Manhattan Associates, Inc. (MANH)
Everything’s Coming Up Cloud – Active Warehouse Management Introduced

Maintain Outperform rating. As part of the virtual Momentum conference, Manhattan highlighted numerous upgrades to its Active Solutions portfolio, including customer testimonials on how inventory optimization, order management and store fulfillment applications are aiding results in the current environment. The big news, however, was the debut of Active Warehouse Management, a cloud-native solution that represents the company’s next-generation offering in the WMS category. We remain positive on the opportunity from digital supply chains and Manhattan’s ability to capitalize given its product positioning.

- **Active Warehouse Management debuts.**
- The introduction of Manhattan’s cloud-native, next-generation WMS is an important development. New/prospective customers were already looking to Manhattan for WMS in the cloud, even before this true cloud-native solution was ready. From a broader industry standpoint, cloud is also becoming a more popular option overall, accounting for an estimated 40-50% of new awards.
- With Manhattan Active Warehouse Management now in market, we expect pipeline development to be strong and for cross-sell opportunities between the other cloud-native Active Solutions to ultimately benefit (e.g., Active Omni and Active Inventory). After the formal keynote presentation at Momentum, Manhattan hosted a call with sell-side analysts and went into additional detail on the next-generation WMS release:
  - Prior to this release, the WMS pipeline was significantly weighted toward a managed service/cloud approach rather than perpetual license. The existing appetite was already apparent.
  - The company still sees a fair amount of pipeline activity from new logos (appr. 30-40% of total). Active WM is a key product to help capitalize on this market share opportunity, while existing WMS customers are expected to pursue a transition over time.
  - Pets Supplies Plus is the initial beta customer and its Active WM implementation was very fast in comparison to normal on-prem timelines; start-to-finish was approximately six months for the company’s largest warehouse and took place during COVID-19 related #WFH changes. Pets is also in the process of implementing Active Omni and Active Inventory, going “full cloud” on Manhattan solutions.
  - While Active WM was designed to be faster and cheaper to implement, management does not expect a material change in Service revenues following the product’s release/adoption. The assumption is that any reduction in time will be made up by new business and market share opportunities.
  - No explicit details on Active WM monetization were provided, other than to say that a license-to-cloud transition will reflect the normal relationship that one might expect: Year 1 revenues go down (given ratable versus upfront recognition) but with greater value generated over a five-year contract term. Management also expects retention to be similar to legacy maintenance levels near 95%+.

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Manhattan Associates, Inc. provides software for supply chain management, inventory optimization, and omnichannel operations.
Investment Thesis

**Modern commerce solutions a strategic imperative for global retailers.** The market for supply chain software has risen steadily over recent years. A modern distribution center, joined with a transportation management system, can enable an organization to improve inventory turnover, lower freight costs, and pursue new business strategies (e.g., same- and one-day shipping) to remain competitive. Over the last five years, the market for supply chain software has realized a 10-15% CAGR nearing $16 billion worldwide. Manhattan’s portfolio of supply chain solutions addresses approximately $8 billion of this opportunity today, with growth rates for recurring software (cloud subscriptions and maintenance contracts) that have tracked near that of the broader industry.

**Manhattan Active Omni a meaningful growth accelerator.** The launch of Manhattan Active Omni (MAO) in mid-2017 was the culmination of a multi-year journey to create a cloud-native, microservices platform that joined Manhattan’s best-in-class order management and store fulfillment offerings with acquired point-of-sale and clienteling applications. MAO has already been a game changer for Manhattan’s cloud subscription business, growing nearly five-fold in the last two years.

**Change is coming for “traditional” warehouse management.** Increasingly, retailers understand that a successful omni-channel strategy requires modern fulfillment solutions and a re-thinking of how distribution centers are designed and operated. This is driving an accelerated pace of innovation at distribution centers, including the increased use of automation equipment and robotics and rising interest in cloud solutions that can be configured and regularly updated to accommodate ongoing technological innovation.

**Service as a differentiator.** One unique aspect of Manhattan’s business mix relative to other enterprise software vendors is the size of its professional service division, representing approximately 60% of total company revenues. While services are optional, a majority of Manhattan customers utilize the expertise of Manhattan associates in the planning and implementation of new software licenses, cloud subscriptions, or system upgrades. The virtues of an expert service network are readily apparent when sophisticated enterprise customers pursue warehouse management implementations/upgrades, typically requiring heavy customization ahead of initial installation, complex onboarding of customer data and integration with other IT systems, and extensive training/education for personnel that will subsequently manage the system.

**Profitably managing the cloud transition.** Manhattan has been debt free and profitable since its founding, so it is perhaps less of a surprise that the company has maintained very strong profitability while accelerating investments in R&D and the buildout of its cloud operations during the transition to greater subscription revenues. In fact, relative to financial guidance around its business model transition that was provided in early 2018, the company has held fairly close to plan with operating margins still projected to trough near the 20% level during 2020. From this point, we believe margins should expand by 400bp through 2022 as the company scales its cloud subscription revenues and leverages growth investments.

**Valuation.** Our $76 price target uses a 32x P/FCF on Fiscal 2022 results, discounted back to arrive at a 12-month time horizon. This is equal to the median valuation of the trading range since the company communicated its cloud transition model in late 2017.

**Key risks.** Key risks: variability in quarterly financial results/guidance, the ability to win new cloud business, retail market fundamentals, competition, risks associated with cloud solutions, the uncertain environment created by COVID-19 and impacts on quarterly financial performance.
Risks & Caveats

Quarterly results can be variable given business model considerations. Manhattan’s ongoing transition to more cloud subscription revenues as a percent of overall company revenues, and lessening mix from on-premise perpetual licenses, can impact quarterly results as a function of ratable revenue recognition for cloud subscription deals versus upfront revenue recognition for new perpetual license deals. For Fiscal 2020, management expects software license revenue to decline approximately 40% year over year with cloud subscription revenues increasing approximately 70% year over year, reflecting the ongoing shift by customers to adopt cloud solutions.

Ability to win new cloud business. We expect Manhattan customers to increasingly choose cloud-based solutions when considering investments in supply chain and digital commerce. However, Manhattan’s technology solutions are complex, expensive (in many cases exceeding $1.0 million between software and services), and often considered alongside other capital commitments such as facility expansion/improvement. A normal sales cycle for Manhattan software can be 9-12 months, although in periods of difficult retail activity for customers and/or consideration of multiple technology solutions (particularly if deciding between on-premise and cloud solutions), sales cycles can extend with a negative impact on Manhattan software growth.

Risks associated with retail market fundamentals. The company’s largest end market is retail, where customers are facing pressure in traditional brick-and-mortar operations from digital commerce. While Manhattan solutions ultimately help to enable omnichannel commerce that can help traditional retailers adapt to a changing commerce landscape, the decision to invest in these solutions can be delayed/postponed during periods of retail weakness and/or alternative cost considerations.

Competition. The opportunity to modernize supply chain and commerce operations is a sizable $16 billion market opportunity that likely provides ample growth for companies like Manhattan with established track records of innovation and customer service. That said, the company does compete against many reputable software vendors in addition to in-house corporate IT departments at potential customers.

In seeking new sources of revenue growth and retaining existing customers, Manhattan competes against the following companies:
- ERP vendors such as Oracle, SAP and Infor;
- Supply chain technology vendors such as Blue Yonder (formerly JDA Software), HighJump, SAS Institute, and the Sterling Commerce division of IBM;
- Point-of-sale vendors such as Aptos, Salesforce.com, and Oracle;
- Smaller independent companies deploying cloud-based supply chain solutions that target specific applications and/or geographies.

Risks associated with Manhattan-managed cloud arrangements, including data security. The success of Manhattan’s cloud services, in part, relies upon the assurance of data security given the company is storing and transmitting sensitive customer data. The company has taken steps to protect confidential information, although security breaches in the future could negatively impact Manhattan’s industry reputation and ability to win new cloud business.

Seasonal characteristics of financial and stock performance. Manhattan typically incurs its weakest operating performance in Calendar Q4 of a given year in light of 1) customers idling new software implementations during the retail holiday peak season; and 2) higher compute costs in its self-managed cloud operations due to the retail holiday peak season.
Company Description

Manhattan Associates, Inc., headquartered in Atlanta, Georgia, provides software for supply chain management, inventory optimization, and omnichannel operations. Warehouse Management Solutions (WMS) are used in some of the most complex distribution center environments, enabling utilization of a facility for everything from direct-to-consumer to wholesale bulk fulfillment. The company’s supply chain solutions also extend beyond the four walls of the distribution center and include the entire commercial network of an organization, including Transportation Management Solutions (TMS) for freight planning and execution, and advanced tools for inventory visibility, planning and forecasting. Over the years, Manhattan has also built out a robust set of capabilities serving omnichannel retail operations, including order management, point-of-sale, clienteling, store fulfillment, customer engagement, and contact center functionality.
Appendix - Important Disclosures and Analyst Certification

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