15th February 2016

TMT

Temenos Group

Price CHF42.45

Feedback from Capital Markets Day: clearly outpacing competition

Fair Value CHF53 (+25%) **BUY**

Bloomberg	TEMN SW
Reuters	TEMN.SW
12-month High / Low (CHF)	52.0 / 29.3
Market Cap (CHFm)	2,828
Ev (BG Estimates) (CHFm)	2,961
Avg. 6m daily volume (000)	222.1
3y EPS CAGR	23.3%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-9.8%	-11.8%	20.9%	-18.3%
Softw.& Comp.	-10.9%	-11.1%	-3.1%	-12.7%
DJ Stoxx 600	-9.0%	-16.1%	-18.4%	-14.6%

YEnd Dec. (US$m)	2015	2016e	2017e	2018e
Sales	542.5	608.8	672.5	741.9
% change		*12.2%*	*10.5%*	*10.3%*
EBITDA	202	247	277	309
EBIT	96.8	144.5	175.6	205.8
% change		*49.4%*	*21.5%*	*17.2%*
Net income	115.7	153.4	179.6	207.0
% change		*32.6%*	*17.1%*	*15.3%*

	2015	2016e	2017e	2018e
Operating margin	28.9	32.4	33.5	34.5
Net margin	12.2	17.4	19.9	21.8
ROE	17.7	23.5	24.3	22.6
ROCE	22.3	29.4	36.6	46.3
Gearing	71.2	30.3	-3.2	-33.4

(US$)	2015	2016e	2017e	2018e
EPS	1.58	2.19	2.57	2.96
% change	-	*38.8%*	*17.1%*	*15.3%*
P/E	27.5x	19.8x	16.9x	14.7x
FCF yield (%)	5.1%	5.5%	6.5%	7.6%
Dividends (US$)	0.45	0.50	0.55	0.60
Div yield (%)	1.0%	1.2%	1.3%	1.4%
EV/Sales	5.8x	5.0x	4.3x	3.6x
EV/EBITDA	15.7x	12.3x	10.4x	8.6x
EV/EBIT	20.2x	15.3x	12.8x	10.4x

We reiterate our Buy rating following the Capital Markets Day held on Friday last week in London. The key takeaways of this event were that: 1) 2015 was a landmark year and the focus is now on how to raise the excellent momentum with tier-1/2 banks to the next level with partners, 2) Market drivers are structural while Cognizant's warning for Banking is related to discretionary IT spending, 3) the competition has been left behind, while Temenos has made the right strategic choices in our view.

ANALYSIS

- **2015 was a landmark year for Temenos in many regards**. First, it signed all the largest deals in the market, with Nordea in Core Banking (Temenos' largest deal ever) and Julius Bär in Wealth Management (in that area Temenos had a 100% win rate), increased scale in the US with the signing of a top 25 bank and USD25m of qualified pipeline built over the past six months, significant progress in Digital (front office, real time campaigns, embedded analytics), the signing of Temenos' first regulated bank on the Microsoft Azure cloud platform, and better traction from partners (Accenture, Capgemini...). The acquisition of Multifonds provides access to fund services and asset management with significant new and installed base opportunities. As such, many competitors like Oracle FSS, FIS, Misys, Infosys and TCS have been left behind in Temenos' core markets.
- **Market drivers are structural**. Temenos estimates its addressable market will rise in the medium-term to USD11bn from USD8bn (+8% p.a.) while the penetration rate of third-party software vendors is still low (18%). Segments with the highest potential are Payments (+11%), Fund administration (+10%), Business intelligence (+9%), Wealth management (+7%), Channels (+6%) and Core banking (+5%). Growth drivers remain unchanged and structural, i.e. changing competition, technology, regulation and customer for banks. Core banking renewal with solutions like those of Temenos provide banks with a productised, scalable and open core with an integrated front and back office with real time processing and embedded analytics. In addition, a modern core is a prerequisite for Digital. As such, renovating the core remains strategic for banks in order to stay in the race and improve their ROE which remains 6ppt below historical levels.
- **Medium-term targets and growth strategy**. Shareholder value drivers are unchanged, i.e. substantial revenue growth (medium-term target of +10% p.a., o/w +15% p.a. on licensing, SaaS & subscriptions, significant recurring sales growth), margin expansion (+1ppt/+1.5ppt p.a., EPS medium-term target of +15% p.a.), significant free cash flow (100%+ of EBITDA, driven by DSOs down 10-15 days p.a. over the medium-term), and disciplined capital allocation. Temenos' medium-term revenue growth is expected to be driven by: 1) Total licensing revenues with tier-1/2 banks engaged in progressive renovation (1.5-2x the USD105m reported for 2015) as they buy an average of USD3-5m additional new license p.a, 2) The maximisation of the installed base (+15%/+20% p.a. on multi-product penetration, progressive renovation and relicensing), 3) North America (+35% CAGR in order to reach 25%+ of sales vs. 17% in 2015); 4) SaaS and subscriptions (+20% CAGR in order to reach 20% of sales vs. 15% in Q4 15).
- **Financial flexibility for acquisitions**. With end-2015 leverage of 1.3x EBITDA and USD725m in available financing (average rate of 3.7% for a maturity of 2.6 years), Temenos is flexible to pursue acquisitions up to 2x EBITDA in accordance to its M&A strategy (focus on key markets and segment, gaining scale in specific areas or countries, and complementary products).

VALUATION

- Temenos' shares are trading at est. 15.3x 2016 and 12.8x 2017 EV/EBIT multiples.
- Net debt on 31st December 2015 was USD267.2m (net gearing: 71%).

NEXT CATALYSTS

Q1 2016 results on 19th April after markets close.

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