

# Technology Company Changes to Selling Services Over Software by 2 to 1\*

**Sustains Great Gross Profit – 49% – Over Long Term**

**Solid Mid-Size Company, Grows from \$52 Million to \$88 Million Over Eight Years, Mostly Organic Growth**

**Focus: Great Example of Finding the Right Focus.  
See Our Other Success Story #28**

*Sustained 5.6% Net Income Over 8 Years – Slightly Above Industry Average\**

*Price / Equity Ratio Averaging 26 Over Time*

*Sales and Marketing Spending in the Range of 20% to 25%*

*Acquired in 2007 for 25 Times Earnings!*

*Economic Value Add: Some Positive Years, Some Negative*

*Appears To Be Much Better Return on Invested Capital Than Some Other Examples, But Not the Best of the Best*

*by Tom Ingram, PMP, CMC*

**Overview:** Docucorp International first came to my attention in 2004 when I interviewed the CEO, Mike Andreck for a study on software companies finding their focus. I was most impressed with Docucorp as an example of finding focus and staying focused. Full text of this case is available at <http://tomingraminc.sharepointsite.net/Public/No28DocucorpSuccess%20Story.pdf> . Docucorp's stock stalled out in the years prior to its acquisition, but the shareholders certainly came away with a big win – selling the company for 25 times earnings. Docucorp's journey from an unfocused software and technology company to a solid business success where 2/3 of revenues came from services and 1/3 from software licenses is a great example to understand. I have

seen dozens of technology companies struggle and fail in their pursuit of the brass ring, the big win, “run up the stock and cash out”, etc.

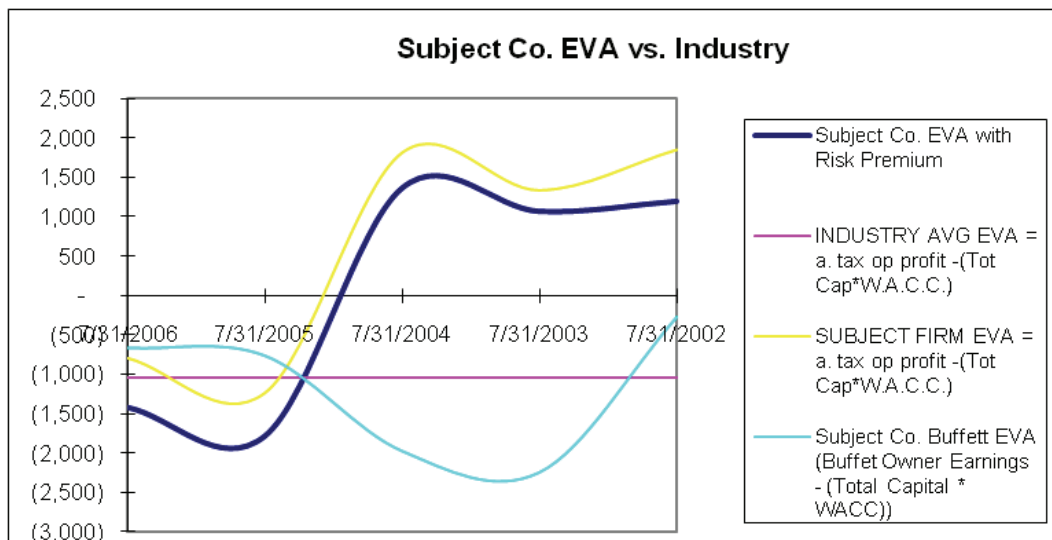
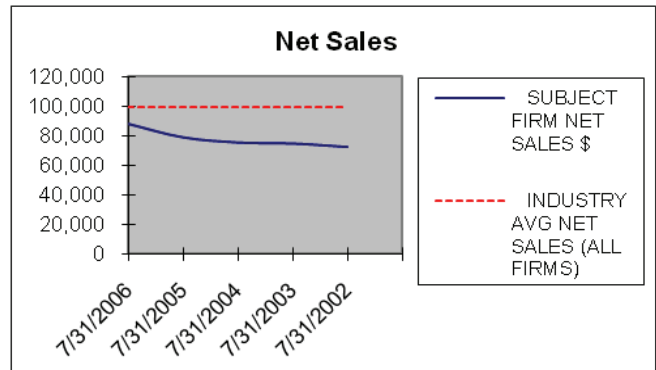
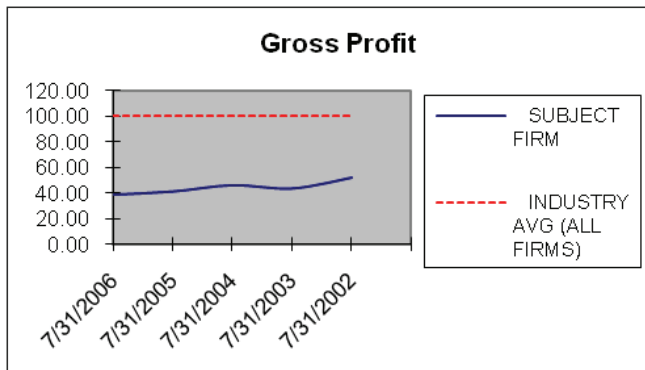
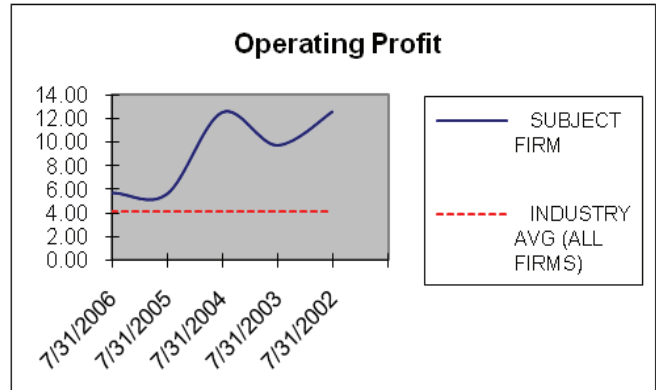
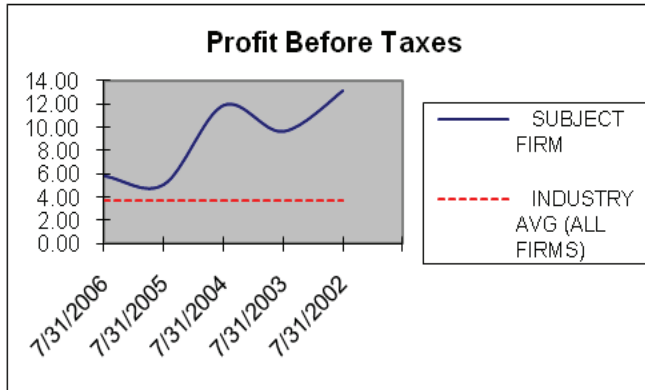
Docucorp illustrates what I am always trying to get my clients to do: “Look at your distinctive competence and your customers’ needs. Can you build a focused business, largely based on services, that requires modest amounts of capital, modest risk and produces steady profits? This has a much higher probability of success...” **The headlines above tell most of our other observations.**

**The Financial and Ratio Analysis:** The bulk of the case is the following financial perform-

ance ratios, which we thought most relevant.

**\* Note on Pre-Tax-Income As Indicator of Excellence:** We believe an average pre-tax profit of 4% to 5%, sustained over time, is a good baseline

for defining exceptional performance in out-sourced business services. The graphs in our cases use a range from a low of 3.7% to a high of 7.7%. See Note 2 for explanation.



<b>Company:</b>	<b>Docucorp International, Inc.</b>	<b>Niche Description (Short)</b>	Software / IT services, 2 to 1 Services to Software, some business process outsourcing
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<b>Relevance to Merchandising Services (1-5)</b>	<b>4.3</b>	<b>Key Customers / Industries Served:</b>	
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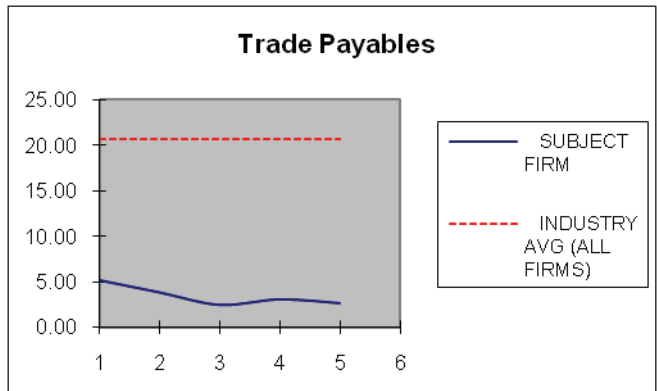
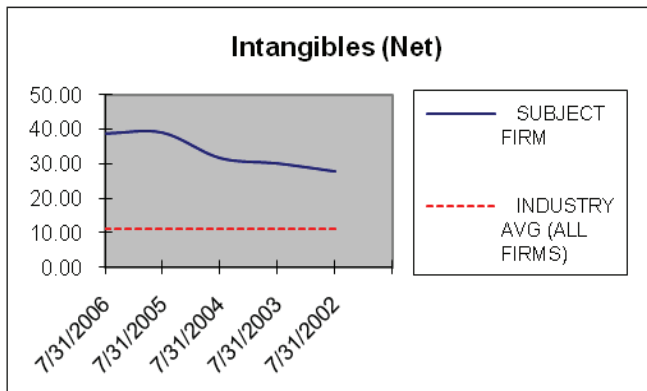
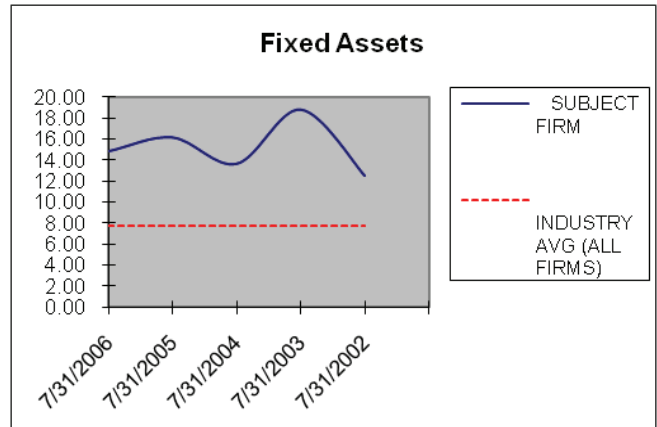
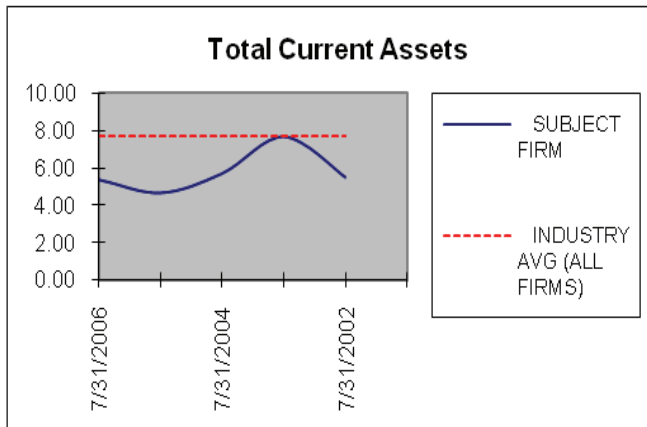
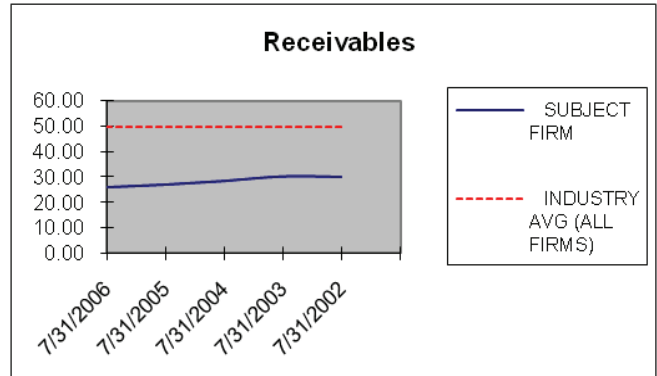
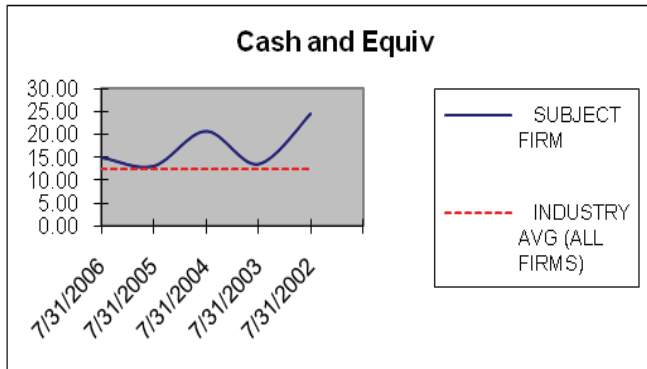
<b>Competitors:</b>	<b>Key Lessons / Items of Note</b>	<ul style="list-style-type: none"> <li>- SEE NEWSLETTER 28 FOR FOCUS CASE STUDY</li> <li>- Services Revenue 2 to 1 over Software Revenue</li> <li>- P/E 26</li> <li>- Gross profit great at 49%</li> <li>- Net income strong at 5.6%</li> <li>- SG&amp;A at 25%</li> <li>- Debt good</li> <li>- Revenue and profit growth strong at 8% and 10%</li> </ul>	
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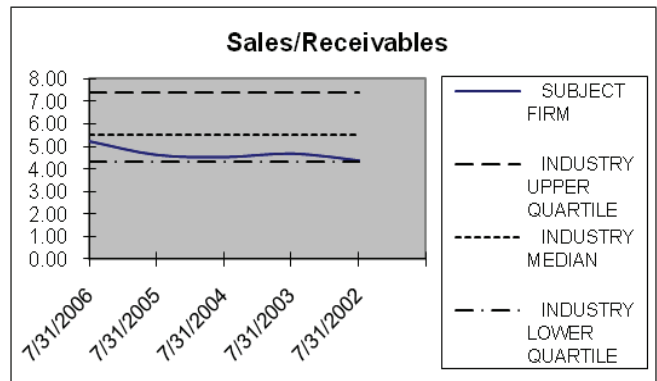
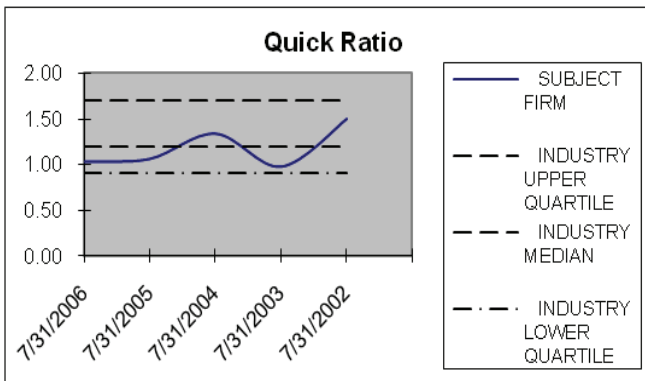
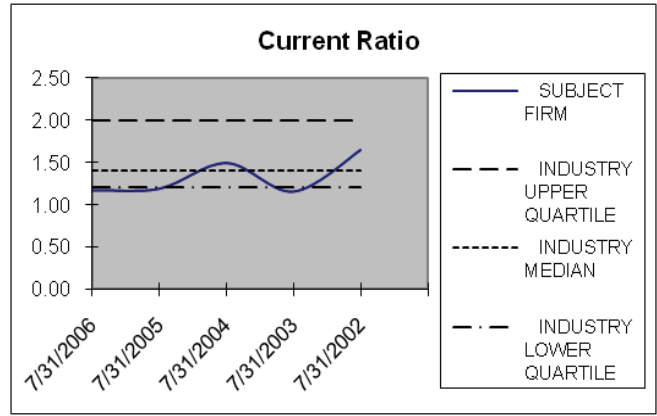
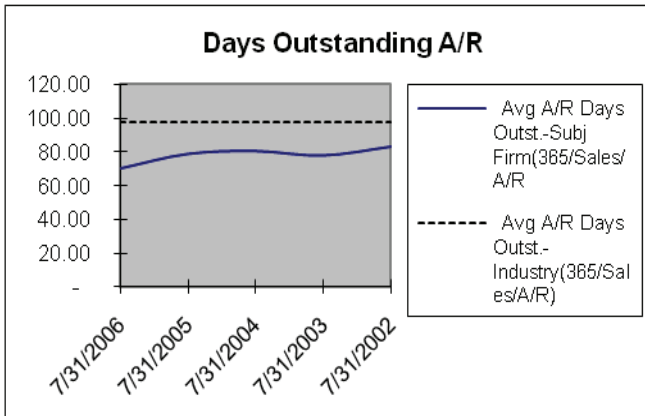
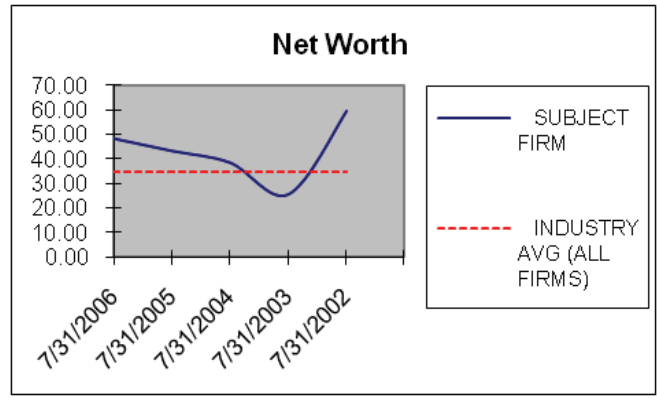
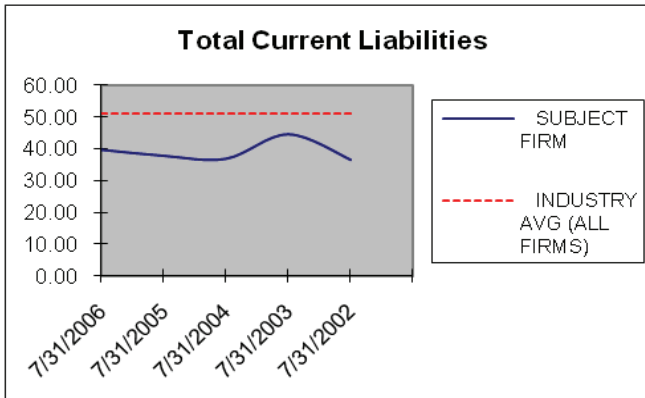
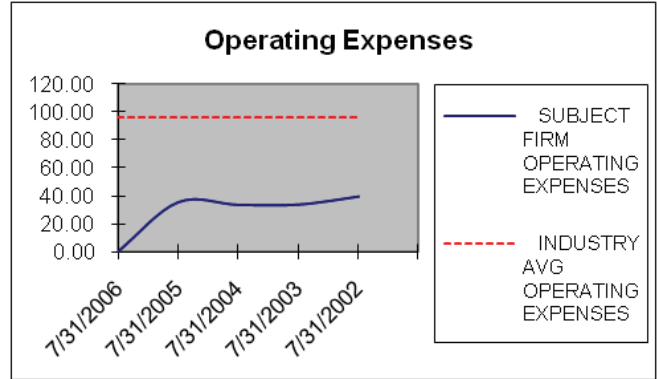
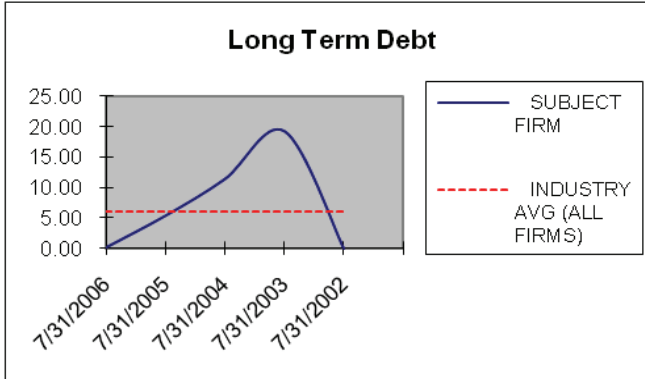
<b>SIC / NAICS Code</b>	SIC: 7372 - SERVICES-PREPACKAGED SOFTWARE [Used SIC 7373 for Ratio Analysis]	<b>Industry Segment:</b>	Sells software and software / implementation services (possibly some customer service, sales, billing services) Property, Casualty and Life Insurance, moved on to other Insurance, Utilities, Financial Services, Health Care.
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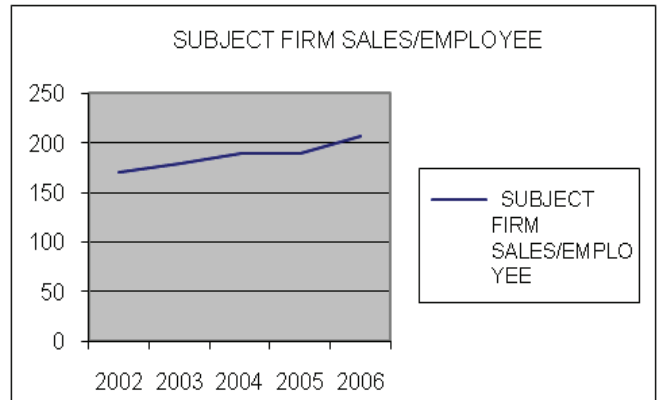
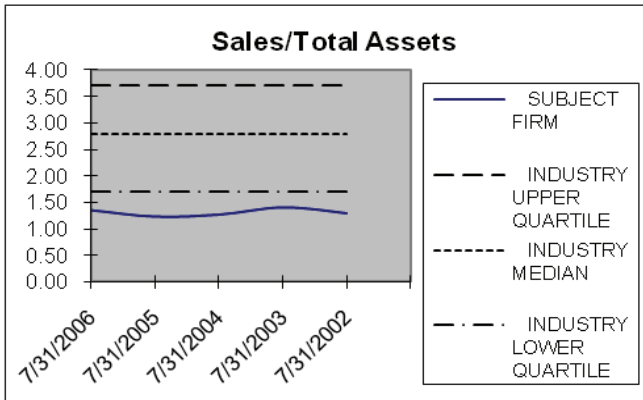
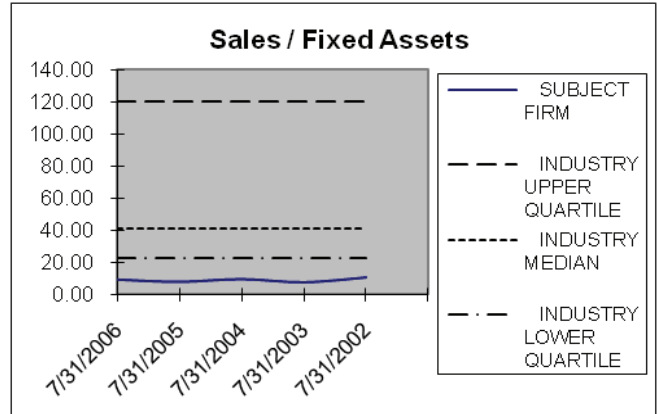
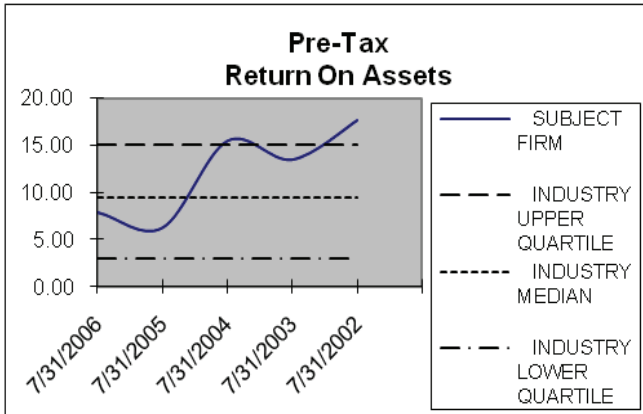
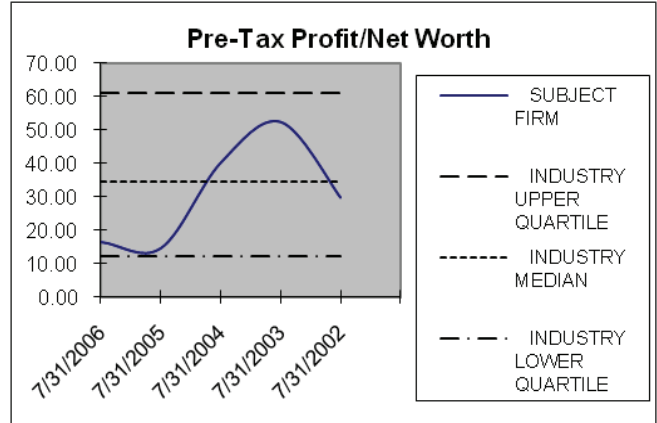
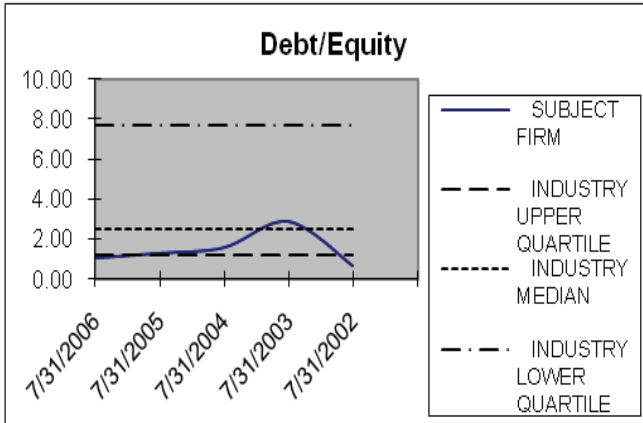
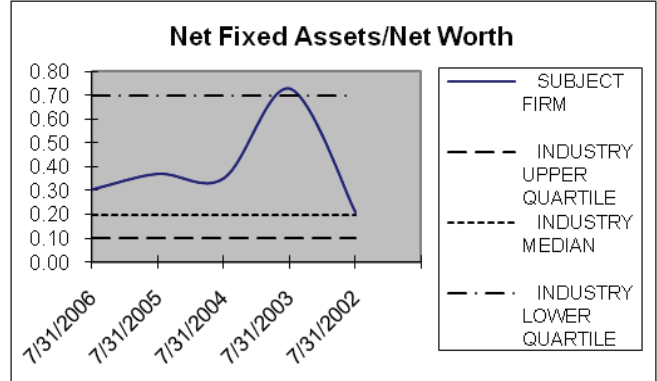
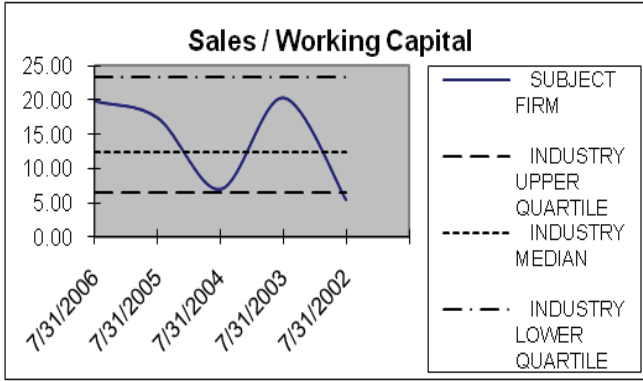
(in Millions except employees and per share data)	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999	Average
Employees			426		400		425		360		403
Total Revenues			\$88	\$79	\$76	\$75	\$73	\$63	\$52	\$52	\$70
License Rev (if shown)			\$10	\$10	\$10	\$8	\$12	\$11	\$9	\$11	\$10
Service Rev (if shown)			\$23	\$21	\$21	\$23	\$21	\$21	\$19	\$21	\$21
Cost of Services			\$54	\$46	\$41	\$42	\$35	\$29	\$24	\$21	\$37
Total SG&A			\$19	\$20	\$18	\$18	\$17	\$16	\$14	\$14	\$17
Net Income			\$3	\$3	\$5	\$4	\$6	\$2	\$3	\$5	\$4
Net Income per common share - Diluted			\$0.28	\$0.22	\$0.47	\$0.28	\$0.40	\$0.17	\$0.15	\$0.26	\$0.28
Total Assets			\$65	\$64	\$59	\$53	\$56	\$52	\$50	\$53	\$57
Total Liabilities			\$34	\$36	\$36	\$40	\$23	\$21	\$16	\$16	\$28
Total Shareholder Equity			\$32	\$28	\$23	\$14	\$33	\$31	\$35	\$37	\$29
Avg Stock Price			\$7.02	\$8.35	\$9.88	\$7.08	\$6.85	\$3.43	\$5.78	\$5.35	\$7
Price / Earnings Ratio			25.08	37.94	21.01	25.30	17.13	20.15	38.52	20.57	25.71
Gross Profit %			38.71%	41.29%	46.37%	43.78%	52.42%	53.47%	54.01%	59.64%	48.71%
Net Income %			3.65%	3.17%	7.09%	5.26%	8.16%	3.93%	4.79%	8.69%	5.59%
SG&A as % of Sales			21.65%	24.93%	23.34%	23.70%	23.67%	25.59%	26.88%	27.43%	24.65%
Revenues Per Employee			\$207,364		\$189,175		\$170,871		\$145,364		\$178,193
Debt to Equity Ratio			1.07	1.31	1.60	2.89	0.69	0.67	0.45	0.43	0.96
Ann. Revenue Growth Rate			11.57%	4.63%	0.97%	3.20%	14.90%	20.78%	0.78%	na	8.12%
Ann. Net Income Growth Rate			28.49%	-53.30%	36.02%	-33.46%	138.88%	-1.08%	-44.41%	na	10.16%

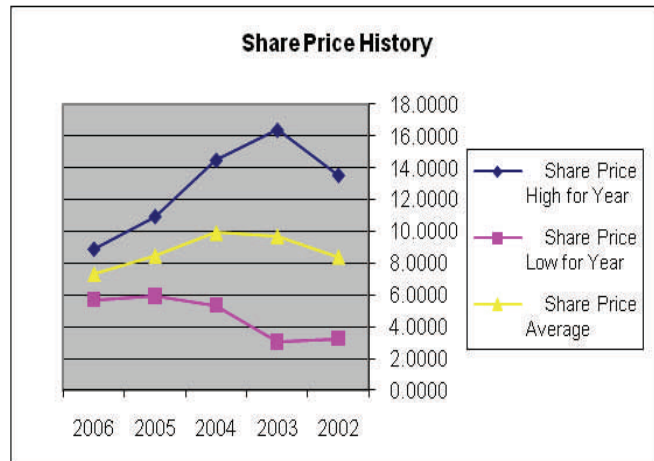
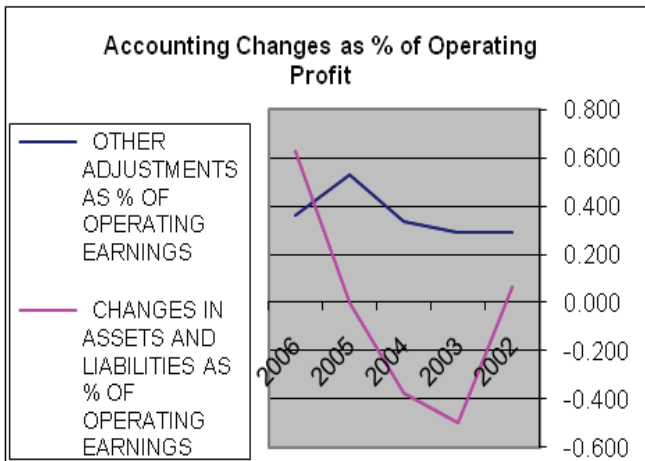
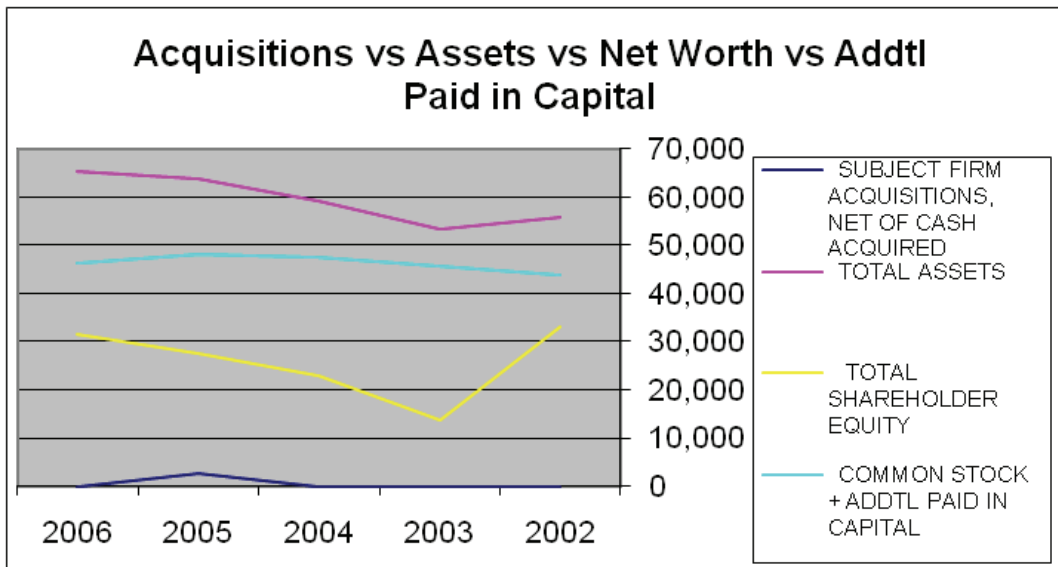
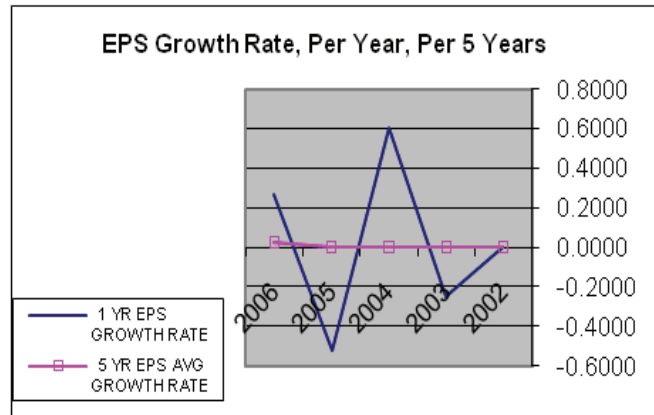
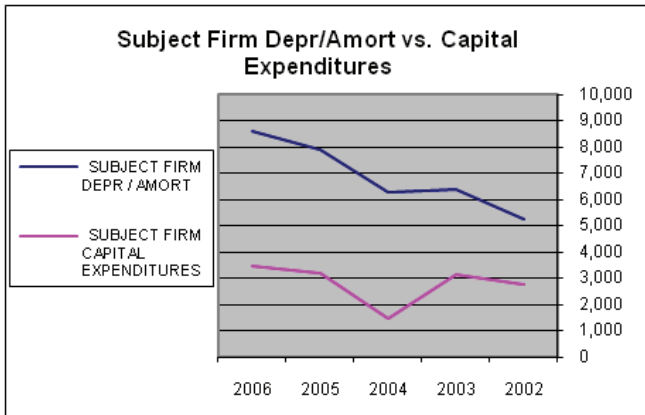
**Additional Notes from Literature Search:**

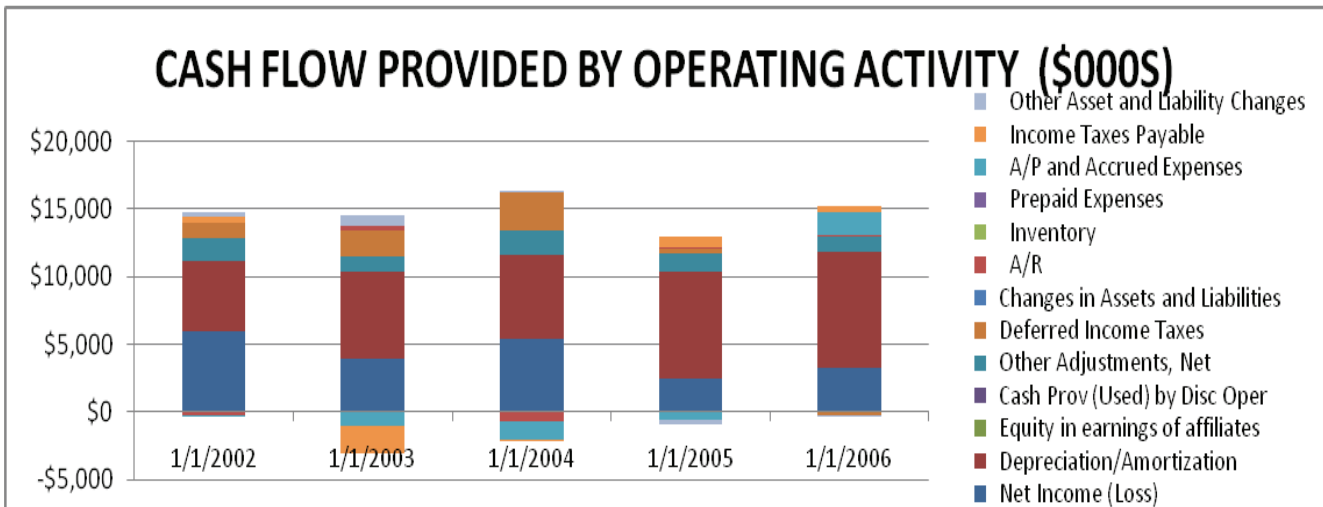
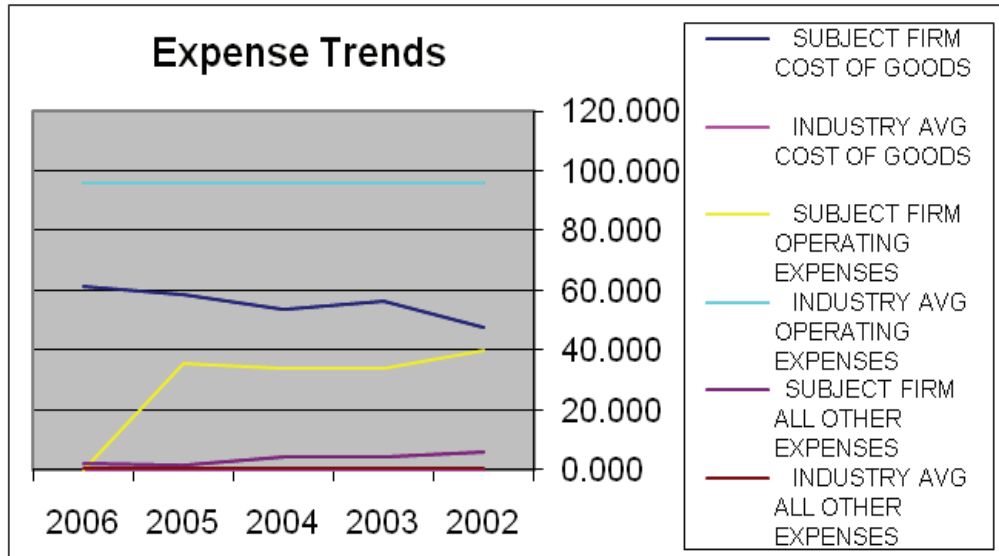
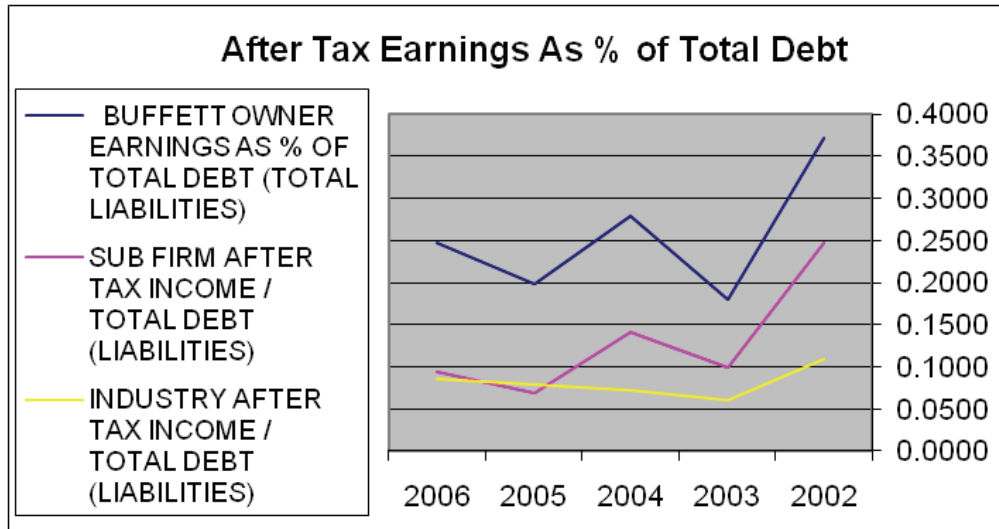
<b>Item:</b>	<b>Source:</b>
<ul style="list-style-type: none"> <li>- Acquired by Skywire!!? For \$128 million - 25 times earnings!</li> <li>- Need Ratio Analysis</li> <li>* Services to Software - only 2 to 1</li> <li>? Lost focus after acquisition?</li> </ul>	TIA Observations



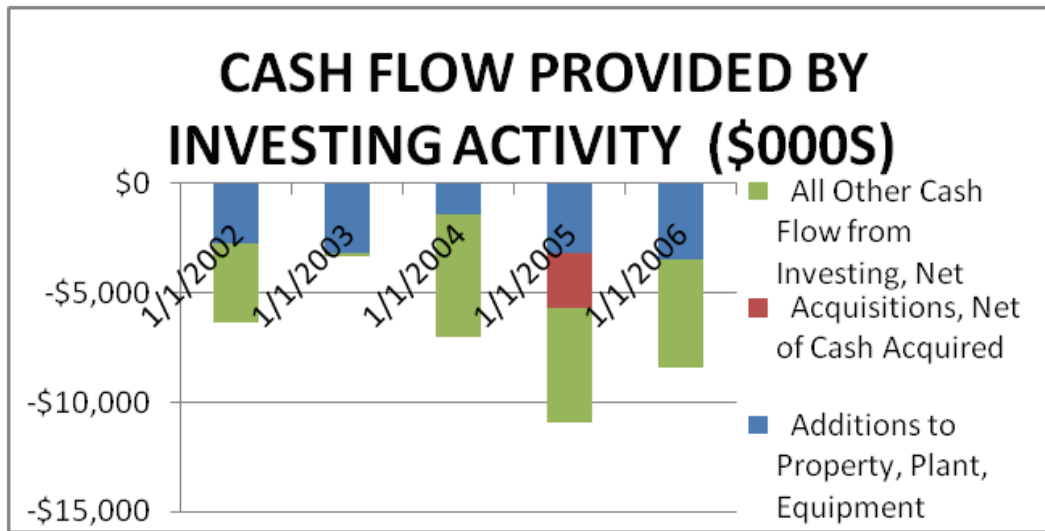
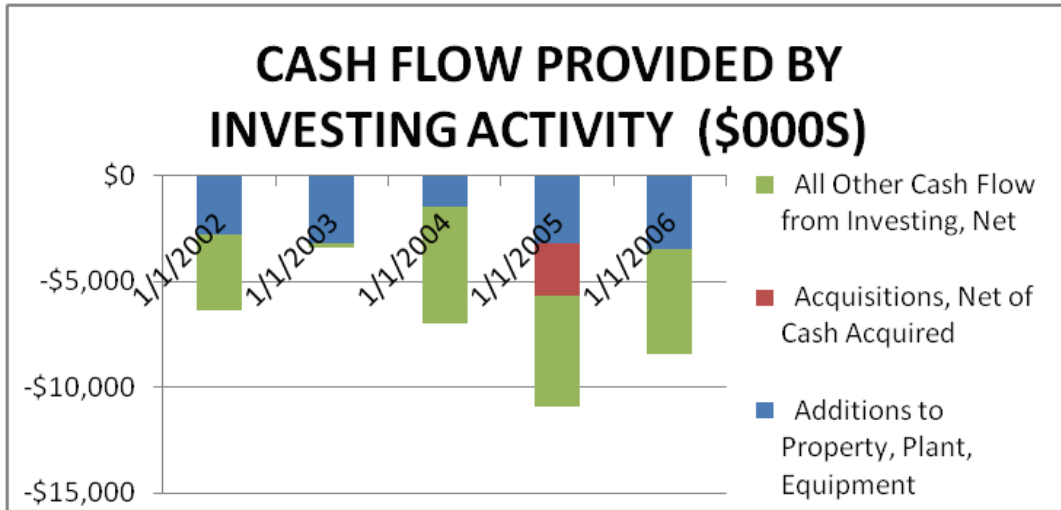












**How The Research Was Conducted:** During the summer of 2009 we set out to identify the best public companies we could find in the area of outsourcing of software, technology and business services. Our approach was to search for companies that produced above-industry-average profits over five to ten years – and study what they are doing to assist us in serving our clients. Our research was primarily based on comparing financial performance ratios to industry averages. We also included a quick

search of citations in the business press. 45 public companies were examined, and we narrowed the “winners” down to 13 which had produced above average industry profits, could be reasonably evaluated for our purposes and were relevant to our client’s interest in outsourced software, technology and business services. Full text of the study is available at <http://tomingraminc.sharepointsite.net/Public/MerchandisingServicesComparisonCompanies-Summary.xlsx>

***Need further information?***

Call us if you have questions or would like more information. This case is written as a teaching tool and is not intended to fully describe exact details or dialog.

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**Note 1:** *The above are Tom Ingram and Associates, Inc.’s observations based on publically available information and our experience. This research was conducted quickly to search for patterns that may help our clients, and was not intended to be exhaustive or accurate in every detail. Please notify us if you are aware of any errors or material omissions.*

**Note 2:** *We initially used an average services industry pre-tax profit of 4% as our hurdle, based on ratio studies prepared by RMA (Robert Morris Associates) of all services companies. This was a necessary simplification for two reasons. We used the data for firms greater than \$25 million in sales for our ratio analysis, even though this greatly reduced the sample size. Also, The government’s SIC (Standard Industrial Classification) codes are not consistently applied to business services companies. SIC code 7389’s average pre-tax profit is 5.9%. SIC code 7371’s average pre-tax profit is 7.7%. SIC code 7373’s average pre-tax profit is 3.7%. SIC code 8742’s average pre-tax profit is 7.5%. **In sum, we believe an average pre-tax profit of 4% to 5%, sustained over time, is a good baseline for defining exceptional performance in outsourced business services.***



