

## ARM Holdings

Price 981.00p

Google is about to support ARM based server chips

Fair Value 1310p (+34%)

BUY

Bloomberg	ARM.LN
Reuters	ARM.L
12-month High / Low (p)	1,205 / 848.5
Market Cap (GBPm)	13,785
Ev (BG Estimates) (GBPm)	12,818
Avg. 6m daily volume (000)	4,242
3y EPS CAGR	17.3%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-5.6%	-4.9%	-2.6%	-5.6%
Semiconductors	-6.5%	-6.4%	-9.6%	-6.5%
DJ Stoxx 600	-8.5%	-11.2%	-15.6%	-8.5%

YEnd Dec. (GBPm)	2014	2015e	2016e	2017e
Sales	795.2	965.8	1,104	1,226
% change		21.5%	14.3%	11.1%
EBITDA	437	543	611	692
EBIT	400.4	498.1	559.6	634.9
% change		24.4%	12.4%	13.5%
Net income	342.8	428.1	481.2	551.2
% change		24.9%	12.4%	14.5%

	2014	2015e	2016e	2017e
Operating margin	50.3	51.6	50.7	51.8
Net margin	43.1	44.3	43.6	45.0
ROE	16.7	18.7	17.4	17.3
ROCE	36.6	46.7	53.2	62.5
Gearing	-43.7	-53.0	-61.2	-67.6

(p)	2014	2015e	2016e	2017e
EPS	24.12	30.21	33.95	38.89
% change	-	25.2%	12.4%	14.5%
P/E	40.7x	32.5x	28.9x	25.2x
FCF yield (%)	0.0%	0.0%	0.0%	0.0%
Dividends (p)	6.06	7.37	9.43	11.70
Div yield (%)	0.6%	0.8%	1.0%	1.2%
EV/Sales	16.5x	13.3x	11.3x	9.8x
EV/EBITDA	30.0x	23.6x	20.4x	17.4x
EV/EBIT	32.8x	25.7x	22.3x	19.0x



According to Bloomberg, Google is about to officially support Qualcomm in its server chips crusade. Indeed, we knew that Qualcomm was preparing a server chip for a top-tier server customer but we did not yet know its name. The official announcement is scheduled for next week Bloomberg says. Since Google is the first server chip consumer with about 5% of WW shipments (>1m processors per year), this would be a real support to the new Qualcomm's server chip business. We see a direct positive read-across for ARM since these chips will be based on the ARMv8-A instruction set. As a result, any shipments from Qualcomm to Google would generate royalties for ARM. In addition, we believe that the indirect positive impacts could also be important since this announcement would give credibility to ARM server processors and strengthen the ARM server ecosystem.

## ANALYSIS

- **According to Bloomberg, Google is about to officially support Qualcomm's server chips.** Citing anonymous sources, Bloomberg says that Google is partnered in the development of a Qualcomm server chip. This is particularly positive for Qualcomm which is currently struggling in a tough and competitive smartphone market. It is also very positive for ARM Holdings since Qualcomm uses ARM architecture to design its server chips. Our first guess would go for a 24-core System-on-Chip (SoC) based on the ARMv8-A instruction set built on the FinFET process and targeting hyper scale data center. We know that Qualcomm has recently tested such a chip running the entire software stack for server (Linux kernel 2.4, KVM virtualization, OpenStack for cloud orchestration and guest virtual machine running standard Linux, Apache and Wordpress).
- **Direct impacts for ARM:** According to IDC, Google is the largest consumer of server chips (almost exclusively Intel so far), with about 5% of worldwide shipments or 1.2m processors per year (making it the largest end-user of Intel processors). This data is set to increase rapidly given the historical evolution of Google's data-center demand, which is 3x bigger today than in 2011. In the (very hypothetical and very first take) scenario of a Qualcomm chip with an ASP of USD200 (half compared to Intel's cheapest one), a 15% market share at Google, and a conservative 2.5% royalty rate for ARM Holding (similar to the current ARMv8-A royalty rate for standard smartphone), the impact would be an additional c. USD1m in ARM's revenues.
- **Indirect impact for ARM:** Bloomberg is right when it says it is a crucial stamp for Qualcomm and we would also add for ARM Holdings. ARM has been trying to penetrate the server market since 2010 at least and the lack of partners in this adventure was disappointing. As we highlighted in our ARM initiation report released in December, we currently observe a growing interest in ARM based server chips from 1/ chip makers, 2/ server manufacturers, 3/ customers and 4/ software developers and vendors. Since it is currently the largest customer of server chips, Google will bring significant credibility to ARM server chips. As a result, in our view, the indirect impacts could be larger than direct impacts.
- Currently, we include a relatively small amount of sales from server chips in our ARM scenario. We expected a development like this in the server segment but it might go faster than our anticipations. Currently we have about 3% of royalties revenues (2% of total group sales), or USD40m, in our 2018e total group revenues estimates of more than USD2bn (GBP1.37bn).

## VALUATION

- Currently, ARM Holdings shares trade at a 2016e P/E ratio of 34.0x.

## NEXT CATALYSTS

- 10th February 2016: FY15 results.

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