Aspen Technology, Inc. (AZPN)

Baird Facts

Please refer to Appendix - Important Disclosures and Analyst Certification.

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<tbody>
<tr>
<td>52WK H-L ($) : 143 - 73</td>
<td></td>
<td>Q1</td>
<td>0.64A</td>
<td>0.79A</td>
<td>0.63E</td>
</tr>
<tr>
<td>Market Cap (mil): 6,874</td>
<td></td>
<td>Q2</td>
<td>0.92A</td>
<td>0.66A</td>
<td>0.69E</td>
</tr>
<tr>
<td>Shares Out (mil): 68.4</td>
<td></td>
<td>Q3</td>
<td>0.96A</td>
<td>0.74A</td>
<td>0.86E</td>
</tr>
<tr>
<td>Float (mil): 67.5</td>
<td></td>
<td>Q4</td>
<td>1.59A</td>
<td>1.20E</td>
<td>1.30E</td>
</tr>
<tr>
<td>Avg. Daily Vol (mil): 0.72</td>
<td></td>
<td>Total</td>
<td>4.09A</td>
<td>3.38E</td>
<td>3.47E</td>
</tr>
<tr>
<td>Dividend ($) : 0.00</td>
<td></td>
<td>FY P/E</td>
<td>24.6x</td>
<td>29.7x</td>
<td>29.0x</td>
</tr>
<tr>
<td>Yield (%): 0.0</td>
<td></td>
<td>EPS (Cal)</td>
<td>4.00A</td>
<td>3.26E</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>P/E (Cal)</td>
<td>25.1x</td>
<td>30.8x</td>
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<tr>
<td>CEO</td>
<td>Antonio Pietri</td>
<td></td>
</tr>
<tr>
<td>CFO</td>
<td>Karl Johnsen</td>
<td></td>
</tr>
<tr>
<td>SVP, Technology</td>
<td>Willie Chan</td>
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| Company Description |

Based in Bedford, MA, Aspen is the leading vertical software pure-play for measuring, monitoring, and analyzing product flows for process industries. Process industries include refining oil (petroleum) and gas, chemicals, engineering and construction (E&C), metals and minerals, and some consumer products. Aspen’s product portfolio includes a comprehensive suite of solutions aimed at enhancing the profitability of process manufacturers by improving capacity/asset utilization, productivity and efficiency. With an installed base of over 2,100 customers worldwide, we estimate the company holds a 40%-50% share in the process software industry. The company introduced a new Asset Performance Management suite in 2016 which is expected to increase TAM and potentially accelerate growth.

| Revenue Profile |

![Annual Spend Chart](https://example.com/annual-spend-chart.png)

| Competition |

Aspen primarily competes with a variety of larger industrial companies and a few single product companies. Large industrial companies include: 1) Honeywell, 2) Schneider Electric, and 3) Siemens. Single product companies which offer a point solution are OSIsoft and a number of smaller players. Most of these larger competing vendors have a hardware focus, and happen to offer a software offering within their product portfolio. Aspen has a competitive advantage in that its singular focus is software, and it offers 35+ years of domain expertise in the vertical.

| Quick Summary |

- AspenTech reported a tough 3Q20 (March) that saw a sharp decline in second half of March due to perfect storm of COVID uncertainty and compounding effect of oil prices collapsing. Many customers took swift action to postpone new spend (including APM deals) and AZPN saw some seeking payment extensions. While we agree with the company’s assertion that they are better positioned to weather a downturn today than in previous cycles, the current uncertainty across their end markets headed into a very high FY21 (June) renewal year keeps us on the sidelines.

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The perfect storm. COVID-19 + oil price deterioration + OPEC price war created a perfect storm in the final weeks of March. Collateral economic damage remains uncertain at this point, however given the shock of oil price decline companies are acting fast to cut costs.

Annual spend of $575M was +9.3% yr-yr in the quarter, roughly in-line with consensus $574M (+9.2% yr-yr). Prior five quarters annual spend growth has now been: +9.7%, +10.6%, +10.0%, +10.0%, +9.3%.

Lowering FY20E (June) Guidance:
- "Hot metric" of Annual spend lowered to +7-9% (prior: +10-12% yr-yr)
- Core engineering/MSC suites are expected to contribute +5.0-7.5% to growth, and APM is expected to contribute 1.5-2.0% (implying ~8-11M of new APM business versus $16M under prior guide).
- Total Revenue lowered by $29M at mid-point to $550-582M (-8% to -3% yr-yr) versus consensus/Baird $571M/$566M.
- Bookings lowered to $540-590M from prior $600-650M (includes $317M of business up for renewal in FY20).
- Non-GAAP EBIT lowered to $249-277M (prior: $272-307M) which implies EBIT margin 40.5%-48.2% or 44.2% at mid-point versus consensus 48.4%.
- Non-GAAP EPS lowered by ~$0.32 at mid-point to $3.16-3.48 (prior: $3.43-3.84) versus consensus/Baird $3.50/$3.47.
- FCF lowered by $20M at mid-point (now using a wider range). New guide $230-260M versus consensus/Baird $241M/$247M.

Resiliency this cycle. Company stated they should be more resilient during this downturn vs previous due, in part, to more diversified end-markets, less reliance on state-run oil companies, and focus on customer success. For these reasons management believe churn rates should remain 3.5%-4.5% (unchanged).

Taking financial measures. AspenTech is suspending its buyback for the nearterm (~$50M quarterly) and cutting back on marketing, events, and discretionary spend for 4Q that likely wouldn’t yield any results.

Looking to project FY21 (June) Annual Spend. Aspen has added between $7M and $16M of net new Annual Spend sequentially each quarter for the past two years. If we assume $8M, $7M, $5M, and $3M for the quarters of FY21, we get to Annual Spend +3.9% yr-yr, which to us feels like an appropriate assumption at this point. We estimate that initial guidance may shake out in the range of +3-5% yr-yr.

AspenTech remains one of the stickiest, highest quality software companies we follow. Their software is mission critical, and they are viewed as a key partner by their customers.

Investment Thesis

Valuation. Our price target is $100. We reach this price target using a P/FCF multiple of 26x our FY21 (June) FCF/share estimate. The P/FCF multiple over the past five years has averaged 25x. We believe a premium multiple is justified by: 1) core business and end-markets are improving and stabilizing (much different environment than post-2014 oil sell-off); 2) potential growth acceleration from new APM suite; 3) Industry 4.0/ IoT infections point; 4) 35+ years of established vertical domain expertise; 5) dominant market position; and 6) strong management team.

Market leadership position. Aspen is known in the industry as an established player with 35+ years selling optimization software to process industries including over 2,100 customers globally.

Best-in-class profitability. Aspen sports EBIT and FCF margins of 47%+ and 36%+, respectively. These profitability metrics place the company in the top decile of margins for software companies.

Subscription model with long-term contracts. Aspen’s revenue model is highly recurring (over 90% of total revenue is recurring) and the company features contract lengths that average 5-6 years.

Growth initiatives. Company believes that most recent round of acquisitions, which are the basis for the APM suite, are arguably the most impactful in company history.

Focus on shareholder value. Aspen has delivered shareholder value by continuing to dramatically reduce its share count. The company repurchased ~$200M annually for the past few years, and the diluted share count has decreased >20% since December 2013. The company has also been proven to be a disciplined and savvy acquirer over the years.

Global customer base. Aspen’s customer base features large, sticky customers in the Energy, Engineering & Construction (E&C), Chemicals, and CPG (to a lesser extent) industries.

Risks & Caveats

Correlation to oil prices. In recent years, Aspen has seen a more direct correlation between declining oil prices, customer demand, and impact on stock price performance. Over the long term (we tested 2007-2017) the correlation was irrelevant, but in 2015/2016, the correlation between WTI and AZPN reached +0.79.

Software Accounting Changes: AZPN is the most impacted of any of our companies by the change from ASC 605 to 606, which creates volatility in the quarterly bookings and P&L. This volatility, which does not bear on the key Annual Spend and FCF metrics, as well as the introduction of new metrics (Bookings and TCV) could cause increased quarterly volatility in shares until investors become accustomed to the impact of the changes.

Macro conditions. Being a vertical software provider has its pros and cons. One of the cons of having customers in the energy sector is the ties to spending environment that correlates to oil prices. Certain customer segments have seen their capex budgets decrease by 40% since the 2014 oil boom. These customers are tempering demand and taking time to digest previously purchased tokens. Additionally, a majority of Aspen business is linked to customers outside of the United States, which creates a complicated macro environment with many moving parts.

Latin America has been a drag. The business environment in Latin America has a number of major state-owned enterprises which have been a net negative as the oil industry in the region continues to struggle to recover from macro-environment and operational challenges.
## Appendix - Important Disclosures and Analyst Certification

Approved on 27 May 2020 10:35EDT/ Published on 27 May 2020 10:40EDT.

### Rating and Price Target History for: Aspen Technology, Inc. (AZPN) as of 05-26-2020

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<th>Rating</th>
<th>Price Target</th>
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</tr>
<tr>
<td>10/26/17</td>
<td>N</td>
<td>$68</td>
</tr>
<tr>
<td>01/24/18</td>
<td>O</td>
<td>$90</td>
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<tr>
<td>08/09/18</td>
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<td>04/24/19</td>
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<tr>
<td>03/11/20</td>
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<tr>
<td>04/22/20</td>
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<td>$100</td>
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Created by BlueMatrix

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

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- Expected to underperform on a total return, risk-adjusted basis the broader U.S. equity market over the next 12 months.

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- **A - Average Risk** – Growth situations for investors seeking capital appreciation with an emphasis on safety. Company characteristics may include: moderate volatility, modest balance-sheet leverage, and stable patterns of revenue and earnings.
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Baird
Aspen Technology, Inc.
May 27, 2020

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