Softline AG

Close Brothers Seydler Research AG

Recommendation:	Risk:	Price Target:	
BUY (-)	HIGH (-)	EUR 4.00 (-)	19 August 2010

Turning back to a sustainable growth path...

..with a streamlined/realigned business model and reputable management

- Softline AG is a Germany based IT service provider headquartered in Leipzig. The company operates through its two wholly-owned business units, Softline Solutions GmbH, located in Leipzig and Prometheus GmbH in Munich. Whereas Softline Solutions GmbH has been established to serve end-customers directly (B2C segment) by Softline´s own employees, Prometheus GmbH is servicing end-customers indirectly (B2B segment) over its clients.

- Softline AG was founded in 1983 and originally focused on software distribution. Within the first 17 years since inception the company experienced dynamic growth that pushed revenues from under EUR 1m in 1983 to approximately EUR 85m in 2001. Since then revenues declined steadily and reached EUR 19.4m in fiscal year 2008/2009 on the group level.

- In the second half of 2009 Softline started a restructuring, recapitalizing and refocusing process. The business model has been aligned to participate from current and future trends in the IT service sector. The restructuring measures lead to reduced revenues of EUR 0.45m and simultaneously decreased workforce to 9 employees as of 31 December 2009.

- Softline´s business model is geared to profit from future trends in the IT industry. One important future trend in the IT industry, which has a major impact on the way enterprises manage and allocate internal resources to their IT infrastructure, is driven by "cloud computing".

- For 2010E we estimate sales of EUR 10,44m. Previous year Softline generated sales of EUR 1,6m without revenue contributions of both Prometheus and Softline Solutions. We expect sales volume to further increase dynamically in 2011E and 2012E.

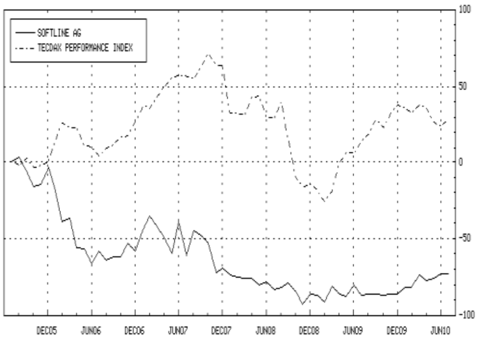
- Our base case DCF model results in a fair value of EUR 4.03 per share. We start our coverage with the price target of EUR 4.00 and recommend to BUY the share.

Key data

Y/E 31.12., EUR m	2008	2009	2010E	2011E	2012E
Sales	19.4	1.6	10.4	15.7	21.1
Gross profit	2.8	0.2	4.8	10.7	14.4
EBITDA	-2.2	-0.7	-2.2	1.3	2.2
EBIT	-1.4	-0.7	-2.4	1.0	1.9
Net income	-1.6	-0.7	-2.4	1.0	1.8
EPS	-0.15	-0.70	-0.55	0.24	0.41
CPS	0.03	0.13	0.06	0.06	0.22
Gross profit margin	14%	15%	46%	68%	68%
EBIT margin	-7.0%	-45.3%	-22.6%	6.7%	8.8%
P/E	n.m.	n.m.	n.m.	11.7	6.9

Source: Softline AG, CBS Research AG

Share price (dark) vs. TecDAX



Source: CBS Research AG, Bloomberg

Change	2010E		2011E		2012E	
	new	old	new	old	new	old
Sales	10.4	-	15.7	-	21.1	-
EBIT	-2.4	-	1.0	-	1.9	-
EPS	-0.55	-	0.24	-	0.41	-

www.softline.de	Sector: Software
WKN: A1CSBR	ISIN: DE000A1CSBR6
Reuters: SFDGk.DE	Bloomberg: SFD1 GY

Short company profile

Softline is a German manufacturer-independent ICT solution provider. Softline services small and midsized companies as well as large customers and IT service providers.

Share data:

Share price (last closing price, EUR):	**2.85**
Shares outstanding (m):	4.30
Market capitalisation (EURm):	12.25
Enterprise value (EURm):	12.75
Ø daily trading volume (3 m., no. of shares):	5,673

Performance data:

High 52 weeks (EUR):	3.00
Low 52 weeks (EUR):	1.08
Absolute performance (12 months):	98%
Relative performance: (vs. TecDAX)	
1 month	12%
3 months	10%
6 months	28%
12 months	80%

Shareholders:

SKMB	25.1%
Dr. Knut Löschke	13.5%
Donner-Reuschel Bank	5.8%
S-Beteiligungen Leipzig	5.0%
Checkmark	5.1%
Christoph Michel	2.4%
Free float	43.1%

Financial calendar:

Fiscal Year End	31 December 2010

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Investment thesis

Germany based IT service provider

Softline AG is a Germany based IT service provider with headquarters in Leipzig. The company operates through its two wholly-owned business units, Softline Solutions GmbH, located in Leipzig and Prometheus GmbH in Munich. Whereas Softline Solutions GmbH has been established to serve end-customers directly (B2C segment) by Softline´s own employees, Prometheus GmbH is servicing end-customers indirectly (B2B segment) over its clients. That is, Prometheus provides over 11,000 freelance experts under contract IT services to its clients that operate by themselves as IT service providers for big end-customers otherwise not accessible to Softline.

Business model geared to profit from future trends in the IT industry...

Softline´s business model is geared to profit from future trends in the IT industry. With regard to its core business activities in Germany Softline has established a business structure that defines the future path of operating activity the company intends to pace. With the sale of its software distribution subsidiary TradeMail Distribution GmbH, Softline refrained from a low-margin and not up to date business model and put more emphasis on IT consulting and IT services.

...which has a major impact on the way enterprises use IT infrastructure

One important future trend in the IT industry, which has a major impact on the way enterprises manage and allocate internal resources to their IT infrastructure, is driven by “cloud computing”. Cloud computing is the convergence of three other major trends namely virtualization, utility computing and Software-as-a-Service (SaaS). Furthermore, cloud computing is internet-based computing, where shared resources, software and information are provided to differing devices for users, on demand.

IT services that benefit customers

Softline AG designs, delivers, optimizes, maintains and operates cloud computing based IT infrastructures as a 100% service model. That is, Softline´s clients are billed on a utility (resources consumed, like electricity) or subscription (time-based, like a newspaper) basis with little or no upfront cost. Furthermore, users can terminate the contract at any time, and the services are often covered by service level agreements (SLAs) with financial penalties. Major benefits of this servicing approach are lower operating costs, lower IT overhead costs, higher flexibility, and immediate access to a broad range of applications without investing in expensive IT infrastructure. Besides avoiding the risk of technological change or obsolescence, clients´ resources can be directed away from IT maintenance toward operation related tasks.

Organic and inorganic growth to propel growth

Cloud computing is likely to take center stage in IT outsourcing in 2010 and beyond, according to market experts. In order to participate in growth potentials cloud computing is promising, Softline focuses on an organic and inorganic growth strategy. Organic growth is expected to be generated within Germany by mainly focusing on small and midsized companies (Softline Solutions GmbH) and by servicing big IT service providers (Prometheus GmbH). Inorganic growth will come from acquiring foreign small IT service providers. Softline has already identified the acquisition targets and communicated the planned capital increase to shareholders and potential investors. The main benefits Softline´s management expects to yield from following this international expansion strategy is a broad substantial growth basis that secures profitability at group level. From our point of view, acquiring competitors and market share is an important prerequisite to successfully operate in this absolutely competitive market environment.

Abbreviated fiscal year and restructuring process cause not representative financial figures for fiscal year 2009

Softline´s restructuring process lead to reduced revenues of EUR 0.45m and a decreased workforce of 9 employees as of 31 December 2009. Net loss for the abbreviated fiscal year amounted to EUR 0,71m. Restructuring costs of EUR 0,068m and provisions of EUR 0,15m for the executed personnel measures negatively affected net profits. These financial figures for the abbreviated financial year 2009 are not representative and comparable with both previous as well as future financial company data. Whereas past financial figures are not comparable due to restructuring measures that changed the business model, company´s future financial figures cannot been extrapolated based on the historical ones. Additionally, in 2009 the company reported according to German commercial code (HGB), the years before the financial statement was prepared in conformity with IFRS. The management plans to move back to the IFRS standard.

Sales of EUR 10.44m for 2010E expected

For 2010E we estimate sales of EUR 10.44m. Previous year the company generated sales of EUR 1.6m without revenue contributions of both Prometheus and Softline Solutions. Therefore, the rapid increase in sales in 2010E is a result of the restructuring process and hence a non-recurring item. We expect sales volume to further increase dynamically in 2011E and 2012E. Whereas for 2011E we assumed a sales growth rate of 50.2% which results in sales of EUR 15.69m, for 2012E we forecast sales to expand by 34.5% corresponding to sales of EUR 21.10m.

Losses carried forward lift earnings after taxes

Operating without financial debt, Softline´s profit is not reduced by interest expenses or increased by interest income. Furthermore, according to Softlines´ losses carried forward of approximately EUR 30m, the company will profit from extremely low income taxes. For EBT (earnings before taxes) under EUR 1m, Softline is exempted from tax payments. That's why in 2011E EBIT of EUR 1.05m translates one-to-one into EAT (earnings after taxes). For 2012E we expect EBIT of EUR 1.85m, which results in EAT of EUR 1.77m.

No peer group analysis

Deriving the fair value of Softline AG, we have confined ourselves to a Discounted Cash Flow Model. The rationale behind this decision is primarily due to the current corporate restructuring process and the risks associated with it.

Fair value and price target refer to the organic growth scenario

In our base case DCF valuation (organic growth) we did not assume any potential acquisitions that might arise in the near future and build a crucial component in Softline´s growth strategy. Instead, we pictured an organic growth scenario that reflects growth opportunities of the two subsidiaries Prometheus GmbH and Softline Solutions GmbH. Hence, the forecasts for the profit and loss account and the balance sheet of Softline refer to already existent corporate structure with its inherent growth potential. We did not explicitly model a separate profit and loss account and balance sheet incorporating the inorganic growth scenario. However, in order to increase transparency and show investors the possible value added range of the inorganic strategy, we decided to complement our analysis with a separate valuation part that illuminates the inorganic growth strategy quantitatively.

Price target of EUR 4.00 and recommendation BUY

Our base case DCF model results in a fair value of EUR 4.03 per share. Our calculated fair value does not include potentials arising out of the inorganic growth scenario. Hence, our fair value and price target refers to the organic growth scenario and not to the one incorporating planned acquisitions. We start our coverage with the price target of EUR 4.00 and recommend to BUY the share.

SWOT

Strengths

- Experienced and reputed management team with proven track record in building up and expanding businesses within the IT sector in Europe.
- Softline AG possesses long-term established relationships with big market players like T-Systems, Siemens, Dell Services, Fujitsu, HP Services, ComputaCenter or DHL. These business relations positively contribute to business activities of Prometheus (B2B) and indirectly benefit Softline Solutions GmbH in servicing end customer (B2C).
- With over EUR 30m in useable corporate tax exemptions potential future corporate profits should evolve disproportionally with regard to revenues and other financial operating key figures.
- The company was restructured and recapitalized so that financial and strategic relics of past corporate development do not exist anymore. Hence, the streamlined business model is now operating on a financially sound operating basis which is the prerequisite for entering a dynamic and profitable growth path.
- The Prometheus business unit manages a pool of approximately 11,000 IT-experts/freelancers. Therefore, the company is able to offer aligned IT services to big IT service providers like T-Systems or HP Services that service their own clients operating in different sectors. Due to the fact that Prometheus´ freelance experts cover a huge range of technical topics, the offered IT support services are not focused or restricted to certain types of IT projects.
- “Softline” is a well known brand that is active in the IT industry since nearly 27 years. Despite the fact that Softline, like many other IT companies, struggled with the economic consequences of the dot-com bubble which had a detrimental effect on corporate profitability, the company´s history reveals that Softline was not a product of the speculative IT bubble that inflated between 1995 and 2000. Rather Softline belongs to the kind of IT companies that went along with the steady growth of the World Wide Web long before the boom and bust cycle started.

Weaknesses

- The company is currently not profitable and the company is still in its restructuring phase because the build-up of Softline Solutions is not accomplished yet. Therefore, besides its well defined growth strategy and the reputed management, the inherent the inherent business risk is quite high.
- Due to the fact that the company was restructured both with regard to the business focus and the capital structure, no reliable track record is available which exacerbates financial analysis and planning.
- The company´s future development is highly dependent on the current management team and its corporate vision.

- In order to establish the depicted business model and simultaneously grab significant market share, Softline has to conduct further capital increases. This increases dependencies on external investors and their willingness to provide the required funds.

Opportunities

- Softline´s core strategy is to concentrate on the high growth potential related to the cloud computing solutions market. In order to secure a significant market share within a relatively short period of time, the company intends to acquire market participants abroad. With successful acquisitions the company would increase market share quickly and participate in broad-based and internationally diversified growth.
- The international acquisition strategy is accompanied by growth strategies targeting the German IT service markets. With the new licensing model Softline is applying, market share could be increased significantly as contractual dependences of customers are avoided. Hence, if the innovative distribution model is successful, Softline will experience above market growth in Germany.
- Market experts predict high value growth in the market segment "Infrastructure as a Service / Cloud Computing" within the next years.
- Softline´s acquisition strategy is supported by the fact, that currently weak economic surroundings alleviate the identification of attractively valued targets.

Threats

- Softline is highly dependent on a qualified and experienced workforce. Therefore, in case of inadequate allocation of vacancies corporate development could be hampered or future prospects deteriorated.
- The order situation for IT service providers is dependent on IT budgets of customers which in case of Softline are small and mid-sized companies as well as big IT service providers. Weak economic surroundings could urge customers to postpone necessary investments into their IT infrastructure which in turn would adversely affect Softline´s assets, financial and earnings situation.
- Due to the fact that big IT projects are long term ventures, the allocation of workforces within the Prometheus business unit have to be implemented carefully. Otherwise, bounded resources would prevent the realization of more attractive business opportunities.
- The need for capital increases dependencies on external financing sources which could detrimentally effect corporate development. The risk of financing (working capital and acquisition targets) will prevail as long as the company reaches a crucial size of enterprise enabling the management to finance further growth by utilizing internal financing sources.
- The IT service sector is a fragmented, dynamic and highly competitive industry. Reacting slowly or making the wrong decisions would not only delay break even but also crucially increase the probability of a downturn.

Valuation

Valuation with the DCF model

In deriving the fair value of Softline AG we have confined ourselves to a Discounted Cash Flow Model. The rationale behind this decision is primarily due to the current corporate restructuring process and the risks associated with it. Although Softline´s business model has been restructured in the second half of 2009 and the management currently is concentrating more on boosting organic and inorganic growth, short- to mid-term corporate development is still prone to significant changes with regard to both corporate structure and growth opportunities. Consequently, the risk of conducting an inadequate peer-group calculation by referring to inappropriate peer group candidates is too high. Additionally, Softline is currently not operating on a profitable basis but expected to turnaround in 2011E.

Base case DCF valuation model reflects organic growth

In our base case DCF valuation (organic growth scenario) we did not assume any potential acquisitions that might arise in the near future and build a crucial component in Softline´s growth strategy. Instead, we pictured an organic growth scenario that reflects growth opportunities of the two subsidiaries Prometheus GmbH and Softline Solutions GmbH. However, to increase transparency and show investors the potential associated with an investment in Softline, we decided to complement our valuation by an inorganic growth scenario that adds up to our base case scenario.

Inorganic growth strategy crucial part of Softline´s equity story

Investors should be aware that the execution of the depicted inorganic growth strategy is quite probable as Softline´s management presented its growth strategy on the general meeting that took place in Munich on the 9th of July 2010. In order to finance the expansion strategy the management suggested a capital increase of up to EUR 4,3m in share capital. More than 99% of the votes represented approved the suggested increase in share capital. With their approval, shareholders have paved the way for engagement on the part of individual strategic and institutional investors, who will provide fresh capital to enable the company to implement the inorganic growth strategy. The company has already received subscription forms of approximately 40% for the approved increase in share capital by Softline´s board of directors. Hence, besides the fact that almost half the capital needed to fund the inorganic growth strategy is already available, the fact that Softline´s management participates in the capital increase indicates a strong incentive to divert the funds efficiently in order to direct the company to a profitable growth path in a timely manner. In sum, the probability of a successful implementation of the inorganic growth strategy is quite high and should therefore been considered as a crucial part of the equity story.

Overall, our valuation approach is based on the following two main assumptions:

- Our base case DCF valuation model indicates the fair value for Softline AG. That is, by analysing the organic growth potential of the company we circumvent the risk of postponed or failed acquisition activity.

Inorganic growth strategy involves chances and risks

- In order to increase transparency and show investors the possible value added range of the inorganic strategy, we decided to complement our analysis with a separate valuation part that illuminates the inorganic growth strategy quantitatively. We argue that investors will benefit from the acquisition process if and only if Softline´s management is able to add value to the acquired corporations. Hence, the inorganic growth strategy not only dangles upward potential for the stock but also a downside risk due to a failed integration policy.

Fair value per share is EUR 4.03

Our base case DCF model results in a fair value of EUR 4.03 per share. The calculated fair value indicates an upside of +41.4%. We would like to point out that this potential comes with high volatility. Since the company is still in its restructuring phase and the build up of Softline Solutions is not accomplished, the inherent business risk is quite high. However, we believe that the reputed management team with its skills and valuable business network possesses the prerequisites to pave the way for a profitable and sustainable growth.

BUY recommendation with share price target of 4.00 EUR

Our calculated fair value does not include potentials arising out of the inorganic growth scenario. To show possible value addition in fair value from the inorganic scenario, we decided to picture a second independent DCF model that derives a fair value incorporating the inorganic growth strategy. Hence, our fair value and price target refers to the organic growth scenario and not to the one incorporating planned acquisitions. We start our coverage with the price target of EUR 4.00 and recommend to BUY the share.

DCF valuation – organic growth scenario

Assumptions:

By means of DCF model (three phases) we calculated the fundamentally deduced fair value of Softline AG. Concerning cash and cash equivalents as well as debts we referred to the balance sheet of the first quarter year of 2010E.

WACC of 12.32%

Weighted average cost of capital (WACC): Based on the long-term yields of German federal bonds, we set the risk-free rate at 3.0%. We assumed an equity risk premium of 6.0%, and a debt risk premium of 3.5%. With regard to company´s beta, we accounted for the fact that Softline belongs to high-beta stocks. High-beta stocks are supposed to be riskier but provide a potential for higher returns. Therefore, in calculating the cost of equity for Softline we assumed a beta of 1.60 mirroring the upward potential but also the downside risk of the stock. For the calculation of Softline´s WACC, we assumed a long-term target equity ratio at market values of 95%. These estimates lead to a WACC of 12.32%.

Phase 1: Detailed financial forecasts

Phase 1 (2010-12E): We estimated the free cash flows (FCF) of phase 1 according to our detailed financial forecasts for these years.

Phase 2: Decreasing growth rates and increasing EBIT margins

Phase 2 (2013-19E): For Phase 2, we made more general assumptions. We allowed annual total revenues growth to decrease successively to 10.0% in 2019E, resulting in a CAGR 2013-19E of 17.7%. This organic growth scenario seems rather ambitious but the early stage of Softline and the dynamic market environment the company is operating in are two important justifications for our assumed growth scenario. Furthermore, we supposed an increase of the EBIT margin to 12.0% in 2019E. We argue that the increasing EBIT margin is the result of more efficient business processes at Softline AG and dynamically evolving technological innovations in the field of cloud computing.

Phase 3: 1.5% growth for terminal value

Phase 3: For the calculation of the terminal value, we applied a long-term FCF growth rate of 1.5% that approximates the estimated long-term inflation rate. This assumption theoretically corresponds to a real-term zero growth, since we use a nominal discount rate (WACC).

Based on these assumptions we calculated a fair value of the operating business of EUR 16.8m. Having added Softline´s cash position of EUR 0.5m we derived the fair value of equity of EUR 17.3m. The fair value per share of the DCF model amounts to EUR 4.03.

DCF model results in a fair value per share of EUR 4.03

Discounted Cash Flow Model

	PHASE 1			PHASE 2							PHASE 3
EURm	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	∞
Total sales	10.4	15.7	21.1	26.3	32.5	39.8	47.2	53.6	59.9	65.9	
YoY growth	552.5%	50.2%	34.5%	24.4%	23.8%	22.4%	18.7%	13.5%	11.8%	10.0%	
EBIT	-2.4	1.0	1.9	2.4	3.1	3.9	5.0	6.1	7.1	7.9	
EBIT margin	-22.6%	6.7%	8.8%	9.1%	9.5%	9.8%	10.5%	11.4%	11.9%	12.0%	
Income tax on EBIT (cash tax rate)	0.0	0.0	-0.1	-0.1	-0.2	-0.3	-0.4	-0.5	-0.6	-0.7	
Depreciation and amortisation	0.1	0.2	0.3	0.4	0.5	0.6	0.7	0.8	0.9	1.0	
Other non-cash items	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Change in net working capital	-1.7	-1.0	-1.1	-1.7	-1.6	-2.1	-2.3	-2.4	-2.6	-2.7	
YoY growth		-41.2%	8.9%	59.2%	-5.3%	30.1%	9.6%	4.4%	5.9%	5.6%	
WC in % Sales	16.5%	17.3%	18.0%	21.7%	24.7%	25.0%	27.2%	29.3%	31.0%	32.5%	
Net capital expenditure	-0.7	-0.3	-0.3	-0.5	-0.6	-0.7	-0.8	-0.9	-1.0	-1.1	
Net capital expenditure in % Sales	6.39%	1.74%	1.51%	1.83%	1.83%	1.83%	1.74%	1.74%	1.74%	1.72%	
Free cash flow	**-4.6**	**0.0**	**0.7**	**0.5**	**1.1**	**1.4**	**2.2**	**3.1**	**3.8**	**4.4**	
Present values	**-4.4**	**0.0**	**0.5**	**0.3**	**0.7**	**0.7**	**1.0**	**1.3**	**1.4**	**1.5**	**13.7**

Present value Phase 1	-3.9
Present value Phase 2	6.9
Present value Phase 3	13.7
Total present value	16.8
+ Excess cash/Non-operating assets	0.5
- Financial debt	0.0
Fair value of equity	17.3
Number of shares (m)	4.3
Fair value per share (EUR)	**4.03**

Risk free rate	3.00%	Target equity ratio	95.0%
Equity risk premium	6.00%	Beta (fundamental)	1.60
Debt risk premium	3.50%	**WACC**	**12.32%**
Tax shield	28.0%	**Terminal growth**	**1.5%**

Source: CBS Research AG

Sensitivity analysis

		Terminal growth (Phase 3)				
		0.5%	**1.0%**	**1.5%**	**2.0%**	**2.5%**
	11.3%	4.38	4.56	4.77	4.99	5.25
	11.8%	4.04	4.20	4.38	4.57	4.79
WACC	**12.3%**	3.73	3.87	**4.03**	4.20	4.39
	12.8%	3.45	3.57	3.71	3.86	4.03
	13.3%	3.19	3.30	3.42	3.56	3.70

		Terminal growth (Phase 3)				
		0.5%	**1.0%**	**1.5%**	**2.0%**	**2.5%**
	2.2	2.22	2.28	2.35	2.43	2.51
	1.9	2.86	2.96	3.06	3.17	3.29
Beta	**1.6**	3.73	3.87	**4.03**	4.20	4.39
	1.3	4.93	5.16	5.40	5.68	5.99
	1.0	6.69	7.06	7.49	7.97	8.54

		Beta				
		1.0	**1.3**	**1.6**	**1.9**	**2.2**
	8.0%	5.19	3.54	2.48	1.76	1.25
Risk	**7.0%**	6.20	4.35	3.14	2.31	1.71
prem.	**6.0%**	7.49	5.40	**4.03**	3.06	2.35
Equity	**5.0%**	9.20	6.84	5.24	4.10	3.26
	4.0%	11.55	8.86	6.99	5.63	4.61

		Risk free rate				
		2.0%	**2.5%**	**3.0%**	**3.5%**	**4.0%**
	5.5%	4.69	4.32	3.98	3.67	3.40
Risk	**4.5%**	4.72	4.34	4.00	3.70	3.42
prem.	**3.5%**	4.75	4.37	**4.03**	3.72	3.44
debt	**2.5%**	4.78	4.40	4.05	3.74	3.45
	1.5%	4.81	4.42	4.08	3.76	3.47

Source: CBS Research AG

DCF valuation – incorporating the inorganic growth scenario

Higher top line, lower bottom line than consensus forecast

As mentioned in the base case DCF valuation section above, this additional DCF analysis aims to increase transparency concerning investment in Softline´s stock but does not influence our fair value and price target. We start our inorganic growth analysis by showing the aggregated sales, EBIT and inherent EBIT-margin of the potential targets Softlines has identified and communicated to its shareholders in the general meeting in July 2010. The table hereunder depicts Softline´s organic sales and our projections for the organic growth scenario. Additionally, we display the potential inorganic sales, EBIT and EBIT-margin metrics for Softline. Furthermore, within the inorganic scenario we have distinguished between a stand-alone and a post acquisition scenario. Whereas the stand-alone scenario shows the expected development of the target companies without the managerial influence of Softline, the post acquisition scenario shows the expected upward potential Softline´s management believe to create in target companies. For example, the consensus forecast for the target companies´ sales amounts to EUR 15.89 in 2011E, whereas Softline´s management believes that sales of EUR 27.47m are realizable. With regard to operating profit, the consensus forecast for 2011E is 1.12m, but Softline´s management expects EUR 1.72m, which imply an EBIT-margin of 6.25%. In general, Softline, with regard to the potential acquisition targets, is planning with a more aggressive top line and a lower bottom line than the consensus forecasts.

Organic & Inorganic scenario estimates

EURm	2008	2009	2010E	2011E	2012E
Sales					
Organic sales	19.43	1.60	10.44	15.69	21.10
Inorganic sales (stand alone)	12.80	13.55	13.78	15.89	17.47
Inorganic sales (post acquisition/ under the managament of Softline)	12.80	13.55	13.78	27.47	33.97
EBIT					
Organic EBIT	-1.36	-0.72	-2.36	1.05	1.85
Inorganic sales (stand alone)	0.87	0.34	0.66	1.12	1.71
Inorganic sales (post acquisition/ under the managament of Softline)	0.87	0.34	0.66	1.72	2.86
EBIT margin					
Organic EBIT	-6.98%	-45.27%	-22.60%	6.67%	8.79%
Inorganic sales (stand alone)	6.81%	2.51%	4.79%	7.02%	9.79%
Inorganic sales (post acquisition/ under the managament of Softline)	6.81%	2.51%	4.79%	6.25%	8.42%

Source: CBS Research AG

We then aggregate the organic and the inorganic sales and EBIT (post acquisition/under the management of Softline) and assume that firstly, sufficient money is available to finance the inorganic growth and secondly, that the management is able to play out its communicated inorganic growth strategy successfully.

The table hereunder shows the aggregated sales and EBIT metrics for Softline. As can be seen, the inorganic growth figures add up to the organic growth figures. In our scenario analysis, we assume that Softline´s acquisition costs do not reflect the targets´ potentials. Otherwise, the acquisition process would not allow Softline´s management to create additional value to its shareholders. Therefore, we used the figures related to the post acquisition scenario under the management of Softline in order to derive potential sales and EBIT of the inorganic growth scenario. Hence, we assume that acquisition costs are lower than the fair value of acquired targets.

Aggregated sales and EBIT of Softline AG (If inorganic strategy is successfully implemented)

EURm	2008	2009	2010E	2011E	2012E
Sales	19.43	1.60	10.44	43.16	55.07
EBIT	-1.36	-0.72	-2.36	2.76	4.72
EBIT margin	-6.98%	-45.27%	-22.60%	6.40%	8.56%

Source: CBS Research AG

In order to conduct a DCF valuation for the inorganic growth scenario, we foremost have to calculate probable acquisition costs for the targets. We have accomplished this by arguing as follows. Softline will pay certain EV/EBIT multiples in the range between 4x and 10x for its targets. Multiplying targets´ EBIT with the range of assumed multiples leads to an acquisition costs matrix of probable aggregate acquisition costs for implementing the inorganic growth strategy.

Analysis of probable acquisition costs

EURm		2008	2009	2010E	2011E	2012E
				EBIT		
		0.87	**0.34**	**0.66**	**1.12**	**1.71**
	4x	3.49	1.36	2.64	4.46	6.84
	5x	4.36	1.70	**3.30**	**5.58**	8.55
	6x	5.23	2.04	**3.96**	**6.70**	10.26
Multiples	**7x**	6.10	2.38	**4.62**	**7.81**	11.97
	8x	6.98	2.72	5.28	8.93	13.68
	9x	7.85	3.06	5.94	10.04	15.39
	10x	8.72	3.40	6.60	11.16	17.10

Source: CBS Research AG

The table above shows possible acquisition costs, which we narrow down to the columns 2010E, 2011E and the rows 5x to 7x. By doing so, we obtain probable acquisition costs in the range between EUR 3.30m and EUR 7.81m. As we do not know the exact cash amount Softline will pay for the targets, we weight them equally and calculate probable acquisition costs of EUR 5.33m. Now we have determined the probable cash amount necessary to implement the inorganic growth strategy. The next step is to conduct a DCF valuation revealing the potentials associated with the inorganic growth scenario.

The adjusted DCF Model

WACC of 11% after beta adjustment

Weighted average cost of capital (WACC): In comparison to our base case valuation, we have adjusted our WACC to reflect the different risk-return structure of Softline after the successfully implemented inorganic growth strategy. That is, we believe that the inorganic growth strategy will lead to more diversified revenues of Softline which in turn decrease volatility with regard to both revenues and operating profit. Consequently, Softline´s stock should show less volatile behaviour, which implies a lower company beta. Therefore, we adjusted Softline´s beta to 1.4. All the other parameters required for calculating WACC remain the same as in the organic growth DCF valuation approach. The beta adjustment results in a WACC of 11%.

Phase 1: Detailed financial forecasts

Phase 1 (2010-12E): We estimated the free cash flows (FCF) of phase 1 by firstly adjusting potential revenues and EBIT relating to the inorganic growth strategy. Then we scaled up income taxes, depreciation amounts, changes in net working capital and net capital expenditure. We considered the acquisition costs of EUR 5.33m by adding half the amount to net capital expenditures in 2010E and the residual in 2011E. The reason for this procedure is the uncertainty associated with the accomplishment of the required capital increase and the subsequent acquisition process.

Phase 2: Decreasing growth rates and increasing EBIT margins

Phase 2 (2013-19E): For Phase 2, similar to our base case DCF valuation, we made more general assumptions. We allowed annual total revenues growth to decrease successively to 8% in 2019E, resulting in a CAGR 2013-19E of 14.9% compared to the 17.7% CAGR in the base case. This somewhat less dynamic inorganic growth scenario is justified by the empirical observation that relatively big companies on average show lower growth than smaller ones. Furthermore, we assumed an increase of the EBIT margin to 11.0% in 2019E. We argue that the reduction in the EBIT margin compared to the base case scenario is the result of the integration process and higher administration/holding costs.

Phase 3: 1.5% growth for terminal value

Phase 3: For the calculation of the terminal value, we applied a long-term FCF growth rate of 1.5% that approximates the estimated long-term inflation rate. This assumption theoretically corresponds to a real-term zero growth, since we use a nominal discount rate (WACC).

Fair value of equity of EUR 41.9m

Based on these assumptions we calculated a fair value of the operating business of EUR 41.4m. Having added Softline´s cash position of EUR 0.5m we derived the fair value of equity of EUR 41.9m. The cash position of Softline does not change in our inorganic growth scenario because we suppose that the collected cash amount is fully exhausted in the acquisition process.

Alternative DCF model results in a fair value per share of EUR 6.76

To derive the fair value per share we adjusted the shares outstanding by dividing the required capital increase of EUR 5.33m by the anticipated offering price. We assumed an issue price of EUR 2.8 per share for the capital increase, which equals the current quotation price of Softline´s stock. Dividing the required capital increase by the supposed issue price, we derive an increase in shares outstanding of 1.9m. Adding this amount to the currently outstanding shares of 4.3m and dividing the fair value of equity by the increased shares outstanding, the fair value per share of the DCF model amounts to EUR 6.76.

Discounted Cash Flow Model

	PHASE 1			PHASE 2							PHASE 3
EURm	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	∞
Total sales	10.4	43.2	55.1	67.2	80.6	95.1	109.4	122.5	134.8	145.6	
YoY growth	552.5%	313.4%	25.0%	22.0%	20.0%	18.0%	15.0%	12.0%	10.0%	8.0%	
EBIT	-2.4	2.8	4.7	5.8	7.1	8.6	10.6	12.6	14.4	16.1	
EBIT margin	-22.6%	6.4%	8.6%	8.7%	8.8%	9.1%	9.7%	10.3%	10.7%	11.0%	
Income tax on EBIT (cash tax rate)	0.0	-0.2	-0.4	-0.5	-0.6	-0.8	-1.0	-1.2	-1.3	-1.5	
Depreciation and amortisation	0.1	0.6	0.8	1.0	1.2	1.4	1.6	1.8	2.0	2.0	
Change in long-term provisions											
Other non-cash items	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Change in net working capital	-1.7	-2.7	-2.8	-4.4	-4.0	-5.1	-5.4	-5.5	-5.8	-6.0	
YoY growth		61.7%	3.3%	56.1%	-8.2%	25.4%	6.1%	3.0%	4.2%	3.6%	
WC in % Sales	16.5%	6.3%	6.9%	8.5%	10.0%	10.5%	11.7%	12.8%	13.8%	14.7%	
Net capital expenditure	-3.3	-2.9	-0.8	-1.0	-1.2	-1.4	-1.6	-1.8	-1.9	-2.0	
Net capital expenditure in % Sales	6.39%	1.50%	1.50%	1.50%	1.50%	1.50%	1.45%	1.45%	1.40%	1.40%	
Free cash flow	**-7.3**	**-2.4**	**1.5**	**1.0**	**2.5**	**2.8**	**4.3**	**6.0**	**7.4**	**8.6**	
Present values	**-6.9**	**-2.1**	**1.2**	**0.7**	**1.6**	**1.6**	**2.2**	**2.7**	**3.1**	**3.2**	**34.2**

Present value Phase 1	-7.9
Present value Phase 2	15.1
Present value Phase 3	34.2
Total present value	41.4
+ Excess cash/Non-operating assets	0.5
- Financial debt	0.0
Fair value of equity	41.9
Number of shares (m)	6.2
Fair value per share (EUR)	**6.76**

Risk free rate	3.00%	Target equity ratio	95.0%
Equity risk premium	6.00%	Beta (fundamental)	1.40
Debt risk premium	3.50%	**WACC**	**11.00%**
Tax shield	28.0%	**Terminal growth**	**1.5%**
Mean value of acquisition costs (in EURm)			5.33
Share price for a successful capital increase of Softline (in EUR)			2.80
Implied number of shares (in m)			1.90

Source: CBS Research AG

Sensitivity analysis

Terminal growth (Phase 3)

		0.5%	**1.0%**	**1.5%**	**2.0%**	**2.5%**
WACC	**10.0%**	7.35	7.71	8.11	8.57	9.08
	10.5%	6.73	7.04	7.39	7.78	8.22
	11.0%	6.18	6.45	**6.76**	7.09	7.46
	11.5%	5.69	5.92	6.19	6.48	6.80
	12.0%	5.24	5.45	5.68	5.93	6.21

Terminal growth (Phase 3)

		0.5%	**1.0%**	**1.5%**	**2.0%**	**2.5%**
Beta	**2.0**	3.58	3.70	3.83	3.97	4.12
	1.7	4.67	4.85	5.04	5.25	5.48
	1.4	6.18	6.45	**6.76**	7.09	7.46
	1.1	8.35	8.80	9.31	9.88	10.54
	0.8	11.68	12.48	13.41	14.51	15.83

Beta

		0.8	**1.1**	**1.4**	**1.7**	**2.0**
Risk prem. Equity	**8.0%**	9.70	6.34	4.33	3.03	2.13
	7.0%	11.34	7.63	5.38	3.89	2.85
	6.0%	13.41	9.31	**6.76**	5.04	3.83
	5.0%	16.10	11.53	8.62	6.63	5.20
	4.0%	19.70	14.61	11.27	8.93	7.21

Risk free rate

		2.0%	**2.5%**	**3.0%**	**3.5%**	**4.0%**
Risk prem. debt	**5.5%**	7.97	7.28	6.67	6.12	5.63
	4.5%	8.03	7.33	6.71	6.16	5.67
	3.5%	8.08	7.38	**6.76**	6.20	5.70
	2.5%	8.14	7.43	6.80	6.24	5.73
	1.5%	8.20	7.48	6.84	6.28	5.77

Source: CBS Research AG

The calculated fair value per share of the inorganic growth scenario is subject to the accomplishment of the capital increase and Softline´s management capability of successfully implementing the inorganic growth strategy. Therefore, potential investors have to account for these uncertainties when considering an investment in Softline´s stock. The table hereunder aggregates the fair values for the organic and inorganic scenario and link them by probabilities. In the upper left corner we insert the organic fair value of EUR 4.03m, whereas the lower right corner contains the fair value of the inorganic growth scenario. Then, we link the two value indicators by the probabilities shown on the horizontal and vertical axes.

Probability adjusted fair value of Softline

		Management capability of successful strategy implementation				
		0%	**25%**	**50%**	**75%**	**100%**
Probability of successful capital increase	**0%**	4.03	4.03	4.03	4.03	4.03
	25%	4.03	4.20	4.37	4.54	4.71
	50%	4.03	4.37	4.71	5.05	5.39
	75%	4.03	4.54	5.05	**5.56**	**6.07**
	100%	4.03	4.71	5.39	**6.07**	**6.76**

Source: CBS Research AG

The interpretation of the probability adjusted fair value matrix is as follows. If the required capital increase will not take place with certainty (probability of successful capital increase = 0) then the fair value will be EUR 4.03 no matter what managerial skills Softline´s management possesses. Furthermore, if Softline´s management does not posses the managerial skill to successfully implement the inorganic growth strategy (Management capability of successful strategy implementation = 0) then a capital increase will not take place as Softline´s management anticipates that potential investors anticipate that a capital increase would not add value to the company. In that case, preparing a capital increase would be a time consuming and cost-intensive waste of Softline´s resources. Again, the company is valued according to the organic growth scenario.

As we move further to the right, the probability of a successful acquisition process increases and hence the probability of a successful capital increase increases simultaneously. That is, the two probabilities are not independent but correlate. The higher the probability of implementing the inorganic growth strategy successfully the more probable is a successful capital increase. In our opinion, Softline´s management skills are above average. Mr. Mischel and Dr. Löschke not only possess sector relevant expertise but managerial experience in conducting and building up businesses successfully. Therefore, we range Sofline´s managerial skills between 75% and 100%. As mentioned before, if an experienced and reputed management team intend to implement an inorganic growth strategy and need cash to realize it, it is also quite likely that potential investors are ready to fund their value added acquisition strategy. Therefore, we argue that the probability of a successful capital increase lies in the range between 75% and 100%. Weighting the organic and inorganic fair value for Softline´s stock adequately with the supposed probabilities we derive probability adjusted fair values for Softline´s stock between EUR 5.56 and EUR 6.76 (lower right corner).

Company profile

At a glance

Revenues of EUR 19.4m in fiscal year 2008/2009

Softline AG is a Germany based IT service provider that was founded in 1983 and originally focused on software distribution. Within the first 17 years since inception the company experienced growth that pushed revenues from under EUR 1m in 1983 to approximately EUR 85m in 2001. Since then revenues declined steadily and reached EUR 19.4m in fiscal year 2008/2009 on the group level.

Shortened fiscal year and sale of subsidiaries brought revenues down to EUR 0.45m

During 2009 Softline´s management started to restructure and align the company. The restructuring measures aimed at refocusing Softline´s business model in order to participate more effectively in future trends currently driving the IT industry. Besides the fiscal year end date adjustment to end in December (before June), the company sold its subsidiaries TradeMail Distribution GmbH and Prometheus GmbH to raise necessary operating liquidity and to disassociate from unfitting business activities. These restructuring measures reduced revenues to EUR 0.45m and simultaneously decreased workforce to 9 employees as of 31 December 2009.

Reintegration of Prometheus GmbH

2010 started with additional restructuring measures. First of all, the company increased subscribed capital by EUR 3.55m shares. Gross inflow amounted to approximately EUR 6.5m and was used to reintegrate Prometheus GmbH (wholly-owned subsidiary) into the Softline Group. Furthermore, the funds have already been used to build up an experienced sales workforce for the newly founded Softline Solutions AG and to finance working capital. Working capital is expected to increase significantly since from now on Softline´s management will put more emphasis on developing and expanding operating activity.

Dr. Knut Löschke has entered the management board

In line with the capital increase Dr. Knut Löschke (founder and former CEO of PC-Ware) acquired a stake of 13.5% in Softline AG as a strategic investor. Shortly after, Dr. Löschke entered Softline´s management board. Along with Christoph Michel, who entered Softline´s management board in June 2008 and initiated the restructuring process, the company is controlled by an internationally experienced management team with an impressive business management track record.

History

Peer Blumenschein founded Softline in 1983

The roots of Softline AG go back to the year 1983 when the first usable microcomputers appeared on the market. Peer Blumenschein founded Softline and started to import and sell US software in Germany. Innovative and efficiency enhancing products like the operating system Windows from Microsoft or Mathcad helped Sofline to expand its operating base and simultaneously enabled software companies to penetrate German market for software products more rapidly.

Sales agreement between Softline and Netscape in the year 1995

In the course of time Softline further increased its product portfolio in order to satisfy demand from various customers operating in different sectors. Simultaneously, the company introduced completely new software applications without existent market demand for them. With Asymetrix ToolBook, Softline launched the first multimedia authoring system for Windows. Moreover, Softline presented at the CeBit an absolutely innovative way to distribute software. The company presented a pay CD that included a number of up-to-date high quality programs which could have been picked out and activated via telephone after paying by credit card. The first sales agreement between Softline and Netscape in the year 1995, a time the name Netscape was known only to insiders, helped to spur growth and increase Softline´s publicity. In 1997 Softline ranked among the five best known IT companies in Germany.

IPO on 14 February 2000 and expansion in Europe

Softline experienced a dynamic and profitable growth. At the beginning in 1983 the company generated EUR 0.2m revenues. Seven years later revenues increased to EUR 2.3m. Then, during the nineties, Softline´s expansion continued and resulted in organic average growth rates of 30% annually that pushed revenues to EUR 24.8m in 1999. At the beginning of the 20th century the company went public and was listed at the Neuer Markt in Frankfurt, Germany. The listing was combined with a capital increase that enabled Softline to start inorganic growth and transfer the company from a German company into a European group. Company revenues were boosted by acquisitions all over Europe. With five acquired companies and new subsidiaries founded in several European countries, Softline lifted its revenues up to EUR 88m in 2002.

2002-2008: Inorganic expansion phase followed by significant downturn in business

During the expansion phase the PC market started to send first signals of economic slowdown. Additionally, the dot-com bubble caused by low interest rates and irrational investors´ market confidence, burst and separated the wheat from the chaff. In the aftermath many companies Softline had acquired showed low growth and profitability performance and put pressure on the management. Challenging years with a significant and continuous downturn in business followed. In the fiscal year 2008/2009 revenues melted down to EUR 19,43m and most acquired subsidiaries were sold or closed down.

Restructuring and repositioning toward future markets

In the second half of 2009 Softline started a restructuring, recapitalizing and refocusing process. With Christoph Michel and Dr. Knut Löschke both highly experienced in the IT service sector, a new and well reputed management team was established. The business model has been aligned to participate from current and future trends in the IT service sector. As a consequence the TradeMail Distributuion GmbH was sold and consequently IT software distribution will no longer be part of Softline´s core business activities. With its two business units (Softline Solutions GmbH and Prometheus GmbH) the company has streamlined its business model and focused activities on internet-based computing services (cloud computing). Furthermore, in February 2010 the company accomplished a capital increase and attracted new shareholders with an international network.

Company structure

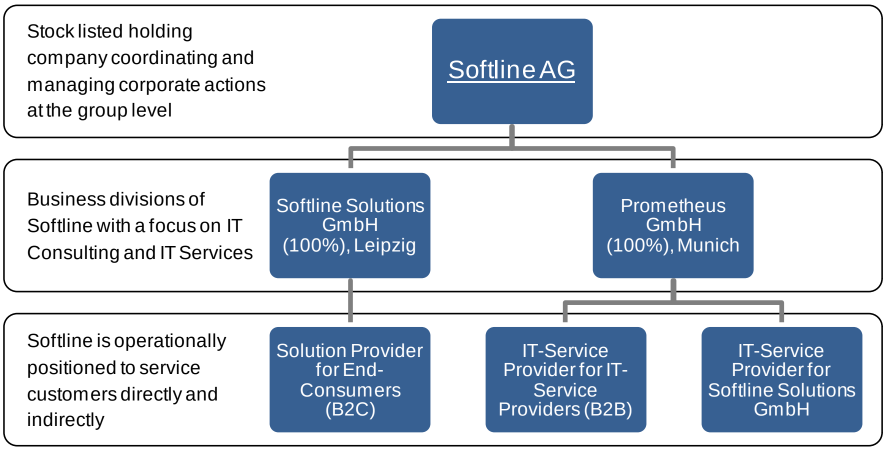
Two wholly-owned subsidiaries in Leipzig and Munich

Softline AG is a Germany based IT service provider with headquarters in Leipzig. The company operates through its two wholly-owned business units, Softline Solutions GmbH, located in Leipzig and Prometheus GmbH in Munich. Whereas Softline Solutions GmbH has been established to serve end-customers directly (B2C segment) by Softline´s own employees, Prometheus GmbH is servicing end-customers indirectly (B2B segment) over its clients. That is, Prometheus provides over 11,000 freelance experts under contract IT services to its clients that operate by themselves as IT service providers for big end-customers otherwise not accessible to Softline.

Transformation to more flexible and market-driven company structure

Softline AG has transformed its business model by focusing operating activity on IT consulting and IT services. In line with this, in the second half of 2009 the company sold its subsidiary TradeMail Distributuion GmbH which processed software distribution. The restructuring process resulted in a more flexible and market-driven company structure without relics putting pressure on the company´s financial stability. Furthermore, the company structure is geared to the appearance of a technological change (cloud computing) that we believe will have far-reaching economic consequences, which Sofline intends to profit from. The demand for IT services, induced by the technological change, is spread over various sectors and will become more important in the course of time. As a small IT service company Softline positioned itself with a focus on small to midsized enterprises, however, not excluding large corporations. Within this customer segment, IT consulting activities will be offered that meet end-consumers´ business needs. Supplementary, IT services providers will be serviced by the second business segment of Softline which is also influenced by the technological change mentioned above. However, as clients in this business segment are IT services providers that service big and internationally diversified enterprises, the support and maintenance requirements will diverge from that in the IT consulting segment.

Company structure and business focus of Softline AG



Source: Softline AG, CBS Research AG

Prometheus with locations in Frankfurt, Düsseldorf and Hamburg

The IT consulting division is represented by the Softline Solutions GmbH. Offered services are Infrastructure-as-a-Service (IaaS), software support (MVPS) or software licensing and Software-as-a-Service (SaaS). In addition, the division offers solutions in the context of virtualization, storage and networking, and core infrastructure. With regard to the IT services division, the company operates through the Prometheus GmbH and offers services like managed services, IT infrastructure outsourcing or IT system or support services. Whereas Softline Solutions is currently located only in Leipzig, Prometheus has also locations in Frankfurt, Düsseldorf and Hamburg.

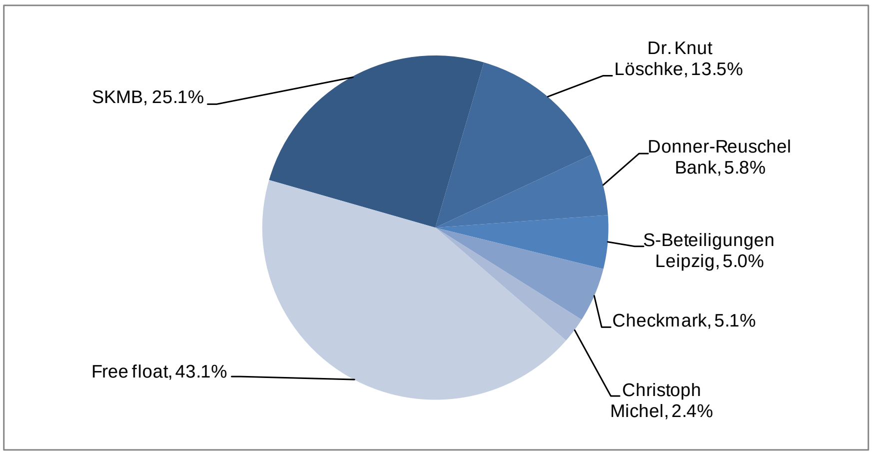
Shareholder structure

Softline´s management board holds 15.9% of share capital

Despite the shares held by Softline´s management board consisting of Dr. Knut Löschke (16.5%) and Christoph Michel (2.4%), other major shareholders are SKMB (25,1%), Donner-Reuschel Bank (5.8%), S-Beteiligungen Leipzig (5.0%) and Checkmark (5.1%). The remaining part of share capital is publicly traded and therefore classified as free float (43.1%).

The biggest sole shareholder of Softline AG is SKMB, which holds a stake of 25.1%. SKMB is a privately held investment company. The remaining shareholders are located in Germany and active in the field of consulting and banking. Whereas Checkmark (located in Baden-Baden, Germany) with a core business focus on consulting activities also invests in dynamic and potentially prosperous start-up companies, Donner-Reuschel Bank is a private bank with headquarters in Hamburg and Munich and a long tradition in investment banking with a focus on institutional clients and mid-sized companies.

Shareholder structure Softline AG



Quelle: Softline AG, CBS Research AG

Management

The management board of Softline AG consists of Christoph Michel and Dr. Knut Löschke. Both board members have extensive management experience in the field of information technology with regard to both international and sector specificities.

Dr. Knut Löschke

Dr. Knut Löschke entered Softline´s management board in April 2010 when the company increased subscribed capital by the issuance of 3,55m shares and Dr. Löschke acquired 13.50% of issued share capital as a strategic investor. Dr. Knut Löschke is the founder of PC-WARE AG, a manufacturer-independent ICT Solution Provider in Europe with a core business focused on software (software licensing, consulting on licensing agreements and software & IT asset management) and revenues of approximately EUR 890m in fiscal year 2008/2009. Before Dr. Knut Löschke became a board member of Softline AG, he acted as chief executive officer (CEO) of PC-WARE AG for nearly 20 years (1999-2009). Dr. Löschke succeeded in establishing PC-WARE as a global player with subsidiaries in 26 countries in Europe, Africa, and Asia and currently about 1,700 employees who serve business customers from industry, public administration and medium-sized businesses as well as major, globally active customers. With its managerial and sector specific experiences, Dr. Löschke not only contributes positively to the current restructuring process of Softline but also benefits Softline with his strong world-wide network through several board memberships as well as representative and consultative functions.

Christoph Michel

Christoph Michel complements Softline´s board of management. Mr. Michel entered Softline´s management board in June 2008. Since February 2010, Christoph Michel holds also a stake in Softline of 2.40% of share capital. Before his current role at Softline, Mr. Michel gained extensive management experience via positions on the boards of Hyperware AG (Munich) and Sage KHK Software (Frankfurt) as well as Directorships of Marketing and Sales for Siemens Nixdorf and Sequent Computer Systems.

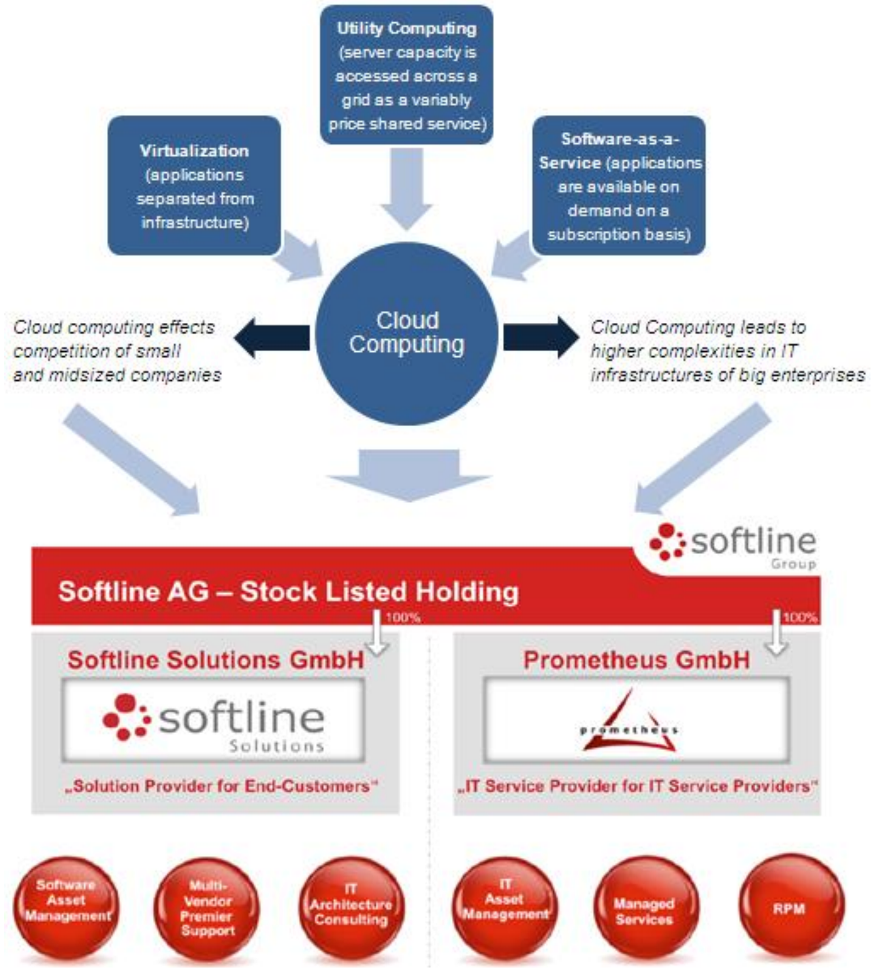
Business model

Business model aligned to profit from future trends in the IT industry

Cloud Computing induces repositioning

Softline´s business model is geared to profit from future trends in the IT industry. One important future trend in the IT industry, which has a major impact on the way enterprises manage and allocate internal resources to their IT infrastructure, is driven by “cloud computing”. Cloud computing can be seen as the convergence of three other major trends namely virtualization, utility computing and Software-as-a-Service (SaaS). Furthermore, cloud computing is internet-based computing, where shared resources, software and information are provided to differing devices for users, on demand.

Softline AG – Business model



Source: Softline AG, CBS Research AG

Cloud computing a paradigm shift with far reaching effects

In general, cloud computing enables customers to utilize certain business applications without investing in software and/or hardware necessary to run the business applications. Customers do not invest in software and hardware. Rather they rent usage (business applications, infrastructure capacity etc.) from a third-party provider. They consume resources as a service and pay only for resources that they use, akin to traditional utility services such as electricity. That is, customers are provided with dynamically scalable and often virtualized resources as a service utilizing internet technology. The implications of this paradigm shift in utilizing and distributing software and hardware will have large-scale effects both for IT service providers as well as for enterprises operating in various industries.

Softline Solutions GmbH enables small to midsized companies to enter the market and to compete on services not budget constraints

In order to participate in the opportunities cloud computing offers, Softline streamlined and refocused its business model. Whereas Softline Solutions is directly servicing midsized companies, Prometheus indirectly services big end-customers. Hereby Softline has the chance to participate in two different economic effects induced by the innovative computing methodology (cloud computing). On the one hand, midsized companies often do not have the budget to be able to afford the technological infrastructure necessary to run innovative and efficient IT business applications. As cloud computing converts capital expenditure to operating expenditure and end-customers are typically billed on a utility computing basis (pay-as-you-use principle), competition in the end-consumers´ industries will no longer be distort by unequal access to IT resources. This in turn will lower barriers to market entry and benefit end-customers´ clients.

Prometheus GmbH support IT service providers in managing more complex IT infrastructure requirements of big enterprises

On the other hand, Prometheus GmbH will participate in IT outsourcing activities of big, internationally diversified enterprises. Here cloud computing will not lead to a reduction in software and infrastructure expenditures as these big enterprises usually possess the required funds to invest. Rather cloud computing will help to optimize and supplement existent or newly acquired IT infrastructure. For example, with the progressive digitalization of business processes IT security is becoming increasingly important, especially for big enterprises. In order to comply with legal requirements regarding secure digitalized business processes, several enterprises with similar legal requirements could establish a community could and seek to share infrastructure in order to profit from some of the benefits of cloud computing. In this theoretical example, Prometheus would support other IT service providers in servicing their clients by allocating labor resources for short to long term projects. But this is only one example out of the multifaceted application area of cloud computing and hence, for Prometheus as an IT service provider for IT service providers.

Lower business risk on the group level by servicing different client segments

Furthermore, Softline Solutions AG is profiting from Prometheus´ pool of approxiomately 11,000 freelancers both with regard to IT knowledge and labor bottleneck issues. Additionally, Softline is reducing its business risk on the group level by servicing clients that are affected in different ways by the technological change which amongst other things implies different propensities to pay for the IT services. As mentioned before, the benefits of cloud computing for small to midsized companies differ significantly from those of big and internationally diversified enterprises realize.

Services offered

Innovative billing

Softline AG is capable to design, deliver, optimize, maintain and operate cloud computing based IT infrastructures as a 100% service model. That is, Softline´s clients are billed on a utility (resources consumed, like electricity) or subscription (time-based, like a newspaper) basis with little or no upfront cost. Furthermore, users can terminate the contract at any time, and the services are often covered by service level agreements (SLAs) with financial penalties. Major benefits of this servicing approach are lower operating costs, lower IT overhead costs, and immediate access to a broad range of applications without investing in expensive IT infrastructure. Besides avoiding the risk of technological change or obsolescence, clients´ resources can be directed away from IT maintenance toward operation related tasks.

IT Consulting (Softline Solutions GmbH)

Softline Solutions GmbH offers technology independent consulting services for the design and implementation of adequate IT infrastructures. The company is targeting small to midsized companies that are operating in highly competitive markets and therefore depend on efficient and cost reducing technologies.
Offered services comprise of:

- **Optimized Software Selection & Licensing** (Although software licenses usually range among the most expensive items within the IT budget, they still lack the necessary attention by many companies. Therefore, most companies inadequately have implemented their software asset management neglecting further potential for cost reduction, which can be obtained by optimizing the use of different license types or by utilizing innovative services like SaaS. Softline supports its clients to implement an efficient and effective use of their software.)

- **Software Asset Management** (SAM is the business practice that involves managing and optimizing the procurement, deployment, maintenance, utilization and disposal of software applications within an organization)

- **Multi Vendor Premier Support** (MVPM provides 2nd & 3rd level support on 24/7 basis for most of the leading infrastructure and application SW vendors)

- **Virtualization** (Virtualization is the process of abstracting computing resources such that multiple operating system and application images can share a single physical server, bringing significant cost-of-ownership and manageability benefits.)

- **IT Asset Management** (ITAM is the set of business practices that join financial, contractual and inventory functions to support life cycle management and strategic decision making for the IT environment)

- **Freelance Expertise** (RPM provides the complete set of services around resourcing, provision and managing freelance IT experts for short and long term projects)

- **Managed Services** (MS delivers on-site services from rollouts, rollbacks and IMAC projects to end user help desk with integrated on-site support services for IT and Telecoms hard- and software)

- **IT Architecture Consulting** (ITAC provides software and IT infrastructure consulting, including process design, project management, delivery and in- & out-tasking)

IT Services (Prometheus GmbH)

Prometheus helps to integrate efficiency enhancing and competitiveness increasing measures

In today’s economic climate, organizations are trying to control expenses. In fact, the primary driver in outsourcing IT services is the need to reduce costs. At the same time, these organizations are working to reduce their number of suppliers, improve the quality of the services they deliver and want to take advantage of new delivery models associated with cloud computing and Software as a Service (Saas).

Prometheus´ operating activities help its clients to integrate these efficiency enhancing and competitiveness increasing measures by reducing IT related personnel costs as well as more effectively allocating of business relevant resources. The company´s customers are IT service provider, software and hardware producers, retail companies, network operators and leasing companies.

- **Managed Services** (Prometheus typically manages and assumes responsibility for providing a defined set of services to their clients either proactively or as they (not the client) determine that the services are needed. Softline bill a flat or near-fixed monthly fee, which benefits their clients by providing them with predictable IT support costs.)

- **IT Infrastructure Outsourcing** (Outsourcing of IT processes to external IT service providers in order to create a more cost-effective and responsive IT infrastructure which promotes service stability and reliability, and enables rapid response to changing market and business conditions)

- **IT System and Software Support** (Software and hardware rollouts as well as rollbacks and maintenance of software and hardware devices for customers´ IT infrastructures. Further managing the migration of IT systems that are often customized to meet specific requirements for the client´s business and are therefore mission-critical systems. The move over to new systems is generally a minefield: a simple configuration missed can put a system or business out of action for hours, if not days. As a result, clients resort to IT service providers with relevant expertise in managing IT projects efficiently ensuring that disruption is kept to a minimum.)

- **IMAC services** (Prometheus´ Installation, Move, Add, Change (IMAC) services look after clients´ essential technology additions and upgrades. That is, the tasks within this service segment involve physical relocation of equipment or system upgrades and reconfiguration, as well as ensuring the hardware is running at optimum efficiency, complementing an existing skill set or providing minimum disruption to business or staff.)

- **Resourcing & People Management** (Prometheus´ pool of approximately 11,000 IT-experts / freelancers is offered to render the IT services mentioned above hereby reducing client´s IT maintenance costs and profiting from the outsourced IT workforce expertise)

Strategy

Organic growth strategy in Germany for small to midsized companies

Prerequisites for organic growth in Germany fulfilled

With regard to its core business activities in Germany Softline has established a business structure that defines the future path of operating activity the company intends to pace. With the sale of its software distribution subsidiary TradeMail Distribution GmbH, Softline refrained from a low-margin and not up to date business model and put more emphasize on IT consulting and IT services. Both business segments are targeting the opportunities arising out of the innovative computation methodology cloud computing. With regard to the German market which represents the home market of Softline and where the core business strategy has been implemented between second half of 2009 and first half of 2010, the company has fulfilled the prerequisites for organic growth within national boundaries. However, the business model was not adjusted just to realize higher organic growth rates but also to improve corporate profitability by offering services more valuable to clients.

Cloud computing services induce favourable profitability adaption behaviour…

Softline Solutions AG is mainly targeting German small to midsized companies and Softline´s managements is confident that this customer focus will not only spur growth but also benefit corporate profitability. Economically, this alignment of business activities makes absolutely sense. First of all, if cloud computing reduces IT capital expenditures necessary to run innovative and modern IT business applications, competition will increase because barriers to market entry decrease due to lower business set-up costs. Hence, lower barriers to market entry imply, other things being equal, a higher number of market participants which in turn implies higher growth to IT service suppliers. Additionally, growth for successful IT service suppliers will be amplified by the fact that cloud computing is not bound to certain sectors or corporate structures as digitalization of business processes influence all economic participants in the same way, no matter which sector they belong to or corporate structure they have.

…and therefore benefit both IT service providers and their clients

Secondly, when it comes to cloud computing clients pay for IT services without being contractually stipulated (IaaS, SaaS), that is clients are typically billed on a utility computing basis (“pay-as-you-use” principle), IT becomes more a variable than a fixed cost component and therefore positively affects clients´ operating profitability. In general, due to the fact that cloud computing enables small to midsized companies to work with innovative and modern business applications otherwise only accessible by investing significant amounts into IT software and hardware, IT services using cloud computing increases competitiveness of small to midsized companies which in return increases their willingness to pay adequately for the service. Furthermore, as clients´ cost are transformed from being fixed to being variable, clients business models become more resilient to economic cycles so that in economic slowdowns the probability of generating profits is higher than without using IT services. Hence, profitability of IT service firms offering cloud computing is not only driven by the intrinsic value of the service but also by the growth of the clients´ business. Whereas in economic slowdowns or in highly competitive sectors cloud computing services will benefit from its intrinsic value (efficient business processes, low operating costs etc.), in growth sectors or in phases of economic boom cloud computing services will be awarded by participating in expanding revenue scales. As a result, offering cloud computing services for small to midsized companies holds out the prospect of both dynamic growth and profitability.

Organic growth strategy in Germany for big enterprises

Big and internationally diversified enterprises face different needs than small and midsized companies

For large international diversified enterprises the above mentioned economic interrelations are not valid. First of all, large companies usually have enough monetary resources to finance IT infrastructures and therefore face other needs concerning IT services. Furthermore, big enterprises mostly possess significant amounts of sensitive personnel data which increases with company size and according to legal obligations have to be stored safely. Also, digitalized information concerning secret techniques, technologies or planned strategic behavior has to be protracted from unauthorized access. Consequently, concerns can persist about loss of control over certain sensitive data which in turn deter big enterprises to fully outsource servers, software, data-center space or network equipment. Instead they hire IT service providers and outsource only certain parts of IT tasks in order to free up own resources and allocate them to more important processes. Additionally, clients benefit from the technological know-how IT service providers bring along, for example when implementing efficient digitalized business processes or operating superior maintenance services.

Positioned to benefit from a wide spectrum of impacts

Softline´s Prometheus GmbH builds the second pillar in the company´s organic growth strategy and is driven by the needs big enterprises are confronted with. As an IT service provider of IT service providers, Prometheus provides external staff when needed to react flexibly whenever additional know-how and capacities are required. Therefore, from a strategic point of view, Softline is positioned to benefit from a wide spectrum of impacts cloud computing will have on corporate landscape in Germany.

Inorganic international growth strategy

Internationalization and a quick gain of market share main reasons for inorganic growth strategy

Whereas for Germany, Softline traces an organic growth strategy, internationally the company focuses on inorganic growth. According to the management, Softline will deploy a buy-and-build strategy to form a focused, highly profitable, international IT solution provider. Another rationale for tracing an inorganic growth strategy is to quickly acquire an attractive share in the IT cloud computing market and to initiate growth from a broad European basis. However, in order to realize this inorganic growth, the company has to conduct a second capital increase in late 2010 providing the funds necessary to acquire adequate targets in European markets.

Acquisition targets already identified

Softline has already identified the acquisition targets and communicated the planned capital increase to shareholders and potential investors. All targets are profitable companies with a favorable market position in their area of business and country. The main benefits Softline´s management expects to yield from following this international expansion strategy is a broad substantial growth basis that secures profitability at group level.

Targets have to be integrated and managed properly

According to management, by the end of 2010 acquisitions in up to 5-6 European countries will be accomplished. However, inorganic growth could turn out to be a risky and unduly expansion activity if acquirers fail to integrate and manage targets properly, that is to establish a common business model applied in all subsidiaries. To support the international organization of Softline prudently, management intends to establish the required infrastructure in Leipzig, Germany. The infrastructure will include organizational functions (Management, Finance etc) as well as systems (ERP/CRM-system, reporting, collaboration tools etc.). Therefore, Softline´s future business model and company structure significantly differ from the current business model already implemented with regard to both inherent risk as well as profitability.

Market environment

General economic situation

Fourth quarter 2009 with annualized growth rate of 4%

The recently witnessed financial turmoil has influenced economic activity all over the world and lead to a decrease in world economic activity (real GDP) in 2009 of -1% year-on-year. But the severe recession in the first months of 2009 was effectively overcome by measures undertaken by governments of economically advanced countries to stimulate global economic activity and bring back market confidence. As a result, global gross domestic product in fourth quarter 2009 increased over the same quarter a year ago by an annualized rate of approximately 4%. This development was supported by a rapid expansion in manufacturing and trade in some countries. For example, the Ifo Business Climate for industry and trade in Germany has risen once more strongly in April 2010, indicating improved assessments of business situation by manufacturers and trade companies. Also with regard to their business expectations in the coming half year of 2010E they are more hopeful than in the previous month.

GDP and Inflation forecast

Forecast of Real GDP and Inflation for selected countries and regions

	Real GDP Growth			Inflation (CPI)		
	2009	2010E	2011E	2009	2010E	2011E
Germany	-5.0%	1.2%	1.8%	0.3%	0.6%	0.8%
Euro Area	-4.1%	0.7%	1.5%	0.3%	0.7%	0.9%
United States	-2.4%	2.5%	2.2%	-0.3%	1.6%	1.2%
World	**-1.0%**	**3.7%**	**3.6%**	**3.1%**	**3.6%**	**3.3%**

Source: IfW, CBS Research AG

Expected growth of 3.7% in global economic output in 2010E (-1% in 2009)

As mentioned before, despite this apparent trend toward recovery in the last quarter in 2009, the worldwide real gross domestic product declined 1.0% for the year 2009 as a whole. However, the IfW Institute for the World Economy in Kiel, Germany projects a growth of 3.7% in global gross domestic product for the current 2010E fiscal year and 3.6% in fiscal year 2011E. Even the International Monetary Fund (IMF) expects global economic output to increase 3.9% for fiscal year 2010E. Whereas within the Euro Area economic recovery is projected to experience a growth of 0.7% in 2010E, according to the experts Germany (+1.2%) and the United States (+2.5%) should enter an even more dynamic recovery growth path. Within the Euro Area certain countries face harder economic conditions due to immoderate deficit spending (especially in Greece, Spain, Italy and Portugal) which is reflected in the forecasted below average growth rate for the Euro Area in relation to Germany. Hence, increasing doubts about the solvency of certain European countries could trigger adverse economic effects that would also influence economically robust countries like Germany.

The ICT Market in Europe and Germany

Development of the worldwide ICT market in 2009 and expectations for 2010E

The IT services industry is evolving rapidly, with major mergers and acquisitions, changing business models, diversification of vendors into new forms of outsourcing, and the impact of the economic climate on technology-related services. According to market experts, following 2009's negative growth, the global IT market will display a single digit rise in spending this year, with telecoms, IT services and hardware leading the way. Global IT spending will increase by 5.3% to USD 3.4tn during 2010E, according to research by Gartner, with computer hardware and IT services demonstrating the strongest growth. This is in contrast to the 4.5% contraction witnessed last year and demonstrates the appetite for new, IT-based services which has returned. During 2009, the worldwide amount spent on hardware was particularly badly impacted, slumping by 12.5%. IT services and computer software saw declines of 4% and 2.5%, respectively. According to Gartner's research, hardware and IT services will enjoy spending growth of 5.7% apiece, while software and telecoms will both benefit from increases of approximately 5.1%.

European ICT market decrease by 2.2% in 2009

The estimated European ICT market value (sales volume) declined by minus 2.2% in 2009 and reached market value of approximately EUR 719bn. The table below shows that with regard to the specific market segments consumer electronics were struck the most by the economic slowdown in 2009 which can be attributed to cyclical demand characteristics within that market segment. However, due to the relatively low market share of consumer electronics, the slowdown of minus 8% influenced total ICT market development only marginally. Information Technology decreased by minus 2.6% to EUR 299bn in total, incorporating hardware revenues that slumped dramatically by minus 11.8% according to the market research institute European Information Technology Observatory (EITO). Following the dramatic slump in 2009, hardware revenues are expected to continue shrinking in 2010 (minus 1.7%).

European ICT Market (Sales Volume) in 2009

Market segement	Products / services included	EU market value estimates (2009)	Change 2008-09
Information Technology	IT hardware, software, services	EUR 299bn	-2.6%
Telecomm-unications	TC end-user equipment, carrier services, network equipment	EUR 361bn	-0.7%
Consumer Electronics	Flat-screen TVs, digital cameras and navigation systems	EUR 58.5bn	-8%
Total ICT market		**EUR 719bn**	**-2.20%**

Source: EITO 2009, CBS Research AG

IT services in Germany relatively stable during the crisis

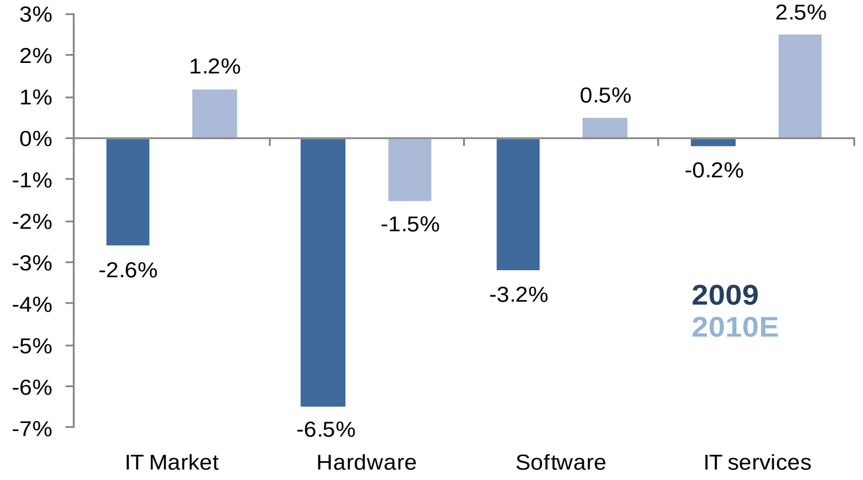
According to market experts (BITKOM) the German IT market has contracted by 2.6% in 2009. The IT hardware and software recorded a decline of 6.5% and 3.2% respectively, while the IT services segment was almost unchanged, with negative growth of minus 0.2%. Outsourcing services, which are included in this figure, grew by 5.1% during the crisis.

Market outlook Germany

Above average growth for IT services segment expected

With regard to the German IT market, the forecast of the industry association BITKOM points to a 1.2% growth in 2010. This means that the expected IT industry growth is approximately the same as the macroeconomic performance expected for Germany, following the decline of 2.6% in 2009. Growth of 2.5% is forecasted for IT services, compared with a decline of minus 0.2% in 2009. The software segment is expected to grow by 0.5%, after a decline of 3.2% in 2009, and the hardware segment is expected to shrink by 1.5%, following a decline of 6.5% in 2009. IT research specialists IDC have similar expectations with regard to the IT services segement. They predict growth of 1.8% in the IT service segment in 2010 and a more dynamic average growth of 2.8% per annum over the period 2008 to 2013. The reasons for the better midterm outlook for the IT services segment, according to IDC, are increased cost-consciousness among companies and the improved general economic outlook for the current year. Once confidence in the economic recovery is established, companies will conclude more medium and long-term outsourcing contracts once again.

Expected growth rates for the German IT market segments



Source: BITKOM, CBS Research AG

The market for cloud computing

Cloud market expected to reach USD 150m in 2013

As Softline has aligned its business model to focus more on cloud computing services and participate in the advantages it offers, this sub-segment of IT services has also to be considered in order to evaluate the future prospects of the company. In general, cloud computing is likely to create new options for combining process, software and hardware in business process outsourcing (BPO) solutions. Cloud computing is seen as the new growth driver in IT services and the worldwide cloud services will reach USD 56.bn in 2009, a 21.3% increase from 2008. According to Gartner the cloud market is expected to reach USD 150m in 2013.

Market potential is too great

Cloud computing is likely to take center stage in IT outsourcing in 2010, according to experts. "2010 will be the first year in which cloud computing will have a real role in procurement decisions," Morrison & Foerster said. "To be sure, cloud providers must deal with the key issues of data security, privacy compliance and service level guarantees, but the market potential is too great for solutions to these problems not to be forthcoming." The analysts noted they expect the outsourcing industry to begin seriously addressing these issues in 2010. That means cloud solutions will become an acceptable risk for customers.

Competition

Price competition and new market participants

The IT service sector can be characterized by intensive price competition and a huge number of small to midsized innovative IT service providers. Besides small and midsized companies focused on IT services entering the market, market experts are also witnessing IT software and hardware producers originally not active in the field of IT servicing rushing into the IT service market. The main reason for IT software or hardware producers to enter the IT service segment is to diversify/stabilize their revenue streams as the demand for IT services is relatively much less prone to economic downturns than the demand for software or hardware products.

Second major competition factor relates to technological aspects

Another major influence on competition emanates from technological developments that change the way information technology serves their clients. Today´s IT services are no longer dependent on or related to the client´s software or hardware infrastructure except for big corporate clients with huge amounts of sensitive technological and/or regularly protected personnel data. Rather, new information technologies like cloud computing separate IT services from clients´ IT infrastructures by virtualizing the resources and adapting it to the clients´ specific needs. For instance, applications are constructed and offered to clients´ as a virtual machine that incorporates all the necessary software and hardware components and is delivered over the internet. Hence, future success of IT service firms is neither determined by exclusively distributed software or hardware products nor by the most focused and specialized IT service for certain business applications. Rather, future competition will be driven by innovative and cheap business applications without the need for high investments in IT infrastructure, especially for small and midsized corporate clients.

Innovation and consolidation balance competition

Softline is operating through two business units which encounter different competitive surroundings. With regard to Softline Solutions AG which is focusing on small and midsized companies, competition will primarily come from small IT service providers focusing the same client base with nearly identical services. In Germany according to BITKOM 2008, more than 70,000 IT service providers were registered in Germany with 437 falling into Softline´s revenue category (revenues between EUR 10m and 25m as of 2008). Only 270 companies generated revenues above EUR 25m. Although not all mentioned service providers operate in the same field as Softline Solutions AG, it is quite clear that competition is very stiff and ever shifting. There are two important factors which will balance competition in the course of time namely innovation and consolidation. Whereas innovation will force IT service providers to improve their services and help clients to cut costs, consolidation forces will relieve competitive pressure and contribute operating margins to cover operating costs. Hence, acquiring competitors and market share is an important prerequisite to successfully operate in this absolutely competitive market environment and not an indication of irrational strategy.

Critical workforce shortages and skill-intensive services run contrary to competition

Referring to Prometheus GmbH, competition is transmitted by the IT service providers Prometheus is servicing. Hence, adverse economic development, influencing the clients of IT service providers Prometheus is servicing, will directly have negative effects on Prometheus bargaining power as long as the offered services are not critical and skill-intensive. As Prometheus is servicing other IT service providers that encounter critical workforce shortages while itself is focusing on innovative (Managed Services, IMAC, IT Infrastructure outsourcing) and one-time (IT rollouts, rollbacks) services, it is quite conceivable that competition is not as stiff as for the clients Prometheus is servicing. In general, competition is determined by the same factors influencing Softline Solutions AG. However, due to the service specific circumstances, operating margins should be significantly higher than for pure IT service companies without a pool of freelancers flexibly deployed for different tasks. This in return increases their competitive ability in bargain situations where workforce shortage is not a decisive factor.

Financials

Fiscal year 2009

Abbreviated fiscal year 2009 not comparable with historical financial figures

During 2009 several measures were taken by Softline´s management to bring back growth and profitability to the core business. The management decided to cease the low-margin distribution of software and concentrate more on IT consultancy. Consequently, Softline sold its TradeMail Distribution GmbH that adversely affected revenues and burdened operating margins. Furthermore, due to liquidity shortages the management sold its stake in Prometheus to set tied-up money free but simultaneously stipulated a repurchase agreement that comprised the option to buy back 100% of shares. Additionally the workforce was reduced significantly and the remaining operating activity, primarily the software distribution for private clients and small companies, phased out during the fiscal year 2009. Therefore, financial figures for the abbreviated financial year 2009 are not representative and comparable with both previous as well as future financial company data. Nevertheless, we hereafter shortly summarize the income statement and the balance sheet for the abbreviated fiscal year.

Revenues at EUR 0.45m and net loss of EUR 0.71m

The restructuring measures described above reduced revenues to EUR 0.45m and simultaneously decreased the workforce to 9 employees as of 31 December 2009. Net loss for the abbreviated fiscal year amounted to EUR 0.71m. Restructuring costs of EUR 0.068m and provisions of EUR 0.15m for the executed personnel measures negatively affected net profits.

Balance sheet assets

With regard to the balance sheet, major influences came from restructuring measures. The balance sheet total decreased to EUR 0.8m (PY: EUR 1.8m) primarily due to the TradeMail disposal (EUR 0.5m) and the reduction of other loans receivables (EUR 0.25m). Major positions on the asset side of EUR 0.46m took receivables with a maturity of less than one year and other assets. Other assets of EUR 0.283m consists of repayment requirements against the former board member Mr. Schneider. Cash and financial assets summed up to EUR 0.19m.

Equity and liabilities

Concerning the equity and liabilities side of the balance sheet, the most important change occurred with regard to the subscribed capital. The company executed a capital reduction by a 10 to 1 ratio, resulting in subscribed capital of EUR 1.014m as of 31 December 2009. Consequently, total equity fell from EUR 0.74m to EUR 0.03m. Furthermore, liabilities decreased by roughly EUR 0.22m to EUR 0.43m. Liabilities solely consisted of short-term commitments with a duration of less than one year.

Financial figures for the abbreviated fiscal year 2009 not representative

In conclusion, the abbreviated fiscal year 2009 is not representative, neither for the past nor for the future. Since past financial figures are not comparable due to restructuring measures that changed the business model, the company´s future financial figures cannot been extrapolated. Additionally, in 2009 the company reported according to the German commercial code (HGB), whereas in the years before the financial statement was prepared in conformity with IFRS. The management plans to move back to the IFRS standard.

Forecasts

The forecasts for the profit and loss account and the balance sheet of Softline depict the organic growth scenario. We did not explicitly model a separate profit and loss account and balance sheet incorporating the inorganic growth scenario. Hence, the forecasts described hereunder refer to Softline´s already existing corporate structure with its inherent growth potential.

Forecasts depict organic growth scenario

Profit and Loss Account

For 2010E we estimate sales of EUR 10.44m. In the previous year the company generated sales of EUR 1.6m without revenue contributions of both Prometheus and Softline Solutions. Therefore, the rapid increase in sales in 2010E is a result of the restructuring process and hence a one-time effect. We expect the sales volume to further increase dynamically in 2011E and 2012E. Whereas for 2011E we assumed a sales growth rate of 50.2% which results in expected sales of EUR 15.69m, for 2012E we forecast sales to expand by 34.5%, leading to forecasted sales forecast of EUR 21.10m. The dynamic increase in sales volume is the result of three major factors.

Sales forecasted to increase from EUR 10.44m in 2010E to EUR 21.10m in 2012E

- Firstly, Prometheus and Softline Solutions are operating in a highly competitive but dynamic market segment. Market players currently have the chance to participate disproportionally in the technologically induced changes of IT services. The crucial factors enabling to do that are innovative IT services and the speed with which the management is to offer these services to potential customers in a customer specific and value driven way.

- Secondly, with Christoph Michel and Dr. Knut Löschke, the founder and former CEO of PC-Ware, the company is controlled by an internationally experienced management team with an impressive business management track record. We believe that Softline´s management will be able to increase sales revenues dynamically, that is high growth in a relative short time period. This belief is based on and related to the restructured business model of Softline, that is focused on innovative IT services enabled by cloud computing.

- Thirdly, Softline´s business model focuses on midsized German enterprises as well as internationally diversified, large corporations. Whereas Softline Solutions concentrates on small and midsized enterprises, Prometheus as an IT service provider for IT service providers indirectly services big corporations. Hereby, Prometheus provides external staff to its clients when needed to react flexibly whenever additional know how and capacities are required. However, as Prometheus manages a pool of approximately 11,000 IT-experts/freelancers, it is also able to support Softline Solutions with workforces. This in return increases the capacity of Softline Solutions with regard to personnel disposability. Hence, Softline AG´s growth potential is spurred by the business model itself. In the strategy section we have discussed the impact of cloud computing on small and midsized companies. We believe that Softline Solutions will be able to profit from this impact and as a result extend sales volume quickly due to the reputed management and the efficient access to a large pool of freelancers and business contacts. On the other hand, Prometheus´ revenues and resource utilization will be more diversified by allocating workforces to Softline Solutions.

Gross margin forecasted to enlarge from 46% in 2010E to 68% in 2012E

With regard to profitability we assume the gross profit margin to increase from 46% in 2010E to 68% in 2011E and 2012E. Costs for raw materials and purchased services are personnel expenses which accrue during the project phase of IT services. Softline Solutions will service its clients with its own IT consulting services and draw workforce resources from Prometheus on demand. The expected decrease in cost of raw materials and purchased services in 2011E is the result of an efficiency enhancing effect we believe will occur during ramp up phase of Softline Solutions. We argue that on the one hand Prometheus´ business activities will experience a dynamic increase in demand for its workforce induced during the ramp up phase of Softline Solutions. Economically spoken, Softline Solutions intensifies its marketing activities which results in higher IT projects for Prometheus. Furthermore we assume, that project acquisition costs for Softline Solutions are lower than for Prometheus, which explains the increase in gross margin. On the other hand, Softline Solutions´s business expansion will be accelerated by Prometheus´ workforce resources. We believe that these combined effects will fade out at the end of 2011E and result in a constant gross profit margin of 68%.

Personnel expenses in percent of sales projected to decrease from 47.4% in 2010E to 41.3% in 2012E

Personnel expenses are the result of both sales and marketing as well as general and administrative activities. We expect aggregate personnel expenses to increase during the forecast period from EUR 4.95m in 2010E to EUR 8.70m in 2012E. In relation to sales, personnel expenses´ share will decrease from 47.4% in 2010E to 41.3% in 2012E. We argue that the disproportionate increase in personnel expenses is a consequence of partly fixed administrative personnel expenses and efficiency enhancing activities during growth. That is, a well-rehearsed IT service team is able to process more IT projects cost-efficiently than otherwise.

Positive EBIT of EUR 1.05m for 2011E expected

Taking into account other operating expenses we forecast EBITDA (earnings before interest, tax, depreciation and amortization) of EUR -2.24m in 2010E and EUR 2.17m in 2012E. Subtracting depreciation amounts our projected EBIT-margin increases during the forecast period from -22.6% in 2010E to 8.8% in 2012E. It should be noted that the projections for other operating expenses and the depreciation amounts are hampered by the current restructuring process. However, our assumed EBIT-margin reveals that the projections lead to no skyrocketing profits or an irrational profit and loss account structure. Softline´s management is targeting a 12% EBIT-margin which we believe will be realized in the mid to long term.

EAT positively influenced by losses carried forward

Operating without financial debt, Softline´s profit is not reduced by interest expenses or increased by interest income. Furthermore, due to Softlines´ losses carried forward of approximately EUR 30m, the company will profit from extremely low income taxes. For EBT (earnings before taxes) under EUR 1m, Softline is exempted from tax payments. That’s why in 2011E EBIT of EUR 1.05m translates one-to-one into EAT (earnings after taxes). For 2012E we expect EBIT of EUR 1.85m, which results in EAT of EUR 1.77m.

EPS expected to increase from EUR -0.55 in 2010E to EUR 0.41 in 2012E

Earnings per share (EPS) are expected to increase from EUR -0.55 in 2010E to EUR 0.41 in 2012E. The dynamic and quick increase in EPS is primarily the result of the tax effects induced by the losses carried forward. These effects will persist and influence reported earnings for a long time period as Softline´s achievable EBTs are small compared to the losses carried forward. In our valuation model the tax effects are active in all phases and are expected to have an impact thereafter for another three to five fiscal years.

Balance Sheet

Noncurrent assets primarily consist of financial assets

For the asset side of Softline´s balance sheet we assume nearly equal shares of current and noncurrent assets for the fiscal year 2010E. Noncurrent assets primarily consist of the item financial assets of EUR 2m, which stands for the reacquired Prometheus GmbH. Minor noncurrent asset positions are intangible assets of EUR 0.14 and property, plant and equipment of EUR 0.43m. Whereas for the intangible assets we assume no change in value during 2010E and 2012E, with regard to the item property, plant and equipment we project an increase to EUR 0.5m in 2012E.

Trade receivables represent pre-financed workforces

Trade receivables hold the biggest share within current assets. Starting with EUR 2.47m in 2010E, we extrapolate trade receivables to reach EUR 4.5m in 2012E. The item trade receivables occur during projects when Softline pay its workforces in advance for their job performance. That is, Softline is pre-financing its costs when servicing its clients, which pay for the services afterwards. During 2010E and 2012E we calculated with days of sales outstanding (DSO) of roughly 80 days. Trade receivables will, according to our estimates, rise dynamically in the forecast period and lead to a gap between the share of current and noncurrent assets in relation to total assets.

Assumption of rising total assets between 2010E and 2012E

Adding the projected cash amount of EUR 0.30m to the trade receivables and the noncurrent assets of Softline, we derive total assets of EUR 5.04m for the fiscal year 2010E. For 2011E and 2012E our projections imply a further increase of total assets to EUR 6.17m and EUR 8.02m respectively.

Accumulated losses increased by reacquisition of Prometheus and build up of Softline Solutions

On the shareholders´ equity and liabilities side the assumed increase in balance sheet total is paralleled by a continuous reduction of accumulated losses which amount to EUR -5.43m in fiscal year 2010E and move down to EUR -2.53m in 2012E. The reduction is the result of the expected increase in profitability during the forecast period. The jump in accumulated loss between 2009 and 2010E can be traced back to the reacquisition of Prometheus and the build up phase of Softline Solutions. Both companies possess accumulated losses that added up to the existent amount of EUR -0.98m.

Capital increase raises shareholders´ equity to EUR 2.23m in 2010E

At the beginning of 2010 Softline conducted a capital increase which led to an increase in subscribed capital from EUR 1.01m to EUR 4.30m. Simultaneously, capital reserves of EUR 3.28m have accrued. Summing up the Subscribed capital, capital reserves and accumulated losses, our expectations for shareholders´ equity are EUR 2.23m for fiscal 2010E, which implies an equity ratio of 44.7%. According to our balance sheet forecast, the equity ratio will reach 62.5% in 2012E, which corresponds to EUR 5.05m in absolute value.

Shareholder debt builds financial protection

Softline is operating without interest bearing financial debt. The shareholder debt of EUR 2m builds a financial protection against liquidity shortages and according to Softline´s management currently is not drawn on. It represents a kind of a loan on overdraft that we assume to be existent during the forecast period. With regard to current liabilities, trade payables form the only component. We tied this item to 8.8% of total equity and liabilities. Trade payables step up from EUR 0.44m in 2010E to EUR 0.71m in 2012E.

Appendix

Softline AG

Profit and loss account

EURm	2008*	2009**	2010E	2011E	2012E
Sales	**19.43**	**1.60**	**10.44**	**15.69**	**21.10**
YoY growth	-26.4%	-91.8%	552.5%	50.2%	34.5%
Cost of raw materials & purchased services	-16.66	-1.36	-5.64	-5.03	-6.75
as % of Total sales	-85.8%	-85.0%	-54.0%	-32.0%	-32.0%
Gross profit	**2.77**	**0.24**	**4.80**	**10.66**	**14.35**
as % of Total sales	14.2%	15.0%	46.0%	68.0%	68.0%
Personnel expenses	-3.31	-0.47	-4.95	-6.68	-8.70
as % of Total sales	17.1%	29.3%	47.4%	42.6%	41.3%
Other operating expenses	-1.61	-0.49	-2.08	-2.73	-3.48
as % of Total sales	-8.3%	-30.5%	-20.0%	-17.4%	-16.5%
Sum SG&A expenses	-4.92	-0.96	-7.04	-9.41	-12.18
as % of Total sales	-25.3%	-59.8%	-67.4%	-60.0%	-57.7%
EBITDA	**-2.16**	**-0.72**	**-2.24**	**1.25**	**2.17**
as % of Total sales	-11.1%	-44.8%	-21.4%	8.0%	10.3%
Depreciation	-0.19	-0.01	-0.12	-0.21	-0.31
as % of Total sales	-1.0%	-0.4%	-1.2%	-1.3%	-1.5%
EBIT	**-1.36**	**-0.72**	**-2.36**	**1.05**	**1.85**
as % of Total sales	-7.0%	-45.3%	-22.6%	6.7%	8.8%
Financial income	0.00	0.00	0.00	0.00	0.00
Financial expenses	0.00	0.00	0.00	0.00	0.00
Financial result	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
as % of Total sales	0.0%	0.0%	0.0%	0.0%	0.0%
Income taxes	0.02	0.00	0.00	0.00	0.09
as % of EBT	-1.6%	0.0%	0.0%	0.0%	4.6%
EAT (Earnings after tax)	**-1.55**	**-0.71**	**-2.36**	**1.05**	**1.77**
as % of Total sales	-8.0%	-44.5%	-22.6%	6.7%	8.4%
Shares outstanding (in m)	10.14	1.01	4.30	4.30	4.30
Earnings per share (EUR)	**-0.15**	**-0.70**	**-0.55**	**0.24**	**0.41**

Source: CBS Research AG; Softline AG

* The financial statement was prepared in conformity with IFRS.

** Abbreviated fiscal year; the financial statement was prepared in conformity with the Germany commercial code (HGB)

Softline AG
Balance sheet

EURm	2008*	2009**	2010E	2011E	2012E
Assets					
Noncurrent assets	**0.94**	**0.17**	**2.57**	**2.63**	**2.64**
as % of total assets	53.5%	22.0%	51.4%	42.8%	32.7%
Intangible Assets	0.01	0.01	0.14	0.14	0.14
Property, plant and equipment	0.03	0.02	0.43	0.49	0.50
Financial Assets	0.90	0.15	2.00	2.00	2.00
Current assets	**0.80**	**0.60**	**2.43**	**3.51**	**5.44**
as % of total assets	45.8%	76.3%	48.6%	57.2%	67.3%
Trade receivables	0.49	0.46	2.16	3.25	4.50
Inventories	0.00	0.01	0.00	0.00	0.00
Cash and cash equivalents	0.32	0.14	0.27	0.26	0.94
Prepaid expenses	**0.01**	**0.01**	**0.00**	**0.00**	**0.00**
as % of total assets	0.7%	1.7%	0.0%	0.0%	0.0%
Total assets	**1.76**	**0.78**	**5.00**	**6.14**	**8.08**
Shareholders´ equity and liabilities					
Shareholders´ equity	**0.74**	**0.03**	**2.23**	**3.28**	**5.05**
as % of total equity and liabilities	42.2%	3.9%	44.7%	53.4%	62.5%
Subscribed capital	10.14	1.01	4.30	4.30	4.30
Capital reserve	0.00	0.00	3.28	3.28	3.28
Accumulated loss	-9.40	-0.98	-5.34	-4.30	-2.53
Noncurrent Liabilities	**0.00**	**0.00**	**2.00**	**2.00**	**2.00**
as % of total equity and liabilities	0.0%	0.0%	40.0%	32.6%	24.7%
Shareholder debt	0.00	0.00	2.00	2.00	2.00
Current Liabilities	**0.65**	**0.43**	**0.44**	**0.54**	**0.71**
as % of total equity and liabilities	37.0%	55.0%	8.8%	8.8%	8.8%
Liabilities to banks	0.00	0.00	0.00	0.00	0.00
Trade payables	0.65	0.43	0.44	0.54	0.71
Tax liabilities	0.00	0.00	0.00	0.00	0.00
Other short-term liabilities	0.00	0.00	0.00	0.00	0.00
Accrued liabilities	0.36	0.32	0.32	0.32	0.32
as % of total equity and liabilities	20.8%	41.1%	6.4%	5.2%	4.0%
Total equity and liabilities	**1.76**	**0.78**	**5.00**	**6.14**	**8.08**

Source: CBS Research AG; Softline AG

* The financial statement was prepared in conformity with IFRS.

** Abbreviated fiscal year; the financial statement was prepared in conformity with the Germany commercial code (HGB)

Softline AG

Cash flow statement

EURm	2008*	2009**	2010E	2011E	2012E
Net income	**n.a.**	**-0.71**	**-2.36**	**1.05**	**1.77**
Depreciation and amortization	n.a.	0.01	0.12	0.21	0.31
Change in prepaid expenses	n.a.	0.00	0.01	0.00	0.00
Increase/decrease in Inventories	n.a.	-0.01	0.01	0.00	0.00
Increase/decrease in trade receivables	n.a.	0.03	-1.70	-1.09	-1.25
Cash flow from operating activities	**n.a.**	**-0.68**	**-3.92**	**0.16**	**0.83**
Cash outflow for investments in intangible assets	n.a.	0.00	-0.25	-0.21	-0.31
Cash outflow for investments in tangible assets	n.a.	0.01	-0.42	-0.06	-0.01
Cash outflow based on financial assets	n.a.	0.75	-1.85	0.00	0.00
Cash flow from investing activities	**n.a.**	**0.76**	**-2.52**	**-0.27**	**-0.32**
Change in short term liabilites	n.a.	-0.22	0.01	0.10	0.17
Change in accrued liabilities	n.a.	-0.04	0.00	0.00	0.00
Cash flow from capital increase	n.a.	0.00	6.56	0.00	0.00
Cash flow from financing activities	**n.a.**	**-0.26**	**6.57**	**0.10**	**0.17**
Total change in cash and cash equivalents	**n.a.**	**-0.18**	**0.14**	**-0.01**	**0.68**
Cash and cash equivalents at the start of the period	n.a.	0.32	0.14	0.27	0.26
Cash and cash equivalents at the end of the period	**n.a.**	**0.14**	**0.27**	**0.26**	**0.94**

Source: CBS Research AG; Softline AG

* The financial statement was prepared in conformity with IFRS.

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