

Guidewire Software (GWRE)

\$84.64 (As of 04/13/20)

Price Target (6-12 Months): **\$94.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 05/06/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:F

Value: F

Growth: F

Momentum: D

Summary

Guidewire is expected to benefit from solid growth in subscription-based offerings driven by robust adoption of InsuranceNow. The company is focused on enhancing Guidewire Cloud platform with new capabilities that include 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. Partner Connect Program has been implemented worldwide, benefiting customers in the property and casualty (P&C) insurance industry. However, reduction in the demand for the company's software management services due to increasing cloud implementations is a headwind. Also, investments on product enhancements are expected to limit margin expansion. Notably, the company has underperformed the industry in the past year.

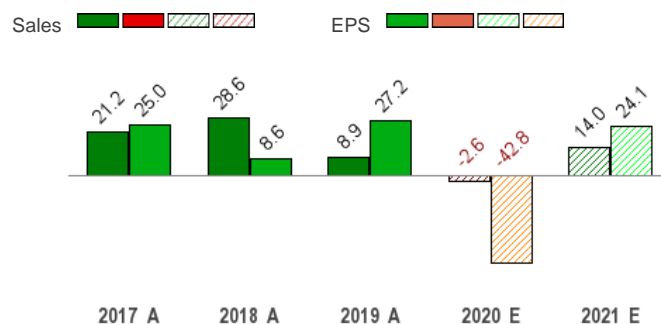
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$124.16 - \$71.64
20 Day Average Volume (sh)	1,019,460
Market Cap	\$7.0 B
YTD Price Change	-22.9%
Beta	1.25
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Business - Software Services
Zacks Industry Rank	Bottom 27% (185 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	61.5%
Last Sales Surprise	5.0%
EPS F1 Est- 4 week change	-9.5%
Expected Report Date	06/02/2020
Earnings ESP	-96.4%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	176 E	194 E	179 E	245 E	799 E
2020	157 A	173 A	153 E	217 E	701 E
2019	180 A	169 A	163 A	208 A	720 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.13 E	\$0.27 E	\$0.11 E	\$0.61 E	\$1.03 E
2020	\$0.13 A	\$0.21 A	-\$0.06 E	\$0.54 E	\$0.83 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.

P/E TTM	78.4
P/E F1	102.0
PEG F1	10.8
P/S TTM	10.0

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 04/13/2020. The reports text is as of 04/14/2020.

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.

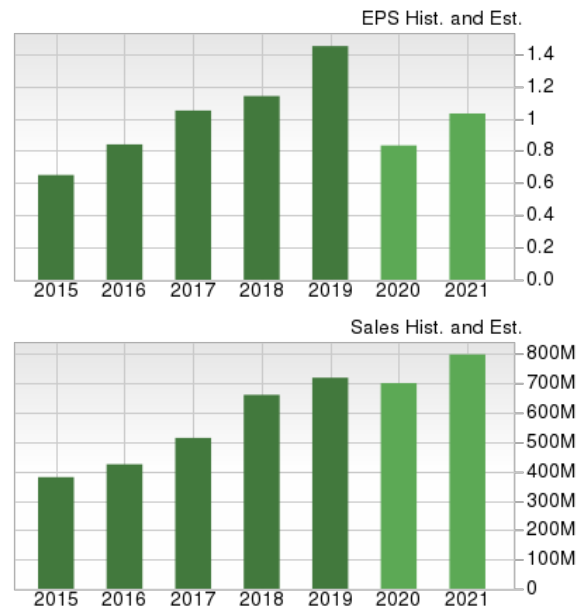
The company has a wide range of customers that use multiple components of Guidewire InsurancePlatform which include InsuranceSuite, digital, data and analytics. The company exited fiscal 2019 with 380 customers.

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 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). 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 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, as of Jan 31, 2020 cash and cash equivalents and short-term investments were \$1.055 billion, compared with \$1.011 billion as of Oct 31, 2019. The company generated cash from operating activities of \$19.5 million in the second quarter of fiscal 2020. During fiscal second quarter, free cash flow came in at \$16.7 million.

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 17.7% of total assets as of Jan 31, 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 9.99. This level compares unfavorably with what the industry witnessed in the last year. 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 Beats on Q2 Earnings & Revenues, Revises View

Guidewire Software reported second-quarter fiscal 2020 non-GAAP earnings of 21 cents per share, outpacing the Zacks Consensus Estimate by 61.5%. However, the bottom line declined 36.4% from the year-ago quarter.

The company reported revenues of \$173.5 million, surpassing the Zacks Consensus Estimate by 5%. Further, the top line surpassed the higher end of management's guided range of \$162-\$166 million. Moreover, the top line improved 3% from the year-ago quarter. The growth can primarily be attributed to higher License and subscription revenues. Further, management remains optimistic on growing clout of its several cloud-based products and InsuranceSuite Cloud deal wins.

Quarter Ending **01/2020**

Report Date	Mar 04, 2020
Sales Surprise	5.03%
EPS Surprise	61.54%
Quarterly EPS	0.21
Annual EPS (TTM)	1.08

Quarter in Detail

License and subscription revenues (60.5% of total revenues) improved 21% from the year-ago quarter to almost \$105 million, driven by growth in subscription revenues.

Term license revenues improved 3.7% year ago quarter to \$74.3 million. Subscription revenues soared 93.9% year over year to \$28.6 million on solid adoption of InsuranceSuite cloud. In the fiscal second quarter, 63% of new software sales were subscription-based, compared with 53% in the year-ago quarter. Perpetual license revenues came in at \$2 million.

Maintenance revenues (12.2%) amounted to \$21.1 million, down 0.7% year over year. Management expects maintenance revenues to be muted as customers opt for cloud-based subscription services over term licenses.

Services revenues (27.3%) decreased 21.7% from the year-ago quarter to \$47.4 million.

Annual recurring revenues (or ARR) were \$474 million as of Jan 31, 2020, compared with \$463 million as of Oct 31, 2019.

Margin Details

Non-GAAP gross margin contracted 100 basis points (bps) on a year-over-year basis to 59%, 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 contracted 880 bps to 80.5%. Non-GAAP gross margin for Maintenance contracted 120 bps to 82.8%. Meanwhile, non-GAAP gross margin for Services came in at 0.8%, compared with 9.6% reported in the year-ago quarter.

Total operating expenses climbed 15% year over year to \$86.9 million.

Non-GAAP operating income came in at \$15.4 million during the reported quarter, down 39.1% year over year. Non-GAAP operating margin during the quarter contracted 610 bps from the year-ago quarter to 8.9%.

Balance Sheet & Cash Flow

As of Jan 31, 2020 cash and cash equivalents and short-term investments came in at \$1.055 billion, compared with \$1.011 billion as of Oct 31, 2019. The company generated cash from operating activities of \$19.5 million in the fiscal second quarter. During fiscal second quarter, free cash flow came in at \$16.7 million.

Guidance

For fiscal third-quarter 2020, revenues are expected to be in the range of \$153-\$157 million. License and subscription are expected to be in the range of \$78-\$82 million. Maintenance revenue is anticipated to be in the range of \$20-\$20.5 million. Services revenues are projected between \$53 million and \$57 million.

The company projects non-GAAP loss of 6-2 cents per share in third quarter fiscal 2020.

Guidewire revised fiscal 2020 outlook on increasing cloud implementations and higher allegiance of large customers to manage reducing the demand for the company's software management services. The company now expects total revenues between \$702 million and \$714 million, compared with prior guided range of \$759-\$771 million.

License and subscription are now expected to be in the range of \$415-\$425 million compared with prior guided range of \$443-\$455 million. Maintenance revenues are now anticipated to be in the band of \$83-\$84 million, compared with previous range of \$85-\$87 million. Services revenues are now anticipated between \$202 million and \$208 million, compared with prior range of \$224-\$236 million.

Management now expects 70-80% of new sales to be subscription-based, compared with prior guided range of 55-75%. The company anticipates non-GAAP earnings of 82-94 cents per share in fiscal 2020.

Recent News

On Apr 6, Guidewire announced that its Core, Data, and Digital products have been selected by NFU Mutual to facilitate the latter's digital transformation process.

On Mar 16, Guidewire announced that its InsurancePlatform has been implemented by Brazil-based insurer, Sancor Seguros do Brazil S.A., to enhance infrastructure and business processes.

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

On Jan 9, 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, Guidewire announced that Safety Insurance Group has adopted Guidewire ClaimCenter, to enhance claims management processes.

Valuation

Guidewire shares are down 22.9% in the year-to-date period and 18.3% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector are down 8.7% and 9.6% in the year to date period, respectively. Over the past year, the Zacks sub-industry and sector are down 11.4% and 0.6%, respectively.

The S&P 500 index is down 14.4% in the year-to-date period and 5.4% in the past year.

The stock is currently trading at 9.01X forward 12-month sales, which compares to 8.68X for the Zacks sub-industry, 3.19X for the Zacks sector and 3.04X 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 9.17X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$94 price target reflects 10.01X 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	9.01	8.68	3.19	3.04
	5-Year High	12.68	9.98	3.58	3.44
	5-Year Low	7.05	6.88	2.32	2.54
	5-Year Median	9.17	8.38	3.09	3.01
P/B TTM	Current	4.41	10.67	4.26	3.65
	5-Year High	6.7	13.16	5.37	4.55
	5-Year Low	3.85	8.25	3.15	2.84
	5-Year Median	5.51	10.25	4.27	3.63
EV/Sales TTM	Current	9.11	8.36	3.62	2.74
	5-Year High	13.69	10.41	4.44	3.46
	5-Year Low	6.28	6.74	2.57	2.16
	5-Year Median	9.43	8.59	3.55	2.83

As of 04/13/2020

Industry Analysis Zacks Industry Rank: Bottom 27% (185 out of 253)



Top Peers

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

Industry Comparison Industry: Business - Software Services				Industry Peers		
	GWRE Neutral	X Industry	S&P 500	DXC Neutral	PEGA Neutral	SAP Neutral
VGM Score	F	-	-	B	F	D
Market Cap	7.02 B	6.14 B	19.08 B	3.96 B	5.84 B	146.07 B
# of Analysts	6	4	14	6	3	4
Dividend Yield	0.00%	0.00%	2.19%	5.39%	0.16%	0.98%
Value Score	F	-	-	A	F	C
Cash/Price	0.15	0.08	0.06	0.63	0.01	0.04
EV/EBITDA	85.87	11.82	11.58	2.26	-69.81	19.52
PEG Ratio	11.12	2.68	2.06	NA	NA	2.12
Price/Book (P/B)	4.41	4.41	2.58	0.44	10.80	4.23
Price/Cash Flow (P/CF)	72.02	20.37	10.19	0.96	NA	21.18
P/E (F1)	105.33	28.65	17.15	3.04	431.59	20.14
Price/Sales (P/S)	10.01	2.77	2.07	0.20	6.41	4.74
Earnings Yield	0.98%	3.49%	5.67%	32.91%	0.23%	4.97%
Debt/Equity	0.27	0.24	0.70	0.80	0.10	0.42
Cash Flow (\$/share)	1.18	2.23	7.01	16.25	-0.60	5.78
Growth Score	F	-	-	C	D	F
Hist. EPS Growth (3-5 yrs)	23.62%	17.95%	10.92%	21.43%	-39.87%	6.28%
Proj. EPS Growth (F1/F0)	-42.53%	-1.78%	-1.91%	-4.62%	138.64%	6.25%
Curr. Cash Flow Growth	99.80%	10.44%	5.93%	1.14%	-208.74%	-1.75%
Hist. Cash Flow Growth (3-5 yrs)	29.98%	14.18%	8.55%	21.84%	NA	3.01%
Current Ratio	6.84	1.56	1.24	0.93	1.34	1.05
Debt/Capital	21.09%	21.09%	42.36%	44.56%	8.89%	29.54%
Net Margin	-2.93%	4.58%	11.64%	-7.98%	-9.92%	12.07%
Return on Equity	0.83%	10.14%	16.74%	16.98%	-17.78%	15.42%
Sales/Assets	0.32	0.73	0.54	0.66	0.96	0.46
Proj. Sales Growth (F1/F0)	-2.58%	2.00%	0.45%	-5.93%	20.38%	4.81%
Momentum Score	D	-	-	D	D	B
Daily Price Chg	1.47%	-0.89%	-2.62%	-3.11%	-3.31%	0.80%
1 Week Price Chg	12.72%	12.72%	16.01%	37.87%	24.39%	15.42%
4 Week Price Chg	8.85%	15.80%	14.48%	43.69%	16.44%	25.53%
12 Week Price Chg	-25.11%	-20.63%	-21.69%	-56.21%	-15.12%	-12.56%
52 Week Price Chg	-18.31%	-18.25%	-14.14%	-76.29%	5.27%	8.49%
20 Day Average Volume	1,019,460	708,450	3,634,618	6,566,692	489,884	1,191,724
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-4.65%	0.00%	0.00%
(F1) EPS Est 4 week change	-9.52%	-7.22%	-5.74%	-4.65%	0.00%	0.75%
(F1) EPS Est 12 week change	-186.25%	-9.00%	-8.41%	-12.23%	-28.45%	7.23%
(Q1) EPS Est Mthly Chg	0.88%	-1.14%	-10.28%	0.00%	0.00%	0.84%

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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