

## ARM Holdings

Price 986.50p

## ARM partners with TSMC for server chips

Fair Value 1310p (+33%)

BUY

Bloomberg	ARM.LN
Reuters	ARM.L
12-month High / Low (p)	1,205 / 848.5
Market Cap (GBP)	13,894
Ev (BG Estimates) (GBP)	12,927
Avg. 6m daily volume (000)	3,840
3y EPS CAGR	17.3%

Yesterday, ARM announced the extension of previous collaborations in leading-edge process technology with TSMC. The IP vendors will now work on the 7nm node with one of the largest independent foundries. The group said it will focus on optimised high performance SoC for data centers and network infrastructure which is seen as a high growth segment. Note that last year, TSMC announced it would start 7nm chips in 2017 with tangible volume production expected for 2018. This matches our expectations of a take-off in ARM server chips perfectly. We remain a strong buyer of the stock and are maintaining our FV of 1,310p.

	1 M	3 M	6 M	31/12/15
Absolute perf.	10.5%	-6.2%	0.6%	-5.1%
Semiconductors	12.5%	-3.7%	0.6%	-3.5%
DJ Stoxx 600	5.9%	-5.2%	-4.4%	-6.8%

## ANALYSIS

- Yesterday, ARM and TSMC announced an expansion of their collaboration in leading edge semiconductor process technology.** More precisely, the two groups announced a multi-year agreement to collaborate on 7nm FinFET process. We understand that they will continue to work on mobile chips which used to be among the drivers for new process technologies. However, in our view, ARM and TSMC will also focus on chips for next-generation networks and data centers. ARM said it is investing in technology designed specifically for data-centers and network infrastructure, and optimised for TSMC 7n FinFET.
- A perfect technological fit.** Note that last year, TSMC announced it would start 7nm chips in 2017 with tangible volume production expected for 2018. This matches perfectly our expectations of a take-off of ARM server chips (see our [initiation report](#)). This also fits server chips vendors (such as Qualcomm, customer of TSMC) roadmap and target in this segment. Indeed, Server is a high growth segment and our discussions at MWC 2016 confirm that customers are looking for an alternative to high priced Intel processors.
- This is not the first time and it has been a success.** Previously, ARM and TSMC partnered on leading-edge technologies for 16nm and 10nm FinFET nodes. The two companies were able to start test production based on ARM Cortex-A72 cores in 16nm and leverage this know-how to launch volume production (such as Apple A9 chip).

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	40.9x	32.7x	29.1x	25.4x
FCF yield (%)	0.0%	0.0%	0.0%	0.0%
Dividends (p)	6.06	7.37	9.43	11.70
Div yield (%)	0.6%	0.7%	1.0%	1.2%
EV/Sales	16.6x	13.4x	11.4x	9.9x
EV/EBITDA	30.3x	23.8x	20.6x	17.6x
EV/EBIT	33.0x	26.0x	22.5x	19.2x

## VALUATION

- We remain strong buyers of the stock.** We believe the market fears of a slowdown due to smartphone weakness is overdone. In our view, Q4 results (in line) and Q1 2016 guidance ([in line](#)) proved the strong resilience of ARM business. In addition, the group's diversification continues and this collaboration with TSMC is further proof of a strengthening ecosystem for ARM based server chips and matches our scenario. Indeed, this news comes after fabless players (such as Qualcomm) were rumoured to have introduced ARM based processors.
- ARM's shares trade at a 2016e P/E ratio of 29.1x, which represents a strong discount compared to the historical average of 39.3x (based on 5y historical data) while the group profile is unchanged.**

## NEXT CATALYSTS

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

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## Distribution of stock ratings

BUY ratings 64.4%

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