11th February 2016

TMT

ARM Holdings

Price 940.00p

ARM proves its resilience, growth profile remains intact

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

Following the conference held today by ARM Holdings following Q4 2015 results, we remain positive about NT and MT momentum. In our view, the group is heading for another year of strong growth, largely outperforming the global semiconductor market. Q4 sales were above consensus estimates despite a slowing smartphone market leading us to think that it can maintain strong growth in a tough environment. In our view, the group's high profitable growth profile remains intact. We reiterate our Buy recommendation and our FV of 1,310p.

ANALYSIS

- **Following the conference held yesterday by ARM Holdings following Q4 results, we remain positive about near-term and mid-term momentum.** Despite some market concern, we believe the group is heading for another year of strong growth, largely outperforming the global semiconductor market. Here are the key points we would like to highlight from the conference. First, regarding the near-term, the group continues to see Networking, Servers and IoT as strong catalysts. However, we note that Automotive is now a segment that the group is looking at more closely since it offers strong opportunities (USD15bn market in 2020, i.e. a 7% CAGR over 2014/20e). We understand that the group will intensify efforts in this segment over coming years. ARM said it works with OEMs and it is sound to believe that the group will develop a dedicated ecosystem soon. In Networking, rapid market share gains continue and the group now holds a 15% market share vs. 10% a year ago thanks to several design wins at top-tier customers and the continuous benefits from the strengthening software ecosystem. Finally, Servers is now ready to take off and the IoT segment is a strong catalyst since it trigger high 32bit ARM based MCUs demand.
- **Regarding Mobile, the group confirmed the slowdown in the market but also added that this is no surprise.** Indeed, the group expected this trend. While it still records nearly 60% of sales from Mobile, the strong momentum in other markets offset lower demand for smartphone. However, the group adds that there is still a pocket of strong growth in low-end terminals for the coming years (targeted by Cortex-A35 and Mali-470 technologies). In addition, the increasing royalty rate in this segment should maintain growth for ARM.
- **No change in the LT business model.** In the past, the group has managed to maintain a 15% outperformance in royalties revenue growth compared to the semiconductor industry. The tonality of the conference prompts us remain confident that this performance can continue. In addition, the group reiterated its estimate for 5-10% growth in license revenues over the medium term.
- **Finally, the group remains committed to maintaining a strong balance sheet and investing in new technologies.** We understand that the return to shareholders policy should not change anytime soon. In addition, we continue to foresee dividend increases in line with EPS growth.
- **Overall, the group's profile of high profitable growth remains intact.** Q4 sales above consensus estimates lead us to thinks that the group can deliver its target in a tough environment and especially a slowdown in smartphone momentum. In our view, the group's profile of high profitable growth remains intact. We reiterate our Buy recommendation and our FV of 1,310p.

VALUATION

- **Following the Q4 publication, we are making no change to our estimates.** The business model is still highly cash generative while it remains flexible and diversified enough. Note that the share trades at a 2016e P/E of 27.7x to be compared to an 5y historical 12m fwd P/E ratio of 40x.

NEXT CATALYSTS

- 20th April 2016: Q1 2016 results.
- 28t April 2016: Annual General Meeting.

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Distribution of stock ratings

BUY ratings 72%   NEUTRAL ratings 0%   SELL ratings 28%

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