

INDEPENDENT RESEARCH
UPDATE

21st July 2016

TMT

Bloomberg	ARM.LN
Reuters	ARM.L
12-month High / Low (p)	1,675 / 848.5
Market capitalisation (GBPm)	23,404
Enterprise Value (BG estimates GBPm)	22,420
Avg. 6m daily volume ('000 shares)	4,680
Free Float	79.4%
3y EPS CAGR	17.9%
Gearing (12/15)	-36%
Dividend yield (12/16e)	0.68%

YE December	12/15	12/16e	12/17e	12/18e
Revenue (GBPm)	968.30	1,179	1,385	1,541
EBITA GBPm)	499.8	590.9	717.3	810.6
Op.Margin (%)	51.6	50.1	51.8	52.6
Diluted EPS (p)	30.20	35.94	43.94	49.54
EV/Sales	23.50x	19.02x	15.89x	13.96x
EV/EBITDA	42.0x	34.7x	28.2x	24.4x
EV/EBITA	45.5x	37.9x	30.7x	26.5x
P/E	55.1x	46.3x	37.9x	33.6x
ROCE	34.9	40.8	49.6	55.7



ARM Holdings

SoftBank leverages Brexit to acquire ARM

Fair Value 1410p vs. 1340p (price 1,663p) Tender to the offer

On 18th June, SoftBank launched the acquisition of ARM for 1,700p per share, valuing ARM at GBP24.3bn. The Japanese group has made the most of a valuation made more affordable by the plunge in the GBP against the JPY, but has above all taken an attractive opportunity to capture profitable growth with 1/ momentum in the internet of things (IoT) and 2/ the rising momentum of ARM architecture in servers and infrastructure. In all, SoftBank is a serious buyer that has the means to pay for ARM in cash while offering historical shareholders a juicy premium (+43%). It has a good track-record in acquisitions and should maintain the group's current profile. We have updated our model, especially for forex, and consequently increased our FV from 1,340p to 1,410p.

SoftBank has invested in capturing the opportunity provided by the Internet of Things. During H1 2016, ARM's share price performance was hampered by the slowdown in the smartphones market. However, ARM still boasts numerous assets and especially 1/moves upscale in processors (32 bits vs. 64 bits), 2/ the multiplication in cores, and 3/ the adoption of ARM's Mali graphics technology, enabling it to increase smartphone revenues (>50% of royalties) by more than 9% a year on average between 2015 and 2018e. In addition to this comes the fresh source of growth harboured in IoT, network equipment and servers. IoT remains a difficult catalyst to materialise but its positive impact was clearly visible in the past two publications and the same is true for network equipment with constant market share gains. Finally, momentum in servers is constantly improving with a stronger ecosystem especially since the arrival of Qualcomm in the list of partners.

In all, SoftBank seems to have the perfect profile as a buyer. In terms of ARM's historical investors, the offer harbours attractive upside (+43% vs. the pre-announcement price) and is paid in cash. Concerning ARM, SoftBank has already stated it would change nothing to the current way of operating. The chip designer is to remain an independent unit with its head offices still in Cambridge and the same management team. SoftBank also stated that it would do everything to provide ARM the means to ramp-up, particularly in human resources with an additional budget to step up the recruitment of engineers.

Bryan Garnier : Semiconductors Looking for lost growth



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ARM Holdings

P&L Structure



ROCE vs. WACC



Company description

ARM is a UK group specialised in the design of processor architectures and graphic chips. Virtually all semiconductor players are licencees of the group and use the designs developed by ARM to help them design their own chips. ARM has benefited massively from the boom in smartphones, 85% of which use processors based on an ARM architecture. To continue expanding, the group now needs to develop new growth sources including IoT, servers and networking infrastructure. Currently, ARM is the subject of a takeover bid by the Japanese company SoftBank.

Simplified Profit & Loss Account (GBPm)	31/12/13	31/12/14	31/12/15	31/12/16e	31/12/17e	31/12/18e
Revenues	715	795	968	1,179	1,385	1,541
Change (%)	23.9%	11.3%	21.8%	21.7%	17.5%	11.3%
Adjusted EBITDA	445	437	542	646	782	882
Adjusted EBIT	351	400	500	591	717	811
EBIT	153	309	406	477	587	666
Change (%)	-26.3%	101%	31.4%	17.4%	23.1%	13.4%
Financial results	13.2	11.0	11.8	13.9	15.2	15.4
Pre-Tax profits	163	317	415	486	595	675
Tax	(73.4)	(68.6)	(82.6)	(95.5)	(110)	(124)
Net profit	105	255	340	400	501	568
Adjusted net profit	291	343	429	509	623	702
Change (%)	41.7%	17.9%	25.2%	18.7%	22.2%	12.8%

Cash Flow Statement (GBPm)

Depreciation & amortisation	94.3	36.6	42.3	54.8	64.4	71.7
Change in working capital	33.2	(45.5)	(57.0)	(24.8)	(24.3)	(18.4)
Operating cash flows	315	342	380	530	652	747
Capex, net	(45.3)	(30.4)	(41.0)	(41.3)	(48.5)	(53.9)
Free Cash flow	270	311	339	489	603	693
Acquisition, net	(24.8)	(12.8)	(65.0)	0.0	0.0	0.0
Financial investments, net	(3.4)	(2.8)	2.6	(5.9)	(6.9)	(7.7)
Dividends	(68.9)	(86.1)	(108)	(159)	(197)	(205)
Issuance of shares	5.9	(60.1)	(82.8)	0.0	0.0	0.0
Issuance (repayment) of debt	(4.4)	(7.6)	(5.1)	0.0	0.0	0.0
Other	28.8	(57.1)	(102)	13.9	15.2	15.4
Net debt	(584)	(668)	(647)	(984)	(1,398)	(1,894)

Balance Sheet (GBPm)

Tangible fixed assets	33.6	43.4	61.6	38.0	10.3	(20.5)
Intangibles assets & goodwill	609	644	743	754	768	784
Investments	149	221	318	322	327	333
Deferred tax assets	72.2	64.8	70.9	70.9	70.9	70.9
Other non-current assets	1.6	1.7	1.4	1.4	1.4	1.4
Cash & equivalents	588	675	658	996	1,410	1,905
Current assets	185	187	267	319	369	407
Total assets	1,638	1,837	2,120	2,501	2,957	3,480
Shareholders' equity	1,311	1,528	1,798	2,152	2,582	3,085
Provisions	45.1	45.6	46.3	46.3	46.3	46.3
Deferred tax liabilities	18.9	32.3	33.8	33.8	33.8	33.8
Current liabilities	259	225	231	258	284	304
L & ST Debt	4.2	6.5	11.3	11.3	11.3	11.3
Total Liabilities	1,638	1,837	2,120	2,501	2,957	3,480
Capital employed	728	860	1,151	1,168	1,183	1,192

Ratios

Gross margin	94.79	95.52	96.19	96.32	96.30	96.60
Adjusted operating margin	49.10	50.35	51.62	50.13	51.80	52.60
Tax rate	45.14	21.67	19.91	19.67	18.45	18.36
Adjusted Net margin	40.68	43.10	44.30	43.21	44.97	45.56
ROE (after tax)	7.98	16.71	18.90	18.59	19.40	18.41
ROCE (after tax)	26.98	36.58	34.85	40.76	49.57	55.65
Gearing	(44.51)	(43.73)	(35.99)	(45.74)	(54.17)	(61.38)
Pay out ratio	65.09	33.36	31.56	39.47	39.11	35.86
Number of shares, diluted	1,412	1,421	1,418	1,417	1,417	1,417

Data per Share (p)

EPS	7.50	18.16	24.10	28.47	35.63	40.41
Restated EPS	20.59	24.12	30.20	35.94	43.94	49.54
% change	39.8%	17.1%	25.2%	19.0%	22.2%	12.8%
BVPS	0.93	1.08	1.27	1.52	1.82	2.18
Operating cash flows	0.22	0.24	0.27	0.37	0.46	0.53
FCF	0.19	0.22	0.24	0.34	0.43	0.49
Net dividend	4.88	6.06	7.60	11.24	13.94	14.49

Source: Company Data; Bryan, Garnier & Co ests.

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NEUTRAL ratings 34%

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