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Softing CEO Dr. Trier: “Jump in profits of around 50 percent expected in 2018”

May 26, 2017 (www.4investors.de) - Softing AG’s start to the 2017 financial year was stronger than expected with organic growth of 11 percent in the first quarter. However, despite lifting its revenue guidance, diagnostics specialist Softing’s stock price has yet failed to gather momentum. The Industrial and IT Networks segments are showing dynamic growth, but delayed product development pushed the Automotive segment into the red.

“We have learned from our mistakes,” Softing CEO Dr. Wolfgang Trier states in a discussion with 4investors.de editors. After a change of management, the new product generation is now expected to hit the market this year. The Group’s CEO and major shareholder can envision a capital increase ranging from 6 to 10 percent for purposes of financing acquisitions. The current undervaluing of Softing’s stock offers “considerable upside potential” in his opinion.

www.4investors.de: Softing’s start to the 2017 financial year was stronger than expected with organic growth of 11 percent in the first quarter. In which segments was business particularly good?

Trier: Our business in the first quarter was driven by the Industrial and IT Networks segments. Industrial’s European activities performed well according to plan, but the particularly high-margin US business, which generates solid revenue, was the top contributor to this development. This made us very happy, because we had initially gone into the year with a more cautious outlook. We can also see that the increase in marketing activity and our strong presence at trade fairs and partner events are significantly stimulating demand.

www.4investors.de: Orders on hand are up 50 percent to EUR 14.6 million. What share of this robust growth is attributable to new products?

Trier: This growth is due to a balanced mix of established and new products. Don’t forget that established products are also regularly updated with new features and enhancements. And that orders on hand additionally include call-offs for the third and fourth quarter of 2017. That helps us with visibility for the second half of the year.

www.4investors.de: As mentioned before, the subsidiary Softing IT Networks GmbH has developed into a growth engine that is expected to deliver a double-digit revenue boost in 2017. Are you reaping the benefits of the increasing focus on the wireless (WiFi) market? What new products do you have in that pipeline?

Trier: First of all, the figures reflect our massively increased marketing efforts. The products of the IT Networks segment are the most closely linked to the end customer of any in the Group. That is why communication with customers through the website, product videos, training, and white papers has major impact on demand. With our new products, we are aiming directly and indirectly at the high growth rates in the wireless market. In the fourth quarter of 2017, we will launch two new products featuring state-of-the-art technology whose superior performance will be an absolute unique selling point. That creates revenue potential for 2018, but also enhances our brand’s technological leadership.

www.4investors.de: There was a bitter pill in the Q1 report, too: the significant delays in product development in the Automotive segment. Can you explain the background to these delays? What products are affected, and why did the delays occur?

Trier: For me, it’s more than just a bitter pill, it’s rather an entire bottle of bitter pills. Last year, we began developing a brand-new family of diagnostic interfaces (VCIs) and, at the same time, started developing completely new and highly complex middleware. Instead of working on these new products step by step, we tried to overhaul everything at once and got trapped in the project’s complexity. We massively underestimated the effort this would take. Now, development is going to cost well over what we had originally budgeted due to the delays. Customers who were enthusiastic and bought these products as early as last year will receive their equipment much later than expected. And we have to ask new customers with an urgent need for specifically these devices to be patient. This is causing us more than considerable financial difficulties at present. All we can do is take a good hard look at ourselves and learn from our mistakes.

www.4investors.de: What unique selling points do these products have? When do you expect them to be able to contribute substantially to revenue and earnings?

Trier: With the computing power of two processors, the diagnostic interfaces (VCIs) represent a technological advance and open up completely new applications. The middleware is a highly complex software layer that developers at automakers and automotive suppliers can use to simulate signals from other control units not yet available at the time of development, a process called restbus simulation. This unlocks a wide range of applications in the development of control units and engine test stands as well as control unit quality control, which were not previously imaginable. That is also the source of the keen interest expressed by our customers.

www.4investors.de: You just said that you have learned from your mistakes. What will be the consequences of the recent unsatisfactory development in the Automotive segment?

Trier: First, we analyzed the situation and reviewed options. The products in development are potentially big sellers, so the decision to develop them was the correct one. However, the way this division handled planning and progress tracking was unfortunately completely unacceptable. This is why the employees responsible no longer work at Softing AG. However, because the demand for these products remains high despite the delays, we have decided to systematically continue development regardless of the additional cost. The new generation will be market-ready as early as this year. And as early as 2018, we already expect our Automotive segment to be in the black again.

www.4investors.de: In the North American market, you report a "massive improvement in sentiment since the presidential election." What do you expect from the US market in 2017 as a whole?

Trier: The first quarter was particularly strong. Both US companies returned to the strong revenue and earnings figures they posted in 2015 and even surpassed them in some areas. The entire manufacturing industry is currently making a leap forward. Projects are coming back, and budgets are flowing again. In times of crisis and upheaval, Americans react more strongly than we are used to in Europe. After an already very favorable first quarter, the main boost is expected in the fourth quarter, for which we have already received a number of call-off orders. In 2017, we therefore look forward to strong growth in the US market.

www.4investors.de: What do you expect from the oil and gas industry?

Trier: The oil and gas industry in the United States is recovering right now, but slowly. Currently, only some 50 percent of extraction capacity is being used productively. With prices expected to rise, however, producers can and must be able to react quickly. The resulting orders are not yet on Softing's books, as they are for series products, which are ordered and shipped at short notice. From the fourth quarter onward, though, we anticipate fresh momentum for growth from new, major infrastructure projects. Examples of these are large pipeline projects still in the planning phase. We are initially receiving costing requests from planners. At this time, we can't yet predict the extent to which the expected orders will already be realized in 2017 or not until 2018.

www.4investors.de: Let's talk about your forecast for the 2017 financial year. To what degree will revenue and earnings for 2017 as a whole still be influenced by the delays in the Automotive sector?

Trier: Well into the third quarter, 2017 will be dragged down by a combination of increased costs and delayed deliveries in the Automotive segment. How quickly we can ramp up revenue with the new products is difficult to say right now. For this reason, our revenue guidance falls between EUR 5 million and EUR 6 million, and I am unable to make a more precise forecast at this time. But overall, we expect strong growth to continue for the rest of the year, with good income in the Industrial segment. As a result, the full-year outlook looks much more positive for us than it did at the start of the year. Accordingly, we have raised our forecast for 2017 revenue to approximately EUR 85 million.

www.4investors.de: In the outlook for 2017, you stated that you would also like to further pursue non-organic growth to close strategic gaps and lay a broader geographical foundation for revenue generation. What specific gaps have you identified?

Trier: The Automotive segment must wrap up development and will at least break even for 2018. For that reason alone, non-organic growth is a possibility only in the Industrial and IT Networks segments. Discussions are underway in both segments in which non-disclosure agreements have been signed, and in some cases, the negotiations are already pretty specific. Until we sign a contract, however, we are keeping all options open. For that reason, we don't yet want to say anything about timing or the likelihood of an actual deal.

www.4investors.de: How much financing do you have available for non-organic growth? Would a capital increase be an option for financing larger acquisitions?

Trier: Taking into account the currently identified takeover candidates and the product initiatives at Automotive and IT Networks, we have calculated our capital requirements for the next 24 months. Our estimate includes a mix of debt and equity. However, a capital increase would only range between around 6 percent and 10 percent. This would enable us to take the opportunity to bring on board additional institutional investors or solidify existing relationships with anchor investors.

www.4investors.de: When will Softing set its sights on the psychologically important revenue hurdle of EUR 100 million?
Trier: In our medium-term planning, we took aim at this target for the 2018 financial year. Achieving this goal would be more realistic to expect in 2019 or 2020 with purely organic growth. An acquisition could speed this up considerably, of course.

www.4investors.de: In the past three years, the price of Softing shares has moved sideways while experiencing sharp volatility. For shareholders, this performance is not satisfactory. Are you indicating with your recent share purchases that Softing's stock currently has a positive risk/reward ratio?

Trier: Although I am a long-term investor and therefore less affected by this development, it is clear that our share performance in the past two years has been totally unsatisfactory. The current low valuation offers substantial upside potential, however. Even though the full potential of the entire Softing Group will not be evident until the third quarter, and even more in the fourth quarter of 2017, the Industrial and IT Networks segments are performing very well thanks to sustained trends. If we were to assume that the Automotive segment's expected losses for 2017 were down to zero in 2018, this would already mean a profit boost for 2018 of around 50 percent, and that is a rather conservative scenario. Anything better than breaking even in the Automotive segment would increase profits even more. This is why I took advantage of this opportunity at a time I was still legally able to.