

Sector View

TMT

Q2 2016 review and our TMT Top Picks for Q3: Wirecard and Infineon.

	1 M	3 M	6 M	31/12/15
Softw.& Comp.	-6.5%	-4.2%	-7.3%	-7.3%
DJ Stoxx 600	-3.5%	-0.3%	-9.2%	-9.2%

*Stoxx Sector Indices

Companies covered

ALTEN	SELL		EUR48
Last Price	EUR53.25	Market Cap.	EUR1,793m
ALTICE	BUY		EUR16.3
Last Price	EUR13.595	Market Cap.	EUR14,877m
ALTRAN TECHNOLOGIES	NEUTRAL		EUR13
Last Price	EUR12.175	Market Cap.	EUR2,140m
ARM HOLDINGS	BUY		1340p
Last Price	1131p	Market Cap.	GBP15,917m
ASML	SELL		EUR81
Last Price	EUR88.09	Market Cap.	EUR38,172m
ATOS	BUY		EUR92 vs. 93
Last Price	EUR75.01	Market Cap.	EUR7,850m
AXWAY SOFTWARE	NEUTRAL		EUR20
Last Price	EUR20.65	Market Cap.	EUR429m
CAPGEMINI	BUY		EUR95 vs. 97
Last Price	EUR77.85	Market Cap.	EUR13,404m
CAST	NEUTRAL		EUR3.6
Last Price	EUR3.35	Market Cap.	EUR54m
DASSAULT SYSTEMES	SELL		EUR64 vs. 63
Last Price	EUR68.56	Market Cap.	EUR17,637m
DIALOG	BUY		EUR35
Last Price	EUR27.165	Market Cap.	EUR2,115m
GEMALTO	NEUTRAL		EUR62
Last Price	EUR55.87	Market Cap.	EUR4,979m
ILIAD	BUY		EUR212
Last Price	EUR182.4	Market Cap.	EUR10,709m
INDRA SISTEMAS	NEUTRAL		EUR10
Last Price	EUR9.637	Market Cap.	EUR1,582m
INFINEON	BUY		EUR15
Last Price	EUR13.075	Market Cap.	EUR14,803m
INGENICO GROUP	BUY		EUR144
Last Price	EUR106	Market Cap.	EUR6,518m
NUMERICABLE SFR	NEUTRAL		EUR28.4
Last Price	EUR22.75	Market Cap.	EUR9,970m
ORANGE	BUY		EUR13.59
Last Price	EUR14.585	Market Cap.	EUR38,797m
SAGE GROUP	SELL		575p vs.555
Last Price	625p	Market Cap.	GBP6,747m
SAP	NEUTRAL		EUR74 vs. 73
Last Price	EUR67.4	Market Cap.	EUR82,801m

LOOKING BACK ON Q2 2016

In Q2 2016, the TMT sector had a negative performance in bear stock markets amidst the vote in favour of Brexit. Over the period, the DJ STOXX Europe technology index fell 4.9% and underperformed the DJ STOXX Europe 600 index by 2.7%.

During the period, the best performers were Ubisoft (+20%, increasing speculative appeal), Wirecard (+18%, rebound after fraud allegations by Zatarra), and Worldline (+16%, good Q1 organic sales growth). The worst performers were Numericable-SFR (-39%, breakdown of merger talks between Bouygues and Orange), Dialog Semiconductor (-23%, downward revision of FY guidance), and Iliad (-19%, same as for Numericable SFR). Our sector Q2 Top Picks Atos and Wirecard, that we removed from the Top Pick list on 24th June after the vote for Brexit were up respectively 4.5% (+6.0% dividend included) and 1.5% (+1.9% dividend included).

NEW ESTIMATES AND FAIR VALUES

We have taken the opportunity to update our 2016-2018 forecasts and our DCF-derived Fair Values, due to new fx assumptions, especially due to the weakness in the British pound and the strength of the US dollar and the Japanese yen against the euro.

On that basis, we have adjusted our DCF-derived Fair Values for Atos (to EUR92 from EUR93, headwinds on GBP), Capgemini (to EUR95 from EUR97, headwinds on GBP), Dassault Systèmes (to EUR64 from EUR63, tailwinds on JPY and USD), Sage Group (to 575p from 555p, tailwinds on USD and EUR), SAP (to EUR74 from EUR73, tailwinds on USD), and Sopra Steria Group (to EUR127 from EUR130, headwinds on GBP).

WHAT WE SEE FOR Q3 2016

For Software & IT Services, based on industry analysts' forecasts, at this stage we are still anticipating stable growth or a slight slowdown in global IT spending for 2016, with est. growth of 5-6% for software (vs. +6% for 2015), still driven by the now established SaaS model, and est. growth of 3-4% for IT Services (vs. +4%) driven by digital transformation projects. However, we cannot ignore Brexit and the negative consequences it may generate short-term (essentially on licence sales for software vendors), so we consider these estimates are now at risk - yet very challenging to quantify as of today - due to several unknowns: 1) Political uncertainty - how the "divorce" between the UK and the UE will be managed and what kind of partnership will replace the UK's membership in the EU, and we cannot rule out that political manoeuvres to slow the Brexit process are likely to generate a 'wait-and-see' attitude for decision makers, so some IT projects could be postponed or cancelled if they are concerned by a lack of visibility; 2). Some industries like Banking and Government are at the frontline for potential cuts in IT budgets as foreign banks may be led to relocate their businesses outside the UK if they lose the "European passport", which allows them to make transactions in euros in the UK, and as the Cabinet Office may decide to freeze new government IT projects before envisaging more efficiency in order to avoid increasing deficits; 3). Concerns about an economic recession in the UK; 4). A contagion effect to other geographies. We consider the companies in our coverage with the highest risk of downward revisions to forecasts are Sopra Steria (27% of revenues in the UK), Capgemini (17% of revenues in the UK), Atos (16% of revenues in the UK) and Temenos (100% of revenues in Banking). In addition, a decline in UK long-term interest rates may have an adverse impact on pension deficits for IT Services firms having significant exposure to the UK (Sopra Steria, Atos, Capgemini).

The payments sector should continue to benefit fully from EMV migration in the US (50% still to be upgraded), equipping emerging markets (notably in China), as well as rising demand for payment services outsourcing (notably e-commerce) and for security in electronic payments. Regarding Brexit, the companies we cover in this segment are extremely flexible and see Brexit in a very relaxed manner and without implications for their businesses (GBP is below 9% of their revenue on average and they have a natural hedge with the respective currency). 1) Ingenico Group (Buy – FV of EUR144, 100% of sales in payment) has the best commercial multi-channel offer available today. We are still confident in Q2 sales (BG est.: +13/14% lfl vs. consensus of +10%) despite VeriFone's comments (facing company-specific issues), and see the FY16 guidance as too cautious (>=10% lfl sales and ~21% Ebitda margin). 2) Wirecard (Buy – FV of EUR54, pure player in online payments) is now a global issuing and acquiring payment service provider (all continents are now covered). It should post FY16 organic sales growth of over 20%, driven notably by south-east Asia, which should translate into 2016 EPS growth of 38%. Its

SOFTWARE AG	BUY	EUR40
Last Price	EUR31.045	Market Cap. EUR2,453m
SOITEC	NEUTRAL	EUR0.45
Last Price	EUR0.54	Market Cap. EUR327m
SOPRA STERIA GROUP	BUY	EUR127 vs. 130
Last Price	EUR95.05	Market Cap. EUR1,943m
STMICROELECTRONICS	NEUTRAL	EUR6.3
Last Price	EUR5.28	Market Cap. EUR4,810m
SWORD GROUP	BUY	EUR26
Last Price	EUR24.35	Market Cap. EUR230m
TEMENOS GROUP	NEUTRAL	CHF52
Last Price	CHF50	Market Cap. CHF3,477m
UBISOFT	BUY	EUR34
Last Price	EUR33.775	Market Cap. EUR3,756m
WIRECARD	BUY	EUR54
Last Price	EUR39.78	Market Cap. EUR4,915m
WORLDLINE	BUY	EUR29
Last Price	EUR25.425	Market Cap. EUR3,358m
WORLDPAY	NEUTRAL	278p
Last Price	274.3p	Market Cap. GBP5,486m

Q2 organic sales growth should continue to accelerate (i.e. over 20% lfl, much the same way as growth in transaction volumes processed). **3) Worldline (Buy – FV of EUR29, 78% of 2016 sales in payment)** is not yet fully considered as a PSP (whereas it is #1 in Europe since the acquisition of Equens vs. #3 before). We expect the group to post ~5% organic sales growth in Q2 (taking into account the termination of the public sector contract in the UK at the end of last year). **4) Gemalto (Neutral – FV of EUR62; less than 25% of its sales in payment)** should post again weak lfl sales growth in Q2 (after -2.5% lfl in Q1). We believe there are still too many risks in the SIM and related services businesses. Shorter term, we do not view the bid on Morpho as positive for the share price as it should be not so easy to integrate given size and profitability levels (Morpho is half the size of Gemalto's sales and half its EBIT margin level). **5) Worldpay (Neutral – FV 278p; 100% of its sales in payment)** is struggling in the US (half of group sales), such that the associated poor lfl top-line growth cannot create any leverage to its proprietary platform. We expect the group to post 7% organic sales growth at best over the FY..., so disappointments cannot be ruled out in our opinion.

For Semiconductors, the environment remains tough with cumulative WW sales from January to April down by 5.9% yoy. Nevertheless, we expect global 2016 sales to be broadly flat thanks to improving momentum in H2 (Q1 was tough for almost all sub-segments) and easier comparison basis. During Q2 2016, we observed a stable environment in smartphones, which was a weak spot in Q1. The PC segment remains penalised by lacklustre sales and shows no sign of rebound. Regarding the other semiconductor end-markets, in which the automotive and industrial sector falls, we note that momentum is continuously improving. As expected, automotive production was particularly dynamic during the first two months of Q2 with aggregated production of US, Europe and China up 6% yoy (5m aggregated sales also up +6%). In addition, the industrial sector is said to be healthy according to industry sources. As for Q1, in our coverage, this should translate into positive momentum for **Infineon (Buy, FV EUR15)** and **STMicroelectronics (Neutral, FV EUR6.3)**. Regarding semi equipment makers, Q2 was the quarter of the 10nm ramp-up at Logic IDM and foundries, triggering equipment orders. We also expect 10nm ramp to act as a tailwind over Q3. However, we remain convinced that most of the positive impact from 10nm investments are already priced in, and particularly for **ASML (Sell, FV EUR81)**.

For Video Games: We are optimistic on fundamentals (no game delays expected) and momentum for the Ubisoft share price. By taking equity stakes in **Ubisoft (Buy – FV EUR34)**, Vivendi has encouraged investors to change the way they look at the share. For this group, speculation will be the main driver behind share price. We would therefore not be surprised if the share started to reflect its speculative premium (in 2017?). As a reminder we estimate a fair offer in the EUR40-51 range.

In Telecom, consolidation hopes on the French market should be over for quite some time now. Nevertheless, the first signs of spontaneous market repair are visible: Orange, SFR and Bouygues Telecom have increased their prices lately, both in fixed and mobile, and Iliad has the opportunity to do so with the launch of its Freebox v7 before the end of the year. While ARPUs are on the way to stabilising, the CAPEX war is in full swing in fibre deployment and 4G coverage. Visibility has increased for **Iliad (Buy - FV EUR212)**, since the 2G/3G roaming agreement with Orange has been extended, growth will continue, supported by strong marketing and direct distribution, although competing on fiber and increasing mobile ARPUs remain a challenge. **SFR (Neutral - FV EUR28.4)** should still struggle for several months with operational and commercial issues, waiting for the effects of increased investment and new management to kick in. Following the closing of Cablevision's acquisition in the US, **Altice (Buy – FV EUR16.3)** should be able to offset the poor performance at SFR with good results at the international level, especially in the US and in Portugal. **Orange (Buy – FV EUR17.1)**, taking advantage of SFR's difficulties, will still be in a good position to steam ahead as the only all-around premium telecom provider on the market.

CONCLUSIONS AND TOP PICKS

In Software & IT Services, due to the environment caused by Brexit and political uncertainties, we have had no pick for Q3 2016 since 24th June when we removed Atos from the list.

In Payments, we expect investors to show an increasing appetite for the rising momentum of eCommerce. As such, **we have placed Wirecard (Buy, FV EUR54) on our Q3 Top Pick list to benefit from** extremely good fundamentals (pure player in ePayment, exposure to South-East Asia) and a still attractive entry-point following the Zatarra story. As a reminder, we expect organic sales growth of more than 20% in FY16e with EBITDA of EUR306.4m i.e. a margin of 30.1% (vs. an increased guidance range to EUR290-310m, which is still cautious in our view). **Wirecard's PEG is still very appealing, with a PE of 21.8x vs. EPS growth of 37.9% in 2016e.**

In Semiconductors, given the current supportive environment in the automotive segment within the semiconductor market, we believe that investors' appetite for auto players will increase as June quarterly publications should be robust. As a result, **we add Infineon (Buy, FV EUR15) to our Q3 Top**



Pick list to benefit from an attractive entry point as the stock has recently suffered from 1/ a downward FY16 guidance revision in May due to a move in the EUR/USD exchange rate (from 1.10 to 1.15), and 2/ the negative impact of Brexit on European stocks. With a supportive environment, we are confident about FQ3 results (to be posted on 2nd August) and given that Brexit caused the EUR/USD to move back to the ~1.10 level, we believe that there are also good chances that the group shows a great confidence for FQ4 and posts a stronger than expected guidance.

In Video Games, 2016 should be buoyant thanks to speculation concerning Ubisoft. This main theme is set to drive the share price in 2016e. However, and despite our buy rating, we find it difficult to predict the exact timing of an increase in Ubisoft's capital by Vivendi and/or a formal takeover bid for the whole company. As a result, **we are not including this name in our Q3 2016 Top Pick list**.

In Telecoms, although market trends are improving, **we are not including any stock in our Q3 Top pick list**. Regarding **Altice (Buy – FV EUR16.3)**, tension in high yield markets related to the Brexit impact and difficulties in France should still weigh on the stock performance, although we expect good trends on the international side. Regarding **Iliad (Buy, FV EUR212)**, the entry point is not as good as it was only a few days ago, having recovered much of the Brexit loss, and we see no specific catalyst for high short term performance. **Orange (Buy - FV EUR17.1)** should maintain its good commercial and financial trend, but with no major catalyst in Q2 justifying adding it to our top pick list.

NEXT CATALYSTS

Software & IT Services: Infosys' Q1 FY17 results next week. TCS' Q1 FY17 results on 14th July after the Indian markets close. IBM's Q2 2016 results on 18th July after US markets close. Q2 2016 and H1 2016 sales and results for European companies start on 20th July (SAP, Software AG).

Payments: Worldline's and Ingenico's H1 earnings on 26th July (after trading), Worldpay's H1 earnings on 9th August (before trading), Wirecard's H1 earnings on 11th August (before trading), Gemalto's H1 earnings on 26th August (before trading), and).

Semiconductors: TSMC's Q2 2016 results on 14th July, ASML's Q2 2016 results on 20th July, STMicroelectronics Q2 results on 22th July, ARM's Q2 results on 27th July, Dialog's Q2 results on 28th July and Infineon's Q3 results on 2nd August.

Video Games: Ubisoft's Q1 sales in July.

Telecom: Orange H1 results on July 27th, SFR and Altice H1 results on August 9th, Iliad's H1 results at the end of August.

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