

Guidewire Software (GWRE)

\$120.62 (As of 02/10/20)

Price Target (6-12 Months): **\$130.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 05/06/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:F

Value: F

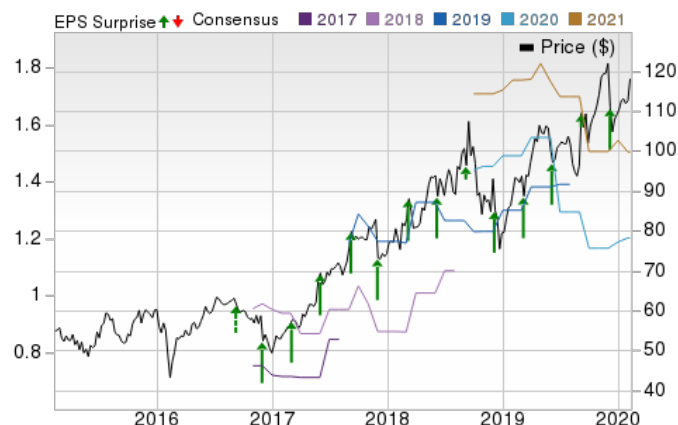
Growth: F

Momentum: D

Summary

Guidewire provides software solutions to property and casualty (P&C) insurers. The company is benefiting from strong adoption of several cloud-based products. Further, growth in Services revenues and License revenues remains a key catalyst. The elaborate partnership programs and strategic collaborations are major growth drivers. Partner Connect Program has been implemented worldwide, which benefits customers in the P&C insurance industry. Guidewire's acquisition strategies are also a major contributor to growth. Moreover, Guidewire's cloud deployment partner, AWS continues to gain momentum, which bodes well. Notably, the company has outperformed the industry in the past year. However, transition to a subscription-based model from a term license based one might hurt the top line in the near term.

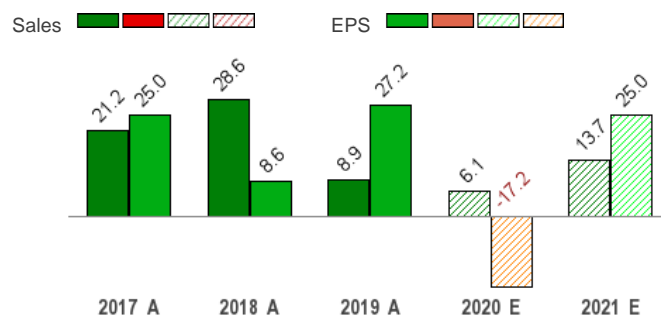
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$123.60 - \$84.19
20 Day Average Volume (sh)	476,203
Market Cap	\$10.0 B
YTD Price Change	9.9%
Beta	1.15
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Business - Software Services
Zacks Industry Rank	Top 5% (14 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	333.3%
Last Sales Surprise	3.8%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	03/04/2020
Earnings ESP	0.0%
P/E TTM	99.7
P/E F1	100.5
PEG F1	10.6
P/S TTM	14.3

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	184 E	194 E	210 E	280 E	869 E
2020	157 A	164 E	188 E	255 E	764 E
2019	180 A	169 A	163 A	208 A	720 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.21 E	\$0.32 E	\$0.28 E	\$0.80 E	\$1.50 E
2020	\$0.13 A	\$0.13 E	\$0.22 E	\$0.71 E	\$1.20 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 02/10/2020. The reports text is as of 02/11/2020.

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.

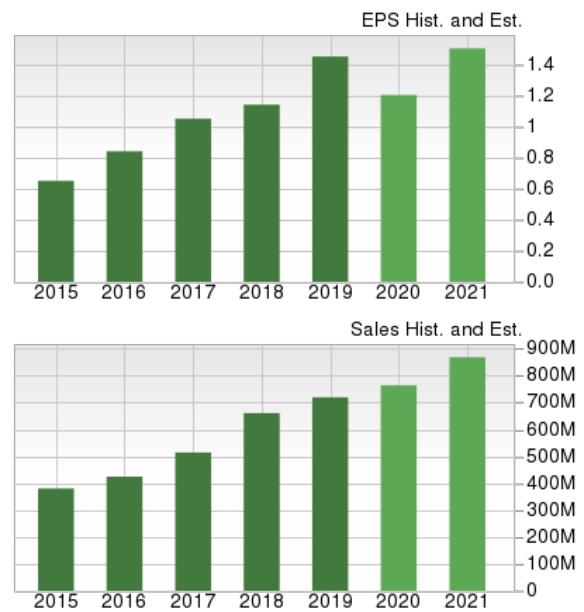
The company has a wide range of customers that use multiple components of Guidewire InsurancePlatform which include InsuranceSuite, digital, data and analytics. The company exited fiscal 2019 with 380 customers.

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, up 10% year over year. 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 have 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), up 25% year over year. Maintenance revenues amounted to \$85.4 million (11.9%), up 10% year over year. However, Services revenues declined approximately 7% from the year-ago quarter's figure to nearly \$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 range of 55-75% for fiscal 2020. Guidewire's cloud deployment partner, Amazon Web Services is also gaining momentum and this bodes well for it. According to Gartner, the global Software-as-a-Service (SaaS) market is expected to hit \$151.1 billion by 2022 from \$85.7 billion in 2018, witnessing a CAGR of 15.2%. This is expected to favor the company's growth prospects.
- ▲ 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. The company recently completed Cyence buyout. Notably, 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 would imply that the company would be able 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. Moreover, the company generated \$116.1 million as cash from operating activities in fiscal 2019. Notably, the company had cash and cash equivalents and short-term investments of \$1.01 billion as on Oct 31, 2019 compared with \$1.12 billion at the end of the previous quarter.

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

Reasons To Sell:

- ▼ 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 18.2% of total assets as of Oct 31, 2019.
- ▼ Although, shares have outperformed the industry in the past year, the company is trading at premium in terms of Price/Sales (P/S). Guidewire currently has a trailing 12-month P/S ratio of 14.27. This level compares unfavorably with what the industry witnessed in the last year. Additionally, the ratio is higher than the average level of 11.5 and is near the high end of the valuation range in this period. Consequently, the valuation looks slightly stretched from P/S perspective.

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

Last Earnings Report

Guidewire Q1 Earnings & Revenues Beat, Down Y/Y

Guidewire Software, Inc. reported first-quarter fiscal 2020 non-GAAP earnings of 13 cents per share, outpacing the Zacks Consensus Estimate of 3 cents. The figure also came ahead of management's guided range of 1-5 cents per share. However, the bottom line declined 65.8% from the year-ago quarter's figure.

The company reported revenues of \$157 million, surpassing the Zacks Consensus Estimate by 3.8%. Further, the bottom line came slightly above the higher end of management's guided range of \$149-\$153 million. However, the top line decreased 13% from the year-ago quarter. The decrease can primarily be attributed to lower License and Services revenues.

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

Quarter in Detail

License and subscription revenues (52.5% of total revenues) decreased 12.9% from the year-ago quarter to \$82.4 million, on decline in term license revenues, partially offset by growth in subscription revenues.

Term license revenues declined 31.7% year ago quarter to \$54.2 million. Management attributes the decline to two term license deals worth \$23.6 million in first-quarter fiscal 2019.

Subscription revenues soared 83.8% year over year to \$28.2 million on solid adoption of InsuranceSuite cloud. In the fiscal first quarter, 43% of new software sales were subscription-based, compared with 26% in the year-ago quarter.

Perpetual license revenues came in at \$49 million.

Maintenance revenues (13.4%) amounted to approximately \$21 million, almost flat year over year.

Services revenues (34.1%) decreased almost 17% from the year-ago quarter to \$53.6 million, primarily owing to the closure and timing of customer projects.

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 roll out of latest InsuranceNow GO offering that accelerates implementation of the solution in a cost-effective manner.

Annual recurring revenue (or ARR) was \$463 million as of Oct 31, 2019, compared with \$460 million as of Jul 31, 2019.

Margin Details

Non-GAAP gross margin contracted 510 bps on a year-over-year basis to 56.2%, on lower term license revenue base and ongoing shift to subscription-based solutions, and increasing investments to enhance Guidewire cloud capabilities.

Non-GAAP gross margin for Maintenance and Service expanded 40 bps and 90 bps, to 84.5% and 10.4%, respectively. Meanwhile, non-GAAP gross margin for License came in at 78.8%, compared with 91.5% reported in the year-ago quarter.

Total operating expenses climbed 4.8% year over year to \$100.8 million.

Non-GAAP operating income came in at \$7.1 million during the quarter, down 78.5% year over year. Non-GAAP operating margin during the quarter came in at 4.5% compared with 18.4% reported in the year-ago period.

Balance Sheet & Cash Flow

As on Oct 31, 2019 cash and cash equivalents and short-term investments came in at \$1.011 billion, compared with \$1.124 billion at the end of the previous quarter.

The company utilized cash from operating activities worth \$18.1 million in the fiscal first quarter, compared with \$102.9 million generated in the prior quarter.

During fiscal first quarter, the company reported negative free cash flow of \$29.1 million.

Guidance

For fiscal second-quarter 2020, revenues are expected to be in the range of \$162-\$166 million.

License and subscription are expected to be in the range of \$92-\$96 million. Maintenance revenue is anticipated to be in the range of \$20-\$20.5 million. Services revenues are projected between \$48 million and \$51 million.

Non-GAAP operating income is expected to lie between \$5 million and \$9 million.

Management noted that Guidewire's latest digital experience framework, Jutro, which facilitates design and development of digital apps, is slated

Quarter Ending **10/2019**

Report Date	Dec 05, 2019
Sales Surprise	3.77%
EPS Surprise	333.33%
Quarterly EPS	0.13
Annual EPS (TTM)	1.21

to be available in Guidewire Cloud in fiscal third quarter and to self-managed customers in the fiscal fourth quarter.

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

Guidewire maintained fiscal 2020 outlook. The company continues to expect total revenues to be in the range of \$759-\$771 million.

License and subscription are expected to be in the range of \$443-\$455 million. Maintenance revenues are anticipated to be in the range of \$85-\$87 million. Services revenues are projected in the range of \$224-\$236 million.

Management continues to expect 55%-75% of new sales to be subscription-based.

The company anticipates non-GAAP operating income in the range of \$96 million and \$108 million.

The company did not divulge guidance on non-GAAP net income per share as it is assessing the impact of base erosion and anti-abuse tax ("BEAT") regulations, issued recently.

Recent News

On Feb 6, 2020, Guidewire announced the adoption of Guidewire InsuranceNow by Vermont Mutual Insurance Group to increase business agility and speed-to-market.

On Jan 9, 2020, Guidewire announced that the company's InsuranceSuite Cloud has been implemented by Canada-based insurer, The Co-operators, to enhance infrastructure and business processes.

On Jan 7, 2020, Guidewire announced that Safety Insurance Group has adopted Guidewire ClaimCenter, to enhance claims management processes.

On Nov 20, 2019, Guidewire announced that the company's InsurancePlatform products have been implemented by Heartland Farm Mutual to enhance infrastructure and business processes.

On Oct 10, 2019, Guidewire announced that Hearsay Systems is joining the Guidewire PartnerConnect program as a Solution partner.

On Oct 8, 2019, Guidewire announced that the company's InsurancePlatform suite of products have recently been implemented by The Commonwell Mutual Insurance Group to enhance customer experience.

Valuation

Guidewire shares are up 25.4% in the past six-month period and 26.3% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector are up 16.4% and 21.9% in the past six-month period, respectively. Over the past year, the Zacks sub-industry and sector are 11.2% and 27.6%, respectively.

The S&P 500 index is up 15.9% in the past six-month period and 20.3% in the past year.

The stock is currently trading at 12.15X forward 12-month sales, which compares to 10.53X for the Zacks sub-industry, 3.71X for the Zacks sector and 3.53X 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 9.16X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$130 price target reflects 13.09X 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	12.15	10.53	3.71	3.53
	5-Year High	12.68	10.53	3.71	3.53
	5-Year Low	7.05	6.88	2.3	2.54
	5-Year Median	9.16	8.40	3.02	3
P/B TTM	Current	6.28	13.21	5.63	4.29
	5-Year High	6.7	13.35	5.66	4.42
	5-Year Low	4.06	8.25	3.13	2.85
	5-Year Median	5.53	10.29	4.23	3.62
EV/Sales TTM	Current	13.5	10.04	4.42	3.06
	5-Year High	13.69	10.04	4.42	3.27
	5-Year Low	6.28	6.91	2.56	2.15
	5-Year Median	9.39	8.59	3.46	2.77

As of 02/10/2020

Industry Analysis Zacks Industry Rank: Top 5% (14 out of 255)



Top Peers

SAP SE (SAP)	Outperform
DXC Technology Company. (DXC)	Neutral
International Business Machines Corporation (IBM)	Neutral
Paycom Software, Inc. (PAYC)	Neutral
Paychex, Inc. (PAYX)	Neutral
Anaplan, Inc. (PLAN)	Neutral
Synopsys, Inc. (SNPS)	Neutral
Pegasystems Inc. (PEGA)	Underperform

Industry Comparison Industry: Business - Software Services				Industry Peers		
	GWRE Neutral	X Industry	S&P 500	DXC Neutral	PEGA Underperform	SAP Outperform
VGM Score	F	-	-	B	F	F
Market Cap	9.96 B	8.59 B	24.17 B	8.02 B	7.11 B	161.41 B
# of Analysts	4	4	13	6	3	5
Dividend Yield	0.00%	0.00%	1.77%	2.66%	0.13%	0.89%
Value Score	F	-	-	A	F	D
Cash/Price	0.10	0.08	0.04	0.31	0.02	0.04
EV/EBITDA	126.08	25.77	13.89	3.59	216.18	21.39
PEG Ratio	10.61	2.80	2.05	1.50	NA	2.28
Price/Book (P/B)	6.28	4.99	3.27	0.89	13.41	4.67
Price/Cash Flow (P/CF)	102.64	25.24	13.60	1.94	160.91	23.40
P/E (F1)	100.52	31.57	19.00	5.86	516.86	21.97
Price/Sales (P/S)	14.29	3.23	2.66	0.40	7.98	5.24
Earnings Yield	0.99%	3.17%	5.26%	17.09%	0.19%	4.56%
Debt/Equity	0.27	0.24	0.71	0.92	0.11	0.42
Cash Flow (\$/share)	1.18	1.99	6.89	16.25	0.56	5.78
Growth Score	F	-	-	C	D	F
Hist. EPS Growth (3-5 yrs)	26.23%	19.05%	10.85%	21.43%	-36.54%	6.28%
Proj. EPS Growth (F1/F0)	-17.07%	10.91%	7.22%	-35.29%	171.23%	7.62%
Curr. Cash Flow Growth	99.80%	14.78%	8.88%	1.14%	-21.46%	-1.75%
Hist. Cash Flow Growth (3-5 yrs)	29.98%	20.27%	8.36%	21.84%	-9.41%	3.01%
Current Ratio	7.22	1.60	1.22	0.93	1.45	1.05
Debt/Capital	21.18%	21.18%	42.90%	48.03%	9.72%	29.53%
Net Margin	0.03%	4.58%	11.81%	-7.98%	-8.41%	12.07%
Return on Equity	2.01%	9.76%	16.98%	16.98%	-14.16%	15.41%
Sales/Assets	0.33	0.73	0.54	0.66	0.94	0.46
Proj. Sales Growth (F1/F0)	6.20%	6.31%	4.06%	-4.98%	13.39%	5.90%
Momentum Score	D	-	-	D	B	C
Daily Price Chg	2.23%	0.74%	0.45%	-3.36%	1.17%	0.13%
1 Week Price Chg	4.88%	2.77%	2.47%	2.57%	2.71%	3.28%
4 Week Price Chg	6.39%	4.16%	0.95%	-11.11%	8.32%	-2.24%
12 Week Price Chg	1.75%	6.65%	5.05%	-14.71%	18.08%	0.04%
52 Week Price Chg	28.37%	20.64%	16.18%	-53.00%	57.95%	29.92%
20 Day Average Volume	476,203	383,354	1,999,386	3,322,202	210,188	759,200
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-1.16%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	-1.31%	5.17%	6.43%
(F1) EPS Est 12 week change	11.11%	-1.03%	-0.18%	-13.54%	-7.84%	6.43%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	-17.07%	-10.53%	-3.09%

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	D
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.

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