Germany

Niche ERP

25 June 2001

Atoss

Downgraded earnings | **EUR 8.4**

Market perform

Year End 31 Dec	Sales (DEM m)	EBIT (DEM m)	EPS (DEM)	PER x	EV/ EBITDA (x)	EV/ Sales (x)
1999A	35.1	3.2	0.37	44.7	15.5	1.9
2000A	42.1	*0.4	(0.03)	Neg	30.4	1.6
2001E	45.3	0.7	0.31	53.7	25.4	1.5
2002E	54.2	4.3	0.78	21.0	9.6	1.2
2003E	67.3	6.7	1.09	15.0	6.9	1.0

. *includes DEM 2.3m of investment return on short term assets

Market Cap
US$32m
(EUR34m)

Reuters
AOFG.F

Bloomberg
AOF NM

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Although we anticipate revenues for the first half in line with market expectations, we are downgrading to take account of the worsening economic conditions. We downgrade our expectations from DEM 51m revenue to DEM 45.2m revenue this year and EBT from DEM 6.3m to DEM 2.5m. However, another large deal similar to the Deutsche Telekom deal signed last year could still push estimates upward. We downgrade our estimate to market perform, although the NPV still appears to offer significant hope of outperformance at EUR 16, we do not see any reason that will crystallise this value before Q3 is out of the way, unless a major deal is signed.

- **Software revenues in Q2 are likely to come in below Q1 levels,** and this is a concern for us, since this is the core product and could affect future revenues from maintenance and services, both currently strong.
- **The new version 2.4 of the Staff Efficiency Suite will not ship until the middle of Q3.** We believe customers are using this as a reason for inaction.
- **The company is likely to reaffirm its DEM 51m revenue forecast,** but we do not feel happy supporting this level of forecast given the worsening economic situation and poor metrics at other software companies in this sector.
- **The shares are backed by around DEM 57m of net cash (EUR7.2 a share)**. We do not believe cash burn is significant, so the shares are trading pretty close to cash value.
- We still believe Atoss has a strong product portfolio and a convincing benefit to customers, but we are puzzled by its failure to execute on the sales front particularly given strong interest at CEBIT. Unless Atoss can increase sales significantly, then we believe a further round of cost cuts may be justified.

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Q2 preview

We already knew that Q2 would be below last year because of the unflattering comparison with Q2 2000, which included the multi million DEM Deutsche Telekom deal. However, revenue performance and in particular software revenue performance appears to have been lower than our expectations.

We anticipate that software revenue could turn out about DEM 1.5m below Q1 revenues, although total revenues are in line due to a good performance from maintenance and consulting. We believe this is a significant shortfall because:

1. software is the core product. What we saw at CEBIT was impressive, and customer interest was extremely keen. The company has however not managed to turn high interest levels into actual sales. Version 2.4 of the core SEM software will be on the market in mid Q3 and a number of customers appear to be sitting it out until this is available.

2. software is a key driver for both services and maintenance revenue. The impact for future quarters is therefore likely to be more substantial than the impact in this period implies.

On the services side, Atoss is actually performing quite well – 20% plus growth in services revenues matches the performance of most of the better consultancies.

Our forecasts are shown below. We believe these are conservative forecasts but the company has indicated that there is a 20% margin of error on current forecasts owing to the end-quarter loading of contract signings.

	Q2	**% change**	**H1**	**% change**
Revenue	9.31	-24%	20.41	-2%
EBIT	-1.93	N/a	-2.21	13% improvement

Cost cuts, as at other companies, are taking longer to implement than to announce. However we do expect to see a benefit in the second half of the year, with the average number of employees reduced by 10-12%. Cost *control* has been tight, but we feel a rather more severe approach to cutting might have proved wise.

Valuation

We believe that fundamentally Atoss shares are undervalued. The shares are now trading around the level of cash in the balance sheet, and the 2002 PER of 21 times earnings appears relatively modest *if* the company can return to historic growth patterns.

The problem is that the company has shown very variable performance over the last four quarters in both revenue and profitability. While Q4 2000 and Q1 2001 appeared to indicate an underlying growth trend of 10-20%, this appears to be slowing, and the benefits of cost cutting are taking longer than we expected to be realised.

What will make the shares' true value crystallise?

- The company could outperform our expectations in these results. We believe this is not unlikely, but we do not expect any marked outperformance in software revenues for the end of the month. Atoss have indicated that in software they believe there is a 20% margin of error on forecasts – that equates to only 6% of total sales.

- A single large deal could be brought in. We believe the company is talking to a number of customers about significant (DEM 2m and above) deals. The pipeline appears strong but it is getting the signature on the dotted line that is crucial.

- Q3 results may put the company back on track for both profitability and revenue growth. However, we currently assess profitability for that quarter as marginal, so that we cannot confidently forecast a good Q3 result.

- Sales of version 2.4 of the Staff Efficiency Suite should start in late August or early September. If sales of this product do well, this would be the clearest signal for us to start buying Atoss shares again.