E	2005E	2006E
Sales (€ m)	3.9	5.2	6.6	8.2
EBITDA (€ m)	-2.0	1.0	0.7	1.2
Net earnings (€ m)	-2.0	1.4	1.5	1.0
Current EPS* (€)	-0.56	0.17	0.13	0.21
Published EPS (€)	-0.54	0.29	0.32	0.21
Dividend per share (€)	0.00	0.00	0.00	0.00
P/E (x)		36.2	46.7	28.4
Dividend yield (%)	0.0%	0.0%	0.0%	0.0%
EV/EBITDA (x)		27.0	36.7	21.9

Source: KBC Securities

*Adjusted for goodwill and exceptionals

The return to profitability over the year-ended 30 September 2004 is extremely encouraging on several levels. Revenues were up 33% and generated by a healthy spread of activities, while the gross margin reflected improvements in the product mix. The cash position of € 2.6m is also reassuring, indicating that notwithstanding the capital provided by the exercise of the subscription rights, Mandrakesoft is managing to finance its strong growth internally. Overall, the 2003/04 results are very satisfying and should encourage management on the eve of the group's capital increase, which will open the door to accelerated growth and the transfer to a regulated market.

Excellent results

Revenue growth came primarily from high-margin activities (on-line sales, license sales, subscriptions to the Mandrakelinux users' club), which accounted for 77% of total consolidated revenues, compared to 66% in 2002 / 03.

Simplified earnings statement (€'000s)

	30/09/03	30/09/04	Change
Revenues	3,901	5,183	32.8%
Other operating revenue	95	1,101	NS
Operating profit	- 2,167	862	NS
Exceptional profit	40	698	NS
Net profit	- 1,987	1,394	NS

Source: company

This trend obviously offered a major boost to the gross margin, which remained at a high level throughout the period. Other operating revenues (€ 1.11m) include € 0.67m generated by the financing of R&D projects. These revenues form an integral part of the group's strategy and are set to increase over the next few years.

Operating profit was transformed from a € 2.7m loss in 2002/03 into a profit of € 0.86m. The operating margin rose to 16.6% thanks to an improved product mix and very strong license sales over the year, which made a significant contribution to the margin.

Prospects

As we saw in our Flash dated 15 November, the development of company services augers well for the future. Mandrakesoft has placed revenue growth from this activity at the heart of its strategy and this will clearly influence the product mix:

Our revenue projections (€'000s)			
	September 2004	September 2005	September 2006
Products	3,527	2,700	3,150
Services	391	1,800	2,200
On-line services	1,265	2,115	2,825
Revenue	5,183	6,615	8,175
Change	32.8%	27.6%	23.6%

Source: KBC Securities

Product revenues are closely linked to license agreements, which were particularly high over the year-ended 30 September 2004. On-line services reflect the strong growth in subscriptions for users' clubs on the part of both private users and companies.

Revenues from services include the external growth generated by Edge-IT (we estimate sales of € 0.4m). The remainder is internal and will include the first payment of the Defence ministry contract of around € 0.3m according to our estimates.

The deliberate targeting of the rapidly growing services segment has paid off: growth has accelerated and teams have been strengthened to meet the rapidly increasing demand. The downside is that margins in this business are lower than those generated by license sales. But we think that growth in services is crucial to maintaining contact with company clients, most of whom are naturally drawn to Mandrakesoft by its strong reputation.

Mandrakesoft therefore needs to resolve the dilemma between growth and profitability. In light of the strong contribution of licenses to 2003/04 revenues, we expect the current year's operating margin to contract to 8.9% from 16.6% before climbing back to 12.1% in 2006. **We project net profit for 2004/05 close to last year's level thanks to more significant one-off contributions we forecast at € 0.9m, which will also allow the group to reinforce shareholder equity.**

Conclusion

We retain our target price of € 7. Mandrakesoft faces two challenges at present:

- The first is financial and well on the way to being resolved; the group needs to restore shareholders equity in order to carry out its transfer to a regulated market.
- The second is operational; that of consolidating growth in services, which has a different business model from the group's other activities.

But these challenges should not overshadow the most important element, which in our view is that Mandrakesoft is now profitable. The 2003/04 results offer a significant boost to the group's longer-term credibility and should raise the odds of in favour of Mandrakesoft winning some of the numerous tenders currently under way.

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