

THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

TOM NIES - CINCOM SYSTEMS INC

published 06/03/2005 - DOCUMENT # ABW100

TOM NIES is CEO of Cincom Systems, Inc

Sector - Application Software

TWST: We'd like to begin, if you will, with a brief historical sketch of Cincom Systems, and a picture of things as they are now?

Mr. Nies: Cincom is one of the founders of the software industry. We were organized in 1968. Our foundations were laid in the areas of database management and applications development technologies.

In 1980 or so, began to provide applications systems with manufacturing and financial applications as well. Then, in the mid-1980s, we began to offer text and text management and text content systems.

During the latter half of the 1980s decade, we also provided Network Management Systems, and today offer CRM, Call Center and Configuration Management systems. In the applications development technology area, we provide Smalltalk offerings, which are major object-oriented technologies. We're now the world's leading Smalltalk provider as well.

In the past three years, we've expanded our offerings beyond software. We now provide outsourcing services for application development, application hosting, call centers and business process outsourcing.

TWST: And you've remained private throughout this time?

Mr. Nies: Yes, we've remained private all this time.

TWST: What is the general climate in your industry at this time?

Mr. Nies: It has become increasingly more competitive and also increasingly more demanding. Immense amounts of capital have been directed into our industry, both in IPOs and in major secondary offerings. And so the capacity in our industry relative to demand may have grown very substantially ahead of normal growth requirements. Our industry may need five to 10 years of consolidation to bring supply more in line with demand. Because supply is so significant, buyers now have an excellent situation.

TWST: What do you do to compete? What advantages do you have within that situation?

Mr. Nies: Whenever supply is greater than demand, pressure is on price, but in every other aspect of competitive performance as well. Cincom's differentiating strategy for the 21st century is to provide much higher value and to reduce overall costs as well. We also deliver very fast Return on Invested Capital, and we significantly Reduce Risk for customers. These four differentiating capabilities are at the heart of our corporate strategy. This is to consistently deliver a lot better value through high-quality products and services. Cincom's approach is to provide greater simplification through innovation and integration. These themes are our major strategic differentiations. Of course, quality, service, support, etc. are also of very great importance.

TWST: I've read that you place a great deal of emphasis on corporate culture. So perhaps you can tell us how your employees now contribute to the goals you are working on?

Mr. Nies: Almost every company tries to develop a corporate culture which operates in an ethical and moral way, and leverages and supports its strategic directions and performance capabilities as well. Almost every CEO today will also say that maximizing shareholder value is their number one objective. Although we're not public, we too try to work very hard at generating very good shareholder value by increasing the return on invested capital, profit margins, cash flow, and all the rest. To do that, we rely on everybody in the company to support and communicate our common and mutual goals, while we increase the productivity of all of our people in every way ethically possible. In the software industry, people costs are by far the largest single cost any company bears. We're no exception to that. So, productivity, teamwork and collaboration must be focused on bringing better value to our customers. Our corporate culture is a team-oriented, customer-focused, productivity-required kind of collaborative execution process which we all quite enjoy.

TWST: How many employees do you have?

Mr. Nies: Our total staff, including contractors, now total about 1,150 to 1,200 people.

TWST: When you say a contractor working for you, he's part of the same culture, right?

Mr. Nies: Yes. We try to include our allies as though they were our own staff. We operate around the world, and try to moderate or regulate our staff size to worldwide demand. This is not so easy as it once was. So we are increasing the percentage of our people who are not necessarily direct employees, but act or work as though they are, as a means to stabilize employment and to increase employment safety and security for all involved.

TWST: How many different locations are your people in?

Mr. Nies: We now operate in 37 locations around the world.

TWST: I was reading about the company, and you've done a great deal of writing and speaking. You really work hard at having one standard all across the board?

Mr. Nies: We operate globally and we must deliver consistently around the world. Many of our customers are in multiple locations, but even if they weren't, we must be consistent if we are to execute well.

Consistency has long been a hallmark of our company.

TWST: In the difficult situation that you've described, what would you say is the main opportunity lying ahead for the company?

Mr. Nies: We anticipate a substantial amount of future consolidation in our industry. By that we mean larger companies buying smaller companies. Oracle acquiring PeopleSoft is one good example of that. But we think we are also going to see mid-tier and others also being consolidated. As that happens, the seller gains immediately because they usually sell their company at a nice premium. The buyer then has to justify and recover the premium paid for that acquisition. Usually this means reducing overall industry capacity by reducing staff, eliminating product lines, and further consolidating activities. We believe that as excess supply is so reduced, there will be increasing opportunity for us. For example, Siebel is now being rumored to be an acquisition target. Cincom has offerings in the CRM space. So, this acquisition, if it happens, should help us quite a lot because the uncertainty surrounding the acquisition and potential liquidation and dismemberment of a Siebel should further increase the preference for Cincom.

TWST: With all these things in mind, in a general way, what would you reasonably expect the company to look like about three years from now?

Mr. Nies: We will be offering far more integrated services and support than we now offer. Our goal is to provide greater simplification through innovation and integration. We will become more and more an outcome or results-based company, which will include software, services, even taking complete responsibility for the entire operation of the company's requirements.

TWST: Perhaps you could go on from there then to tell us something about your own career? How have you developed your career and ideas over the years?

Mr. Nies: Some might credit hard work. But one can't overlook luck. I've had the good fortune to be in the right place at the right time. By working with IBM through most of the 1960s, I gained a foundation for strategic thinking, a worldwide approach, high-quality services emphasis, and a customer oriented focus approach. But, over time we saw the ever increasing need to deliver very high quality, and extremely good value to boot.

We moved away from having only a fast growth strategy, which helped to grow our company about 600-fold from 1969 to 1984, to become also a high value, high quality delivering organization as well. Over the years, as our size has increased, our growth rate has slowed. But I think the value generation, the value contribution we provide to customers, has significantly increased in the last 15 years. This value-oriented emphasis has been one of the reasons for our longevity – and increasing success. We believe the software industry is going to continue to be one of the most important industries throughout the entire 21st century. We're not in business to maximize ourselves over a seven- to 10-year lifecycle. We are a company that's built to last, and a

company that's striving to go from being a good company to become a truly great company. But, our ongoing goal is to thrive, not just to survive.

TWST: Then with all these things in mind, can you tell us something about your approach to R&D?

Mr. Nies: Consistently we have invested about 20%-25% of revenues into R&D. At one time we believed, along with many others, that marketing and sales was the name of the game in the software industry. But we're in a field where technology cycles change fast. And with technology cycles now changing very fast, one cannot expect to have a 10-15 year lifecycle in technology any more. Three to five years is about it. Anything beyond that is a bonus. So, investing heavily in research and development to keep technologies moving forward, having competitive advantages, fulfilling customer requirements, and also being able to compete in an intensively competitive environment are all becoming increasingly important as both near-term and longer term survival imperative. So R&D is just as key for us as is marketing, sales and support.

TWST: Now this suggests to me, but of course I could be wrong, that your R&D is both customer related and also some might be, what we might call pure R&D as well?

Mr. Nies: That's correct. Some pure R&D, but most of our R&D is focused on delivering what our customers really want, really need, and will buy – now. Pure R&D, trying to advance the state of the art, is important. But 85%-90% of all of our R&D investment is in technologies that we know there's a need for and will deliver great customer value.

TWST: For you, as CEO, how close can you stay to tech at this time?

Mr. Nies: With the increasing complexity of our science and with the multiplicity of technologies, it becomes increasingly more difficult as we scale up for me to be close to all of the technologies. So we're technologically organized around what we call STAR teams. These teams would be the counterpart to a Brand Manager function for Procter & Gamble. Our STAR teams cover all aspects of product requirements, direction, competitive aspects, marketing support, potential and so on. These teams all report to one senior executive, who reports directly to me. My interest is not personally understanding or managing all technologies, but making certain that we are doing everything necessary to be sure that these pursuits are being well and ably managed.

TWST: Are you open to outside investors?

Mr. Nies: We are open to outside investors in various aspects of our business, but not yet into the overall corporation. We do have a number of different subsets of our business that are open to investment. And these are areas where we see tremendous growth that we can't totally fund to the fullest degree necessary.

TWST: What areas, for example?

Mr. Nies: We provide a lot of technology that greatly increases the productivity and capability in certain industries. Acquisition and consolidation are options we are considering to more readily leverage our current capabilities.

TWST: What were the two or three best reasons for a long-term investor to consider investing in one of your subsets?

Mr. Nies: The top three reasons are Return on Investment, Return on Investment and Return on Investment. Cincom is consistently delivering return on invested capital that may be the best in the software industry. We expect to be able to offer investment opportunities well in excess of possibilities typically found elsewhere. That's our key attraction for capital.

TWST: Could you then perhaps make a summary statement on your vision for the company?

Mr. Nies: Our vision is to grow our performance on those four foundations I mentioned earlier: higher value for the customer; low overall total cost; low risk on investment; and significant return on investment for the customer. We intend to accomplish these objectives by providing increasingly greater simplification through innovation and integration.

From our standpoint, the vision for the company is to continue to deliver excellent return on invested capital that is among, or above, the very best rates achieved in our industry — or any industry. But to increase revenues at the same time we're increasing margins and return on invested capital is an ever increasing challenge as size and scale increase. But we believe we are doing a reasonably good job of balancing satisfaction of these conflicting demands.

Let me give you just a couple of key 12-month trailing data points through this year's first half fiscal year.

Our revenues were increased 36.5%, but our profits were up 80%. Our before-tax margins have increased by 34.5%. Our cash flow was increased 45.3%. And, our return on invested capital, which last year may have been the best in our industry, was increased by another 11.3 percentage points over the past 12 months. All of this has been gained through organic growth.

TWST: One thing, I didn't ask you is about your colleagues. Would you like to tell us a little bit about the backgrounds and the expertise of a couple of the people you work with?

Mr. Nies: Currently, the average tenure of employment within our company is about 12 years. Our management staff, on average, has been with us over 15 years. Twelve percent of our staff are people who have left us for one reason or another and have returned to Cincom. But, while we are a very experienced firm, our growth enables us to also be a fairly youthful organization as well. But above all else our colleagues and associates are top performers and team players. That's always been one of Cincom's greatest strengths and secrets to our long-term top performing capability. Teamwork works well for us.

TWST: To crystallize then what you've been saying, bring it down to one important thing, yourself. What occupies most of your professional attention day by day?

Mr. Nies: Improving our business. Always improving our business. Always.

My interest is to do everything I can to elevate the standards of Cincom and to help ours become one of the highest performing and best quality industries in the world. Emphasizing value to customers even more than return on one's own shareholder investment may be our industry's most important need. I believe that we can do that and still balance attention to all stakeholders, including our staff, our customers, our shareholders, and our partners and allies. I believe that Cincom can set standards by which everybody else can compare themselves over time. This is one of our great objectives, to elevate the quality of the industry — and to have Cincom continue to lead forward in these pursuits.

TWST: Is there anything you would like to add to what we've been talking about?

Mr. Nies: You were quite insightful and thorough. I appreciate very much the nature of your questions. I hope that my responses are useful and helpful.

TWST: Thank you. (MC)