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2012 Annual Results

Christophe FABRE
CEO, Axway

We will start with traditional legal statements, which I am sure you know about. We will cover three areas today. I will start with the 2012 analysis; then Patrick, our CFO, will discuss the financial results. I will end with a discussion about the project and the strategy for the future.

Let us start right away with the revenue per country and region. The results contrast greatly. The US is leading growth for Axway, with an organic growth of 4%. We had some difficulties in France last year, with negative organic growth of 8%. The rest of Europe and Asia is nominal. Overall, the revenue was EUR224 million and the organic growth was -1.6%. It has to be said that the Vordel acquisition we completed in Q4 of last year is included for the last two months of the year. The annual growth of Vordel, meaning the full 2012 revenues compared to 2011, is approximately 40%.

In business lines, we can see a strong growth in the maintenance stream, which comes from hard work at the level of features. This translates into a better average maintenance rate, associated with the licence deals. Also, we have quite a good retention rate; I think it is above 90% in the high end of the market. Services are decreasing slowly, at -1.8% throughout the year, as a result of poor activity on new projects. They were definitely affected by the decrease of 15% in licences. This mainly occurred during the first three quarters of the year; in fact, the fourth quarter was very good. In the numbers for the last quarter, there was 25% organic growth in the US, which was a real improvement in activity. This is a good point for 2013.

France experienced a rebound of 9.8% growth, after three poor quarters. In this area, the issue relates more to flush of budget and frozen deals. That has now concluded, but it does not mean that we see France continuing with this trend in 2013. I think France, Europe and FSI combined have difficulties and we still do not see a better trend for next year. The rest of Europe is at -8, but there is only a small number in Asia, of +50; this is a small number too. This 10% growth shows the ability of Axway to deliver higher revenues anyway.

There has been a 14% improvement on last year with regard to licences in this last quarter. The figure of EUR34 million is nearly half of a licence of a year, so it just shows the importance of this last quarter in the full-year numbers. Maintenance is at 9.7%, which is quite good and the figure for services is 2.6%, which is better than the beginning of the year. There are still some concerns in Europe, but the US is building momentum.

With regard to balance between the regions, it is official now that the US is the first market for Axway; it is 38%. France is still very important, at 34%; the rest of Europe is at 25%. Regarding activities, maintenance is a strong and growing area at 44%, which is good for the stability of the business model. Licences represent 32% of Axway's revenues.

I have a few comments on deals concluded last year. There was Dignity Health in the US, which was one of the big deals we were waiting for last year. It is an eight-digit deal and it is good for Axway; it is one of the first we had of this dimension. It mainly concerns governing the flow of data in their ecosystems, therefore, between their 38 hospitals and all the ancillary care sites. All the physicians and employees are connected through that. It just shows that customers are ready to pay a good premium to ensure that their flow of data is governed.

There are a few others. The first one relates to a big brand in the car market, a Japanese one. We cannot say the name, but it is a very well-known Japanese player which selected Axway in a very competitive environment. It covers the entire management of the transfer of data flows worldwide. There are other examples showing that Axway is still winning big accounts. In particular, the target of Axway is to win large accounts, large-enterprise business.

I will give you an example. Among the governments of Europe, Tullverket has been a customer of Axway for a while. They extended their usage of the platform of a suite last year. Another example is the French FSI; there is still a certain level of business. For instance, we have La Banque Postale **Erreur ! Signet non défini.** in France. FSI is an area where we experienced some decrease in demand.

Now I will give you some metrics to explain this decrease of 15% in the licences. It is significant, but we are not very worried about it in the medium term. The first element is that the number of deals was approximately 2,500 last year. These are pure licence deals; we are not discussing service or maintenance deals. This represents a decrease of 10% compared to last year, so it really concerns the number of opportunities.

We like to present our business as having three tiers. The first tier involves big projects, with large-scale implementation, or generic licences; this tier presents licences of more than EUR250,000. This tier has decreased regarding the total share of the revenues of Axway. For 2012, this tier represents 35% of the licence revenues and that is a decrease of nearly 30% compared to last year. It is where we experienced a lack of traction. Once again, Europe and the FSI is easing that number greatly.

The level of indirect business is stable, at approximately 12%. 15% of EUR70 million are made with resellers, who are being referred or come from partners. New business is a very tight area, because it does not include the cost selling. It is purely lending in new accounts. It accounts for 12% of revenues, in amounts again, so it is stable and is quite a good number.

Then there is an average price for the three tiers. Tiers Two and Three are quite stable. In Tier Two, the average price is at EUR100,000. That is usually the first implementation. In the small projects, there is technology. Tier Three centres on the extension; Tier One and Tier Two deal with the new protocol, new seats. The average sale price is approximately EUR10,000.

To grasp the trend, in the Tier-One business, where the activity is the issue, it is necessary to consider the vertical analysis. FSI is still our vertical, at 30%; then we have supply chain at 22% and in the public sector, it is 23%. The two sectors that have grown in 2012 are healthcare with 26% and the public sector, with 15%. FSI has seen a decrease to 30%. FSI went from 40% of the business to 30% of the business last year. If we combine France, FSI and Tier One, it indicates that the problem is in the licences. This is mainly due to the economy in Europe and in FSI in particular.

The workforce of Axway is increasing a little, with approximately 1,800 people in 2012, with 1,100 people working outside of France. Regarding cost, the gross profit is at 68%. How do we compute that with a total revenue of EUR224 million? We ascribe this to the cost of sales. We have a definition of that and we must realise that it varies from one software editor to another to another.

We subtract the cost of the product revenues. This mainly involves the Original Equipment Manufacturer (OEM) section of the licence deals and the support team which deliver the maintenance. We add the services people to that, then we subtract. We add this figure of EUR71 million to the EUR224 million to arrive at a growth margin of 68%.

This is in line with our editors. Some of our editors have different numbers, but this is mainly because we compute them differently.

Regarding the types of expenses, the market team is stable, at approximately 28% of revenues. R&D has decreased slightly in the last three years, but it is stable with regard to workforce and ability to produce. It is at EUR32.5 million, 15% of the revenues. We are still investing in that. 20% is pure innovation and 90% is in the correction, evolution and support of the software. General and Administrative (G&A) is stable, at approximately 9% of revenues. The operation margin is at 15.6% for 2012, which shows that despite some issues in the European market, Axway is able to deliver a good level of margin. We are able to control our costs. I will introduce Patrick, who will discuss the financial results.

Accounting and Financial Results

Patrick DONOVAN
CFO, Axway

As Christophe said, for 2012, we had EUR224 million in revenue, compared to EUR217 for 2011. That generated EUR35 million in profit on operating activities, compared to EUR35 million for 2011. Regarding the currency, there was stable rate for 2011. The profit on operating activities as a percentage of revenue was 15.7%, compared to the 15.6% for 2012.

I will now comment on some items after the profit on operating activities. For 2012, the stock-option-related expense created a four-year impact in the free-share and stock-option plans. Regarding the amortisation of intangible assets, we gained a little amortisation from the acquisition of Vordel later in the year. Other income and expenses represented in 2012 include acquisition-related charges. In 2011, from memory, this includes quite a few of the spin-off costs from Sopra. Our net profit for 2012 was EUR24.7 million, compared to EUR21.5 million for 2011. That represents 11% of our revenues for 2012, compared to 9.9% for 2011. This is a 15% improvement, year on year.

I will now discuss the balance sheet. Our total assets represent EUR377 million for 2012, compared to EUR304 million for 2011. A lot of this increase came with the acquisition of Vordel, which increased goodwill and intangible assets. Additionally, our trade receivables increased because of the strong performance in the fourth quarter, as Christophe mentioned before. Our cash finished strongly at EUR35 million, compared to EUR24 million for 2011.

In our total liabilities, in 2012, we had EUR40 million in bank-credit-line utilisation in the acquisition of Vordel. In the area of equities, there is not much activity apart from the profit for the period for 2012. However in 2011, there was quite a lot of activity related to the spin-off operation from Sopra.

In our cashflow statement for the year, we generated EUR11.7 million in cash. There is the activity related to the loan of EUR40 million for the Vordel purchase. This was also reflected in the net cash used in investing activities. For the year, our changes in operating working-capital requirements decreased. They were at EUR10.8 million, which reflects a higher trade-receivables balance at the end of 2012.

Regarding our financial covenants, the bank-credit lines are all quite good and are considerably below the current thresholds. We have the ability to borrow the remaining line amounts within these covenants, with our current operating activities. At the end of 2012, we had 20.3 million shares outstanding and quite a stable shareholder structure. Now I will return to Christophe for a few additional comments.

Positioning and Strategy

Christophe FABRE
CEO, Axway

Let us talk now about how Axway is performing in the market and what our plans are for the medium term. The first element is that our plan is still to reach USD500 million in the coming years. I used to say it would be 2015, but with a slower economy, it may be 2016. According to the trend for the last 10 years, we are on our way to achieving this. For 2010-12, we have been on a kind of plateau, which is mainly due to a flat performance in licences. To reach EUR500 million, we have to adapt and change gears for 2012. It should be possible for us to leverage some of the opening market without losing our core know-how.

To consider all the facets of our projects, let us hear about the trends, firstly, the global one on the economy. Next year, the growth in the US is predicted to be approximately 2%; growth in the Eurozone will be nearly zero and France is also at zero. Europe is important in the Axway business model, but that gives us a tough context. Even emerging economies are showing single-digit growth: Brazil is at 4% and Russia is at 3.8%, which is a low number. We also have to adapt to an economic market which is growing tougher. We can expect that this will last like that for a few years.

According to Gartner, IT spending will increase by 4.2% next year. Remember too that Garner analyses are heavily weighted towards the US, because the US accounts for half of the spend in IT. Axway has two-thirds in Europe, so that number has to be adapted to the context of Axway. If it is matched to the weight of the concrete in Axway, we will be at less than 4%.

However, Axway is in middleware; it is not on the global software market. Middleware is supposed to grow in the next four years, at 7.5%. Middleware will be worth USD26 billion in 2016, so it is also a big market, where Axway is a specialist. We have a medium-term plan to grow at close to 10%, which is achievable, but in 2013, the traction on the market will definitely be less than that.

The key point relates to how to leverage what is working; today, customers are asking for mobile first. They want to know how they can govern their flow of data with mobile and how to connect the new applications to their internal systems. They want to know how to connect to the cloud and how to connect the cloud to the application they have on their premises. They also want to run Axway's traditional software, which helps to connect partner communities, providers, customers and employees to their system. They want that Axway platform to be used in the cloud as well, as a trans-function mode.

We had to evolve our positioning in the market and I think we achieved that quite well last year and we may start to leverage that in 2014. The first element we will leverage is Vordel. What does Vordel involve? Vordel involves providing a server for Application Programming Interfaces (API). What is an API? An API is a link that companies are providing to their information systems in order for external personnel to obtain data. That data can be leveraged in many ways.

This API concept is the Service-Oriented Architecture (SOA) concept for Business to Business (B2B). Why use SOA? Why can service architecture not be used for B2B? It is because of two elements. Internal personnel do not have to be concerned with who is connecting to the company. However, when data is being provided externally, it is

necessary to ensure that the people are able to use these data have the right tools for top-load into the system.

The API has to control and secure their utilisation. At the same time, the API is leveraged a lot by mobile applications and mobile has that particularity to be quite similar with regard to applications. However, it is possible to reach numerous mobiles; thousands of mobiles can connect to a system. It is necessary to manage thresholds and warranty Service-Level Agreements (SLA) and protect a system against an overflow of demand.

These APIs usually leverage a type of architecture called West. This is very suitable for a security level and scale which traditional SOAs are not able to deal with. We believe that APIs can change the point of inflection in the B2B market and that is why we undertook the acquisition of Vordel.

I will give an example of what it is possible to achieve with an API server. It involves Blackhawk Network, which is a company in the US. It provides gift vouchers that people can buy for their families. People may want to give their children USD60 so they can buy music on iTunes, or to give their wife USD100 to buy a dress at Macy's. Then they usually buy a card which is powered by Blackhawk.

What is Vordel undertaking regarding that? It relates to the amount remaining on the card. If a person buys from Om Depot, Om Depot may develop an application which connects to their background structure. They may check the balance of the card. It indicates what this could be. For Blackhawk, this involves a lot of volume; 1 billion cards are sold every year and they generate USD5 billion in revenue. There is a lot of traffic.

It is possible to connect an API to power another e-commerce site. For instance, it is possible to buy a gift card from another portal and the e-commerce site may connect it from your own website for an API server. It is possible to combine data from multiple companies, for instance multiple products, to provide a new level of services. We have included a sample application. API is a way to generate business at the edge of an enterprise.

The big consumers use it for mobile, but there are also some websites with some more traditional applications. Finally, we also have an example with BMWs; the consumer on the other side is a car. People use their BMW and they have an adaptive navigation or the [inaudible] system. When they do this, the car connects to a central application in BMW, through an API, so the car becomes a consumer of an API. There is a concept of API is very well-suited to these new developments.

I do not have to comment on the trends in IT, which have been changed massively by these mobile and telematic applications. Before, we were beaming applications to be consumed through a laptop or a unique system. Now, the first target is to reach consumers through a mobile or a tablet and that implies a change in technology. I believe in APIs for enterprises, open APIs that are given to partners so they can carry out business as well as the enterprise's business.

This is a development that should emerge in the future. It is still a small business, but I think it is very coherent to the core business of Axway. Ultimately, large enterprises will want to manage these new flows, as well as the existing ones, in one single application, in one single area. These areas should offer a way to govern all those flows of data, whatever the group, because the data and the consumers are the same.

That is what we want to undertake at Axway. It is not only a firewall to protect a system when undertaking this kind of implementation. It is also an element that should be used positively. Suppose a company has the ability to cover the flow of data, to take any flow of

data in its system and provide it through any kind of device, at any volume. This could include a small message, or gigabytes of data. It also involves any kind of recipient.

A company could run an application through a machine, like BMW, at the time needed. It could be in real time, at the time it is needed, once a month, once a year etc. Then it is possible to ensure that the business runs more smoothly and innovate better. By governing, I refer to the ability to design the flows, the ability to connect the entities. It also includes the ability to control the flows and to make sure that they are in line with the SLAs and that the systems are operating smoothly. It also means analysing the flow, to determine what is working and what is not working, and to improve the system. This creates a very important tool for information systems.

We have enabled that ability in the new version of our portfolio, which we call Axway 5 Suite. That is the direction we see our company taking and that is the kind of offering that can help us reach USD500 million. We have included the traditional areas of expertise Axway and the expertise Vordel brings to us. There are the servers at the edge of the enterprise, which give us the ability to connect the mobile and the cloud applications, but also offer interesting internal elements.

Axway 5 Suite does not only involve Vordel; it involves more innovations. It is the first suite to be completely API-driven. The suite itself allows for APIs to be consumed, internally or in a B2B way. We also have new analytics, for analysing the flows of data. We have a new generation of file transfer. We will make a series of announcements as we move through 2013 on a lot of improvements that this new generation of suites will provide.

This will reinforce our strategic position in this area. In the middleware sector, there are generalists. Oracle and IBM are dominant; they want to provide every service to everybody. These are not the companies we want to compete with. In the car market, they would be the Fords, the Renaults and the Hondas of the world. There are many specialists in this sector, companies like Informatica, Software GA, TIBCO, GXS and Axway. They are trying to leverage one part of the middleware.

They are best at achieving that and deliver competitive advantage to large enterprises. Informatica focused on data integration, Software GA on process excellence and TIBCO on real time. GXS will focus on B2B integration and Axway wants to focus on governing the flow of data. This is exactly the concept I explained to you earlier.

We are not in competition with these companies, but we are in a sector which is growing. There are some niche players that we are competing with; in the API market, there is Layer 7, Apijee and Mashery. In B2B, there is Seeburger in Managed File Transfers (MFT) and Ipswich. In the cloud, there is Liaison, OpenText and Metastorm.

However, the key point is that these niche players do not have the breadth of platform. They do not govern all the flows of data. Also, with regard to governance, they do not give the entire spectrum of what is required to govern the flows of data. That positioning can help us reach to USD500 million or even USD1 billion, when it is considered. Informatica and Software ID are just examples, but they demonstrate that it is achievable, because they are at close to USD1 billion and Software ID is even above that.

We confirm our plans. First, we can confirm that we are strong operationally. In an unfavourable environment, we delivered a good level of margin and we demonstrated our resilience. Secondly, last year, we adapted our vision to take new drivers on the market into account. This brings us more in line with the target of USD500 million and of governing the flow of data, the entire flow of data. This is what we need to achieve.

We have just implemented the new offering to achieve that vision, with a broader market reach. We are integrating the Vordel acquisition and also providing new innovations regarding Axway 5 Suite. We have also worked on strengthening our management structure and last year, we included a lot of high-level managers, who used to run at USD500 million.

What is the outlook for 2013? The first key point is that the IT context is uncertain. A survey was carried out in France, which is still a well of Axway, so it is important. In the survey, IDC asked the managers to state whether the IT expense should be flat in 2013. Did they think it would increase or decrease? Nearly 68% said it should be flat, 15% said it would increase and 18% said it would decrease again. It can be said that 85% view that it would be flat or decrease. This does not mean that this will be the case for Axway, but it means that the market is tough in France and especially in FSI.

Secondly, we are continuing our transformation. I think we are taking the right action with Vordel. We are investing in the cloud. I made the comment in the beginning that in the services cost, we have a cloud infrastructure and we are building an operating team here. That has certainly impacted on the services margin, but we are investing step by step. We may also have the ability to acquire. We do not have anything secured in the short term. However, if it involves strengthening our suites or developing our sales network, we will definitely consider it and we have to acquire to reach our target.

All in all, that gives us prudent guidance, with positive organic growth, and we are maintaining our level of operating margin. The other key point is that we acquired nearly half of our licences in Q4 and a big element of the Q4 figure originates in December, so it is nearly 10 months from now. Even if we have a very encouraging commercial direction for Q1, we will know better where we will arrive at mid-year. At the moment, we have to remain prudent in that guidance. That is our presentation and we are open to questions. We are correct with our timing.

Questions and Answers

From the Floor

Do you plan to increase the service margin and what is your objective? What are the main reasons for the actual level?

Christophe FABRE

The first major reason for the actual level is the investment in the cloud, which can be estimated at approximately EUR4-5 million for 2012. It will improve a little more in 2013. It is not breaking even yet. We hope to break even in 2014, so that is impacting on the margin. Secondly, unfortunately, we have strong activity in France, especially in FSI, which was damaged last year.

We do not see that recovering very well next year. Normally, services should not prevent us from attaining a 20% margin in the future, which is our target. It is to reach 20% of operating margin. However, it is true that at the moment, we have not achieved it. We are working to deliver a higher level of services, consultations on architecture. This is only in relation to our products; we do not undertake any activities regarding system integration. We only offer software services.

We also have some interesting long-term managed-services contracts; we signed two big ones at the end of last year. These are good contracts which should give us some momentum in 2013. However, the key point is that we do not want that part of services to grow in our mix; 25% of services or less will be enough for Axway. It cannot be the whole, because our technology requires some services to be implemented. We have to target 20% growth in our services, but we will not also be developing activity; we try to focus more on added value. Regarding the cloud question, maybe it will not be in 2013, but we will break even in 2014 and start to not penalise the margin.

From the Floor

The next question is about the Vordel acquisition. The revenue growth of Vordel was approximately 30% last year. Do you expect the same level of growth for the coming years?

Christophe FABRE

Even last year, technically, it was 40%. I will consider the period of 12 months, not just the two months in Axway. The 2012 exercise for Vordel measured 40% compared to 2011. However, we expect an even stronger growth as part of Axway in the coming years. We are working on the synergies, so it will not come in the first few quarter, but I think it will be a strong contributor to Axway in 2013, for sure.

From the Floor

The next question is about the operating working-capital requirement. What is the actual Days Sales Outstanding (DSO) level and what is your forecast for 2013?

Patrick DONOVAN

The DSO level for 2012 is just over 100 days. Historically, we have achieved a DSO of closer to 85-90 days, but with our end of year results being so important for 2012, this causes our DSOs to increase. I would expect it as a target to be just below 90 days.

Conclusion

Christophe FABRE

Thank you very much for your attention and we hope to see you at the next web conference.