Sage Group

SGE

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SGE Snapshot +

Fat Prophets take some profits

Following what was a solid start to 2019 in the first quarter, the **Sage Group** (LSE.SGE) has continued this trend with its first half report showcasing sustained growth with robust subscription growth in North America and Europe. Progress towards the subscription model is pleasing. However, the valuation has hit relatively lofty levels and we believe it to be an opportune time to take some profits.

What's new?

Back in April (FAT-UK-777), we covered the company's first quarter fiscal 2019 wherein it showed that it was quite the 'comeback kid' staging a solid recovery following an unusually bumpy FY18.

Management also issued their guidance for FY19 with recurring revenue set to grow 8%-9% while Software and Software Related Services (SSRS) and processing revenues are expected to report a more muted performance, being flat to a mid-single digit decline. Organic operating margins are also expected to fall between 23% and 25% due to the ongoing investments towards the SaaS (Software-as-a-Service) model.

Since then, the company has issued its interim update providing more colour on progress. Overall this was solid with statutory revenues up 6.4% year-on-year to £957 million but the more important metric is organic recurring revenue which is still growing at a pleasing double-digit pace, up 10.2% to £779 million.

Subscription growth was stronger, surging 27.7% year-on-year with more subscriptions in North America and Europe. However, this was offset by an 11.8% decline in SSRS as the business continues to transition out of 'licence revenues' towards a more stable subscription model.

In light of this continued growth, CEO Steve Hare commented that they "*... are encouraged by the strong start to FY19*" and he also added that they will maintain focus on the transition to SaaS as "*... reflected in the strong performance in high quality recurring revenue, underpinned by subscription in the first half of the year. We will continue to focus on driving high-quality recurring and subscription revenue in the second half of the year.*"

Organic operating profit, though, fell a slight 0.8% to £218 million largely reflecting the impact of taking out recurring income and one-off gains from the sale of its US Payroll processing business and restructuring costs. On that note, Statutory Operating Profit did increase 13% to £210 million from the mix of one-off gains and new accounting policies (IFRS 15 – unbundling subscription revenues et al).

	H1 19 £m	H1 18 £m	Change %
Total Organic Revenue	£941m	£886m	6.2%
Recurring revenue	£779m	£707m	10.2%
Organic operating profit	£218m	£220m	(0.8%)
Organic operating profit margin %	*23.2%*	*24.8%*	*(1.6 %pts)*
Underlying operating profit	£218m	£224m	(2.9%)
Underlying operating profit margin %	*22.7%*	*24.6%*	*(1.9 %pts)*
Underlying basic EPS	13.93p	14.24p	(2.2%)
Dividend per share	5.79p	5.65p	2.5%
Annualised Recurring Revenue (ARR)	1,545m	1,402m	10.2%

Source: 17 May 2019 Company Presentation

As evident from the image above, the company's organic operating margin fell within guidance while recurring revenues were ahead of the target. As a result, management reaffirmed their targets for FY19 and added that they expect that results will be "*at the top end or slightly exceed the guided range*" for revenues while the operating margin will be within the 23% and 25% range.

Unsurprisingly, optimism followed the results and has lifted the company's valuations with the forecast P/E now at 26 times, which is somewhat lofty in our view given that the sector median is trading far below that at a multiple of 15.9 times while profit growth will continue taking a hit from company 'investment' in pursuing the new model.

As reflected in the Daily chart below, the share prices are near peak levels while looking to have stabilised as the growth was priced in with the shares now currently trading in a tight range between the 737.8p (support, blue line) and 773p (resistance, thick red line) levels.

In light of that, we see this as an opportune time to cash in on some gains and issue a SELL HALF recommendation on the Sage Group.

Summary

Following what was a solid start to 2019 in the first quarter, the **Sage Group** (LSE.SGE) has continued this trend with its first half report showcasing sustained growth with robust subscription growth in North America and Europe. Progress towards the subscription model is at a pleasing pace.

That said, the progress has pushed sentiment to upbeat levels and lifted the valuation to a somewhat lofty level with the forecast P/E now at 26 times which is well above the sector median's 15.9 times figure.

Accordingly, we believe it a prudent time to cash in some gains and issue a SELL HALF recommendation on the Sage Group.

ELD, EVN, FID, FMG, FPC, FPP, GMG, GOR, GPT, HUB, IGO, ILU, JHK, MAI, MCR, NAB, NCM, NEC, NUF, NXT, ORE, OSH, OVH, OZL, PAN, PPS, QBE, RI(SAR, SBM, SCG, SCP, SFR, SGP, SHL, SHV, SLR, SPK, SRV, STO, SUN, SYD, TLS, TPM, VCX, VOC, WBC, WES, WHC, WPL, WSA, International stocks: Aliba Alphabet, Alstria Office, American Homes 4 Rent, Apple, Ashford Hospitality Trust, Avalonbay Communications, Baidu, Braemar Hotel & Resorts, Brookfield Property Partners, Camden Property Trust, Castellum, Champion Real Estate Investment Trust, China Lodging Group , CNOOC, Coeur Mining, Columbia Property Trust, Cubesmart, Deutsche Wohnen, Entra ASA, Euronext, Extended Stay America, Extra Space Storage, FedEx, Frasers Hospitality Trust, Guangzhou Automotive, Heineken, Harmony Gold, Hufvudstaden, Icade, Industrial Logistics Properties Trust, Inmobiliaria Colonial Intu Properties, Japan Airport Terminal, Land Securities Group, Meituan Dianping, MGM China, Mitsui Fudosan Co, National Storage, Nintendo, Office properties income Trust, Prologis, Retail Value, Sands China, Segro, Seritage Growth Properties, Site centres Corp, SMC Corp, Sony, SPDR Gold Trust, Spirit Reality Capital, Sumitomo Mitsui Financial, Tanger Factory Trust, Taubman Centres, Tencent, Vail Resorts, VanEck Vectors Gold Miners ETF, VanEck Vectors Junior Gold Miners ETF, Vereit, Vodafone, Vonovia, Vornado Reality, Trust, Walt Disney, Wharf Real Estate Investment Co, Wynn Macau, Wynn Resorts, Zillow, ZOZO. These may change without notice and should not be taken as recommendations.