EDISON

Solera

In good repair

Initiation of coverage

Software & comp services

Solera is the leading supplier of productivity solutions to the global automotive repair industry. Diverse customer exposure and a transaction/ subscription revenue model give it highly visible revenue streams growing at a mid-single-digit rate organically. Its EBITDA margin of 43% is best in class and cash generation is strong. These attributes give Solera a strong platform to gain leverage from acquisitions, which will be key to achieving management's goal of $2bn sales and $800m EBITDA by 2020.

Year end	Revenue ($m)	PBT* ($m)	EPS* ($)	DPS ($)	P/E (x)	Yield (%)
06/11	685	241	2.46	0.30	23.1	0.5
06/12	790	265	2.71	0.40	20.9	0.7
06/13e	833	258	2.68	0.50	21.1	0.9
06/14e	877	278	2.89	0.60	19.6	1.1

Note: *PBT and diluted EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. EPS is fully diluted.

Optimising the global automotive repair industry

Solera supplies software and services to the global automotive insurance repair processing industry, operating in 63 countries and holding number one or two market position in all its core markets. Audatex, its core product, is the leading repair estimating solution globally and is set to remain so given its unique global footprint and the barrier to entry implicit in the cost of replicating its estimating database. Solera has used in-house development and acquisitions to expand the portfolio to include a range of workflow, data analytics and decision support solutions. The long-term goal is to build a complete end-to-end solution for the automotive and property insurance repair chains.

Robust financial platform for expansion

Growth is stable and predictable, averaging 4.7% pa (constant currency excluding major acquisitions) since 2009 driven by increasing car and insurance uptake in industrialising economies, and cross-selling a broader bundle into developed ones. Margins at 43% EBITDA, 40% adjusted EBIT in Q3 are best in class, born out of Solera's strong market position, a rapid customer ROI, high barriers to entry and rigorous cost control. Growth is supplemented by regular acquisitions, with synergies and earnings accretion generated through the leverage of Solera's global footprint, bundling with existing products and reducing costs.

Valuation: Leverage not priced in

Solera's 2014 P/E of 19.6x is toward the premium end of its peer group. This is justified, in our view, by the company's good earnings visibility, high margins and particularly its strong cash backing of earnings. A DCF using 5.5% mid-term growth and 42% EBITDA margins returns a fair value of $62, implying that steady state performance is barely priced in. We see catalysts for estimates to move up organically as the contribution from higher-growth evolving and emerging markets increases, and as investment in expanding the product suite bears fruit in advanced markets. The rating also discounts Solera's demonstrable ability to achieve leverage from acquisitions, which could be a significant longer-term value driver.

15 May 2013

Price	**$56.6**
Market cap	**$3,917m**

Net debt ($m), as at end Q313	699
Shares in issue (m)	68.89
Free float (%)	99.3
Code	SLH
Primary exchange	New York
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	3.3	1.6	24.4
Rel (local)	(0.5)	(6.3)	0.9
52-week high/low		$58.3	$37.0

Business description

Solera provides software and data solutions to the automotive repair industry on a global basis. Its solutions are used by insurance companies, collision repair facilities and independent assessors to improve claims processing efficiency and reduce overall repair costs.

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FY results	August 2013

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Investment summary

Optimising the automotive insurance and repair industries

Solera is the leading provider of estimating software and data to the automobile claims processing industry worldwide. Its solutions are used by insurance companies, collision repair facilities and independent assessors to improve claims processing efficiency and reduce overall repair costs. The core product, Audatex, combines a comprehensive database of vehicle parts (with associated data for repair times, costs and methodologies) with workflow software to enable repair costs to be quickly and accurately estimated. The company operates in 63 countries and plans to expand this to 100 by 2020. The key elements of its growth strategy are; 1) to capitalise on increasing car and insurance uptake in industrialising economies and, 2) invest in expanding and enhancing the product set to facilitate cross-selling – across all geographies into both the automotive and property insurance repair chains. In-house R&D has been supplemented with regular bolt-on acquisitions to expand the product portfolio and strengthen the competitive position. Most core offerings combine software and proprietary data, the combination of which is fundamental to both the customer proposition and raising barriers to entry.

Financials: Robust organic profile, leverage from acquisitions

Since 2009, constant currency growth excluding major acquisitions has averaged around 4.7% pa, and, while relatively stable, has been trending up of late, averaging 5.2% over the past 12 months. Adjusting for the non-renewal of business from Allstate (-ve) and Hurricane Sandy (+ve), we estimate underlying growth was c 5.5% over Q2 and Q3. Demonstrating the company's ability to generate leverage from acquisitions, adjusted EPS has grown at a CAGR of 22% from 2008 to 2012. With a diverse customer base and a subscription/transaction-based revenue model, the predictability of sales and cash receipts is good compared to software peers. Acquisitions and accelerated investment in product development have resulted in some margin compression, but they remain best in-class at 43% adjusted EBITDA and 40% adjusted operating profit, supported by offering a strong customer ROI and high barriers to entry. Cash generation is robust, with free cash flow per share closely matching adjusted EPS. Management has set an ambitious target of reaching $2bn sales and $400m EBITDA by 2020. Achieving this will require more aggressive expansionary investment to accelerate growth, more likely toward the later end of the period.

Valuation: Leverage from investments should drive upside

A DCF using 5.5% mid-term growth and 42% EBITDA margins returns a fair value of $62, implying that steady state performance is barely priced in. We see potential for estimates to move up as the contribution from higher-growth evolving and emerging markets increases and as investment in expanding the product suite bears fruit. The valuation also discounts Solera's demonstrable ability to gain leverage from acquisitions through its 'industrialised private equity model'.

Sensitivities: Currency, economic activity, competition

Currency – With 68% of 2012 sales coming from outside the US, Solera is exposed to currency movements, particularly the euro and sterling. **Economic activity** – In times of economic hardship, people drive less and are less likely to repair their cars. Our estimates assume no underlying improvement or deterioration in claims activity, with Western Europe expected to remain difficult overall. Solera's potential to grow revenues in **evolving and emerging** markets such as Brazil, Mexico and China is a key element of the growth story. The rate of evolution of the repair industry could lag expectations, while China still carries substantial execution risk. **Competition** – Individual customer exposure is low, but the loss of Allstate has disrupted growth. State Farm (c 1% of sales) is thought to be considering consolidating its suppliers, which could drive upside or downside.

Company description: In good repair

Solera provides software and data solutions to the automotive repair industry, with a customer base that includes insurance companies, collision repair facilities and assessors. Around 70% of sales are related to the automotive claims cycle, with 54% directly related to claims volumes. Here, the company's solutions estimate the costs to repair damaged vehicles; determine pre-collision fair market values for vehicles damaged beyond repair and automate or outsource the steps of the claims process that insurance companies have historically performed internally. Non-claims related services account for 30% of sales (up from 5% in 1996), including workflow, data reporting and analysis tools for insurers.

History

The company has its origins in the 1960s in Germany, where Dr Wilfried Reuter founded Audatex Reuter and developed the world's first computer-aided accident claims-handling solution. Audatex Reuter was acquired by Swiss Re in 1966, which then expanded usage of the platform into other European countries, and then into the US through a licence agreement with the Fireman's Fund Insurance Company. These licensing rights were acquired in 1979 by Automatic Data Processing (ADP), which then went on to acquire Audatex from Swiss Re in 1998. Solera, a vehicle set up by CEO Tony Aquila (previously COO and president of competitor, Mitchell International Inc) and US private equity firm, GTCR, acquired ADP in 2006 for an estimated $1bn. In 2007, Solera debuted on the New York Stock Exchange, raising $421m at $16 per share.

Strategy: Building a comprehensive solution

The company's growth strategy revolves around building a complete end-to-end processing solution for the automotive insurance and repair chain, from policy monitoring, partial loss, parts solutions, total loss and salvage disposition. The company is also looking to leverage its automotive footprint to grow revenues in the property insurance segment, which currently accounts for a low single-digit percentage of revenues. Repair-estimating products (Audatex) remain at the core of Solera's offering, accounting for c 60-70% of revenues in 2012, and are the most widely used solutions of their type globally. Using Audatex as a foundation, the company has progressively enhanced and broadened its offering and expanded its geographical footprint using a combination of in-house development and acquisitions. In addition to estimating solutions, the key product areas are workflow solutions for insurers and repair shops, and solutions for automotive salvage and recycling. Exhibit 1 shows the company's core portfolio, with availability in selected markets. Audatex (repair calculation) is available across the geographical footprint. Other products have been acquired and developed across the geographical footprint and development is decentralised. Sales synergies are developed through cross-selling and bundling with existing products and leveraging Solera's international footprint. The company reports having 30 new products and services in the development pipeline. Sales are made on a return on investment basis, typically generating returns of 4:1 – 8:1 for customers deploying solutions (ie on a 5:1 return basis, a customer saving an average $50 per transaction would pay Solera $10 per transaction).

Data and software

Solera's core offerings combine both software and proprietary data, the combination of which is fundamental to both the customer proposition and raising barriers to entry. The company's parts database, for example, forms the backbone of the Audatex offering, covering the vast majority of vehicles in its advanced markets, and holding the essential data and repair logic to enable repair times and costs to be accurately estimated. Other databases include parts salvage, total loss, driver risk, insurance claims and vehicle validation, which can either work on a standalone basis or in combination with others. The company spends over $115m annually, updating, enhancing and maintaining its databases and related applications, which, taking into account the additional overhead to build up the historic data, forms an enviable barrier to new entrants. By bundling higher-value products, it aims to grow average transaction revenue by 4-6% pa.

Exhibit 1: Product portfolio with availability in selected geographies

		US	UK	Ger	Fra	Spa	Pol	Brz	Rus	Rom	Chn
Estimating solutions											
Repair calculation	Damage assessment, including labour hours and parts	■	■	■	■	■	■	■	■	■	■
VIN decoding	Parts decoding for specific OEM delivered vehicle	■	■	■	■	■	■		■	■	
3D Graphics	Enhanced parts viewer	■									
Digital imaging	Image capture, management and transfer	■	■	■	■	■		■		■	
OEM parts locator	Locates/orders OEM parts	■	■	■		■	■	■	■	■	
Recycled parts locator	Locates/orders recycled parts	■						■			
Aftermarket parts locator	Locates/orders after-market parts	■					■	■			
Paintless dent repair	Database for PDR	■		■	■	■					
Tire repair	Database for tires	■									
Estimate check	Rules-based automated estimate checking	■	■	■		■		■			
Estimate review/audit	Automated estimate review and audit tool	■	■	■		■		■			
Estimate reinspection	Automated reinspection tool	■		■		■		■			
Business intelligence/ reporting	Report writing tools and analytics	■	■	■		■		■			
Workflow Solutions											
Previous damage vehicle check	Previous damage check done before policy acceptance	■	■					■			
First notice of loss	Electronic capture of accident claim and policy information	■	■					■	■		
Dispatch	Intelligent routing and assignment of appraisal/repair work	■	■	■		■		■	■		
Claims/case management	Case file and event log management; real-time, centralised access to claims information	■	■	■	■	■	■	■	■	■	■
Claims viewer/tracker	Real-time access to claim and repair status	■	■		■	■		■	■		
Claims settlement	Invoicing and payment services	■	■								
Total loss solutions											
Vehicle valuation	Vehicle valuation/fair-market-value determination	■	■	■	■			■			
Vehicle validation	Eg mileage check, ownership check, vehicle history check	■	■		■						
Salvage solutions											
Decision support	Repair or salvage calculation	■	■	■	■		■			■	
Logistics assistance	Tow, assignment and disposition arrangement services	■		■							
Auction/disposition	Auction and title transfer services		■	■	■	■	■			■	
Parts inventory mgmt	Salvage parts inventory management system	■									
Warranty/Maintenance solutions											
Mechanical repair	Mechanical assessment, including labour hours and parts					■					
Warranty services	Warranty assessment, including labour hours and parts					■					

Source: Solera

Estimating solutions

Solera's estimating solutions account for over 60% of sales and are anchored by the Audatex repair estimating (estimatics) solution. Audatex combines software with a proprietary database to enable the user to quickly and accurately estimate the time and cost to repair a vehicle based on the damage done. A broad suite of add-on features has been developed over the years, including 3D graphics, direct parts procurement (manufacturer and aftermarket) and individual information based on the Vehicle Identification Number (VIN). These solutions are typically charged for on a per transaction basis (or a fixed subscription for a certain number of transactions), which clearly increases as more products are used as part of a broader bundle.

Parts database – Audatex's backbone

The company's parts database forms the backbone of the Audatex offering, identifying the correct part number based on the model, style, year and engine option of the vehicle, and holds the logic to estimate the repair based on the damage done. Solera maintains direct relationships with the vast majority of vehicle OEMs globally, which provide it with raw data on each new part brought to market, including pricing information and times for removal, refit and replacement. Solera's data development teams then process, augment and update this data into a form that enables the software to produce an accurate repair logic, estimated repair price and time based on the damage received. Solera invests over $115m pa in expanding, enhancing and maintaining the database. In advanced markets, the company covers well over 97% of all vehicles on the road, with coverage dating back to 1970, meaning that replicating the database would cost a multiple of Solera's annual investment and take a considerable time, providing a major barrier to entry.

Audatex is also the only estimating solution used on a global basis, with each of its key competitors only operating in one or two regions. In addition to the obvious scale benefits, this global footprint has been instrumental in enabling the company to secure international partnerships with major players such as Allianz, AXA and Liberty Mutual.

Exhibit 2: Competitors by geography

Geographic presence	Solera	CCC	Mitchell	EurotaxGlass's	DAT
North America	✓	✓	✓		
South America	✓		✓		
Europe	✓			✓	✓
Middle East	✓				
Africa	✓				
Asia-Pacific	✓			✓	

Source: Solera

Workflow solutions

Solera supplies workflow solutions to both independent appraisers (eg estimate writing, total loss evaluation) and insurers (eg first notification of loss, claims-handling workflow, compliance solutions).

The 2011 acquisition of Explore for $520m was Solera's largest since IPO, expanding the offering into re-underwriting solutions for insurers. These solutions help underwriters in the US and Canada to identify and model risk using decision support software underpinned by data matching and predictive analytics. Examples include solutions to notify the insurer of a change in risk profile due to driver violations, the registration of a newly qualified driver, or the driver moving to an area more prone to damaging hailstorms. Explore also provides solutions into the home insurance segment, such as fire and hail risk-scoring tools.

In the US, Solera has combined its Audatex automotive claims-related business with Explorer under the banner Auda Explorer, with organic growth contributing 16% ($2.2m) of the overall revenue growth witnessed in Q213.

Consumer-focused products are also being developed (eg mobile and internet-based repair status tracking) and are seen as an important area of innovation given the power of mobile technologies to add transparency to the estimating and repair processes. A particular focus is on developing products attractive to 'Generation Y' using mobile technology, social networking and 'gamified' user interfaces to enhance appeal to the upcoming generation of car owners.

Recycling and salvage

Solera's Hollander business provides salvage and yard management systems and parts-locating software to the automotive recycling industry in the US and Canada. This business was established in the 1930s and acquired in 1992 by ADP. Again, the solution combines a proprietary database for identifying interchangeable automotive parts with software to assist in the identification of parts, track inventory and exchange data. In 1993, Hollander launched EDEN, an automated parts-locating network linking recyclers across the US and Canada, and in 2010 it launched e-Link, allowing recyclers to automatically generate eBay listings and sell parts direct to consumers or trade across the globe. More recently, through the acquisition of APU (October 2012, undisclosed amount), a cloud-based locator of recycled, aftermarket and surplus equipment management, Solera intends to link the Hollander recycled inventory system with collision shops using Audatex.

AUTOonline (acquired in October 2009 for an estimated $120m including earn out) is Europe's largest trading portal for crashed and used vehicles. The business is based in Germany, which, as the hub of the European automotive industry, still accounts for the majority of trade. However, by leveraging Solera's international footprint, the business has doubled its geographical footprint to 28 countries (as far afield as South Africa and China) and values over 1m vehicles annually.

Acquisition strategy

Solera has made 19 acquisitions since IPO, investing more than $960m over this period. Most of these have been relatively small, for undisclosed amounts, with the largest being the acquisition of re-underwriting solutions provider Explore for $520m in June 2011.

Describing its approach to M&A as "industrialised private equity", the company vets targets based on three fundamental criteria:

- **Management capability**. Solera invariably seeks to retain management, incentivising them to realise the leverage gained through the Solera platform. Earn-outs are integral part of the incentivisation strategy.
- **Margins.** With sales and cost synergies, EBITDA margins are expected to be brought up to the 45% level of the core business within approximately 18 months. Delivery on the 2020 $2bn revenue target may well require larger-scale acquisitions running with substantially lower margins than Solera. This explains the lower 40% ($800m) 2020 EBITDA target, although significant margin improvements will still be targeted and 40% is seen as a floor level, which management hopes to exceed. The company has improved EBITDA margins of the companies it has acquired by over 15 percentage points on average (deals closed for over 12 months as of 7 May 2013).
- **Core business.** The strategic fit with the core business is determined by the target's ability to **leverage** the company's position in a particular geography or **domain**, **diversify** the offering or geographical footprint, or disrupt the market.

Sales synergies are typically generated through Solera's improved sales leverage in the target's domestic market. It then looks to roll out the solutions into international markets where the fit with the established business and prevailing market dynamics are deemed good. Cost synergies come from reduced central costs and "delayering" through Solera's rigorous approach to waste reduction.

The mathematical average EBITDA multiple paid for acquisitions at closing has been 9.2x. Management has commented that high pricing expectations have stymied the rate of mid- to large-sized deal flow lately, but maintaining price discipline is made easier by alternative options in most cases. Nevertheless, for unique, strategically important assets, as was the case with Explorer, Solera has been prepared to pay low double-digit EBITDA multiples based on the target's financials at the time of acquisition. Through generating substantial sales and cost synergies, robust accretion is expected within a one- to two-year timescale. Explore was acquired at respective EV/sales and EV/EBITDA multiples of 6.7x and 15.3x, although a 15-year tax benefit estimated at $120m brought these down to 5.2x and 11.8x. With synergies expected to drive robust double-digit EBITDA growth, the EBITDA multiple is expected to fall close to single digits based on FY13 performance.

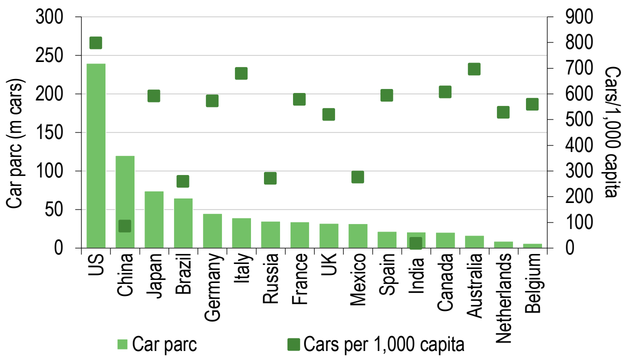
Global markets and international strategy

Evolving and emerging geographies driving market growth

Overall, global spend on collision repair and claims is estimated at $150bn and growing at 5-6% annually, primarily driven by increasing car sales, usage and accident rates in evolving and emerging markets.

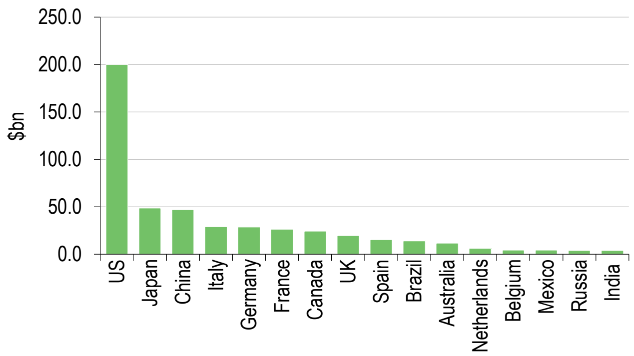
The addressable market for Solera's products and services in a particular geography is defined by a number of factors, including the number of cars on the road (car parc), accident rates, the percentage of cars insured, average repair costs and the maturity of the insurance/repair industries.

Exhibit 3: Car parc and penetration by country 2011



Source: Various sources

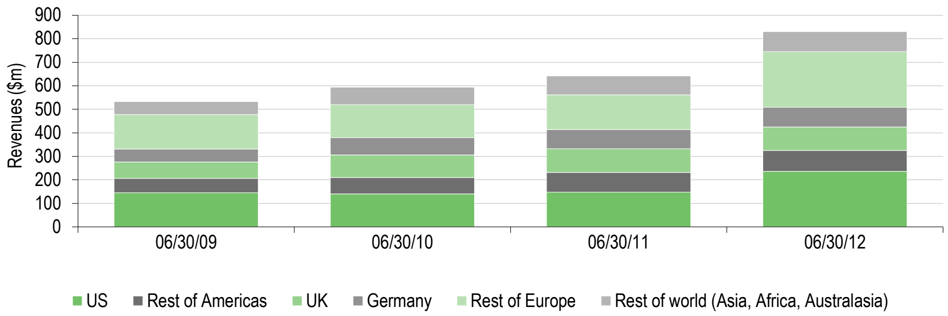
Exhibit 4: Gross motor insurance premium 2011



Source: Association of British Insurers, Lloyd's

Solera has a global footprint, with a number one or two position in all its key markets. It has expanded the number of countries in which it operates from 49 in 2007 to 63 and has plans to expand this to 100 by 2020.

Exhibit 5: Revenues by geography



Source: Company information

The company categorises its geographical markets into three segments: advanced, evolving and emerging (see Exhibit 6).

Advanced markets account for the vast majority of revenues, and sustained low to mid-single-digit growth is targeted primarily through broadening the range of products offered. The company launched the Highly Established Markets Initiative (HEMI) in August 2010, designed to drive growth in the US through investing in innovative products that either deliver improved value to the core products or diversify the business around the company's key customers. Similar principles are also being applied in other advanced markets. As a result, only 45% of sales in advanced market revenues are directly dependent on automotive claims volumes, as opposed to 54% for the business as a whole. The company is also increasingly looking to leverage its footprint in automotive to expand into the property insurance segment. As a result, the company is now measuring progress in advanced markets in terms of revenue per household, rather than revenue per claim. Annualised revenue per household in Q3 was $2.73, up 8.5% y-o-y. Management estimates that its penetrated revenue opportunity across advanced markets is around $10, with the potential to reach $20 in very advanced markets where the company offers a very broad bundle.
Evolving markets, such as China, Brazil and Mexico, present the most obvious organic growth opportunity as the car parc grows rapidly, and a developing insurance/repair industry expands the addressable market for Solera's products and services. **Emerging markets**, with China the largest example, accounts for only a small proportion of sales, and while the car parc is growing, the growth opportunity is suppressed by low insurance rates, fragmented repair industries and low average repair values.

Exhibit 6: Types of market and characteristics

	Market characteristics	Solera characteristics	Main geographies	Sales FY12	Anticipated growth rate
Advanced	High car penetration and a highly developed insurance/repair industry	Profitable. Lower organic growth. Investment in diversifying solution set and disruptive technology.	US, Western Europe, Canada, Australia	83%	4.5%-5.3%
Evolving	Growing vehicle penetration and a developing insurance/repair industry	Profitable (typically higher margins than advanced markets) and growing at a healthy rate.	CEE, Russia, LATAM	16%	15-20%
Emerging	Low but growing vehicle penetration and an immature insurance/repair industry	In a 3/5 year investment phase. Not yet break-even.	China, India, Turkey	1%	40%-59%

Source: Company data, Edison Investment Research

US (30% of 2012 sales)

The US is Solera's most important (and heavily scrutinised) geography, although with 30% of 2012 sales coming from the region, its US revenue weighting is lower than for many US software companies.

While the US represents the largest addressable market for Solera’s products by some margin, leading the world in terms of new car sales, car parc, and a high average repair cost, it is also mature and one of the most competitive. Unlike Europe, Solera is not the leading market player in the core estimatics market, holding a number two position, with an estimated 30% market share, behind CCC (50%) and ahead of Mitchell (20%). Historically, margins also lagged the rest of the world, but through its HEMI initiative and good cost control, EBITDA margins across the Americas have expanded from 43% in 2009 to 53.7% in 2012 (excluding central costs). The competitive situation means that price-based competition is more prevalent than in other geographies. Management’s decision not to compete on price has contributed to the loss of a large customer, AllState, at the end of 2011, when Solera was unprepared to meet the insurer’s low price expectations, which depressed overall growth by 1% (c $2m) and 2.5% (c $5m) in Q2 and Q3 respectively.

Solera’s strategy for growth in the US (as with other advanced markets) is to out-innovate and out-invest the competition. Through the HEMI initiative, investment in expanding and enhancing the product set has been stepped up, both organically and through acquisitions. Targets are selected for their ability to gain leverage from the Solera platform, diversify the offering or provide a disruptive entry point into adjacent markets.

Europe (57% of 2012 sales)

With a strong market leadership position in the main markets, exposure to Europe is significant, with 57% of sales coming from the continent in FY12. Clearly, the weak economic situation creates a headwind. Major markets such as Germany, the UK and the Netherlands are mature, and HEMI principles are also being applied in these regions. Acquisitions such as HPI, Carweb (vehicle history and specific technical data) and AUTOonline (damaged/fleet car trading portal) have diversified revenue streams beyond Audatex. The company also believes it can disrupt the parts procurement supply chain through cross-introducing a solution originally developed in Brazil (acquired from the 2008 Inpart acquisition). Evolving markets such as Russia and other CEE geographies offer structural growth opportunities. An improvement in the economic situation in Europe would be one of the largest potential catalysts for acceleration in growth, but we see little evidence to suggest such a scenario is likely in the near or medium term.

UK (12% of 2012 sales) – The UK is Solera’s second-most important market, accounting for 12% of 2012 sales. The company has a strong leadership market position in estimatics (ahead of EurotaxGlass’s). This is supported by a broad range of other solutions, including CarWeb (workshop data) and HPI (vehicle history). With all top 25 insurers as customers, the most obvious growth opportunity comes from cross-selling more solutions to this customer base. Sales declined 2% in 2012, and we expect the market to remain difficult, with claims volumes suppressed by the economic environment. High insurance costs and the overall income squeeze have resulted in a significant drop-off in young people taking driving tests (down 20% in five years) and owning cars, creating a longer-term structural challenge. More immediately, sterling's recent depreciation versus the dollar creates a headwind.

Germany (11% of 2012 sales) – Germany is also a mature market for Solera, with growth driven by product extensions. Despite a recent deterioration, generally the economic and automotive claims environment looks more robust than the UK. Market share is strong, with the company holding a large majority share of the electronic claims-processing market. Strong relationships with global German companies such as Allianz, BMW, Mercedes and VW have also provided important leverage in overseas markets. For example, Solera has a global relationship with Allianz,[1] and has benefited from the insurer standardising operating procedures across geographies. Relationships with Mercedes, VW and BMW are key to the company's strategy in China. Good international leverage has also been generated from the 2009 acquisition of AUTOonline, Germany's leading used/damaged car trading portal, which now operates in 28 countries, more than doubling its international presence since acquisition. AUTOonline has recently extended its product offering into the fleet/lease market, tripling its addressable market to 3m vehicles in Germany alone.

Rest of Western Europe – This region is a patchwork of advanced markets facing various severities of economic challenges. Solera's market position is particularly strong in Benelux, Spain and Portugal. It is worth noting that despite the severe impact of the economic turmoil, the company achieved mid-single-digit revenue growth in Portugal and Spain in 2012. To put this in context, the performance in Portugal has been achieved despite a 20% reduction in automotive claims from the peak and 30% of body shops closing down.

CEE and Russia – Sales and EBITDA have grown by c 25% annually in CEE since 2009, driven by a combination of rising car usage, increasing sophistication of the insurance/repair industries, footprint expansion and adding more products to the bundle. These dynamics should continue to be broadly supportive, and we would expect the company to further expand its geographical footprint to cover most of the 28 countries in the region, up from 17 at present.

Latin America

Latin America presents a robust growth opportunity, with car ownership growing, a high accident rate and competition coming mainly from paper-based systems. Brazil and Mexico are already important markets for Solera. Mexico has recently broken into the company's top 10 revenue-contributing countries. Brazil is now the fourth-largest car producer globally and has the fourth largest car parc, although only around 40% is insured. However, it is the third-largest market globally for new car sales (3.8m sold in 2012) and c 70% of these are bought using finance, where insurance is compulsory. Solera offers Audatex, AUTOnline and InPart in Brazil, the latter of which is an electronic exchange for the purchase and sales of vehicle replacement parts, acquired in 2008. Solera has relationships with seven of the top 10 insurers.

China

Solera's ability to scale up its business in China could be a key value driver for the business. Revenues within the region are still modest, but the Chinese team has the ambition to become the number one geography for the company by 2020. This is clearly an ambitious target, but with the second-largest car parc globally after the US, and new car sales volumes exceeding the US, the region has the potential to grow into a major market for the company.

Having initially entered the market in 2007, the challenge for Solera has been that its proposition has been diluted by low average repair costs and widespread use of non-dealer parts within the low to mid-range. To circumvent this and to gain leverage from affiliation with high-end brands, Solera is

[1] Allianz is the third-largest insurer globally by market capitalisation.

penetrating this market from the top down through relationships with premium OEMs. BMW and Porsche have mandated the use of Audatex in their repair networks to control and improve the aftermarket experience. Solera also has relationships with Mercedes, Volvo and VW. To build on this position, we will be looking for the company to secure similar relationships with the major mid-market manufacturers, such as Toyota, Nissan and GM, and to establish more extensive relationships with the three major insurers that account for 75% of all policies in the country. From a product perspective, the focus now is on cementing Audatex's position in the region, with leverage from other products likely to come later. Primary competition comes in the form of Gingyou, a local (typically non-dealer) parts database supplier, founded around 10 years ago, which has established a position with repair networks and insurers.

Structure and management

Solera has a mission-based culture, as exemplified by the "Mission 2020", $2bn sales $800m EBITDA target. It operates a decentralised structure, with key divisions and geographies run by "Alpha leaders", who are attractively incentivised to drive local sales and profits, but also to drive the international sales of locally developed products.

Tony Aquila – founder, chairman and CEO. Mr Aquila defines Solera's mission-based culture, following a set of organisational principles based around prioritisation, accountability and re-investing savings from waste reduction. He has over 20 years' experience in the insurance and automotive repair industry. He founded and sold MaxMeyer America Inc, an importer and distributor of European finishing products, before founding Ensera, which developed software to streamline automotive repair workflows. Ensera was sold to Audatex competitor, Mitchell International, where he became president and COO from 2001-04. He founded Solera in early-2005 with a vision to transform the automotive insurance claims industry, partnering with private equity firm GTCR Golder Rauner to acquire ADP for $975m in 2006.

Renato Giger – CFO. Before becoming CFO in July 2010, Mr Giger was Solera's global corporate controller (from 2009) and CFO of EMEA (from 2006). He has been with the company since the acquisition of Claims Services Group from ADP in 2006 and worked with predecessor companies for 13 years.

Sensitivities

Overall, we believe Solera has a resilient, predictable financial profile, with a diverse customer base (no customer accounted for more than 2% of sales in 2012), broad geographical exposure and a transaction/subscription-based revenue model offering good visibility. The key sensitivities to the investment case, as we see them, are:

- **Currency** – With 30% of 2012 revenues derived outside the US, the company is exposed to currency swings, although transactional risk is partly mitigated by a decentralised cost structure. On the 2012 business mix, a 1% strengthening of the US dollar versus other currencies would have negatively affected sales by 0.6% and EBITDA by 0.7% (and vice-versa).
- **Economic activity** – In times of economic hardship, people drive less, buy fewer cars, and are less likely to repair their cars. Solera has seen an impact from the financial crisis, and repair volumes in most European countries are still well below their pre-crisis peak. Our forecasts do not assume a recovery in Europe. Any recovery could drive upside to our estimates and equally a further economic shock, downside.
- **Evolving market uptake** – Solera's potential to grow revenues in evolving markets, such as China, Brazil and Mexico, is a key element of the investment story. While growth in car usage looks assured, the insurance and repair industries may be slower to evolve, suppressing

Solera's growth opportunity. The opportunity in China still carries substantial execution risk, but broader penetration could drive upside to our estimates.

- **Acquisitions and valuation expectations** – Solera's acquisition leverage depends on its ability to make the right acquisitions at the right price and then generate synergies to bring financial performance in line with the rest of the group. High valuation expectations or increased bid competition could hamper its progress. Larger acquisitions will be targeted to deliver on the 2020 target. Retaining similar leverage for larger deals may be challenging.
- **Competition** – Customer exposure is low, but the loss of Allstate in 2011 is negatively affecting growth. State Farm is thought to be considering moving to a sole supplier (from three currently) and is operating on a short-term contract. Revenue exposure is currently just over 1% of annual sales, giving an indication of the potential upside or downside impact if Solera survives the cut or not.

Financials

Revenue model: Transaction and subscription based

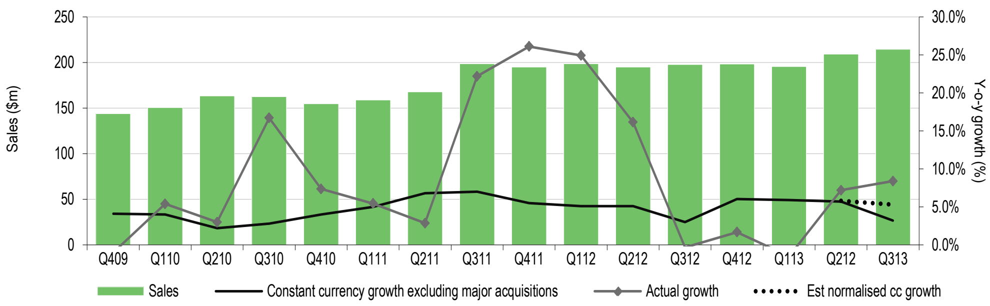
Solera's solutions are mostly delivered via a hosted, client/server or web-based model to enable access to the proprietary, centralised databases. Around 70% of sales are related to the automotive claims cycle, with 54% generated on a transactional basis, charging a fee per transaction (the predominant model for Audatex). Approximately 16% of sales are generated by subscriptions, which are also related to repair volumes (eg a subscription fee that covers a set monthly volume of transactions). The remaining 30% of sales are generated from monthly subscriptions, not related to the claims cycle.

Transaction revenues are recognised when the transaction is completed. Subscription services are charged and recognised on a monthly basis. While the bulk of revenues are not contractually recurring, they are predictable and recurring in nature. Revenue visibility has been improved by an acquisition-driven shift in revenue mix toward subscriptions, which has helped reduce direct revenue dependence on volumes from 95% of sales in 1996 to 54% level as of Q313 (and 45% advanced markets).

Stable, mid-single-digit organic growth

Overall, sales have grown at a CAGR of 11% from 2007 to 2012, although the depreciation of the euro (13%) and sterling (27%) supress this figure by 1-2%. The 'pure' organic growth rate is difficult to isolate, but post-2009 constant currency growth excluding major acquisitions has averaged around 4.7% p.a. and has been trending up of late, averaging 5.2% over the past 12 months. Stripping out the negative impact from the loss of Allstate and positive impact from Sandy, we estimate underlying growth in Q2 and Q3 was c 5.5% (vs 5.7% and 3.2% unadjusted).

Exhibit 7: Quarterly revenue growth



Source: Company data, Edison Investment Research. Note: Normalised growth excludes the estimated negative impact from the loss of AllState and positive impact from Hurricane Sandy.

Estimates

Our estimates are cautious, assuming an overall growth rate of 5.3% in FY14 (which will include the full year benefit from acquisitions), in part reflecting currency movements (sterling's 7% slide versus the dollar since the start of Q3), but also the expectation of a generally difficult trading environment in Western Europe.

Exhibit 8: Revenue model

Revenue model	FY10	FY11	FY12	FY13e	FY14e
US	140.6	147.4	236.2	263.5	275.4
UK	95.2	100.6	98.7	102.1	103.2
Germany	73.9	81.5	84.8	85.2	86.9
Rest of Europe	240.3	257.8	266.6	270.1	283.6
Rest of Americas	70.0	84.3	89.6	97.3	109.0
Rest of world (Asia, Africa, Australasia)	11.5	13.1	14.3	16.4	18.7
Other	81.5	97.4	103.8	111.9	127.7
Total	**631.3**	**684.7**	**790.2**	**832.8**	**876.7**
Growth (CC)					
US	-4%	5%	60%	12%	4%
UK	38%	5%	-1%	4%	2%
Germany	31%	13%	6%	4%	1%
Rest of Europe	14%	10%	5%	5%	4%
Rest of Americas	17%	20%	6%	9%	12%
Rest of world (Asia, Africa, Australasia)	-40%	15%	9%	15%	14%
Other	3%	20%	7%	8%	14%
Total	**13.2%**	**8.5%**	**15.4%**	**5.4%**	**5.3%**

Source: Company data, Edison Investment Research

Margins

Driven primarily by improving profitability of the US operations, adjusted EBITDA margins have expanded from 30% in 2007 to 43.7% in 2012. The company's target operating model is 45% and while investment in growth (acquisitions of lower-margin business, accelerated investment in product development) and the weak European trading environment have prevented this figure being reached at group level, margins remain exceptionally strong compared to most software companies. In our view, this reflects the strength of Solera's market position in key markets, its value proposition and a rigorous approach to waste reduction.

Exhibit 9: P&L – Margin and adjustments summary

$m	FY10	FY11	FY12	FY13e	FY14e	Comment
Sales	631.3	684.7	790.2	832.8	876.7	
Growth	13.2%	8.5%	15.4%	5.4%	5.3%	Expect constant currency organic growth of 5-6%. Could tick upwards.
Gross profit	432.6	481.1	544.5	571.9	602.0	
Margin	68.5%	70.3%	68.9%	68.7%	68.7%	
EBITDA Adj	261.9	295.3	345.5	355.5	373.5	
Margin	41.5%	43.1%	43.7%	42.7%	42.6%	Operational model is 45%. Some compression due to accelerated investment in HEMI, digesting lower-margin acquisitions. 2020 target of 40% factors in potential margin dilution from larger acquisitions.
EBIT adj	237.6	270.0	317.7	327.3	345.3	
Margin	37.6%	39.4%	40.2%	39.3%	39.4%	
Other unusual costs	(9.9)	(16.8)	(15.0)	(32.7)	(32.7)	Restructuring, acquisition related. Should reduce in the absence of acquisitions.
Amortisation of acquired intangibles	(64.7)	(57.8)	(75.7)	(75.0)	(80.0)	
Share-based payments	(9.6)	(13.6)	(18.4)	(26.4)	(26.4)	
Minority Interest (add back)	9.7	11.7	11.4	10.9	11.4	
Operating income GAAP	163.1	193.5	219.4	204.1	217.7	
Margin	25.8%	28.3%	27.8%	24.5%	24.8%	
Net Interest	(30.9)	(29.0)	(52.7)	(69.7)	(67.1)	
Net Income adjusted	148.8	173.5	190.8	185.4	200.3	
Net income GAAP	84.4	157.3	107.5	84.6	95.4	
EPS Adj FD ($)	2.13	2.46	2.71	2.68	2.89	
EPS GAAP FD ($)	1.30	2.38	1.55	1.24	1.37	

Source: Company data, Solera

Given these attributes, and factoring in ongoing investment in growth, we forecast adjusted EBITDA margins of 42.7% and 42.6% for 2013 and 2014 respectively. Solera's 2020 mission of achieving $2bn turnover and $800m EBITDA implies a compression in EBITDA margins to 40%, which we believe gives the business latitude to buy larger businesses with lower operating margins. The 40% margin target is also seen as a 'floor', which management hopes to outperform.

Robust cash generation

With stable growth, high margins, modest capex (averaging less than 4% of sales) and working capital demands (total working capital outflow from 2010 to 2012 has been just $12m), Solera's underlying cash generation is robust. Free cash flow from operations (excluding acquisitions and interest) to EBITDA has averaged 73% over 2011 and 2012. Earnings are strongly cash-backed, with free cash flow per share (inc interest payments) matching up very favourably to adjusted EPS.

Exhibit 10: Free cash flow vs adjusted EPS comparison

	2011	2012	2013e	2014e
Free cash flow per share (including interest payments)	2.68	2.71	2.61	2.83
Adjusted EPS	2.46	2.71	2.68	2.89

Source: Company data, Edison estimates. Note: Free cash flow = cash flow from operations – capex and capitalised intangible assets + proceeds from the sale of property and equipment.

Solera returns cash to shareholders through dividends (DPS has increased from $0.25 in 2010 to $0.40 in 2012) and via a share repurchase programme authorised in November 2011, through which it has bought around 3.6% of outstanding share capital at an average price of $46.7. As of Q313, around $59m of the $180m programme had yet to be used.

Comfortable balance sheet position

Net debt at Q313 stood at $699m, comprising $447m cash and equivalents, $1,143m long-term and $2.8m short-term debt. The debt comprises unsecured debt totalling $855m at FY12 with a nominal 6.75% interest rate, paid semi-annually, and secured debt facilities of $106.5m and €142.8m, paid quarterly at a rate of LIBOR/EURIBOR +3.0%. The secured debt matures in 2017 and unsecured in 2018. The interest on the unsecured debt is relatively high, in part because covenants are relatively light. A make-whole call provision may give the option to reduce this in the 2015 timescale. Net debt to trailing 12-month EBITDA was a comfortable 2x in Q313. Management states it would be comfortable pushing net debt/EBITDA up to c 3x to support the appropriate acquisitions.

Valuation

Leverage from strategy, acquisitions not being priced in

Overall, the shares do not look mispriced with estimates as they stand, but we feel that short-, medium- and longer-term estimates have scope for upside that should follow through in share price performance. In the short term, guidance was nudged up at both the Q2 and Q3 results, and we see scope for this trend to continue as the contribution from higher-growth evolving and emerging markets increases, and as investment in expanding the product suite bears fruit in advanced markets. Looking longer term, the potential leverage from future acquisitions under Solera's 'industrialised private equity model' should continue to drive value, but clearly cannot be factored into estimates.

DCF sense check – scope for upside

A reverse DCF approach suggests the market is pricing in broadly consistent growth with minimal margin expansion from current levels, ie 5% organic growth with EBITDA margins of 40%. (Our 2013 forecast EBITDA margin, including restructuring, deal-related and other unusual costs is 39% or 43% when excluding these factors.) As we highlighted above, if Solera was to move into a 'harvest mode' and not make further acquisitions, we would expect exceptional costs to fall away and adjusted EBITDA margins to expand, closer to Solera's 45% group level. This scenario would suggest a valuation of c$65, while execution on the longer-term, acquisition-enhanced growth strategy offers significant potential above this level.

Exhibit 11: DCF Valuation sensitivity to mid-term (to 2020) growth and EBITDA margins

Mid-term growth EBITDA margin	4%	5%	5.5%	6%	7%
38%	51.1	53.9	55.3	56.8	59.8
40%	54.2	57.2	58.7	60.3	63.5
41%	55.8	58.8	60.4	62.0	65.3
42%	57.4	60.5	62.1	63.8	67.2
43%	58.9	62.1	63.8	65.5	69.0
45%	62.1	65.5	67.2	69.0	72.7

Source: Edison Investment Research. Note: Cost of debt 6%, WACC 8.8%, terminal growth rate 2.5%.

Peer analysis

A lack of direct peers prevents us from using a peer analysis as our primary valuation methodology. In Exhibit 12 below, we compare Solera to a selection of companies sharing a similar business model – providing a combined data and software offering across a broad range of industries, companies supplying into the automotive repair and salvage industry (albeit with very different business models) and software companies supplying into the insurance industries.

On a P/E basis, Solera trades toward the premium end of its peer group. Given its robust, cash-backed earnings profile and high margins, combined with its potential to grow and gain leverage through acquisitions, we believe this is entirely justifiable.

Exhibit 12: Peer comparison

			Share price (local)	Market cap (local m)	Current EV/S	Next EV/S	Current EV/ EBITDA	Next EV/ EBITDA	Current P/E	Next P/E	Current EBIT margin	Next EBIT margin
Data and software providers												
Solera Holdings	**30/06/2013**	**US$**	**56.6**	**3,917**	**5.5x**	**5.0x**	**12.8x**	**11.8x**	**21.1x**	**19.6x**	**39%**	**39%**
CoStar Group	31/12/2013	US$	111.3	3,174	7.4x	6.6x	35.2x	24.6x	51.1x	40.2x	12%	17%
Dun & Bradstreet Corp	31/12/2013	US$	93.5	3,736	2.9x	2.9x	8.5x	8.2x	12.4x	11.5x	29%	31%
FactSet Research Systems	31/08/2013	US$	96.1	4,228	4.7x	4.4x	12.4x	11.4x	20.2x	18.2x	33%	34%
IHS	30/11/2013	US$	102.0	6,704	4.4x	4.0x	13.9x	12.0x	23.0x	19.3x	24%	26%
MSCI	31/12/2013	US$	33.9	4,091	4.6x	4.4x	10.6x	10.2x	15.8x	14.9x	36%	36%
Thomson Reuters Corp	31/12/2013	US$	34.5	28,590	2.7x	2.6x	10.1x	9.6x	18.9x	17.1x	16%	17%
Verisk Analytics	31/12/2013	US$	60.3	10,154	6.7x	6.2x	14.7x	13.4x	26.1x	23.0x	38%	39%
Automotive repair/salvage												
Copart	31/07/2013	US$	36.1	4,532	4.7x	4.5x	12.9x	11.8x	23.3x	20.4x	32%	33%
Dealertrack Technologies	31/12/2013	US$	30.4	1,320	2.8x	2.5x	11.9x	10.5x	24.3x	21.0x	6%	9%
LKQ Corp	31/12/2013	US$	24.5	7,316	1.8x	1.6x	13.7x	11.8x	23.2x	19.3x	11%	12%
Insurance software												
Guidewire Software	31/07/2013	US$	42.5	2,397	7.6x	6.3x	48.9x	40.9x	89.2x	89.2x	14%	14%
Innovation Group	30/09/2013	£	26.8	261	1.1x	1.0x	8.1x	7.2x	17.8x	15.7x	10%	11%

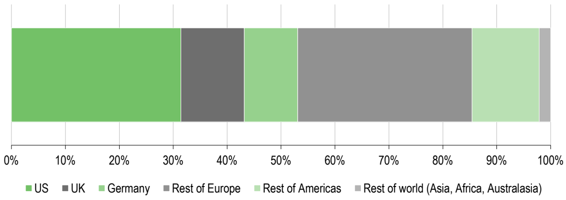
Source: Bloomberg consensus, Edison Investment Research estimates. Note: Priced as at 13 May 2013.

Exhibit 13: Financial summary

	$m	2010	2011	2012	2013e	2014e
June						
PROFIT & LOSS						
Revenue		631	685	790	833	877
Cost of Sales		(188)	(199)	(204)	(246)	(261)
Gross Profit		443	486	587	587	616
EBITDA		262	295	346	356	373
Operating Profit (before amort. and except.)		238	270	318	327	345
Acquired Intangible Amortisation		(65)	(58)	(76)	(75)	(80)
Share based payments		(10)	(14)	(18)	(26)	(27)
Exceptionals		(10)	(17)	(16)	(33)	(33)
Minority interest (add back, excluded from adjusted figs)		10	12	11	11	11
Operating Profit		163.1	193.5	219.4	204.1	216.6
Net Interest		(31)	(29)	(53)	(70)	(67)
Profit Before Tax (norm)		207	241	265	258	278
Profit Before Tax (GAAP)		132	165	166	134	150
Tax		(32)	14	(46)	(37)	(42)
Profit After Tax (norm)		149	174	191	185	200
Profit After Tax GAAP)		100	179	120	97	108
Average Number of Shares Outstanding (m)		69.6	70.4	70.2	68.8	68.8
EPS - normalised ($)		2.14	2.47	2.72	2.69	2.91
EPS - normalised and fully diluted ($)		2.13	2.46	2.71	2.68	2.89
EPS - (IFRS) ($)		1.30	2.38	1.55	1.24	1.37
Dividend per share ($)		0.25	0.30	0.40	0.50	0.60
Gross Margin (%)		70.2	71.0	74.2	70.5	70.2
EBITDA Margin (%)		41.5	43.1	43.7	42.7	42.6
Operating Margin (before GW and except.) (%)		37.6	39.4	40.2	39.3	39.4
BALANCE SHEET						
Fixed Assets		979	1,608	1,463	1,459	1,390
Intangible Assets		911	1,476	1,330	1,318	1,241
Tangible Assets		53	65	59	67	75
Investments		14	68	74	74	74
Current Assets		365	543	670	652	812
Stocks		0	1	2	3	4
Debtors		100	136	129	136	143
Cash		241	371	508	483	635
Other		25	35	31	30	30
Current Liabilities		(147)	(217)	(183)	(194)	(204)
Creditors		(133)	(180)	(171)	(191)	(201)
Tax		(9)	(12)	(10)	0	0
Short term borrowings		(5)	(24)	(3)	(3)	(3)
Long Term Liabilities		(606)	(1,075)	(1,197)	(1,203)	(1,200)
Long term borrowings		(538)	(1,020)	(1,143)	(1,141)	(1,138)
Other long term liabilities		(68)	(55)	(54)	(62)	(62)
Net Assets		591	860	753	713	798
CASH FLOW						
Operating Cash Flow		263	282	326	322	338
Net Interest		(32)	(31)	(61)	(71)	(67)
Tax		(41)	(39)	(42)	(37)	(42)
Capex		(27)	(22)	(32)	(35)	(35)
Acquisitions/disposals		(83)	(525)	(16)	(141)	0
Financing		(5)	(1)	(117)	(31)	(0)
Dividends		(18)	(21)	(28)	(33)	(40)
Net Cash Flow		58	(357)	31	(25)	155
Opening net debt/(cash)		375	303	673	638	661
HP finance leases initiated		0	0	0	0	0
Other		13	(13)	5	2	(6)
Closing net debt/(cash)		303	673	638	661	513

Source: Company data, Edison Investment Research estimates

EDISON

Contact details	Revenue by geography
Solera Holdings Inc. 7 Village Circle, Suite 100 Westlake, TX 76262 Suite 100 +1 817 961 2100 www.solerainc.com	

CAGR metrics		Profitability metrics		Balance sheet metrics		Sensitivities evaluation	
EPS CAGR 2010 to 2014	7.9%	ROCE 2013e	23.6%	Gearing 2013e	92.7%	Litigation/regulatory	◖
EPS CAGR 2012 to 2014	3.4%	Avg ROCE 2010 to 2014	24.7%	Interest cover 2013e	4.7	Pensions	○
EBITDA CAGR 2010 to 2014	9.3%	ROE 2013e	30.2%	CA/CL 2013e	3.4	Currency	◖
EBITDA CAGR 2012 to 2014	4.0%	Gross margin 2013e	68.7%	Stock days 2013e	1.3	Stock overhang	○
Sales CAGR 2010 to 2014	8.6%	Operating margin 2013e	39.3%	Debtor days 2013e	59.7	Interest rates	◖
Sales CAGR 2012 to 2014	5.3%	Gross mgn/Op mgn	1.7	Creditor days 2013e	83.9	Oil/commodity prices	○

Management team

Founder, Chairman and CEO : Tony Aquila

Mr Aquila has over 20 years' experience in the insurance and automotive repair industry. He founded Ensera, which developed software to streamline automotive repair workflows, sold to Audatex competitor, Mitchell International, where he became president and COO. He founded Solera in early-2005 with a vision to transform the automotive insurance claims industry, partnering with private equity firm, GTCR Golder Rauner, to acquire ADP for $975m in 2006.

CFO: Renato Giger

Before becoming CFO in July 2010, Mr Giger was Solera's global corporate controller (from 2009) and CFO of EMEA (from 2006). He has been with the company since the acquisition of Claims Services Group from ADP in 2006 and worked with predecessor companies for 13 years.

Lead Director: Stuart Yarbrough

Mr Yarbrough is an investment banking professional. He joined Solera's board of directors in 2009. He is currently managing director of investment bank Moelis & Co. Previous experience includes senior positions at Bear Stearns and Donaldson, Lufkin & Jenrette.

Principal shareholders	(%)
Morgan Stanley	21.5
Neuberger Berman	7.6
Janus Capital Management	6.8
Timessquare Capital Management	6.1
Wellington Management	5.6
Blackrock	5.5
Vanguard Group	4.9

Companies named in this report

FactSet Research Systems Inc (FDS US), Thomson Reuters Corp (TRI US), CoStar Group Inc (CSGP US), Verisk Analytics Inc (VRSK US), IHS Inc (IHS US), MSCI Inc (MSCI US), Dun & Bradstreet Corp (DNB US), LKQ Corp (LKQ US), Copart Inc (CPRT US), Dealertrack Technologies Inc (TRAK US), ANSYS Inc (ANSS