

Software publishing

Marché Libre



Mandrakesoft

The rising star of the Linux Market

SUMMARY

Mandrakesoft, the publisher of the Mandrakelinux platform, is one of the three global players in Linux operating systems and ranks third in revenues behind Red Hat (the clear leader) and Suse (recently acquired by Novell). After three difficult years, the Linux market strong growth outlook and limited number of international competitors should enable Mandrakesoft to benefit from corporate, individual user and government interest in Linux solutions. This stock is one of the few Linux growth plays and the only Linux vehicle in Europe.



May, 20 th 2004

Stock Price : 4,15 €

Market cap: 19,7 m

Number of shares : 4,753,906 titres

Average volume (6 months) : 18,930 shares

Stock price range (12 months)

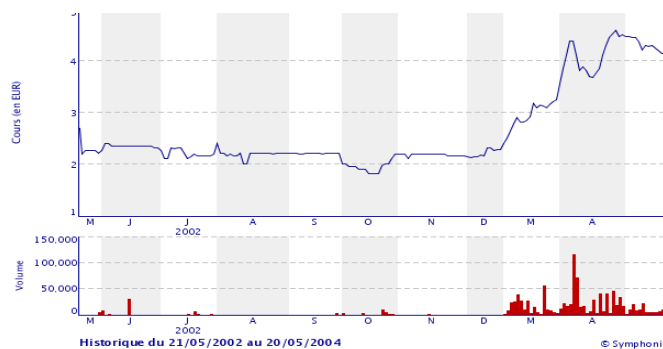
4.60 / 2.39

Share turnover (6 months) : 61.9 %

Free float : 83.1 %

Code ISIN : FR 0004159382

Share price and volume trend, 2002-2004



Financial highlights

Enterprise Value €20m
EV/S €0.3m

FY 2004
H1 revenue growth +20%
H1 net profit €0.3m

FY 2003
Revenues €3.9m
Net profit -€2.0m

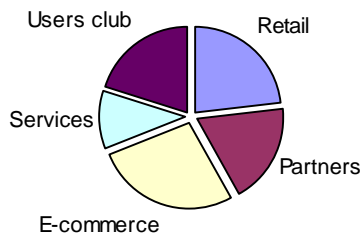
OVERVIEW

Strengths	Weaknesses
<ul style="list-style-type: none"> Expanded float and substantial trading volumes. Renewed profitability in H1 2004. Mandrakesoft is the only European Linux publisher. 	<ul style="list-style-type: none"> Limited partnerships with major software companies and manufacturers. Financial structure remains strained with negative equity.
Opportunities	Threats
<ul style="list-style-type: none"> Major corporations and government agencies seek an alternative to Microsoft. Mandrakelinux installed base of 4m users (Mandrakesoft estimate). 	<ul style="list-style-type: none"> Mandrake brand litigation could impact the group's reputation given user attachment to the brand. Legal risks if software becomes patentable in Europe.

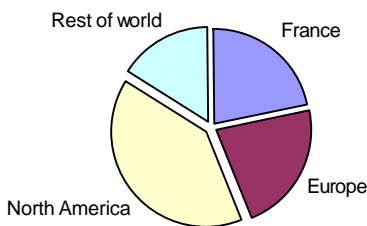
After FY 2003's more than 16 % slide in revenues, Mandrakesoft reported a 20 % increase in H1 2004 sales to €2.5m, which should lead to annual revenues in the €4m-6m range. The group has also returned to profitability after four years in the red, with operating profit of €0.2m reflecting a margin of 7.9%. Despite its listing on an unregulated market, Mandrakesoft continues to emphasize transparency by regularly reporting financial results. The group also foresees a transfer to the Euronext Nouveau Marché by the end of the year.

Revenue breakdown

Sales by activity 2003



Sales by region 2003



Linux is an operating system based on Open Source software. Open Source includes the underlying source code (i.e., the programming "nuts and bolts"), thereby encouraging duplication as well as improvement, modification and localization through direct user input. This strong association of clients, users and software companies in the R&D process greatly reduces product R&D costs. Mandrakesoft has 1,000 contributors who donate their time to the development of its products, in exchange receiving free access to software applications and source code. Linux and Open Source software are used in numerous areas : Internet / Intranet, corporate networks, super-computing, embedded systems, retail/ agency networks, etc.

Launched via the internet in 1998 by a group of young Linux enthusiasts, Mandrakesoft has become an international reference in the Linux field. Its Mandrakelinux distribution is a turnkey solution encompassing an operating system and numerous applications accessible in 68 languages. Mandrakesoft's products are recognized for their quality and innovation and have received numerous awards.

The group's business is being helped by the strategy of industry giants such as IBM and HP who are increasingly offering Linux-based solutions. Government agencies have also come out in favor of Open Source software as a means of severing dependence on Microsoft. Mandrakesoft's business model was initially founded on CD-Rom sales of complete versions of Mandrakelinux at an attractive price. With a light version of Mandrakelinux available for free download via the web, few users purchased the CD-Rom, despite the substantial time savings relative to the download (which could take days using a standard 56k modem). Widespread availability of broadband access quickly highlighted the weaknesses of the group's previous approach.

Today, Mandrakesoft's business model emphasizes the development of services, a sharp increase in Mandrakeclub subscriptions and greater penetration of the enterprise market. The group also aims at boosting royalty payments from partners who integrate the Mandrakelinux solution. Retail distribution of CD-Rom packs and online sales will both account for an increasingly marginal portion of revenues in the future.

NOTEWORTHY ITEMS

Mandrakesoft experienced a period of turmoil following the recruitment of an expensive management team (subsequent to the entry of financial investors) that shifted the focus away from the core business and quickly burned through the €22m raised since 1999. The elimination of part of this team and a renewed emphasis on core strengths helped reduce losses, but liquidity problems forced Mandrakesoft to seek bankruptcy protection in January 2003. During the ensuing recovery period, the group was able to withdraw from certain contracts that were generating unnecessary costs. Substantial effort was employed to complete the core refocus and to reduce fixed costs in order to hike margins. These steps led to a return to profitability by the end of 2003.

In March 2004, Mandrakesoft emerged from bankruptcy having negotiated repayment of its liabilities over a nine-year period without interest. These liabilities include €3.3m in outstanding debt and €5.4m of creditor claims (o/w €4.6m is related to ongoing litigation involving the use of the Mandrake brand). Regarding the latter amount, the Commercial Court anticipated a potential debt of €0.8m.

STRATEGIC OUTLOOK

Mandrakesoft will target continued growth by capitalizing on its reputation, its position as one of the three leading Linux solution providers and its unique role as the only European Linux specialist. Its near-term strategy takes a dual approach:



The group will seek to develop its services (support, training, product customization to user needs) in order to generate recurrent revenue streams via annual or multi-year service contracts. Mandrakesoft hopes to proceed through acquisitions that can rapidly bring the operational teams necessary to meet the needs of major accounts. The group is now considering a number of targets that would be acquired through share swaps.

MandrakeClub will be emphasized as a means of rapidly boosting margins. Club subscribers can download the latest versions of Mandrakelinux prior to general release and have access to numerous online services. The subscriber base now includes 17,000 individual users (for an annual subscription cost of between €60 and €120) and 30-40 companies (annual fee of between €2,500 and €30,000). The growth potential here is substantial considering the 250,000 subscribers to the group’s newsletter and an estimated 4m users of Mandrakelinux.

FINANCIAL OUTLOOK

After suffering substantial losses as a result of its unwieldy cost structure, Mandrakesoft has continued to slash costs pursuant to the core refocusing begun in April 2001. The group has returned to profitability since the final quarter of 2003. In the first half of fiscal 2004 (October-March 2004), Mandrakesoft recorded revenue growth of 20 % and net profit of €0.3m. Customer concerns have eased since the emergence from bankruptcy. Acceleration in subscriber numbers will be reflected by a sharp improvement in the operating margin owing to the near 100 % gross margin generated by this activity. The Linux market is projected to grow by 25 % per year through 2007 according to IDC.

Equity remains negative, but will nevertheless improve during 2004 thanks to the exercise of warrants that raised €2.28m. The group will also benefit from its debt rescheduling over a nine-year period, which could be reduced in the event of early repayment.



Red Hat, the only comparable Linux pure play, trades on a 2004 P/S of 31x, a 2005 P/S of 22x and a 2005 P/E of 107x, compared to respectively 5.2x, 3x and 30x for Mandrakesoft, according to our estimates. Mandrakesoft as a smaller challenger clearly does not enjoy the same valuation levels. At the current share price, the market is not discounting the impact on profitability from exceeding breakeven (fixed cost structure), forecast growth for the Linux market (further offsetting the group’s structural costs), or the desire of government agencies to promote Linux (directly benefiting Mandrakesoft as the sole European player). The current discount to its direct competitor is excessive, particularly as both groups are facing the same type of legal challenges.

PRACTICAL INFORMATIONS

Shareholder structure

Jacques Le Marois (cofounder)	10.07 %
André Jolivet (business angel)	8.44 %
Millenium Partners	7.91 %
FCPR BBS Capital	7.03 %
Windhurst	6.55 %
Frédéric Bastok (cofounder)	5.61 %
François Bancilhon	3.86 %
Gaël Duval (cofounder)	3.02 %
Iliad	2.33 %
Other	45.18 %

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● SUMMARY ACCOUNTS AND FORECASTS

En K€	2001	2002	2003	2004F	2005F
Revenues	3 557	4 673	3 901	5 383	6 913
Operating profit	-13 378	-5 726	-2 167	530	931
Net interest income	192	114	141	41	47
Exceptionals	- 407	- 495	40	83	0
<i>Goodwill amortization</i>	0	0	0	0	0
Net attributed profit	-13 595	-6 108	-1 987	653	977
Fixed assets	874	618	420	390	400
<i>O/w goodwill</i>	0	0	0	0	0
Current assets	1 083	863	628	865	1 111
Net cash	4 030	604	247	4 515	5 431
Total assets	5 987	2 085	1 295	5 769	6 942
Shareholders equity	1 888	-3 874	-5 776	-2 840	-1 994
Loans and other debt	133	375	720	720	640
Operating debt	2 225	4 080	5 215	6 753	7 160
Cash flow	-13 000	-6 114	-2 219	833	1 167
Change in WCR	-1 088	-2 049	-1 390	-1 302	- 161
Capex	362	- 34	- 69	150	200
Free Cash Flows	-12 274	-4 031	- 760	1 985	1 127
Operating margin	ns	ns	ns	9,8%	13,5%
Net margin	ns	ns	ns	12,1%	14,1%
Return on equity	ns	157,7%	34,4%	ns	ns
Net gearing	-206,4%	ns	ns	ns	ns
Average employees	113	82	59	56	70
Staff costs / Sales	226,6%	102,0%	80,6%	46,5%	46,0%
EPS (in €)	-4,81	-1,78	-0,54	0,18	-0,27

Fiscal Year to Sep-tember

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Strong anticipated growth driven by increase in subscriptions and services

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Equity still negative but improving

+
Financial debt essentially consists of government R&D loans which are going to be forgiven

++
Strong rise in profitability thanks to better coverage of fixed costs and robust growth in very high margin Club subscriptions

+
Streamlining following departure of management team

+
High net margin linked to positive net cash and tax credits

Source : Euroland Finance

● PEER GROUP COMPARAISON

2003 Data (K€)	Market Cap	EV	S	EBITA	Net profit	EV/S	EV/EBITA	PER	Average employees
Red Hat (2004/02)	3938 135	3866 696	126 100	2 745	11 964	30,7	ns	ns	nc
Novell (2003/10)	3200 381	2563 218	982 663	-24 731	-143 915	2,6	ns	ns	nc
Peer group average	3569 258	3214 957	554 382	-10 993	-65 975	16,6	ns	ns	ns
Mandrakesoft (2003/09)	19 717	20 190	3 901	-2 167	-1 987	5,2	ns	ns	56

EuroLand Finance



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