First-half 2014 results presentation

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Introduction

Vincent Paris
Chief Executive Officer

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Hello everyone, and welcome to this presentation conference on the results for the first half-year. I'd also like to welcome everyone who has joined us via the web-conference.

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These are the standard caveats for this type of presentation.

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The contents page follows the usual format. We have planned a three-stage presentation. After the highlights for the six-month period, François Lefebvre, our Chief Financial Officer, will present you with the key financial items. In the third section, I will give a quick overview of the market environment, our main strategic thrusts and objectives.

Highlights

Vincent Paris

Chief Executive Officer

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In the first half of the year, despite a challenging, even highly challenging, market environment, the Group met its targets for business performance and growth. The Group's profit and profitability levels were also in line with expectations. And it cannot be emphasised enough that the environment was especially difficult.

In a challenging market, achieving growth means taking market share from our competitors. We did this particularly in France, Spain and Belgium.

We have resolutely pursued our strategy focusing on Solutions. For Sopra Banking Software, we acquired COR&FJA in Germany early in the year. More recently, in the area of human resources solutions, we acquired HR Access Service Line, which had been owned by IBM.

The last event, and major highlight, of the period was the proposed tie-up between Sopra and Steria. It is well on track. We will speak more about this later.

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Growth and profitability are on target. We recorded organic growth of 4.5% in the first half of 2014, which breaks down into 4.4% in the first quarter and 4.7% in the second quarter. Total growth was 9.3%. It is worth noting the increase of 100 basis points in the operating margin on business activity compared to the year-earlier period, to 7.2%.

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Let's turn now to our main businesses and operating entities. In France, we achieved 2.5% growth amid a sluggish market. This was an excellent performance, especially since our operating margin on business activity rose by 80 basis points in the period. It reached 8.3%, demonstrating the relevance and strength of our business model as well as very good momentum.

In Europe, we recorded organic growth of 4.4%, with varying results in each country. Spain, Belgium and Switzerland all saw strong growth. However, these excellent results were tarnished by a few difficulties relating to economic conditions in Italy and Germany, and to a lesser extent in the United Kingdom. Overall, Europe recorded growth of 4.4%, but the margin eroded slightly, from 2.8% to 2.1% over the half-year period.

As planned, Sopra Banking Software was the focus of major investments in the period, in connection with the acquisitions of four companies over the last two years, with four product lines. We devoted considerable resources to R&D and made significant marketing investments in the period. At this stage, thanks to this programme of investments, I am confident that the second half of the year will be a strong period for Sopra Banking Software. We are currently awaiting the results of major calls for tenders. They should be announced very soon. We thus expect to bring full-year profitability for this business into double-digit territory. We also anticipate excellent growth in the second half.

With respect to Other Solutions, which covers the Group's human resources and real estate solutions, we saw very strong organic growth, of about 22.3% in the first half. This growth was driven by all three product lines: Pléiades, HR Access and the Group's real estate solutions. All three units saw strong growth. The 12% margin was also driven by the performance of all three of these product lines. The Pléiades line and the Group’s property management solutions achieved completely satisfactory profitability levels, in line with first-half expectations for these businesses. HR Access’s profitability remains structurally positive. It was very positive in the first half, buoyed by the production of a licence with the French finance ministry for ONP, the recently created French national payroll agency under the ministry’s supervision. We were not able to produce this licence before the first half of the year.

Overall, the Group recorded organic growth of 4.5%, for an operating margin on business activity of 7.2%.

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In terms of the overall balance by sector, financial services reaffirmed its leading position, accounting for 36% of Group revenue. We saw growth in the services/transport/utilities segment, which accounted for 20% of revenue in the period. Driven by several key accounts in manufacturing, especially aerospace clients, this segment represented 14% of Group revenue. The public sector remained at 17%. The telecoms and media segment held up well at 8%. Lastly, retail was stable at 5%.

The breakdown by offering, between services and solutions, shifted slightly in the period. We remain focused on executing our strategy to build the Group’s Solutions business. This approach is reflected in the new breakdown. Solutions accounted for 25% of our total revenue in 2013. Today, this figure stands at 28%, an increase of 3%. Revenue generated by the Group’s Services business now accounts for 72% of the total.

In terms of the balance of geographies, the same trends seen in previous periods still hold sway. We continue to generate two-thirds of our revenue in France and one-third outside the country.

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Within revenue generated by the Group’s Services business (72% of the total), application outsourcing plays a major role, now accounting for 41% of revenue. This proportion remains significant because application outsourcing serves the core businesses of our clients. It is also a recurring business built on our strong partnerships with clients. This has long been a deeply held value for the Group, and we will continue to pursue this approach. Fixed-price projects account for 21% of our revenue. At 8%, the Group’s consulting activities now account for a slightly larger proportion of total revenue. We will continue to focus efforts on raising this percentage. Managed services are a growing area, today accounting for 7% of Group revenue.

Our top 30 clients include many major names. The growth rate for revenue generated with these top 30 clients, now in excess of 9%, is twice that for the Group as a whole. Our efforts to better target these clients, an important aspect of our activities over the last several years, brought further results in the first half. Evidently, we will be staying this course.

Major client decisions and significant contract signings are expected in the third quarter and are set to underpin growth in the second half.

In terms of the breakdown by region, 75% of revenue was generated in France in the first half, followed by two key European countries for the Group, Spain and the United Kingdom.

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In the Group's Solutions business, corresponding to 28% of total revenue, Sopra Banking Software understandably accounted for 60% and our human resources solutions came in at 30%. This latter figure is expected to increase slightly, when it will include the HR Access services business acquired from IBM. Real estate solutions represented 10% of revenue for the Solutions business.

In terms of the breakdown relating to products, licence sales accounted for 11% of revenue. Maintenance came to 26%, while integration services accounted for 50%. Managed services also saw growth in this business, representing 13% of revenue.

There is now a more balanced distribution of revenue by region, with France at 53%, Europe excluding France at 35% and the rest of the world at 12%.

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Workforce growth mirrored that of the Group's businesses, rising by 5.3% in the first half. Over the six-month period, 900 employees joined the Group, comprised of 500 new hires in France and 400 outside France.

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Before turning the floor over to François, who will be commenting upon these financial highlights in detail, I would like to recap the key figures for the period.

Group revenue amounted to €722 million, corresponding to organic growth of 4.5%, an increase of €61 million compared to the year-earlier period. Operating profit on business activity was €52 million, or 7.2% of revenue. Lastly, net profit came to €22 million.

Financial results

François Lefebvre

Chief Financial Officer

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Thank you, Vincent. Hello everyone. I would like to suggest that we rapidly review the financial highlights of the first half.

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The income statement shows revenue of €722 million, representing total growth of 9.3% and organic growth of 4.5%. The first profit item, which is the operating margin on business activity, came to 7.2%, 100 basis points higher than in the first half of 2013. This margin improvement was due mainly to the Group’s constant focus on productivity.

Since total revenue growth was 9.3%, and staff costs (for both employees and contractors, thus covering all staff and subcontractors employed by the Group) were only 7.6% higher, the margin improvement was thus primarily the result of productivity gains achieved by the Group. Operating expenses and the net charge for depreciation, amortisation and provisions remained stable overall between first-half 2013 and first-half 2014. These items do not prompt any particular observations.

The operating margin on business activity was 7.2%. The two other expense items before profit from recurring operations relate to stock option and bonus share plans on the one hand and the amortisation of allocated intangible assets on the other. These are calculated expenses. At this stage, they remain equivalent to those reported for the year-earlier period. They thus came to 6.7%.

The comparison of the two periods is a little more complex this year. In the first half of 2013, we had recorded positive goodwill following the acquisition of HR Access. Non-recurring operating income and expenses in the amount of €26 million had been recorded at 31 December 2013. In the first half of 2014, the net charge under this heading amounted to €7.8 million, mainly due to costs in connection with the Sopra-Steria project and costs relating to the two acquisitions carried out during the period.

The operating margin thus came to 5.6%. After subtracting financial items and the income tax expense, we arrive at a net margin of about 3%.

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With respect to the change in net debt, the comparison between 2013 and 2014 is also a little difficult. At the beginning of the period, net debt was €154 million, while at the end of the period it amounted to €197 million.

In the first half of 2013, a positive cash inflow of €44 million was included under the impact of changes in scope, in order to offset the positive goodwill. In the first half of 2014, a negative charge of €20 million was recorded for this item, offsetting the two acquisitions carried out since the start of the year, the service business purchased from IBM and Sopra Banking Germany.

The dividend in respect of the 2013 financial year was paid in early July 2014. It is therefore not included in the statement. We have continued our investment drive, with net cash used in investing activities of €11 million in the first half. Our net debt thus amounted to €197 million.

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Equity remained stable between first-half 2013 and first-half 2014. Dividends to be paid out by the Group were approved by the General Meeting and are recorded under “Other movements” on the statement of changes in equity at 30 June 2014. After subtracting a few other items, equity amounted to €361 million at the end of the period.

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Let’s look now at the main balance sheet items. Goodwill amounted to €317 million at 31 December 2013 and was €344 million at 30 June 2014. The difference is the result of the goodwill recognised for the two acquisitions mentioned above. Allocated intangible assets were subject to amortisation and thus were mechanically lower in the first half. Added to this are equity-accounted investments, in the amount of €117 million. This item includes the value of our investment in Axway, which corresponds to €25 million.

Equity came to €361 million and debt was €197 million. The Group’s financial position remains robust.

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This robust financial position is reflected in the Group’s performance with respect to its bank covenants at 30 June 2014. The first of these relates to the debt service coverage ratio (operating profit to debt). This ratio must be higher than 5. It was 13.75 at 30 June 2014. We note a slight decline year-on-year, but the operating profit at 31 December 2013 included a positive goodwill amount. This explains the fall in the ratio, which nevertheless far exceeds the minimum requirement.

The gearing ratio was 47%. Under the Group’s bank covenants, this ratio excludes employee profit sharing. We have €170 million in net bank debt, for €197 million in total net financial debt. Net debt to EBITDA was less than 3, reaching a very satisfactory level of 1.40.

Now I would like to turn the floor back to Vincent.

Market, strategy and objectives

Vincent Paris
Chief Executive Officer

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Thank you. I would like to give you a quick overview of the market environment, the key aspects of our strategy and our main objectives.

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The first half of 2014 ultimately followed the underlying trends that we have been observing for the last several half-year periods. We are seeing that everything is happening at an ever faster pace. The underlying trends are the same. Client relations have been totally revamped and this will be even more the case in the future. All of our clients' value chains, irrespective of their vertical market, have been revamped.

Our major clients tell us that in five years' time, over a quarter of their business activities will be completely upended or will be totally jettisoned. This means that everyone is being extremely vigilant and proactive to this phenomenon – the digital revolution – which is affecting all areas of the economy.

Against this backdrop, our clients have been setting very exacting requirements. They are facing three major issues. The first of these involves trying to regain some room for manoeuvre by lowering prices and increasing the quality on all recurring projects and legacy systems. The focus is on investing, innovating, reclaiming market share, enhancing their competitive edge and performance and bringing their offerings to market more rapidly, thus reducing their time to market. These are the big issues that they are facing.

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So how can we try to respond to all of their issues? By developing an increasingly end-to-end approach. We have to establish an end-to-end approach in terms of business activities, legacy systems, or on a vertical basis: top-down. We will be making more and more end-to-end commitments.

The services for which we need to apply this end-to-end approach basically cut across all of our business activities. Upstream, we have consulting, both business-specific and technology consulting, major transformation programmes, rollout, application outsourcing and, of course, managed services. And right at the heart of all that, we obviously have solutions, whether they are our solutions or those of our peers, competitors or partners, even if we prefer them to be our own. This solutions-based approach really needs very strong synergies and a complementary fit with an overall vision for all business activities.

Around that, you have a certain number of specialities and expert skills, particularly when it comes to leveraging value from IT assets and enterprise architecture. Both of these key skill sets enable recurring projects and legacy systems to be rationalised by regaining room for manoeuvre. Alongside these two essential areas of expertise, with the cloud, big data and mobility, we will be co-innovating with our clients to help them enhance their performance and power on the market.

Just like our competitors, we all want to roll out this end-to-end positioning. We have two main differentiating factors to come out on top. The first is in solutions, which have always been at the heart of our strategy and which we are going to carry on amplifying on an ongoing basis. And then there's client confidence. Confidence is absolutely key for this type of transaction. It’s not something you can just lay it down by decree, it has to be built up over the years.

The approach that we have developed of making a long-term commitment is what makes the real difference. We are going to continue to draw on both of these factors which should mean that we can still make a difference over the years ahead.

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In terms of objectives and ambitions for financial year 2014, our results allow me to confirm all of the annual objectives that we set for ourselves in February as part of our “standalone” project, namely:

- organic growth of between 3 and 5%;
- an improvement in the operating margin on business activity;
- net debt at the end of the financial year of between €130 – 160 million, including the two acquisitions that we have mentioned, COR&FJA for Sopra Banking Software and IBM Services HR Access for HR Access, as well as the subscription of convertible bonds at CS. These three transactions are included in this objective.

Finally, the last extremely important factor is the Sopra-Steria tie-up which obviously broadens opportunities and accelerates the strategy that we have been talking about. The operation is making good progress. Sopra’s Public Exchange Offer for Steria will close on 30 July. We are highly focused on this objective and are all working very actively and with a great deal of synergy to achieve this major objective. The objective consists of successfully completing the merger of the companies before the end of the year so as to be able to work together on an operational level on 1 January 2015.

This wraps up the presentation. I will now respond, with François, to any questions that you may have.

Questions & Answers

Derric Marcon, Société Générale

I would like to ask three questions. What are your objectives in terms of capex for the year as a whole? Secondly, I would like to come back to your comment about the possibility of some major contract signings in the third quarter. Is this something that's rather unusual? Can you tell us some more about this today? Finally, could you comment on commercial activity for the first half of the year? What was the level of order intake? What are the factors that you foresee for the second half of the year which make you confident that you can meet your annual targets? Thank you.

Vincent Paris

In response to your first question I would say that we are aiming to increase profitability. I won't say any more than that.

François Lefebvre

In terms of capex, from memory, I'd say that for financial year 2013 we invested round €26 million. For 2014 as a whole, capex will be less than €20 million. We are going to slightly reduce our investments but we will still maintain them at a relatively high level.

Vincent Paris

With regard to your second question about major contract signings, if these take place in the third quarter rather than the second or fourth quarter as is usually the case, it's because major contracts are being pushed back. The whole market has been keeping tabs on these projects for many months now. A whole roster of decisions are now expected, but they are taking more time. No particular factor explains this situation, except maybe the fact that decisions are getting pushed back. We would have liked them to come through a little more quickly. That's part of the overall market environment. The book to bill ratio is decent, as it is higher than 1. Forecast order intake is good and robust, despite the fact that we have not booked any major new contracts. In the first half, we experienced something of a boom, as we pursued market share around projects that we had already. This enabled us to maintain and continue our overall growth. No single major factor explains this overall growth.

Laurent Daure, Kepler Cheuvreux

I would like to ask you one main question. Could you present in a bit more detail the Solutions division so that we can understand the respective trends of real estate and HR Access and get a clearer idea of your vision for the second half of the year? Could you also tell us some more about the integration of IBM's Services division. What are your expectations for this over the next six to twelve months?

Vincent Paris

These activities are enjoying strong growth for quite a range of different reasons. Pléiades had some great commercial successes at the end of the year and the beginning of this year. These successes are boosting the business and will continue to do so in the second half without any problem. So this is a business with a very strong growth rate. HR Access also achieved some really good contract signings. Services revenue grew very strongly around HR Access. Our acquisition of IBM's Services business looks set to give this growth an extra boost. We have high expectations, first because of the activities that the deal gives us, but also because we can reinforce our clout around HR Access. This transaction gives us a lot to look forward to. The vast majority of our major clients work with HR Access and we can see all the service potential that will open up for us in the second half of the year and in 2015.

In the Real estate segment, we are following the same line as in previous years. We continue to gain market share compared to our peers. We are therefore maintaining our product strategy in this market segment.

Grégory Ramirez, Bryan Garnier

I would like to come back to Sopra Banking Software. You mentioned some relatively big deals which may come to fruition in the second half of the year. Could you tell us a bit more about these. Obviously, without disclosing the names of the clients, what do you think the probability is that these contracts will be signed, I imagine, mainly in the fourth quarter? Do you already have any visibility about the 2015 pipeline? And another point about Sopra Banking Software, you mentioned an operating margin of over 10% for 2014. Can we expect to see a level just over the 10% mark or much higher than that?

Vincent Paris

I don't want to give you any more details on the deals that are in progress. We are staying patient. But I can confirm that we are confident about turning in a good performance in the second half of the year at this stage.

Brice Prunas, Exane BNP Paribas

I would like to ask two questions. The first is about the Group's organic growth. You set a range of between 3 – 5% for the full-year. You published 4.5% for the six-month period. So can we say that the bottom of the range is no longer applicable as things stand? Can you imagine a scenario where it may still occur? With my second question, I'd like to know whether you can give us any anonymous, qualitative feedback you have received from your major clients over the past few months about the prospect of the tie-up with Steria.

Vincent Paris

As far as the objective is concerned, we simply reiterated what we indicated in February. To be frank with you, we are hoping to do better than 3%. Based on the vision that we have today, there is no reason to expect to go back down to 3%. We are maintaining a decent growth rate, which is more towards the top than the bottom of the range.

As far as clients are concerned, there's bound to be a range of different opinions. Our major clients and decision-makers have a very favourable opinion about this tie-up. It makes a lot of sense. We will become more powerful. We will be able to be closer to our clients and the transaction gives us a much better backbone, power and coverage as far as they are concerned. We are seeing margin effects with buyers who aren't necessarily looking at this tie-up in very favourable terms. However, it's a cyclical effect as there can be a number of trade-offs. Over the long term, this tie-up is definitely good news for them. We have had a very good reception from our clients.

Derric Marcon, Société Générale

Have you quantified the positive impact of the CICE (tax credit to boost competitiveness) on the margin for France in the first half of the year and the change from 7.5 to 8.3%?

François Lefebvre

We did not see any significant change in the amount of the CICE between the first half of 2013 and the first half of 2014. The increase in the France margin is not related to the increase in the CICE over the same period.

Vincent Paris

If you have no further questions, thank you for your attention. We look forward to seeing you next time. Thank you.