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19th August 2016

BG's Wake Up Call

	Last close	Daily chg (%)	Chg YTD (%)
Indices			
Dow Jones	18552.02	-0.45%	+6.47%
S&P 500	2178.15	-0.55%	+6.57%
Nasdaq	5227.11	-0.66%	+4.39%
Nikkei	16528.91	+0.26%	-12.80%
Stoxx 600	343.318	-0.79%	-6.15%
CAC 40	4460.44	-0.83%	-3.81%
Oil /Gold			
Crude WTI	45.74	0.00	+22.96%
Gold (once)	1348.07	+0.45%	+26.89%
Currencies/Rates			
EUR/USD	1.126	+0.56%	+3.65%
EUR/CHF	1.08495	-0.32%	-0.23%
German 10 years	-0.089	-30.51%	-114.08%
French 10 years	0.19	+25.27%	-80.63%
Euribor	-	+%	+%

Economic releases :

Date	
19th-Aug	CAD - Consumer Price Index Jul. (129.2 YoY E) CAD - Bank Canada Consumer Price Index Core Jul. (2.1% YoY E) USD - Baker Hughes US Rig Count Aug.

Upcoming BG events :

Date	
1st-Sept	L'OREAL (BG Paris roadshow with CFO)
8th-Sept	ACCOR (BG Roadshow with CFO)
13th-Sept	Thematic Breakfast with ARCEP
14th-Sept	SAINT GOBAIN (BG Luxembourg roadshow)
22nd-Sept	Thematic Lunch with HC specialist
30th-Sept	Thematic Breakfast with Vimpelcom

Recent reports :

Date	
26th-Jul	NICOX Don't turn a blind eye to opportunities
21st-Jul	SEMICONDUCTORS : Looking for lost growth
13th-Jul	Oncology is an increased focus
12th-Jul	DANONE No redemption
1st-Jul	UBISOFT Same player shoot again?
29th-Jun	ORANGE : Lights are turning green.

List of our Reco & Fair Value : Please click here to download



NESTLÉ

BUY, Fair Value CHF84 vs. CHF80 (+6%)

An attractive profile

In the current environment, we favour Nestlé's defensive profile. The group remains the most diversified in terms of geographies and categories in our coverage universe. The release of the H1 2016 results reinforced our conviction that in the future it will better leverage its size to optimize its cost base and improve its working capital. The arrival of the new CEO at the beginning of 2017 could also trigger a more active acquisitions policy. Fair Value adjusted to CHF84. Buy recommendation maintained.

SOFTWARE AND IT SERVICES

Four takeaways from the Q2 2016 earnings season

While the earnings season for Q2 2016 finished three weeks ago for European Software & IT Services companies, we consider it has been quite positive with results generally in line or above expectations, revenue momentum globally improving, and no big concern related to Brexit for now. Amidst for valuation multiples recently boosted by very low or negative interest rates, we consider that, at this point, Sopra Steria is the stock having the strongest share price upside potential (+21%).

Food & Beverages

Nestlé

Price CHF78.95

An attractive profile

Fair Value CHF84 vs. CHF80 (+6%)

BUY

In the current environment, we favour Nestlé's defensive profile. The group remains the most diversified in terms of geographies and categories in our coverage universe. The release of the H1 2016 results reinforced our conviction that in the future it will better leverage its size to optimize its cost base and improve its working capital. The arrival of the new CEO at the beginning of 2017 could also trigger a more active acquisitions policy. Fair Value adjusted to CHF84. Buy recommendation maintained.

ANALYSIS

- **Weak pricing penalized organic sales growth but volumes/mix remained solid. RIG was up 2.7% in Q2, decelerating vs Q1 (+3.0%) due to an extra day in the quarter (29 days in February 2016) but in line with the historical trend (+2.9% over the past five years). But pricing continued to slow down (+0.4% in Q2 after +0.9% in Q1),** reflecting the deflationary environment in a number of developed markets, the lack of rebound in commodity prices and the tough comparison base (price increases in Latam and Eastern Europe last year). The company reported to have increased or maintained its markets shares in 57% of its geographies.
- **Nestlé is confident in achieving around 5% organic sales growth in H2.** The group has reiterated its full year guidance of organic sales growth in line with 2015 (+4.2%), which implies +4.6% in H2. **We think this is achievable. The pricing should recover from the historical low reached in Q2** as the group has already started (at the end of June) and will continue to take price increases to offset currency depreciation/inflation in Brazil, Russia, Turkey, Ukraine and the UK... **The comparison base is also very favourable** as H2 2015 was affected by a rebate adjustment on skin health products in the US and the Maggi noodles recall. Of note, the group said that it has regained a 60% market shares of the noodles market in India (80% before the recall). Finally, **the closing of the Froneri transaction** at the end of the summer should generate an acceleration of organic sales growth by the deconsolidation of the poorly performing ice cream business in Europe.
- **China remains a concern.** Organic sales in the country (8% of the group's sales) were down in Q2. The group reported that it continues to gain market shares in 60% of its categories in a food & beverage market which has now stabilized. The trend is negative for Yinlu and is not expected to improve before 2017. Infant nutrition also proves to be challenging in the mainstream and premium ranges due to the low dairy prices, the tough competitive environment and the new regulatory measures. Organic sales of the Nestlé Nutrition division were up only 0.1% in Q2.
- **Raising our estimates. We now have deeper confidence in the group's ability to optimize its cost base.** In H1, it delivered CHF660m of savings as part of its Nestlé Continuous Excellence program. It is also implementing the first initiatives of the new cost savings program it has announced at its investors' Day. In a three-year timeframe from 2019, it will generate CHF2bn per year of structural economies stemming from 1/ procurement (CHF0.5bn), 2/ asset intensity (CHF1bn) and 3/ reduction in SG&A expenses (CHF0.5bn). **We raise our EPS estimate by 2% on average over the next three years. We also factor into our forecasts a stronger improvement in working capital** (in 2016, -100bps as % of group's sales vs -50bps previously). In H1, Nestlé decreased its working capital by 150bps to 4.3%, which contributed to the 41% growth in free cash flow. **We are convinced by its willingness to continue its efforts in this area.**

VALUATION

- Our DCF now points to a Fair Value of CHF84. At yesterday's share price, the stock is trading at 22.4x P/E 2016e and 20.7x P/E 2017e (respectively 22.5x and 20.5x for Danone and 22.1x and 20.2x for Unilever).

NEXT CATALYSTS

- Q3 2016 sales in October: Unilever on 13th, Danone on 18th and Nestlé on 20th

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Bloomberg	NESN.VX
Reuters	NESZn.VX
12-month High / Low (CHF)	79.9 / 68.4
Market Cap (CHF)	245,705
Ev (BG Estimates) (CHF)	256,922
Avg. 6m daily volume (000)	5 579
3y EPS CAGR	8.3%

	1 M	3 M	6 M	31/12/15
Absolute perf.	1.4%	8.2%	8.1%	5.9%
Food & Bev.	0.4%	4.4%	7.0%	0.8%
DJ Stoxx 600	1.6%	2.6%	7.2%	-6.1%

YEnd Dec. (CHFm)	2015	2016e	2017e	2018e
Sales	88,785	90,267	94,021	99,553
% change		1.7%	4.2%	5.9%
EBITDA	17,210	17,850	19,061	20,736
EBIT	13,382	14,066	15,169	16,547
% change		5.1%	7.8%	9.1%
Net income	10,353	10,890	11,772	12,956
% change		5.2%	8.1%	10.1%

	2015	2016e	2017e	2018e
Operating margin	15.1	15.6	16.1	16.6
Net margin	11.7	12.1	12.5	13.0
ROE	16.6	16.7	17.5	18.2
ROCE	12.5	13.0	14.5	16.0
Gearing	0.9	0.6	0.3	0.0

(CHF)	2015	2016e	2017e	2018e
EPS	3.30	3.52	3.81	4.19
% change	-	6.7%	8.1%	10.1%
P/E	23.9x	22.4x	20.7x	18.8x
FCF yield (%)	4.0%	4.1%	4.9%	5.3%
Dividends (CHF)	2.25	2.30	2.35	3.35
Div yield (%)	2.8%	2.9%	3.0%	4.2%
EV/Sales	2.9x	2.8x	2.7x	2.5x
EV/EBITDA	15.2x	14.4x	13.2x	11.9x
EV/EBIT	19.5x	18.3x	16.6x	14.9x



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Sector View

Software and IT Services

Four takeaways from the Q2 2016 earnings season

	1 M	3 M	6 M	31/12/15
Softw.& Comp. SVS	8.3%	9.8%	16.1%	4.0%
DJ Stoxx 600	1.6%	2.6%	7.2%	-6.1%

*Stoxx Sector Indices

Companies covered

ALTEN	SELL	EUR52
Last Price	EUR61,8	Market Cap. EUR2,082m
ALTRAN TECHNOLOGIES	BUY	EUR14
Last Price	EUR12,675	Market Cap. EUR2,228m
ATOS	BUY	EUR93
Last Price	EUR88,49	Market Cap. EUR9,270m
AXWAY SOFTWARE	BUY	EUR28
Last Price	EUR25,71	Market Cap. EUR535m
CAPGEMINI	BUY	EUR94
Last Price	EUR85,28	Market Cap. EUR14,684m
CAST	NEUTRAL	EUR3,6
Last Price	EUR3,5	Market Cap. EUR57m
DASSAULT SYSTEMES	SELL	EUR64
Last Price	EUR74,7	Market Cap. EUR19,216m
INDRA SISTEMAS	NEUTRAL	EUR11
Last Price	EUR11,62	Market Cap. EUR1,907m
SAGE GROUP	SELL	600p
Last Price	733,5p	Market Cap. GBP7,918m
SAP	NEUTRAL	EUR75
Last Price	EUR77,99	Market Cap. EUR95,811m
SOFTWARE AG	BUY	EUR40
Last Price	EUR36,165	Market Cap. EUR2,857m
SOPRA STERIA GROUP	BUY	EUR125
Last Price	EUR103,25	Market Cap. EUR2,114m
SWORD GROUP	BUY	EUR25
Last Price	EUR23,82	Market Cap. EUR225m
TEMENOS GROUP	NEUTRAL	CHF54
Last Price	CHF58,8	Market Cap. CHF4,090m

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ANALYSIS

- A quite positive earnings season.** Out of the 14 stocks we cover in European Software & IT Services, 9 reacted positively (above +2%), 3 did not react significantly (between -2% and +2%: Altran, Capgemini, and Sage), and only 2 reacted negatively (below -2%: Dassault Systèmes and Cast) following the release of Q2/H1 2016 sales and results. Such a quite positive situation has not happened since Q2 2014, and we explain it by two items: 1) all companies reported results in line (Dassault Systèmes, Atos, Sage) or above consensus (SAP, Capgemini, Temenos, Software AG, Altran, Sopra Steria, Alten, Indra, Axway, Sword), except Cast; 2) the negative interest rate environment, which favours investment in stocks, and particularly IT stocks given the recent wave of M&A (Oracle-NetSuite USD9.3bn, CSC-HPE Services USD8.5bn, NTT Data-Dell Services USD3.1bn, Salesforce-Demandware USD2.8bn) and purchases by private equity funds (Marketo, Cvent).
- Revenue momentum globally improving.** Except Cast, all companies in our coverage reported positive lfl revenue growth in Q2 2016, and growth rates are globally better than in 2015, driven by digital transformation becoming mainstream since the topic has moved from business lines to the Board level. lfl growth momentum even improved vs. Q1 2016 in Software for SAP (+8.6% vs. +6%), Dassault Systèmes (+6% vs. +5%), Temenos (+17% vs. +14%) and Axway (+8.6% vs. +2.3%). In Services, such a momentum improved for Capgemini (+3.8% vs. +2.9%), Altran (+9.6% vs. +6%), Sopra Steria (+7.8% vs. +3.3%), Alten (+10.6% vs. +5.5%), and Indra (+3% vs. -6.3%), notably due to a positive impact from the number of billable days (2-3 days more compared to Q2 2015).
- Brexit: not a big concern for now.** Only two companies in our coverage made negative comments on Brexit: 1) Capgemini, which now considers lfl revenue growth in H2 is unlikely to accelerate from H1 as Brexit may have some impact to discretionary IT spending of banks in Q4, yet it has not materialised so far; 2) Cast, which experienced one deal slippage from a US bank based in London just after the referendum, but pre-closing discussions resumed 3 weeks later for possible closing in Q3. Atos mentioned it had a quite limited exposure to discretionary spending in the Financial Services sector in the UK, and Sopra Steria reassured for the UK as post-Brexit discussions with the Cabinet Office under the new Prime Minister Theresa May indicated that no U-turn would be envisaged regarding the outsourcing of G&A functions in ministries and state agencies. Instead, all companies in our coverage see Brexit as a medium-term opportunity.
- Sopra Steria offers the best upside potential.** While we no longer have any top pick in Software & IT Services since the referendum on Brexit, and valuation is rich in our view for most of the stocks in our coverage following an outstanding performance during the last 6 months. That said, we consider that Sopra Steria, which derives in the UK (26% of sales) 68% of its revenues from the government while its exposure to British banks is low, offers the best upside potential (+21%).

VALUATION

- European Software companies: est. 17.1x 2016 and 15.5x 2017 EV/EBIT multiples.
- European IT Services companies: est. 11.2x 2016 and 9.8x 2017 EV/EBIT multiples.

NEXT CATALYSTS

Altran's H1 2016 results on 8th September before markets open



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BG's Wake Up Call

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Stock rating

BUY	Positive opinion for a stock where we expect a favourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential upside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
NEUTRAL	Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
SELL	Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 55.7%

NEUTRAL ratings 32.9%

SELL ratings 11.4%

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