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Despite Credit Risks, More Software LBOs Are On The Horizon

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Table Of Contents

1907483 | 300931657

Despite Credit Risks, More Software LBOs Are On The Horizon

Over the last three years S&P Global Ratings has seen growing credit risks among leveraged buyouts (LBOs) of software companies. Initial leverage immediately after these LBOs has surged by an average of about 25%, and many recent issuers are paying down very little of the debt they've incurred. Although software companies can generate strong cash flow, and EBITDA margins have substantially improved at some of them, these improvements could prove all too fleeting in the dynamic software industry. Consequently, our ratings on software LBOs have generally declined to the low single 'B' area from mid-single 'B'.

We expect, however, that private equity (PE) firms are likely to continue their buying spree in the software industry, spurred by aggressive activist investors and buoyed by a previous history of strong returns on these investments. PE firms specializing in the software industry have amassed record amounts of capital—the necessary 'dry powder' for these transactions. Ultimately, this could lead to struggles at software LBOs as they grapple with growing debt burdens, increasingly aggressive cost cutting, and rising interest rates.

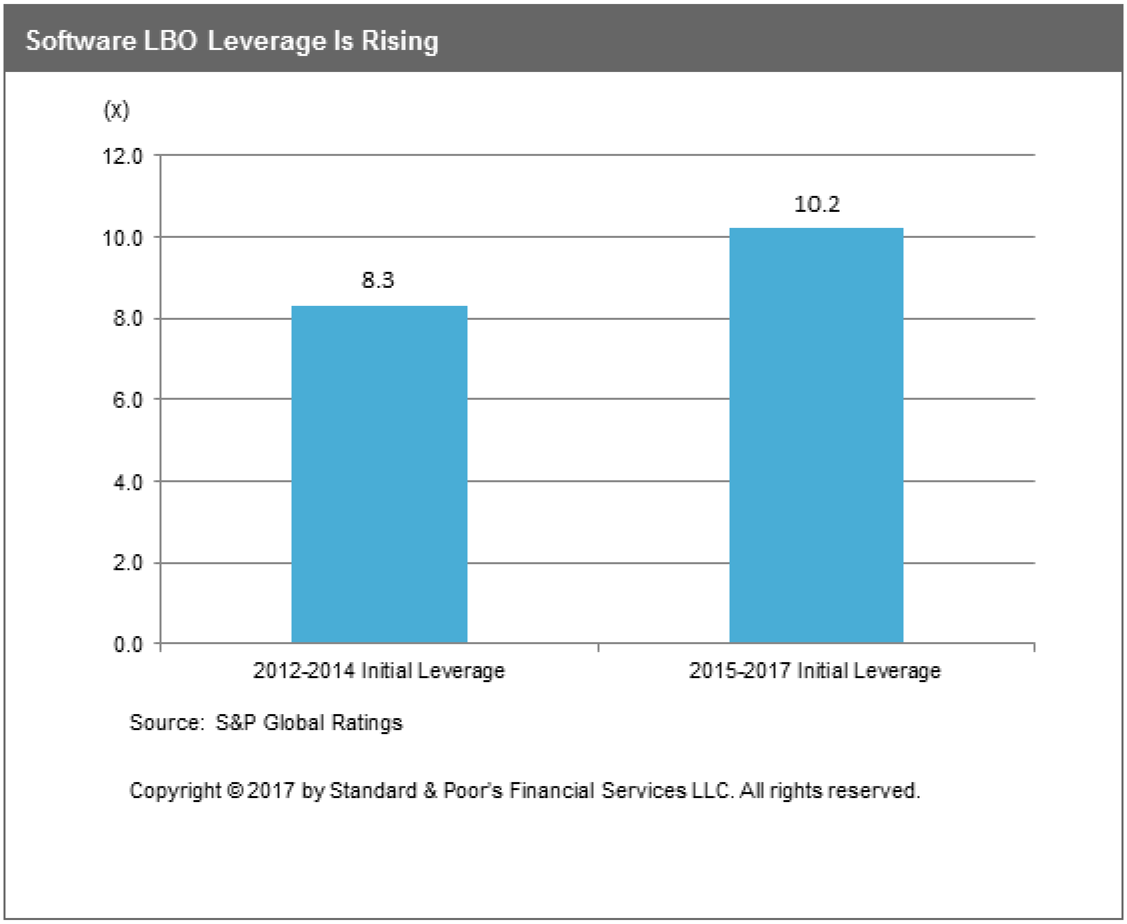
Overview

- Recent software company leveraged buyouts (LBOs) have generally resulted in weaker credit metrics, with the typical rating slipping to the low end of the 'B' category.
- Overall, software company LBOs have increased leverage at target companies, although some have managed to quickly increase EBITDA.
- Activist investors, looking for better returns, have pushed for LBOs at public software companies with sluggish revenue growth.
- Slashing operating expenses or research and development too quickly, later acquisitions, and competition from cloud service providers can all hinder profitability at a software company LBO.
- Despite these risks, private equity investors have amassed large pools of capital to finance more software company buyouts.

Rising Leverage, Despite What Investment Banks Say

As the Great Recession of 2007-2009 has faded from memory, we have seen rising leverage in new debt transactions, especially among software LBOs. Leverage out of the gate for newly minted software LBOs is higher than just about any subsector. By our calculation, the 10 rated LBO transactions from 2015 through 2017 closed with average adjusted leverage of 10.2x. That is up from an average closing leverage of 8.3x on the nine rated LBO transactions in the years 2012 through 2014 (see chart 1).

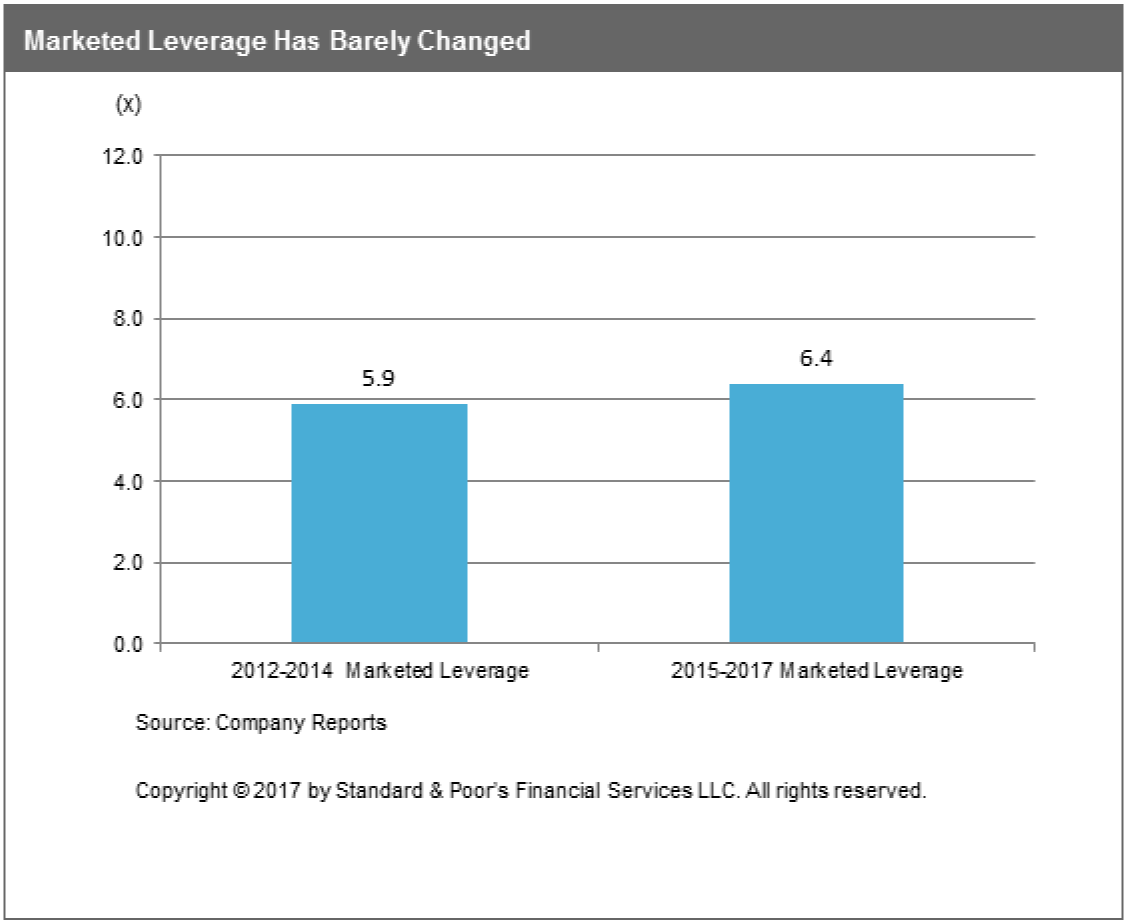
Chart 1



Yet the leverage marketed by investment banks to potential investors has changed little over the last few years according to the marketing materials they provide. Based exclusively on this material the marketed leverage on 2012 through 2014 software industry LBOs averaged 5.9x, while the marketed leverage on the 2015 through 2017 deals averaged just 6.4x, a difference of only 0.5x (See chart 2).

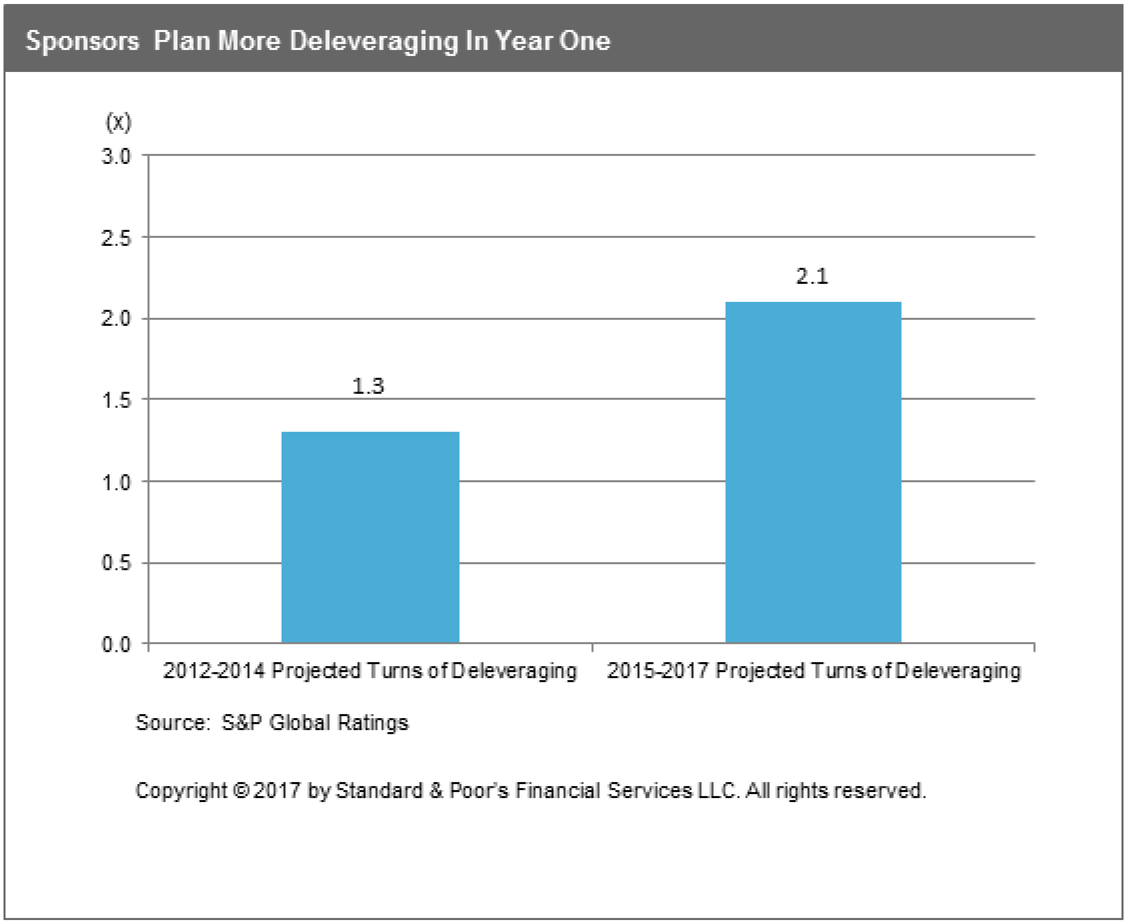
The apparent discrepancy in leverage between investment banking figures and those calculated by S&P Global Ratings reflects a growing number of adjustments to EBITDA made by banks and sponsors, such as 'cash EBITDA' and transaction synergies.

Chart 2



There are several key reasons for the proliferation of these adjustments. Certainly, the U.S. Federal Reserve Bank has played a role with its leveraged lending guidance that restricts bank lending in transactions where debt to EBITDA exceeds 6x. Accordingly, it's no surprise that many of the software industry LBOs have been marketed with leverage of 6x or slightly less. Moreover, the addbacks reflect more aggressive targets for deleveraging, as bankers generally incorporate planned cost savings in their marketed leverage statistics. Our base case projections for software LBOs bear this out. For LBOs from 2015 to 2017, we projected a reduction of 2.1x of leverage to 8.1x during the first year following the transaction. In the deals from 2012 through 2014, we projected an improvement of just 1.3x to 6.8x (see chart 3).

Chart 3



A Path To Deleveraging

Software companies have unique characteristics that can enable them to quickly reduce debt, and many software providers often realize big cost savings following a buyout. But while most mature software companies can generate strong EBITDA margins, given their high gross margins, their actual profitability can vary dramatically because of the different operating strategies pursued by public software companies and private software companies.

Equity investors in public software companies tend to look for topline growth at all costs. Management at public companies will often prioritizes revenue growth at the expense of profits, investing aggressively in sales and marketing regardless of the payback, and public shareholders will sell their stakes if they don't see rapid revenue growth. By contrast, software companies under private ownership can afford to take a more measured view of revenue growth. Without the relentless pressure from public equity holders to grow, management can spend significantly less on sales and marketing, saving anywhere from 5% to 10% of revenue. Private owners can also eliminate the reporting and regulatory costs of running a public company while realizing deal specific savings, such as facility closures or the reduction in management positions. All in, the total potential savings can approach 20% of revenue.

Even without these savings, however, free cash flow generation by software companies is often stronger than traditional leverage metrics would imply. Not only can software companies generate more cash than EBITDA in a given period, but they also spend less on property, plant and equipment, and working capital than other firms. Above average cash flow generation can be attributed to how software companies report revenue. Currently, they report revenue as services are provided. Thus, many software providers must defer maintenance revenue or software as a service (SAAS) revenue. As long as a software company grows its deferred revenue base, unlevered cash flow will be greater than EBITDA, other factors being equal. At the same time, software companies typically have low working capital requirements, as well as low property, plant, and equipment capital expenditures given the low costs to deliver software to customers. So software companies can keep more of the cash they generate.

While not a factor that leads to a reduction in leverage, a high degree of recurring revenue can minimize the volatility of operating results. In turn, lower volatility in operating results makes it more likely that a software company will achieve projected savings. Software companies can generate anywhere from 50% to 90% of revenues on a recurring basis through maintenance or subscriptions. This makes it less likely that business will suffer in a temporary economic downturn.

Taken together, these circumstances create a credible case for rapid deleveraging. A number of recent LBOs have cut costs significantly and reduced leverage. Compuware Corp., for example, dramatically improved its cost structure after its LBO. Prior to the deal, Compuware's EBITDA margins were below 20%. But as a private company it aggressively cut costs in the first 18 months after the LBO and margins rose to the low 30% area. Similarly, Riverbed Technology Inc. increased EBITDA margins by almost 15 percentage points to the low 30% area in the span of one year.

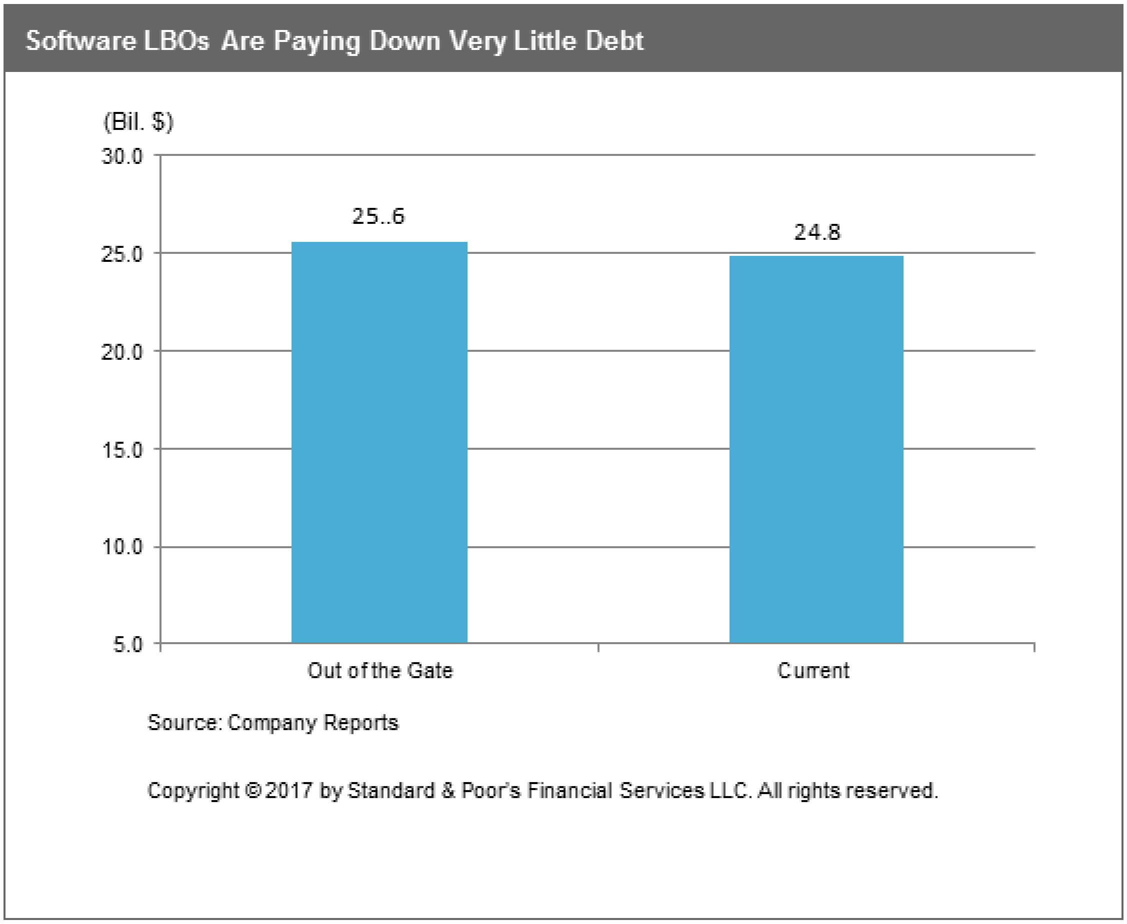
Deleveraging Can Be Slow

Despite generally strong cash flow generation, the actual results of recent LBOs are not uniformly positive and in recent deals, very little debt has been paid down.

In some cases, it is simply too early to gauge the success of restructuring. Significant restructuring costs in the first few quarters can drain cash and make reported financials look messy. Software LBOs may also have other expenses. A growing number of sponsors, for example, are electing not to pay out unvested stock options and restricted stock units (RSUs) prior to the buyout. That means that the companies are responsible for these payouts as the options or RSUs vest. While most LBO reporting will back out so called one-time expenses, these expenses can continue for quite some time.

By and large, cash has been used for acquisitions and to pay dividends to sponsors. The last 10 software LBOs to close more than a year ago, and which we have rated since then, began with total reported debt of $25.6 billion (see chart 4). Currently, these issuers have $24.8 billion in debt, a reduction of only 3%. On average, these issuers have been private for slightly more than 2 years. Therefore they are averaging a reduction in debt of 1.5% per year, slightly more than the typical 1% amortization on term loans.

Chart 4



With very little debt pay down, deleveraging through EBITDA growth can prove temporary. If a software provider decides to ramp up research and development (R&D) or marketing investments, or if demand deteriorates for its software, EBITDA margins will contract and leverage will rise once again. Since trends change rapidly in the software world, a company can see sharp swings in profitability, and consequently its leverage, in a short time. And reported EBITDA margin can actually overstate profitability in some cases. As more software providers build SAAS solutions, they are increasingly capitalizing R&D expenses as required by GAAP. Thus EBITDA margins are higher for a company that capitalizes some of its R&D relative to a company that expenses all of its R&D. In our analyses, we typically reduce an issuer's adjusted EBITDA by the amount of capitalized R&D.

Private Investors On The Hunt

Despite the lower ratings we've seen recently at software company LBOs, such deals are still attractive to private equity firms hunting for investments they hope will pay off big, and we see little likelihood of a pullback in activity. There are record inflows to private equity firms specializing in technology and software such as Thoma Bravo, LLC, Vista Equity Partners, and Silver Lake Partners.

In September of 2016, Thoma Bravo, known for investing in the software sector, closed its Flagship Fund XII with $7.6 billion in committed capital, which is more than double the size of its last flagship private equity fund that closed in 2014, the $3.65 billion Thoma Bravo Fund XI. Vista closed its largest buyout fund in May of this year with more than $11 billion in committed capital according to the Wall Street Journal. Silver Lake closed its fifth fund dedicated to technology with $15 billion in April of this year. And Masayoshi Son, founder of SoftBank Group Corp. said that he had $93 billion in committed capital for Softbank's latest technology investment fund, The Vision Fund.

A portion of these funds will undoubtedly go to earlier stage technology investments. Nevertheless, given the inherent size limitations of early stage investment and the sheer amount of capital that funds are looking to invest, most of the money may be put to work in established tech providers with bigger valuations. We have already seen a shift in the investment landscape. A recently published study from the Boston Consulting Group indicated that PE firms' investments in software companies increased to 8% of their total investments in 2016 from 4% in 2007. Over the same time, the number of annual acquisitions more than doubled to 481 from 228.

Activist Investors And Other Complications

Of course, just because there is money earmarked for technology buyouts does not necessarily mean that transactions will occur. With technology stock prices approaching record highs, the amount of buyout activity has slowed somewhat in 2017. There are, however, other market dynamics that should contribute to increased activity if there is any pullback in the broader market or in specific software companies. Chief among them is the growing size and clout of activist investors.

With more assets, activist firms can take bigger stakes in their targets and target companies with larger market capitalizations. In many cases, activists' positions place them among the largest shareholders, which help them enlist other top shareholders to force change. Activists often target companies with stagnant stock prices and urge management to consider strategic alternatives, including buyouts. Activists have played significant roles in recent LBOs including Riverbed Technology Inc., Infoblox Inc., Mitel Networks Corp., Informatica LLC and Qlik Technologies. Another common demand among activist investors is for large target companies to rationalize their business by divesting non-core assets which can include software businesses. PE firms are frequent buyers of these non-core assets.

Compounding the pressure on public software companies is the difficult operating environment, particularly for legacy software providers operating under the perpetual license model. These companies are facing significant competition from new cloud software providers. These relatively new competitors have tapped into growing interest from enterprise customers to pay for software as it is used instead of making a larger upfront investment. This makes it difficult for legacy software providers to report consistent growth. And lackluster growth can devastate a public company's stock price. Companies that miss street estimates can see their stock price fall significantly. Such a move essentially forces management to consider buyout offers to maximize shareholder value.

Finally, a growing number of software providers are opting to avoid the public markets altogether. Instead of using an

IPO as a path to exit their investments, more venture capital firms are selling software companies to PE firms. This speeds an investment's return, as venture capitalists can liquidate all ownership at once, but software companies can continue as private companies without the pressure to produce immediate results. IPOs can come later or not at all if the PE buyer opts to sell the software firm to another PE firm or a strategic buyer. BCG estimates that VC firms will look to exit their investments in 900 software firms over the next 5 years with 200 being bought by PE firms.

Anatomy Of A Software LBO: Qlik Technologies

Data analytics software provider Qlik Technologies went public in mid-2010. At that time, it had just under $200 million in annual sales and modest EBITDA margins in the high-single-digit percentages. The relatively low profit margins were largely a function of the company's focus on growing its sales and market position. Over the subsequent six years as a public company, Qlik demonstrated strong revenue growth both organically and through acquisitions. By early 2016, annual sales topped $600 million, representing a compound annual growth rate above 20%. Despite the added scale, however, profit margins were still quite low. Even after adding back stock compensation, adjusted EBITDA margins were still below 10% of sales. Qlik continued to invest heavily in sales and marketing to help grow market awareness and generate new sales.

By early 2016, Qlik's organic growth had slowed. While cloud providers weren't then a significant threat in the data analytics space, Qlik's revenue base had grown to the point where 20+% topline growth was no longer sustainable. In its fourth quarter that ended December 31, 2015, Qlik reported particularly disappointing results. Revenue growth was in the low-double-digit percentages and operating profits were essentially flat. Investors punished the stock, sending it down to levels not seen since its IPO. The rapid decline attracted the attention of activist Elliott Management Corp., which bought a 9% stake in the company. At the time, Elliott said Qlik shares were significantly undervalued and that there are "strategic and operational opportunities" for the company that would boost its stock. Within three months, Qlik had agreed to a $3 billion buyout from Thoma Bravo.

To help fund the transaction, Qlik issued $1 billion in debt in the largest ever unitranche deal. Given the low profit margins at Qlik, trailing 12 month adjusted EBITDA including stock compensation was less than $70 million following the buyout. That meant leverage was extremely high at around 14x debt to EBITDA. Clearly investors were skeptical. The large term loan priced at 8.25% over LIBOR, for a yield of 10%. It also included several maintenance covenants. Investors, however, were aware of the rapid deleveraging potential at software companies, and quickly became comfortable with the transaction. Qlik was able to refinance its capital structure just 10 months later in April of 2017 with a new covenant lite credit facility at an interest rate of only 3.5% over LIBOR.

We then rated Qlik 'B' with a stable outlook. Leverage was still very high at more than 12x, but Qlik had already accomplished most of the restructuring with little disruption to its business. Qlik laid off about 10% of its workforce in the nine months after the LBO but maintained solid organic revenue growth and strong maintenance renewals. Under our current base case, we expect Qlik to reduce leverage to the 7x area by the end of 2017, with continued revenue growth and solid free cash flow generation. Specifically, we expect high-single–digit to low–double-digit percentage revenue growth in 2017. Additionally, we project EBITDA margin will improve almost 800 basis points to the 20% area in fiscal year 2017. The significant improvement in 2017 reflects a full year under the new cost structure. Importantly, this margin includes $40 million to pay out RSUs. Margins should expand even further when these costs are eliminated. With modest capital expenditures of around 2.5% of revenue in line with Qlik's historical capital spending, we project free cash flow to debt above the mid-single-digit percent area. Currently, we project no shareholder returns or debt repayment beyond the required 1% amortization.

When LBOs Go Bad

Over the last few years, the software sector has not been immune to distress. In March 2016, Aspect Software Inc., which provides software solutions used in contact centers, filed for Chapter 11 bankruptcy protection. A year later in March of 2017, Answers Corp., a combination of a web portal and a digital marketing software provider, also filed for Chapter 11 bankruptcy. We currently rate Triple Point Group Holdings Inc. and Pinnacle Holdco S.a.r.l. 'CCC' based on capital structures that we consider unsustainable. Both companies provide specialized software solutions to the oil and gas industry. Given the prospects for higher interest rates, higher initial leverage, and more aggressive cost cutting in new deals, we could see a rise in distressed software LBOs over the next few years.

One of the biggest reasons that a software LBO struggles is that a sponsor cuts operating expenses too deeply too quickly. Restructuring isn't ever easy, but a company's operations can be badly hurt if the cuts are not carefully considered and implemented. For example, deep cuts to a software firm's direct salesforce can lead to reductions in renewal rates and a slowdown in new deals, both of which can directly cut cash flow.

Software LBOs can also suffer if R&D investment is curtailed. Part of the rationale for taking software companies private (or for software providers to remain private) is to enable a proper level of investment for the long term. This can certainly be the case when a company does not have to meet significant debt obligations. The company can invest appropriately in research and development, anticipating future market developments. With LBOs, however, sponsors may prioritize cost cutting over long term investment. To the extent sponsors curtail long term product development, software companies can lose ground to competitors. Because technology markets evolve quickly, software companies may never recover once they fall behind.

Another reason software LBOs struggle is the rapid emergence of new cloud competitors. Companies such as Salesforce.com Inc. and Workday Inc. have built multi-billion dollar revenue bases offering software delivered through the cloud. While much of the business has come from smaller customers that never used enterprise software in the past, a large portion has come by taking share away from traditional software providers Nimble cloud software providers have proven adept at attacking new markets more quickly than expected, catching incumbents unprepared to respond, turning once stable markets upside down relatively quickly.

A traditional software provider's response to growing competition can actually compound the firm's operational struggles, at least in the short term. The most likely response from traditional providers to growing cloud competition is to offer a competing cloud solution. To the extent this new offering cannibalizes existing perpetual software customers, a software company's operating performance can suffer during the transition. S&P discussed credit implications of such a transition in "Software-As-A-Service Offers Short-Term Pain But Long-Term Gain For Rated Global Software Providers" published last year. From a high level, revenues and EBITDA decline until the company builds up the subscriber base large enough to offset the loss of upfront perpetual license revenues.

In some cases, a PE firm's decision to combine portfolio companies following a buyout can cause problems. The goal is to achieve greater scale and synergies through the elimination of duplicate costs and cross selling. Often, though, the integration of two companies adds another layer of complexity to an already challenging process. If the synergies are not ultimately realized, or are less meaningful than expected, leverage can remain elevated while performance at the combined firm suffers.

Finally, software LBOs can struggle for more basic reasons, such as a target company revamping its internal systems. Software providers often revamp their own internal systems following an LBO, and under normal circumstances such upgrades generally don't impact operations, even if the install takes more time than expected. However, when a company undergoes multiple changes at the same time, the potential for disruption is magnified. A botched system migration can prove to be the straw that broke the camel's back.

S&P Global Ratings Opinion Of Recent Software LBOs

CCC Information Services Inc. (B-/Stable/--)

On March 30, 2017, we lowered our corporate credit rating on auto and casualty insurance claims software and service provider, CCC Information Services Inc. to 'B-' from 'B' as a result of its leveraged buyout transaction by Advent International Corp. We expect leverage will remain in excess of 7.5x over the next 12 months, despite our expectations for low to mid-teens percentage organic revenue growth and EBITDA margin expansion and for the free operating cash flow (FOCF) to debt ratio to be in the mid-single-digit percent area.

Cvent, Inc. (B-/Stable/--)

On Nov 21, 2016, we assigned ratings to Cvent Inc, a developer of software and services that facilitate event and conference management for corporations, nonprofit organizations, and providers of hospitality services. The U.S. Department of Justice had also concluded its investigation into Vista Equity Partners' planned $1.65 billion acquisition of Cvent Inc. funded partially with a $718 million secured credit facility, which led to adjusted leverage above 10x. Subsequent to the acquisition, Cvent merged with Lanyon Solutions Inc., a Vista portfolio company that competes in the event management software market. Despite high leverage and below average EBITDA margins, Cvent's leadership position in software event planning and management should enable the company to generate strong top-line and EBITDA growth, and positive free cash flow over the next year.

Digital River Inc. (B-/Stable/--)

Digital River Inc., acquired by Siris Capital in February 2015, provides a global end-to-end outsourced ecommerce platform to large mid-market and enterprise customers primarily within the software and consumer branded electronics markets. Since the closing of the acquisition, the company divested businesses and used proceeds from the sales and cash on hand to repay funded debt of about $170 million. Leverage, as a result, declined to the low-3x area at the end of 2016, from the low 6x area at the close of the LBO transaction. We expect leverage to remain in the 3x area in 2017, as the benefits from its debt repayment will be offset by lower revenue and EBITDA from its Microsoft contract loss.

Infoblox Inc. (B-/Stable/--)

On October 18, 2016 we assigned ratings to Infoblox Inc., a provider of network automation solutions, following its acquisition by Vista Equity Partners. The company's DDI technology, which consists of DNS, dynamic host configuration protocol (DHCP), and Internet protocol address management (IPAM), allows for the efficient administration of networks by automating many of the critical processes needed to maintain network uptime. We estimated pro forma adjusted leverage in the low 11x area by fiscal 2017, improving to the low 9x in 2018 as the company increases EBITDA through revenue expansion and reduced its RSU liability.

Infor Inc. (B-/Stable/--)

We lowered our rating on enterprise resource planning (ERP) software provider Infor Inc. to 'B-' from 'B' following a refinancing in January 2017. The downgrade reflected adjusted leverage in the mid-10x area, up from around 8x in fiscal 2015, due to elevated one-time costs related to cost reductions, the acquisition of GT Nexus, and the company's increasing sales of SaaS products, which provide lower near-term revenue than higher-margin perpetual license sales. We expect leverage to fall to the mid- to high-8x area in fiscal 2018, as the company realizes cost savings and as high one-time costs moderate. We project the company's good operating performance to continue and expect FOCF around $300 million per year should allow the company to sustain its capital structure.

Informatica LLC (B-/Stable/--)

In March of 2017, we lowered our rating on data integration provider Informatica LLC to 'B-' from 'B'. The downgrade stemmed from our revised expectation for Informatica's leverage to remain above 8x, compared with our prior expectations for mid 7x leverage in 2017. We revised our estimate following Informatica's fourth-quarter earnings announcement, when it reported meaningfully lower-than-expected perpetual license sales as customers shifted their purchases to subscription pricing. We believe this trend will continue.

Solera Holdings Inc. (B-/Stable/--)

On Jan 19, 2017, we downgraded the corporate credit rating on Solera Holdings Inc., a U.S. provider of risk and asset management software and services to the global automobile and property market. We took the rating action after Solera said that it would acquire Autodata, a U.K.-based vehicle diagnostics and repair information provider. As a result of the company's acquisitive growth strategy, pro forma adjusted debt to EBITDA ratio increased to 10x. We project low- to mid-single-digit percentage organic revenue growth over the next 12 months. We expect that the company will achieve its previously identified cost savings, although we expect pro forma leverage to remain high.

TIBCO Software Inc. (B-/Stable/--)

TIBCO Software Inc. provides information technology infrastructure software that enables companies' systems to communicate efficiently. The company also provides business analytics software that allows users to extract insights from large and active data sets. Our assessment of the company's business risk profile incorporates its competitive operating environment with larger competitors, such as International Business Machines Corp., SAP SE, and Oracle

Corp. However, TIBCO's contractually recurring revenue base is modestly above average relative to that of rated software peers, it has a reputation as a leading provider in the infrastructure software market, and its products are embedded within its customers' operations, which has resulted in customer retention in the mid-90% area. TIBCO is likely to deliver revenue growth in 2017 from a weak base in 2016. Remaining unrealized cost savings and moderating one-time costs will allow the company to meet its debt service obligations in 2017.

Riverbed Parent Inc. (B/Negative/--)

Riverbed Parent, Inc. is the holding company for Riverbed Technology Inc.. Owned by Thoma Bravo and Ontario Teachers, Riverbed provides wide area network (WAN) optimization solutions primarily through appliances and application performance management solutions (70% of revenue). The company also offers Application Performance Management and Network Performance Management (APM/NPM) and is a leading solution provider in the emerging software defined WAN market. We revised our outlook to negative from stable in May 2017 after two quarters of disappointing product sales and a lack of visibility into the second half of the year. Budgetary issues at government clients have hurt WAN optimization sales, along with uncertainty surrounding the impact of next-generation software defined WAN solutions on Riverbed's products. On a trailing 12-month basis, our adjusted leverage is in the low 7x area, although we note that cash flow performance has remained strong, with free operating cash flow to debt above 5%.

SolarWinds Holdings Inc. (B/Negative/--)

We assigned SolarWinds Holdings Inc. a 'B' CCR with a negative outlook following its acquisition by Thoma Bravo in early 2016. The negative outlook reflects the potential for leverage to remain elevated in the 9x if the company fails to execute on planned revenue growth, cost synergies, or debt reductions. SolarWinds provides IT management software that primarily manages and monitors networks and application performance. Its network management software segment includes products that collect and analyze network traffic for IT operations and for security and compliance management. Subscription revenue, when combined with maintenance revenue from network management and systems management software, constitutes an expected recurring revenue base in the mid-70% area, and is expected to surpass 80% over time

Veritas Bermuda Ltd. (B/Stable/--)

We assigned our 'B/Stable' rating to Veritas Bermuda Ltd. on its acquisition by The Carlyle Group in May 2016, following its spin-off from Symantec Corp. Veritas is an information management software firm focused on high-availability solutions for organizations ranging from small businesses to large enterprises. Execution improved markedly in the second half of their fiscal year ended June 30, 2017, and recent management changes in the sales organization and growing deferred revenue balances may augur more stable top-line performance. Veritas should therefore be able to navigate the shifting marketplace at least as well as larger competitors, barring further sales execution problems.

BMC Software Inc. (B/Stable/--)

In December 2016, we revised our outlook to stable from negative primarily because leverage declined to 9.7x from over 11x for a year earlier. BMC Software Inc. began as a mainframe software vendor, but since the middle 1990s has been developing software to monitor, manage and automate distributed and mainframe systems. We expect BMC to continue to reduce leverage over the next year as growing renewal bookings support stronger cash flow generation

1907483 | 300931657

and enable the firm to continue to reduce debt despite revenue weakness.

Project Alpha Intermediate Holding Inc. (B/Stable/--)

Project Alpha Intermediate Holding, Inc. is the holding company for Qlik Technologies, which we rated B/Stable following the refinancing of its capital structure in March of 2017. While leverage is very high, we expect Qlik will rapidly deleverage over to around 7x by the end of 2017, primarily through EBITDA growth with prospects for further deleveraging subsequent to 2017.

Compuware Corp. (B/Stable/--)

The company operates through two separate business units: Dynatrace, which provides application performance management (APM) solutions, and Compuware, which offers a variety of development and testing applications for mainframe computers. Dynatrace represents about half of total EBITDA and is growing faster than overall global technology spending due to strong demand for APM solutions. On the other hand, Compuware has seen declines in revenue as enterprises migrate off of the mainframe. We consider Compuware to be highly leveraged which incorporates adjusted leverage of about 11x EBITDA. Excluding the impact of $900 million in sponsor-owned preferred equity, which we consider debt, adjusted leverage is about 7x. We project free operating cash flow to debt, excluding the impact of the preferred equity, will surpass 5% in fiscal 2017.

Related Research

- Adjustments to EBITDA in Technology Leveraged Buyouts: How We Read the Story They Tell, Dec. 21, 2016
- Software-As-A-Service Offers Short-Term Pain But Long-Term Gain For Rated Global Software Providers, Oct. 19, 2016