Manhattan Associates, Inc. (MANH)

Baird Facts

Please refer to Appendix - Important Disclosures and Analyst Certification.

<table>
<thead>
<tr>
<th>Price ($) (5/20/20):</th>
<th>74.07</th>
</tr>
</thead>
<tbody>
<tr>
<td>52WK H-L ($) :</td>
<td>90 - 35</td>
</tr>
<tr>
<td>Market Cap (mil):</td>
<td>4,800</td>
</tr>
<tr>
<td>Shares Out (mil):</td>
<td>64.8</td>
</tr>
<tr>
<td>Float (mil):</td>
<td>62.5</td>
</tr>
<tr>
<td>Avg. Daily Vol (mil):</td>
<td>0.84</td>
</tr>
<tr>
<td>Dividend ($) :</td>
<td>0.00</td>
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<tr>
<td>Yield (%):</td>
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<tr>
<td>Rating:</td>
<td>Outperform</td>
</tr>
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<td>Price Target ($) :</td>
<td>76</td>
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<tr>
<td>L-Term Rev. Gr Rate Est:</td>
<td>10%</td>
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<tr>
<td>L-Term EPS Gr Rate Est:</td>
<td>20%</td>
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<tr>
<td>Debt/Cap:</td>
<td>0.0%</td>
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<tr>
<td>ROE:</td>
<td>76.0%</td>
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<tr>
<td>FY Dec</td>
<td>Q1 0.41A</td>
</tr>
<tr>
<td>FY P/E</td>
<td>42.6x</td>
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<tr>
<td>2019A</td>
<td>2020E</td>
</tr>
<tr>
<td>Revenue (Mil):</td>
<td>617.9</td>
</tr>
<tr>
<td>% Growth</td>
<td>(9.4)%</td>
</tr>
<tr>
<td>Operating Margin</td>
<td>24.0</td>
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Headquartered | IPO/Founded | Dec | 2019A | 2020E | 2021E |
<table>
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</thead>
<tbody>
<tr>
<td>Atlanta, GA</td>
<td>1998/1990</td>
<td>Revenue (Mil)</td>
<td>617.9</td>
<td>560.0</td>
<td>625.6</td>
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<tr>
<td>Management</td>
<td></td>
<td>% Growth</td>
<td>(9.4)%</td>
<td>11.7%</td>
<td></td>
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<tr>
<td>Chief Executive Officer</td>
<td>Eddie Capel</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Chief Financial Officer</td>
<td>Dennis Story</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Investor Relations</td>
<td>Matt Humphries</td>
<td></td>
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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.

Revenue Profile

Source: Baird estimates, Factset, Company reports
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.

Quick Summary
- Maintain Outperform rating. F1Q EPS of $0.40 (down 2% YoY) above our $0.32 estimate/$0.33 consensus. Manhattan reduced FY20 revenue guidance by 15% from earlier views (3-4% below updated estimates) with 90% of the reduction from lower Services activity. On the other hand, aggressive expense reduction measures are providing a lift to FY20 margin guidance (now 23% vs. earlier 20%) and helping safeguard EPS (now $1.50-1.58 vs. earlier $1.53-1.60; consensus = $1.22). While the near-term remains uncertain, we believe risk/reward is favorable after guidance update and longer-term opportunity remains compelling.
- Maintain Outperform rating.
- We view Manhattan’s updated financial outlook for FY20 and ability to largely reaffirm EPS guidance as encouraging relative to the stock which has faced significant pressure YTD (down 35%).
- For long-term investors, Manhattan could offer some of the greatest absolute upside in our coverage once conditions return to “normal.” F1Q updates on new business activity and the rising importance of supply chain strategies (e.g., pipeline of opportunities up 20% from quarter ago) reinforce this view.
- FY20 guidance update.
  - Revenues are now anticipated at $541-565 million (down 9-12% YoY) versus prior guidance of $644-656 million (up 4-6% YoY); consensus estimates had been moving lower ahead of the update, with the current view approximately 3-4% below updated estimates.
  - The outlook for Services revenues was revised lower by 22% and is responsible for approximately 90% of the overall change in Manhattan’s forecast ($86 million of the $98 million reduction). Retail end markets represent 20% of near-/mid-term Services revenue and appear to account for much of the pressure; the company has not seen project cancellations but is seeing projects pushed out.
  - The outlook for recurring Software revenue (cloud + maintenance) saw a comparatively small 2-3% revision from earlier views. Cloud bookings remain very strong, aided by “accelerating” demand for WMS in the cloud and continued momentum for Active Omni. Relatedly, RPO – representing cloud bookings value of unearned revenue under non-cancelable contracts over one year – increased 102% YoY during F1Q and management reiterated full-year RPO guidance for nearly 60% YoY growth.
  - Offsetting the lower revenue outlook is $45 million in lower expenses during the balance of FY20 (lower compensation, hiring freezes, reduced discretionary spending). As a result, operating margins are now seen 22.9-23.1% (down 100bp YoY); retail end markets represent 20% of near-/mid-term Services revenue and appear to account for much of the pressure; the company has not seen project cancellations but is seeing projects pushed out.
  - The outlook for recurring Software revenue (cloud + maintenance) saw a comparatively small 2-3% revision from earlier views. Cloud bookings remain very strong, aided by “accelerating” demand for WMS in the cloud and continued momentum for Active Omni. Relatedly, RPO – representing cloud bookings value of unearned revenue under non-cancelable contracts over one year – increased 102% YoY during F1Q and management reiterated full-year RPO guidance for nearly 60% YoY growth.
- EPS of $1.50-1.58 (down 9-14% YoY) are down slightly from prior guidance of $1.53-1.60 but well above consensus of $1.22

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
Manhattan Associates, Inc.
May 20, 2020

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 lessoning 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.

Supplemental Information
Our $76 price target uses a 32x P/FCF on Fiscal 2022 results, discounted back to arrive at a 12-month time horizon.
Appendix - Important Disclosures and Analyst Certification

Approved on 20 May 2020 17:11EDT/ Published on 20 May 2020 17:16EDT.

1 Robert W. Baird & Co. Incorporated makes a market in the securities of MANH.

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