Jul 02, 2020

# Guidewire Software (GWRE)

**$112.60** (As of 07/01/20)

Price Target (6-12 Months): **$120.00**

| | | |
|---|---|---|
| Long Term: 6-12 Months | **Zacks Recommendation:**<br>(Since: 05/06/19)<br>Prior Recommendation: Outperform | **Neutral** |
| Short Term: 1-3 Months | **Zacks Rank:** (1-5)<br>Zacks Style Scores:<br>Value: F \| Growth: F \| Momentum: C | **2-Buy**<br>VGM:F |

## Summary

Guidewire is well positioned to benefit from growth in subscription-based offerings driven by solid adoption of InsuranceNow. The company is focused on enhancing Guidewire Cloud platform with new capabilities including digital frameworks, automation, tooling and other cloud services. This is expected to lead to higher new sales being subscription-based. Strategic acquisitions and collaborations also bode well. Markedly, Guidewire revised fiscal 2020 outlook on increasing cloud implementations and higher allegiance of large customers to adopt subscription-based services. However, lengthening sales cycles and delayed decision making due to COVID-19 are headwinds. Also, investments on product enhancements are likely to weigh on margins at least in the near term. Notably, shares of Guidewire have underperformed the industry on a year-to-date basis.

## Price, Consensus & Surprise

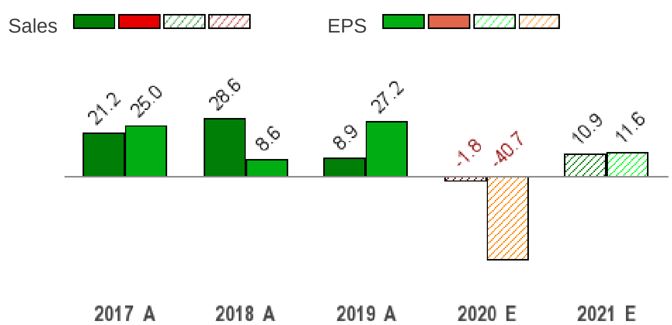

## Data Overview

| | |
|---|---|
| 52 Week High-Low | **$124.16 - $71.64** |
| 20 Day Average Volume (sh) | **656,658** |
| Market Cap | **$9.4 B** |
| YTD Price Change | **2.6%** |
| Beta | **1.29** |
| Dividend / Div Yld | **$0.00 / 0.0%** |
| Industry | **Business - Software Services** |
| Zacks Industry Rank | **Top 33% (84 out of 252)** |

| | |
|---|---|
| Last EPS Surprise | **250.0%** |
| Last Sales Surprise | **10.3%** |
| EPS F1 Est- 4 week change | **30.8%** |
| Expected Report Date | **09/03/2020** |
| Earnings ESP | **-1.4%** |

| | |
|---|---|
| P/E TTM | **113.7** |
| P/E F1 | **130.9** |
| PEG F1 | **13.8** |
| P/S TTM | **13.3** |

## Sales and EPS Growth Rates (Y/Y %)




## Sales Estimates (millions of $)

| | Q1 | Q2 | Q3 | Q4 | Annual* |
|---|---|---|---|---|---|
| 2021 | 168 E | 190 E | 190 E | 235 E | 784 E |
| 2020 | 157 A | 173 A | 168 A | 208 E | 707 E |
| 2019 | 180 A | 169 A | 163 A | 208 A | 720 A |

## EPS Estimates

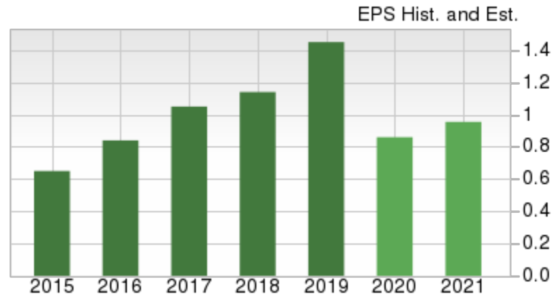
| | Q1 | Q2 | Q3 | Q4 | Annual* |
|---|---|---|---|---|---|
| 2021 | $0.11 E | $0.24 E | $0.12 E | $0.54 E | $0.96 E |
| 2020 | $0.13 A | $0.21 A | $0.09 A | $0.45 E | $0.86 E |
| 2019 | $0.36 A | $0.34 A | $0.18 A | $0.56 A | $1.45 A |

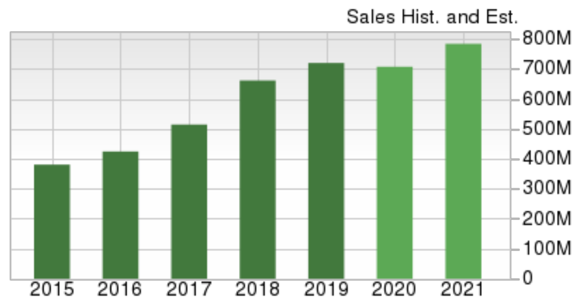
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 07/01/2020. The reports text is as of 07/02/2020.

## Overview

San Mateo, CA-based Guidewire Software, Inc. is a provider of software solutions for property and casualty (P&C) insurers.




The company's solutions aid in reducing risk via increased productivity, bringing speed to market, digital engagement and simplifying IT infrastructure.

Guidewire InsurancePlatform is a P&C industry platform which is deployed through Guidewire Cloud joining software, services, and partner ecosystem to customer business.

Further, the company also offers Guidewire InsuranceSuite and Guidewire InsuranceNow, which provides solutions to support the entire insurance lifecycle, including product definition, distribution, underwriting, policy-holder services, and claims management.

The company has a wide range of customers that use multiple components of Guidewire InsurancePlatform which include InsuranceSuite, digital, data and analytics. The company exited fiscal 2019 with 380 customers.

Some of the major customers are Aviva, AXA, Zurich, Basler Versicherung (Switzerland), Direct Line Group (U.K.), Farmers Insurance (U.S.), IAG (Australia), MS&AD (Japan), Canadian Automobile Association Insurance Company (Ontario), Kentucky Farm Bureau (Kentucky), and Vermont Mutual Insurance Group (Vermont), to name few.

Fiscal 2019 revenues were $719.5 million. The company had adopted a new revenue recognition standard — ASC 606 — which came into effect from first-quarter fiscal 2019. Per the new accounting standard, the company will has three main segments — License and subscription, Maintenance, and Services.

In fiscal 2019, Guidewire delivered License and subscription revenues of $385.3 million (53.5% of total revenues). Maintenance revenues amounted to $85.4 million (11.9%). Services revenues came in at $248.8 million (34.6%).

The company faces competition in the software market that caters to the P&C insurance industry. Some of the key competitors are DXC Technology, NTT Data, Pegasystems and SAP.

## Reasons To Buy:

- Guidewire is slowly shifting from the term license based model to subscription base. This will be beneficial for the company in the long run as majority of the enterprises are expected to lean toward cloud based infrastructure going forward. A substantial portion of fiscal 2019 revenues were from subscription-based products, accounting for approximately 65% of new sales. It is a considerable improvement over 36% reported in fiscal 2018. Backed by strong performance of subscription products, management continues to expect new sales from subscription offerings in the lower end of 70-80% for fiscal 2020. Guidewire's cloud deployment partner, Amazon Web Services is also gaining momentum and this bodes well for it. According to Technavio, the global Software-as-a-Service (SaaS) market is expected to hit $60.36 billion by 2023, witnessing a CAGR of 9% between 2019 and 2023. This is expected to favor the company's growth prospects.

A less competitive market, regular customer additions, positive acquisition synergy and transition to a cloud-based model are key positives for the company.

- Guidewire faces less competition due to its unique line of business. Though there are private players with similar offerings, among the listed entities, the company's software suite is not common, more so because it serves specifically the P&C insurance industry. This is a major tailwind for the company's top line, which will result in impressive earnings per share if the cost structure is stringent.

- Guidewire's acquisition strategy has aided growth. The cross-selling of the product suites has increased customer base and revenue generation. Notably, the company's acquisition of Cyence has been a tailwind. Cyence determines the economic impact of a cybercrime via a software platform, which is built on cyber-security related data science. The integration of Cyence has allowed the company to provide an entire life cycle to the insurance products starting from designing to transaction management. ISCS acquired in February 2017 (now called InsuranceNow), and FirstBest, (now called Guidewire Underwriting Management) and EagleEye Analytics, (now known as Guidewire Predictive Analytics), which were acquired in 2016 form a few prominent segments of the company. Guidewire's customer base has expanded consistently as evident from the addition of new customers selecting comprehensive Guidewire InsurancePlatform suite in fiscal 2019.

- Guidewire portrays a strong balance sheet, with no debt. Notably, as of Apr 30, 2020 cash and cash equivalents and short-term investments were $1.034 billion. The company generated cash from operating activities of $4.6 million in the third quarter of fiscal 2020. During fiscal third quarter, free cash flow came in at $1 million. Moreover, the company generated $116.1 million as cash from operating activities in fiscal 2019. The solid liquidity and cash flow position reflect that the company is making investments in the right direction. Moreover, since it carries no long-term debt, the cash is available for pursuing strategic acquisitions, investment in growth initiatives and distribution to shareholders.

## Reasons To Sell:

> Single industry centric offering, lower innovation, pressure on margins due to higher investments and an overstretched P/S ratio are negatives for the company.

- Guidewire's total addressable market (TAM) is limited only to the insurance sector. This industry-concentric feature is a headwind for the company. In fact, the market is limited due to the fact that the company's services are meant for property and casualty (P&C) insurers. Lack of product diversification is also a major headwind in our view.

- Guidewire's transition from a term license based to a cloud-based model will negatively impact the top line in the short haul, as term license revenues include advance payments whereas subscription-based revenues are a bit delayed. The transition related investments are also expected to squeeze margins. Moreover, the company received certain advance payments related to term licenses, which are anticipated to be headwinds for revenue generation.

- Guidewire frequently acquires companies, which exposes it to integration risks. This puts pressure on cash flow as well. Notably, the company acquired Cyence in 2018, ISCS in fiscal 2017, and both Firstbest and EagleEye Analytics in 2016. We believe the dependence on inorganic growth rather than on innovation is also a negative and may affect the company in the long run. Moreover, we note that the buyouts negatively impacted the company's balance sheet in the form of high level of goodwill and net intangible assets, which comprised of 17.5% of total assets as of Apr 30, 2020.

- The company is trading at premium in terms of Price/Sales (P/S). Guidewire currently has a trailing 12-month P/S ratio of 13.23X. This level compares unfavorably with what the industry witnessed in the last year. Additionally, the ratio is higher than the average level of 12.39X and is near the high end of the valuation range in this period. Consequently, the valuation looks slightly stretched from P/S perspective.

## Last Earnings Report

**Guidewire Q3 Earnings & Revenues Top Estimates**

| Quarter Ending | 04/2020 |
|---|---|
| Report Date | Jun 03, 2020 |
| Sales Surprise | 10.26% |
| EPS Surprise | 250.00% |
| Quarterly EPS | 0.09 |
| Annual EPS (TTM) | 0.99 |

Guidewire Software, Inc. reported third-quarter fiscal 2020 non-GAAP earnings of 9 cents per share, against the Zacks Consensus Estimate pegged at loss of 6 cents. However, the bottom line declined 50% from the year-ago quarter’s figure.

The company reported revenues of $168.2 million, which surpassed the Zacks Consensus Estimate by 10.3%. Further, the top line surpassed the higher end of management’s guidance of $153-$157 million. Moreover, the top line increased 3% from the year-ago quarter’s figure.

The growth can primarily be attributed to higher License and subscription revenues.

Further, management is optimistic on growing clout of its several cloud-based products and InsuranceSuite Cloud deal wins.

**Quarter in Detail**

License and subscription revenues (55.4% of total revenues) improved 22% from the year-ago quarter’s level to $93.2 million, driven by growth in subscription revenues.

Subscription revenues soared 105% year over year to $30.1 million on solid adoption of InsuranceSuite cloud.

In the fiscal third quarter, 61% of new software sales were subscription-based compared with 63% in the last reported quarter.

During the reported quarter, new and existing customers selected multiple components of Guidewire InsurancePlatform, which included InsuranceSuite, digital, data and analytics.

Management is banking on adoption of InsuranceNow to increase with the implementation of latest InsuranceSuite 10 and InsuranceSuite Cloud offerings.

Maintenance revenues (12.3%) amounted to $20.7 million, down 3% year over year.

Services revenues (32.3%) fell 17% from the year-ago quarter’s figure to $54.3 million.

Annual recurring revenues (or ARR) were $483 million as of Apr 30, 2020, compared with $474 million as of Jan 31, 2020.

**Margin Details**

Non-GAAP gross margin contracted 200 basis points (bps) on a year-over-year basis to 56%, on increasing investments to enhance cloud capabilities that more than offset growth in license and subscription revenues and ongoing shift to subscription-based solutions.

Non-GAAP gross margin for Licensing and subscription contracted from 87% reported in the prior-year quarter to 76%. Meanwhile, non-GAAP gross margin for Services contracted 400 bps to 12%.

Total operating expenses on a non-GAAP basis, climbed 8% year over year to $88.5 million.

Non-GAAP operating income came in at $5.8 million during the reported quarter, down 54% year over year.

Non-GAAP operating margin (as a percentage of total revenues) during the quarter contracted 430 bps from the year-ago quarter’s tally to 3.4%.

**Balance Sheet & Cash Flow**

As of Apr 30, 2020, cash and cash equivalents and short-term investments came in at $1.034 billion, compared with 1.055 billion as of Jan 31, 2020.

The company generated cash from operating activities of $4.6 million compared with $19.5 million reported in the fiscal second quarter. During fiscal third quarter, free cash flow came in at $1 million compared with $16.7 million reported in the fiscal second quarter.

**Guidance**

For the fiscal fourth quarter, revenues are expected in the range of $204.9-$212.9 million.

License and subscription are expected in the range of $138.4-$146.4 million. Maintenance revenue is anticipated in the range of $20.2-$21.2 million. Services revenues are projected between $42.7 million and $48.7 million.

Non-GAAP operating income is anticipated between $36.7 million and $44.7 million.

The company projects non-GAAP earnings of 41-49 cents per share in fourth quarter of fiscal 2020.

Guidewire updated fiscal 2020 outlook on increasing cloud implementations and higher allegiance of customers to adopt subscription-based services. The company now expects total revenues between $703.5 million and $711.5 million compared with prior guidance of $702-$714 million.

The company anticipates non-GAAP earnings of 84-92 cents per share in fiscal 2020 compared with prior range of 82-94 cents.

For fiscal 2020, License and subscription are now in the range of $419-$427 million compared with prior guided range of $415-$425 million. Services revenues are now anticipated between $198 million and $204 million compared with the prior range of $202-$208 million. Nevertheless, management continues to project Maintenance revenues in the band of $83-$84 million.

Management now expects new subscription-based sales to be at the lower end of the previous range of 70-80%.

The company is focused on enhancing Guidewire Cloud platform with new capabilities including digital frameworks, automation, tooling and other cloud services.

The company now anticipates non-GAAP operating income in the band of $65-$73 million compared with prior range of $61-$73 million.

## Recent News

On Jul 2, Guidewire announced that its PolicyCenter solution garnered two xCelent award wins in the Advanced Technology and Customer Base categories for strength in Policy Administration.

On Jun 30, Guidewire announced that Beazley has completed claims transformation program by leveraging Guidewire ClaimCenter.

On Jun 29, Guidewire announced that Hi Marley has joined Guidewire PartnerConnect as a Solution partner.

On Jun 10, Guidewire announced that Optio Group has adopted Guidewire Cyence for Cyber Risk Management to enhance its data warehouse capabilities. Moreover, Guidewire Cyence for Small Business was selected to support profitable small business growth.

On Jun 4, Guidewire announced that Aviva Italy has selected Guidewire InsuranceSuite Cloud to accelerate innovation, maintain technical currency, and empower its employees. Aviva Italy has also selected Guidewire EnterpriseEngage to deliver omni-channel experiences to all its stakeholders.

On May 18, Guidewire announced that ISB Global Services has joined Guidewire PartnerConnect as a Solution partner. It also stated that ISB's new Ready for Guidewire validated accelerator is now available to Canada-based insurers in the Guidewire Marketplace.

On May 4, Guidewire announced that its InsuranceNow solution has been adopted by Mutual Assurance Society of Virginia to modernize its business operations.

## Valuation

Guidewire shares are up 2.6% in the year-to-date period and 9.8% over the trailing 12-month period. Stocks in the Zacks sub-industry and Zacks Computer & Technology sector are up 7% and 11.3% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and Sector are up 8.1% and 23%, respectively.

The S&P 500 index is down 3.7% in the year-to-date period but up 4% in the past year.

The stock is currently trading at 12.05X forward 12-month sales, which compares to 10.39X for the Zacks sub-industry, 3.86X for the Zacks sector and 3.47X for the S&P 500 index.

Over the past five years, the stock has traded as high as 12.68X and as low as 7.05X, with a 5-year median of 9.27X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our $120 price target reflects 12.84X forward 12-month sales.

The table below shows summary valuation data for GWRE

**Valuation Multiples - GWRE**

| | | Stock | Sub-Industry | Sector | S&P 500 |
|---|---|---|---|---|---|
| P/S F12M | Current | 12.05 | 10.39 | 3.86 | 3.47 |
| | 5-Year High | 12.68 | 10.39 | 3.86 | 3.47 |
| | 5-Year Low | 7.05 | 6.88 | 2.32 | 2.53 |
| | 5-Year Median | 9.27 | 8.58 | 3.13 | 3.02 |
| P/B TTM | Current | 5.91 | 12.07 | 5.8 | 4.27 |
| | 5-Year High | 6.7 | 13.16 | 5.81 | 4.56 |
| | 5-Year Low | 3.85 | 8.25 | 3.16 | 2.83 |
| | 5-Year Median | 5.51 | 10.26 | 4.36 | 3.69 |
| EV/Sales TTM | Current | 12.4 | 9.85 | 4.45 | 3.06 |
| | 5-Year High | 13.69 | 10.41 | 4.46 | 3.47 |
| | 5-Year Low | 6.28 | 6.74 | 2.58 | 2.14 |
| | 5-Year Median | 9.54 | 8.61 | 3.61 | 2.84 |

As of 07/01/2020

## Industry Analysis **Zacks Industry Rank:** Top 33% (84 out of 252)


## Top Peers

| Company (Ticker) | Rec | Rank |
|---|---|---|
| Anaplan, Inc. **(PLAN)** | Outperform | 1 |
| International Business Machines Corporation **(IBM)** | Neutral | 3 |
| Paycom Software, Inc. **(PAYC)** | Neutral | 3 |
| Paychex, Inc. **(PAYX)** | Neutral | 3 |
| Pegasystems Inc. **(PEGA)** | Neutral | 2 |
| SAP SE **(SAP)** | Neutral | 2 |
| Synopsys, Inc. **(SNPS)** | Neutral | 3 |
| DXC Technology Company. **(DXC)** | Underperform | 5 |

## Industry Comparison Industry: Business - Software Services

Industry Peers

| | GWRE | X Industry | S&P 500 | DXC | PEGA | SAP |
|---|---|---|---|---|---|---|
| **Zacks Recommendation (Long Term)** | Neutral | - | - | Underperform | Neutral | Neutral |
| **Zacks Rank (Short Term)** | 2 | - | - | 5 | 2 | 2 |
| **VGM Score** | F | - | - | B | D | B |
| Market Cap | 9.37 B | 7.83 B | 21.87 B | 4.10 B | 8.20 B | 167.20 B |
| # of Analysts | 6 | 4 | 14 | 6 | 3 | 5 |
| Dividend Yield | 0.00% | 0.00% | 1.94% | 5.20% | 0.12% | 0.89% |
| **Value Score** | F | - | - | B | D | C |
| Cash/Price | 0.11 | 0.08 | 0.07 | 0.94 | 0.07 | 0.06 |
| EV/EBITDA | 117.77 | 9.49 | 12.69 | 2.33 | -98.34 | 21.76 |
| PEG Ratio | 13.86 | 1.70 | 2.86 | NA | NA | 2.86 |
| Price/Book (P/B) | 5.91 | 4.94 | 2.98 | 0.80 | 14.47 | 4.93 |
| Price/Cash Flow (P/CF) | 95.82 | 23.97 | 11.63 | 0.40 | NA | 24.24 |
| P/E (F1) | 131.28 | 32.99 | 21.27 | 6.66 | NA | 25.30 |
| Price/Sales (P/S) | 13.26 | 2.76 | 2.27 | 0.21 | 8.50 | 5.38 |
| Earnings Yield | 0.76% | 2.66% | 4.48% | 14.99% | -0.02% | 3.95% |
| Debt/Equity | 0.27 | 0.27 | 0.76 | 1.69 | 0.98 | 0.41 |
| Cash Flow ($/share) | 1.18 | 2.23 | 6.94 | 40.21 | -0.60 | 5.78 |
| **Growth Score** | F | - | - | C | C | B |
| Hist. EPS Growth (3-5 yrs) | 2.98% | 14.15% | 10.93% | 20.80% | -45.38% | 7.48% |
| Proj. EPS Growth (F1/F0) | -40.69% | -14.07% | -9.61% | -56.60% | 95.45% | -3.22% |
| Curr. Cash Flow Growth | 99.80% | 9.60% | 5.51% | 133.97% | -208.74% | -1.75% |
| Hist. Cash Flow Growth (3-5 yrs) | 29.98% | 14.18% | 8.62% | 44.41% | NA | 3.01% |
| Current Ratio | 6.93 | 1.60 | 1.30 | 1.14 | 2.90 | 0.99 |
| Debt/Capital | 21.17% | 22.90% | 44.46% | 62.84% | 49.39% | 28.90% |
| Net Margin | -6.08% | 4.35% | 10.62% | -27.43% | -9.03% | 15.27% |
| Return on Equity | 0.02% | 9.99% | 15.75% | 16.91% | -16.20% | 16.19% |
| Sales/Assets | 0.32 | 0.74 | 0.55 | 0.67 | 0.89 | 0.46 |
| Proj. Sales Growth (F1/F0) | -1.75% | -2.24% | -2.57% | -13.12% | 16.61% | 1.24% |
| **Momentum Score** | C | - | - | A | C | C |
| Daily Price Chg | 1.58% | 0.71% | -0.32% | -2.18% | 1.16% | 0.06% |
| 1 Week Price Chg | 3.58% | -0.38% | -3.90% | 0.32% | 3.57% | -0.18% |
| 4 Week Price Chg | 2.21% | -2.98% | -4.56% | -9.58% | 2.72% | 4.88% |
| 12 Week Price Chg | 35.04% | 14.72% | 9.62% | 2.15% | 37.29% | 21.79% |
| 52 Week Price Chg | 9.80% | 6.80% | -7.80% | -71.02% | 38.97% | -0.07% |
| 20 Day Average Volume | 656,658 | 640,032 | 2,688,665 | 5,062,933 | 361,818 | 804,201 |
| (F1) EPS Est 1 week change | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| (F1) EPS Est 4 week change | 30.80% | 0.00% | 0.00% | 0.00% | 11.79% | 3.31% |
| (F1) EPS Est 12 week change | 20.77% | -5.56% | -9.63% | -55.00% | -35.57% | -6.55% |
| (Q1) EPS Est Mthly Chg | -17.61% | 0.00% | 0.00% | 0.00% | 13.48% | 2.44% |

## Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

## Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

## Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

## Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

| | |
|---|---|
| Value Score | F |
| Growth Score | F |
| Momentum Score | C |
| VGM Score | F |

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

## Disclosures

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ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.