

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.	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

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%).

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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