

**Analyst**

Chris Savage 612 8224 2835

**Authorisation**

Olivia Hagglund 612 8224 2813

# Altium (ALU)

## Core strength

### Recommendation

**Hold** (unchanged)

**Price**

**\$45.20**

**Target (12 months)**

**\$44.00** (previously \$40.00)

### GICS Sector

**Software and Services**

### Expected Return

Capital growth	<b>-2.7%</b>
Dividend yield	<b>1.4%</b>
Total expected return	<b>-1.3%</b>

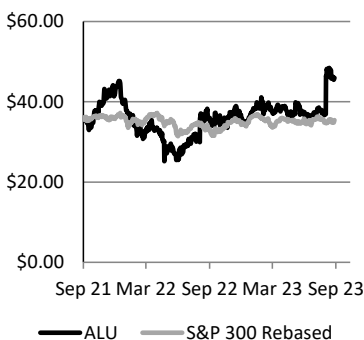
### Company Data & Ratios

Enterprise value	<b>\$5,665m</b>
Market cap	<b>\$5,963m</b>
Issued capital	<b>131.9m</b>
Free float	<b>95%</b>
Avg. daily val. (52wk)	<b>\$13.9m</b>
12 month price range	<b>\$32.90 - \$49.41</b>

### Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	37.14	37.32	37.80
Absolute (%)	23.77	23.18	21.61
Rel market (%)	25.96	22.39	17.98

### Absolute Price



SOURCE: IRESS

### Forecasts tweaked, little overall change

We have revised our forecasts for Altium post the release of the FY23 result last month and have made some modest changes including: revenue upgrades of c.1% driven by higher design software revenue partially offset by lower cloud platform revenue; NPAT upgrades of c.1% driven by the revenue upgrades with no change in our margin forecasts; and negligible change in our EPS forecasts as an increase in our forecast number of fully diluted shares has wholly or largely offset the impact of the NPAT upgrades. We now forecast FY24 revenue of US\$322.0m (vs US\$320.4m previously) which is still within the guidance range of US\$315-325m albeit more towards the upper end. (Our design software and cloud platform revenue forecasts of US\$252.6m and US\$69.4m (vs US\$248.5m and US\$71.9m) are now also consistent with the guidance of US\$250-255m and US\$65-70m.) As mentioned, there is no change in our EBITDA margin forecast of 37.0% which is at the top end of the 35-37% range. We also now forecast FY26 revenue of US\$454.9m (vs US\$450.5m previously) which is still below the company's aspirational target of US\$500m.

### Investment view: PT up 10% to \$44.00, Maintain HOLD

We have increased the multiples we apply in the PE ratio and EV/EBITDA valuations from 45x and 25x to 50x and 27.5x and reduced the WACC we apply in the DCF from 9.4% to 9.0% given the upgrades in our design software revenue forecasts which we view as higher quality given its stickiness and/or recurring nature. The net result is a 10% increase in our PT to \$44.00 which is still a modest discount the share price so we maintain our HOLD recommendation. Intuitively, we believe the stock looks around fair value trading on an FY24 PE ratio of c.48x which is higher than Technology One on c.42x but still well below WiseTech Global on c.82x. Like-for-like comparison with these peers is difficult due to different accounting practices (i.e. Altium expenses everything while both Technology One and WiseTech capitalise around 50% of their R&D) but in our view Altium and Technology One should trade on broadly similar multiples given the positive of being a global software company is largely offset by being very early in its transition to SaaS.

### Earnings Forecast

Year end 30 June	2023	2024e	2025e	2026e
Total revenue (US\$m)	263.3	322.0	385.8	454.9
EBITDA (US\$m)	96.0	119.1	146.6	177.4
NPAT (US\$m)	66.3	83.8	105.2	129.2
EPS (diluted) (US¢ps)	49.9	63.0	79.0	96.8
EPS growth (%)	19%	26%	25%	23%
PER (x)	61.1	48.4	41.5	35.0
Price/CF (x)	72.8	45.1	37.4	31.7
EV/EBITDA (x)	39.8	32.1	28.0	24.0
Dividend (A¢ps)	54.0	62.0	72.0	82.0
Yield (%)	1.2%	1.4%	1.6%	1.8%
ROE (%)	21.8%	23.9%	25.7%	26.7%
Franking (%)	18.5%	20.0%	20.0%	20.0%

SOURCE: BELL POTTER SECURITIES ESTIMATES

# Pros and Cons

A number of key positives emerged from the recent Altium result and these are highlighted below (pros). There does remain, however, some areas of uncertainty or risk and these are also highlighted (cons). On balance we believe the pendulum swung more towards the former following the result but this in our view is also now reflected in the share price.

## Pros

- **ASSV increasing strongly:** Average subscription seat value (ASSV) increased by 22% to US\$2,408 in FY23 and was driven by an improving mix with customers – both existing and new – shifting towards the higher value Pro and Enterprise products.
- **Strong growth in subscribers:** Perhaps the surprise of the FY23 result was the 7% growth in subscription seats to 61,159 after this only grew 5% in FY22. The growth in FY23 was particularly impressive given the loss of subscriptions in China and a challenging business and political environment in China.
- **Strong cloud adoption:** Monthly active users of Altium 365 reached 36,741 in August 2023 and there is evidence of a network effect with the ratio of users to accounts increasing to a new high of 2.94. There is also evidence of the platform drawing users from outside of the traditional electrical engineer user base (e.g. mechanical engineers, procurement managers) which suggests increasing collaboration.

## Cons

- **Uncertainty over monetising cloud platform:** Altium has an aspirational FY26 revenue target of US\$500m which comprises US\$350m from design software and US\$150m from cloud platform. We believe the design software target is very achievable but are less confident on cloud platform target. In our view Altium needs to successfully monetise Altium 365 and generate around US\$50m or more from this platform in FY26 to achieve its target.
- **Consensus well below aspirational target:** Consistent with the above, the consensus revenue forecast for FY26 – according to Bloomberg – is US\$437m which is well below the aspirational target of US\$500m. We are notably higher than consensus as shown below but the sell-side belief appears to be the aspirational target is unachievable without perhaps a material acquisition.

Figure 1 - Breakdown of FY24-FY26 revenue forecasts

Year end 30 June	FY24e	FY25e	FY26e
<b>Revenue (US\$m)</b>			
Consensus	319.6	378.3	437.2
Bell Potter	322.0	385.8	454.9
<b>Guidance/Aspirational target</b>	<b>315-325</b>	<b>n.a.</b>	<b>500.0</b>

SOURCE: BLOOMBERG, BELL POTTER SECURITIES ESTIMATES AND COMPANY DATA

- **Very early in transition to SaaS:** Altium has very successfully transitioned its business model from perpetual to term-based licenses over the past few years but has yet really to start the transition to SaaS. This will come and likely commence with the monetisation of Altium 365 but it will be many years before Altium can be considered a SaaS company. This contrasts with many of its software company peers on the ASX with, for instance, both WiseTech and Xero pure SaaS companies and Technology One only a year or two away from being the same.



# Forecast and Valuation Changes

## Forecasts Tweaked, Little Overall Change

We have revised our forecasts for Altium post the release of the FY23 result last month and have made some modest changes including: revenue upgrades of c.1% driven by higher design software revenue partially offset by lower cloud platform revenue; NPAT upgrades of c.1% driven by the revenue upgrades with no change in our margin forecasts; and negligible change in our EPS forecasts as an increase in our forecast number of fully diluted shares has wholly or largely offset the impact of the NPAT upgrades. We now forecast FY24 revenue of US\$322.0m (vs US\$320.4m previously) which is still within the guidance range of US\$315-325m albeit more towards the upper end. As mentioned, there is no change in our EBITDA margin forecast of 37.0% which is at the top end of the 35-37% range. We also now forecast FY26 revenue of US\$454.9m (vs US\$450.5m previously) which is still below the company's aspirational target of US\$500m.

Figure 2 - Change in key forecasts

Year end 30 June	FY24e			FY25e			FY26e		
	Old	New	Change	Old	New	Change	Old	New	Change
Revenue (US\$m)	320.4	322.0	0.5%	383.1	385.8	0.7%	450.5	454.9	1.0%
EBITDA	118.6	119.1	0.5%	145.6	146.6	0.7%	175.7	177.4	1.0%
NPAT from cont. ops.	83.3	83.8	0.5%	104.4	105.2	0.7%	127.9	129.2	1.0%
<b>Diluted EPS from cont. ops. (USc)</b>	<b>63.1c</b>	<b>63.0c</b>	<b>-0.1%</b>	<b>78.9c</b>	<b>79.0c</b>	<b>0.1%</b>	<b>96.4c</b>	<b>96.8c</b>	<b>0.4%</b>
DPS (Ac)	62.0c	62.0c	0.0%	72.0c	72.0c	0.0%	82.0c	82.0c	0.0%

SOURCE: BELL POTTER SECURITIES ESTIMATES

## 10% Increase in PT to \$44.00

We have increased the multiples we apply in the PE ratio and EV/EBITDA valuations from 45x and 25x to 50x and 27.5x and reduced the WACC we apply in the DCF from 9.4% to 9.0% given the upgrades in our design software revenue forecasts which we view as higher quality given its stickiness and/or recurring nature.

The change in each valuation and the impact on our PT calculation is shown below.

Figure 3 - Change in valuations and impact on our PT

Methodology	Old (as at 22-Aug-23)			New (as at 18-Sep-23)		
	Valuation per share	% weighting	Price target	Valuation per share	% weighting	Price target
PE ratio	\$42.05	33%	\$14.02	\$46.02	33%	\$15.34
EV/EBITDA	\$37.04	33%	\$12.35	\$40.22	33%	\$13.41
DCF	\$40.90	33%	\$13.63	\$45.77	33%	\$15.26
<b>Total</b>			<b>\$40.00</b>			<b>\$44.00</b>

SOURCE: BELL POTTER SECURITIES ESTIMATES

The figure shows a high single digit percentage increase in the relative valuations and a low double digit percentage increase in the DCF. The net result is a 10% increase in our PT to \$44.00 which is still a modest discount the share price so we maintain our HOLD recommendation. Intuitively, we believe the stock looks around fair value trading on an FY24 PE ratio of c.48x which is higher than Technology One on c.42x but still well below WiseTech Global on c.82x. In our view Altium and Technology One should trade on broadly similar multiples given the positive of being a global software company is largely offset by being very early in its transition to SaaS.

# Altium

## Company Description

Altium Limited (Altium) develops and sells software and hardware for the design and development of electronic products. The company has four key products:

- **Altium Designer:** Software for the design of printed circuit boards (PCBs);
- **Nexus:** A collaborative, cloud enabled PCB design solution;
- **Altium 365:** A cloud based electronics development platform; and
- **Octopart:** An electronic parts search engine.

Altium is based in San Diego, California and sells its products globally (>95% of revenue is outside Australia). The company is one of the largest providers globally of PCB design software and has an estimated market share of around 25%.

## Investment Thesis

We maintain our HOLD recommendation on Altium. Our investment thesis is based on:

- **Valuation:** Our 12 month price target for Altium is \$44.00. The price target is generated from a blend of three valuation methodologies we apply to the company: PE ratio, EV/EBITDA and DCF. The price target is a 3% discount to the current share price and the total expected return (including the dividend yield) is -1%.
- **Higher recurring revenue:** Altium has been steadily increasing its recurring revenue base over the past decade or so with a shift to subscription. Recurring revenue represented 77% of total revenue in FY23 which was up from 75% in FY22. Altium has a target of reaching 95% recurring revenue by FY25 (excluding China and developing countries).
- **Potential takeover target:** Altium received an unsolicited takeover offer from Autodesk in 2021 at \$38.50 which was rejected. Our view is Autodesk's Fusion 360 platform is lacking a high powered ECAD offering so we believe Autodesk would still be very interested in Altium and may come back with a revised offer.

## Key Risks

Key downside risks to our estimates and valuation include (but are not limited to):

- **Foreign currency fluctuations:** The majority of Altium's sales are in USD and EUR while the majority of Altium's costs are in USD. There is, therefore, a currency risk from fluctuations in the USD/EUR exchange rate. If there is a material appreciation of the USD against then EUR then this would have a negative impact on our forecasts.
- **Increased competition:** Altium is releasing new products to target the low-end and high-end areas of the market and in our forecasts we have assumed some success in penetrating these new areas. A risk is these products are not successful or cause a competitive response from the established players in these areas of the market.
- **Global economy:** The key market for Altium is the global PCB market and the future condition of the global economy will therefore have an impact on Altium and the growth of its key market. A risk for Altium is a downturn in one or both of Europe and the US as these two regions combined represent approximately 80% of Altium's sales.

Table 1 - Financial summary

Altium (ALU)						Share price:	\$45.20	Target price:	\$44.00		
						No. of issued shares:	131.9m	Market cap:	\$5,963m		
Profit & Loss (US\$m)						Valuation data					
Year end 30 Jun	2022	2023	2024e	2025e	2026e	Year end 30 Jun	2022	2023	2024e	2025e	2026e
Revenue	220.8	263.3	322.0	385.8	454.9	NPAT from cont. ops. (US\$m)	55.5	66.3	83.8	105.2	129.2
Change	23%	19%	22%	20%	18%	Diluted EPS (USc)	42.1	49.9	63.0	79.0	96.8
Expenses (excl. D&A, int.)	-141.0	-167.3	-202.9	-239.2	-277.5	Change	57%	19%	26%	25%	23%
% of revenue	-64%	-64%	-63%	-62%	-61%	Diluted EPS (Ac)	58.0	73.9	93.4	108.9	129.1
EBITDA	79.8	96.0	119.1	146.6	177.4	P/E ratio (x)	77.9	61.1	48.4	41.5	35.0
Depreciation	-8.4	-6.4	-6.1	-5.8	-5.5	CFPS (Ac)	75.8	62.1	100.2	120.7	142.7
Amortisation	-3.6	-3.2	-3.0	-2.9	-2.7	Price/CF (x)	59.6	72.8	45.1	37.4	31.7
EBIT	67.9	86.4	110.0	137.9	169.2	DPS (Ac)	47.0	54.0	62.0	72.0	82.0
Net interest (exp)/rev.	0.0	1.4	1.7	2.3	3.1	Yield	1.0%	1.2%	1.4%	1.6%	1.8%
Pre-tax profit	67.9	87.8	111.7	140.2	172.2	Franking	100%	19%	20%	20%	20%
Income tax expense	-12.4	-21.4	-27.9	-35.1	-43.1	EV/Revenue (x)	18.6	14.5	11.9	10.6	9.3
NPAT from cont. ops.	55.5	66.3	83.8	105.2	129.2	EV/EBITDA (x)	51.4	39.8	32.1	28.0	24.0
Profit from discount ops.	-0.1	0.0	0.0	0.0	0.0	NTA per share (Ac)	242.3	296.5	351.1	390.3	454.0
NPAT	55.3	66.3	83.8	105.2	129.2	Price/NTA (x)	18.7	15.2	12.9	11.6	10.0
Cash Flow (US\$m)						Performance ratios					
Year end 30 Jun	2022	2023	2024e	2025e	2026e	Year end 30 Jun	2022	2023	2024e	2025e	2026e
EBITDA	79.8	96.0	119.1	146.6	177.4	EBITDA margin	36.2%	36.5%	37.0%	38.0%	39.0%
Change in working capital	2.0	7.6	-19.4	-17.9	-19.9	EBIT margin	30.7%	32.8%	34.2%	35.8%	37.2%
Gross operating cash flow	81.8	103.6	99.7	128.7	157.5	Return on assets	14.5%	15.5%	17.6%	19.5%	20.9%
Interest received	0.4	2.2	2.4	3.1	3.8	Return on equity	20.2%	21.8%	23.9%	25.7%	26.7%
Interest paid	-0.5	-0.9	1.7	2.3	3.1	ROIC	NM	NM	NM	NM	NM
Tax paid	-9.2	-49.2	-14.0	-17.5	-21.5	Payout ratio	80.7%	72.3%	65.8%	65.5%	62.9%
Operating cash flow	72.5	55.7	89.9	116.6	142.9	Effective tax rate	-18.2%	-24.4%	-25.0%	-25.0%	-25.0%
Payments for subsidiary	0.0	0.0	0.0	0.0	0.0	Leverage ratios					
Payments for PPE	-1.0	-3.7	-2.5	-3.0	-3.5	Year end 30 Jun	2022	2023	2024e	2025e	2026e
Proceeds of sale of PPE	-15.8	0.0	0.0	0.0	0.0	Net debt/(cash) (A\$m)	-274.9	-297.7	-350.8	-394.7	-465.5
Investing cash flow	-17.3	-3.7	-2.5	-3.0	-3.5	Net debt/equity	NM	NM	NM	NM	NM
Proceeds from equity/options	0.0	0.0	0.0	0.0	0.0	Gearing	NM	NM	NM	NM	NM
Dividends paid	-40.1	-45.3	-51.6	-64.2	-76.4	Net debt/EBITDA (x)	NM	NM	NM	NM	NM
Repayment of borrowings	-5.7	-4.3	0.0	0.0	0.0	Net interest cover (x)	>100	>100	>100	>100	>100
Payment for treasury shares	0.0	0.0	0.0	0.0	0.0	Segmentals (US\$m)					
Financing cash flows	-45.8	-49.6	-51.6	-64.2	-76.4	Year end 30 Jun	2022	2023	2024e	2025e	2026e
Net change in cash	9.4	2.4	35.8	49.4	62.9	Revenue					
Cash at start of period	191.5	199.3	201.0	236.8	286.2	Software licence revenue	85.2	103.6	133.3	166.7	204.2
Exchange rate impact	-1.6	-0.7	0.0	0.0	0.0	Hardware revenue	1.6	4.1	6.2	8.0	10.0
Cash at end of period	199.3	201.0	236.8	286.2	349.1	Subscription revenue	80.4	95.0	114.0	133.9	154.0
						Service revenue	3.5	4.2	5.0	5.8	6.4
						Search advertising revenue	49.8	56.2	63.2	71.1	80.0
						Other revenue	0.3	0.3	0.3	0.3	0.3
						Sales revenue	220.8	263.3	322.0	385.8	454.9
						Interest income	0.7	2.0	2.4	3.1	3.8
						Other revenue	0.0	0.0	0.0	0.0	0.0
						Total revenue	221.5	265.2	324.4	388.8	458.7
						Growth					
						Software licence revenue	8%	21%	29%	25%	23%
						Hardware revenue	0%	164%	50%	30%	25%
						Subscription revenue	17%	18%	20%	18%	15%
						Service revenue	22%	21%	20%	15%	10%
						Sales revenue	23%	19%	22%	20%	18%
						Interims					
						Year end 30 Jun	1HFY22	2HFY22	1HFY23	2HFY23	
						Revenue (US\$m)	102.2	118.6	119.5	143.7	
						Change	28%	18%	17%	21%	
						EBITDA	34.8	45.0	43.3	52.7	
						Depreciation	-4.0	-4.3	-3.1	-3.4	
						Amortisation	-1.8	-1.8	-1.6	-1.6	
						EBIT	29.0	38.9	38.6	47.8	
						Net interest (exp)/rev.	0.0	-0.1	0.6	0.8	
						Pre-tax profit	29.0	38.8	39.2	48.6	
						Income tax expense	-6.1	-6.2	-9.5	-11.9	
						NPAT from cont. ops.	22.9	32.6	29.6	36.7	

SOURCE: BELL POTTER SECURITIES ESTIMATES

**Recommendation structure**

**Buy:** Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

**Hold:** Expect total return between -5% and 15% on a 12 month view

**Sell:** Expect <-5% total return on a 12 month view

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**Research Team**

Staff Member	Title/Sector	Phone	@bellpotter.com.au
Chris Savage	Head of Research/Industrials	612 8224 2835	csavage
<b>Analysts</b>			
John Hester	Healthcare	612 8224 2871	jhester
Anubhav Saxena	Healthcare	612 8224 2846	asaxena
Thomas Wakim	Healthcare	612 8224 2815	twakim
Michael Ardrey	Industrials	613 9256 8782	mardney
Marcus Barnard	Industrials	618 9326 7673	mbarnard
Sam Brandwood	Industrials	612 8224 2850	sbrandwood
Olivia Hagglund	Industrials	612 8224 2813	ohagglund
Joseph House	Industrials	613 9325 1624	jhouse
Daniel Laing	Industrials	612 8224 2886	dlaing
Hayden Nicholson	Industrials	613 92351757	hnicholson
Chami Ratnapala	Industrials	612 8224 2845	cratnapala
Jonathan Snape	Industrials	613 9235 1601	jsnape
Regan Burrows	Resources	618 9236 7677	rburrows
David Coates	Resources	612 8224 2887	dcoates
Stuart Howe	Resources	613 9325 1856	showe
Brad Watson	Resources	618 9326 7672	bwatson
James Williamson	Resources	613 9235 1692	jwilliamson
<b>Associates</b>			
Connor Eldridge	Associate Analyst	612 8224 2893	celdridge
Baxter Kirk	Associate Analyst	613 9235 1625	bkirk
Ritesh Varma	Associate Analyst	613 9235 1658	rvarma

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**Bell Potter Securities Limited**

ABN 25 006 390 772  
Level 29, 101 Collins Street  
Melbourne, Victoria, 3000  
Telephone +61 3 9256 8700  
www.bellpotter.com.au

**Bell Potter Securities (HK) Limited**

Room 1601, 16/F  
Prosperity Tower, 39 Queens  
Road Central, Hong Kong, 0000  
Telephone +852 3750 8400

**Bell Potter Securities (US) LLC**

Floor 39  
444 Madison Avenue, New York  
NY 10022, U.S.A  
Telephone +1 917 819 1410

**Bell Potter Securities (UK) Limited**

16 Berkeley Street London, England  
W1J 8DZ, United Kingdom  
Telephone +44 7734 2929