1st August 2016

TMT

Indra Sistemas

Price EUR10.85

Q2 2016 conference call feedback: encouraging order intake

Fair Value EUR11 vs. EUR10 (+1%) **NEUTRAL**

Bloomberg	IDR SM
Reuters	IDR.MC
12-month High / Low (EUR)	10.9 / 7.7
Market Cap (EUR)	1,780
Ev (BG Estimates) (EUR)	2,415
Avg. 6m daily volume (000)	882.6
3y EPS CAGR	

	1 M	3 M	6 M	31/12/15
Absolute perf.	18.6%	6.0%	19.9%	25.1%
Softw.& Comp.	13.2%	10.1%	6.8%	4.3%
DJ Stoxx 600	4.7%	0.1%	-0.1%	-6.5%

YEnd Dec. (€m)	2015	2016e	2017e	2018e
Sales	2,850	2,719	2,774	2,880
% change		*-4.6%*	*2.0%*	*3.8%*
EBITDA	107	221	298	360
EBIT	-641.0	159.0	232.0	290.0
% change		*NS*	*45.9%*	*25.0%*
Net income	-73.0	86.0	147.0	189.0
% change		*NS*	*70.9%*	*28.6%*

	2015	2016e	2017e	2018e
Operating margin	1.6	5.9	8.4	10.1
Net margin	-22.5	3.1	5.2	6.5
ROE	-208.1	21.3	27.0	25.8
ROCE	-11.7	12.2	18.3	22.6
Gearing	227.0	163.0	88.0	35.0

(€)	2015	2016e	2017e	2018e
EPS	-0.40	0.47	0.81	1.04
% change	*-*	*NS*	*72.3%*	*28.4%*
P/E	NS	23.1x	13.4x	10.4x
FCF yield (%)	NM	0.8%	8.4%	10.9%
Dividends (€)	0.00	0.00	0.00	0.00
Div yield (%)	NM	NM	NM	NM
EV/Sales	0.9x	0.9x	0.8x	0.7x
EV/EBITDA	23.2x	10.9x	7.5x	5.7x
EV/EBIT	53.9x	15.2x	9.7x	7.0x

We reiterate our Neutral recommendation and raise our DCF-derived Fair Value from EUR10 to EUR11, after increasing our estimates for medium-term lfl revenue growth (+4% vs. +3%) and adj. EBIT margin (10.5% vs. 10%). While management remains cautious for the rest of the year due the current political and economic environment in Spain and LatAm and free cash flow remains low, we consider Indra is paving the way for future growth with strong order intake. Brazil has started to turn around with opex slashed by 30% and a bouncing book-to-bill ratio.

ANALYSIS

- **Realistic cautiousness for H2**. Q2 2016 was good, helped by a strong performance in Defence & Security in Spain (+42%) and sales related to Eurofighter with management acknowledging that revenues were slightly higher than expected. Despite solid order intake with a book-to-bill ratio of 1.2x for H1 2016 vs. 1.12x for H1 2015 essentially driven by Spain (order intake +7% lfl) and America (order intake +13% lfl), management refrained from being too optimistic for the full-year as it remains concerned by the absence of a government in Spain for nine months, oil prices, the economy in Latin America, and more deal selectiveness. In addition, although order intake is growing faster than revenues, sales cycles and transformation times between orders and sales are longer. Finally, growth in Defence & Security is unlikely to be as high in H2 2016 as it was in H2 2015 and H1 2016 due to the start of tougher comps. As such, the company reiterated its guidance for a slight lfl revenue decline - we expect -3% lfl for 2016, including -11.9% lfl for Q3 with tough comps in Government & Healthcare, Financial services and Defence, and +2.7% lfl for Q4 -, but the trends looks more encouraging going forward - we estimate +1.4% lfl for 2017 and +3.8% for 2018.
- **Brazil starting to turn around**. H1 2016 revenues in Brazil were down 16% lfl to EUR410m, but order intake was up 11% lfl to EUR436m (+50% lfl in Q2 to EUR252m) pointing to a surge in the book-to-bill ratio to 1.06x from 0.8x (1.21x in Q2 2016 vs. 0.67x in Q2 2015). In addition, operating costs were slashed by 30%, leading to a non-IFRS operating loss of EUR15m vs. EUR118m a year ago, and the margin reached -4% (and even a positive 4% excluding labour contingencies) vs. -24% a year ago. Four out of the seven loss-making projects that were identified have been terminated or finished, and the three remaining ones are on track to be resolved by end 2016.
- **Free cash flow to remain negative in Q3**. Free cash flow in Q2 was not a surprise as the EUR2m generated in the quarter was done by using the factor (EUR25m increase). As indicated in the press release, assuming the same level of factoring as in Q1, free cash flow would have been a negative EUR23m. As such, management reiterated guidance for negative free cash flow in Q3 and a positive level in Q4. That said, with net working capital representing 24 days of sales, Indra continues its efforts on cash collection regarding receivables and expects further improvement regarding suppliers. Finally, capex appeared to be low in H1 (EUR9m), but they are in line with the EUR35-40m projected for the full-year as some investments are planned on Defence projects.

VALUATION

- Indra's shares are trading at est. 15.2x 2016 and 9.7x 2017 EV/EBIT multiples.
- Net debt on 30th June 2016 was EUR659.4m (net gearing: 199%).

NEXT CATALYSTS

Q3 2016 results in November.

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