

ARM Holdings

Price 940.00p

Q4 2015 results in line – FY 2016 should be another year of solid growth

Fair Value 1310p (+39%)

BUY

Bloomberg	ARM.LN
Reuters	ARM.L
12-month High / Low (p)	1,205 / 848.5
Market Cap (GBPm)	13,209
Ev (BG Estimates) (GBPm)	12,242
Avg. 6m daily volume (000)	4,210
3y EPS CAGR	17.3%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-0.4%	-11.2%	-1.2%	-9.5%
Semiconductors	-3.7%	-16.9%	-13.7%	-14.4%
DJ Stoxx 600	-9.4%	-17.7%	-22.1%	-15.4%

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	39.0x	31.1x	27.7x	24.2x
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	15.8x	12.7x	10.8x	9.4x
EV/EBITDA	28.7x	22.5x	19.4x	16.6x
EV/EBIT	31.3x	24.6x	21.2x	18.1x

ARM Holdings has reported Q4 2015 results in line with consensus expectations and company guidance. Q4 sales came in at USD408m or GBP269m, up 10.7% sequentially, with normalised operating margin at 50.5%, and EPS at 8.2p. This was in line with the consensus forecasts for sales at GBP265m, normalised operating margin of 50.6% and adjusted EPS at 8.2p. The group added that the current environment is not particularly supportive but we understand that it should achieve 14% top-line growth (in dollar terms), in line with current market expectations, thanks to an increase in market share, a larger serviceable market and a higher royalty rate. We also note that the impact of the recent slowdown in the smartphone market is limited given ARM's growing diversification.

ANALYSIS

- **While Q4 top-line growth was slightly above expectations EPS was in line with forecasts.** The company reported Q4 revenues of USD408m, or GBP269m up 10.7% seq. (+19.1% yoy), slightly above the company's guidance and consensus expectations. Gross margin came in at 96.5%, up 30bp vs. Q3, and operating expenses came out at GBP124m. As a result, normalised EBIT was in line with expectations at GBP136m (cons. GBP135m/BG ests. GBP134m), as for EPS at 8.2p (cons. 8.2p / BG ests. 8.1p). On a full year basis, revenues came in at GBP968m, up 21.7%, gross margin improved by 70bp to 96.2% compared to 2014, and 2015 EPS stood at 30.2p, compared with 2014 EPS of 24.1p. Normalised cash generation was GBP112m in Q4 2015, up from GBP87m in Q3. As a result, the net cash position at the end of Q4 was GBP951m compared with GBP898m at the end of Q3.
- **Licencing sales grew by 9.2% in Q4 vs. Q3 and royalties by 6.7%.** Q4 licencing revenues accounted for GBP159m of which GBP140m from the processors business and GBP19m from the physical IP activity. Overall, the licencing business was the most dynamic with sequential growth of 9.2%. Royalties revenues grew by 6.7% seq. to GBP217m, of which GBP197m from the processors business and GBP20m from physical IP. Software & tools and services revenues came out at GBP17m and GBP15m respectively, compared with GBP12m and GBP16m achieved in Q3.
- **Management sees 14% growth in 2016 if current market conditions hold.** Despite a cautious message regarding current economic conditions that could possibly lead customers to lower spending and impact the entire semiconductors industry, the group is nevertheless guiding on growth of about 14% in 2016 (in dollar terms), i.e. in line with market expectations. The group added that the beginning of 2016 has brought solid opportunities in licencing thanks to new technologies and management is confident about market share gains by its flagship design ARMv8-A, which is thought to be gaining further market share in the mobile and enterprise markets and an increasing royalty rate.

VALUATION

- We are making no change to our estimates at this point and will wait for further details from today's conference call (10:30am CET).
- ARM's shares are trading on 2016e P/E of 27.7x, well below its 5y historical average of 39.3x.

NEXT CATALYSTS

- Today: Q4 2015 results conference call (10:30am CET, +44 (0) 1452 555 566, ID: 20744122).
- 20th April 2016: Q1 2016 results.
- 28th April 2016: Annual General Meeting.

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BUY ratings 61.2%

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