22nd September 2016

TMT

Alten

Price EUR62.66

H1 2016 analysts' meeting feedback: fairly valued only if research tax credit status changes

Fair Value EUR54 vs. EUR52 (-14%) **SELL**

Bloomberg	ATE FP
Reuters	LTEN.PA
12-month High / Low (EUR)	63.8 / 44.3
Market Cap (EUR)	2,111
Ev (BG Estimates) (EUR)	2,072
Avg. 6m daily volume (000)	29.80
3y EPS CAGR	12.4%

	1 M	3 M	6 M	31/12/15
Absolute perf.	1.1%	14.1%	17.3%	17.3%
Softw.& Comp.	4.2%	11.4%	12.7%	8.1%
DJ Stoxx 600	0.7%	0.7%	0.5%	-6.4%

YEnd Dec. (€m)	2015	2016e	2017e	2018e
Sales	1,541	1,723	1,853	1,985
% change		*11.8%*	*7.5%*	*7.1%*
EBITDA	164	187	205	226
EBIT	152.0	175.0	192.0	213.0
% change		*15.1%*	*9.7%*	*10.9%*
Net income	110.0	123.0	139.0	156.0
% change		*11.8%*	*13.0%*	*12.2%*

	2015	2016e	2017e	2018e
Operating margin	9.9	10.1	10.4	10.7
Net margin	6.8	6.8	7.2	7.5
ROE	16.3	16.7	16.6	16.2
ROCE	16.7	17.7	18.8	20.6
Gearing	-3.0	-5.0	-15.0	-25.0

(€)	2015	2016e	2017e	2018e
EPS	3.26	3.66	4.14	4.63
% change	-	*12.3%*	*13.1%*	*11.8%*
P/E	19.2x	17.1x	15.1x	13.5x
FCF yield (%)	4.7%	4.7%	6.1%	6.8%
Dividends (€)	1.00	1.00	1.00	1.00
Div yield (%)	1.6%	1.6%	1.6%	1.6%
EV/Sales	1.4x	1.2x	1.1x	0.9x
EV/EBITDA	12.8x	11.1x	9.7x	8.3x
EV/EBIT	13.8x	11.8x	10.3x	8.8x

We reiterate our Sell rating and raise our DCF-derived Fair Value to EUR54 from EUR52 on adjustments to our tax rate assumption (30% vs. 31%). In a scenario where Alten would drop its "research tax credit-approved" status for R&D work done on behalf of clients, we consider our Fair Value would gain EUR7-8 based on a 2ppt margin gain. The stock is, at best, fairly valued in our view.

ANALYSIS

- **Improving trends in market segments**. Lfl sales growth in H2 2016 is set to suffer from 2.4 fewer billable days than in H2 2015 (-2ppt). Automotive (20% of sales) offers strong visibility for the next 2-3 years with lots of projects concerning engines, connected vehicles and security. In Aerospace (16%), business is growing thanks to the ramp up of manufacturing engineering and Space. In Tertiary/Services (18%), growth is poised to accelerate, driven by Banking, Insurance and Retail. In Energy & Life Sciences (18%), the decline in Oil & Gas and Areva's turmoil are strong enough to offset the rise in Life sciences. In Telecoms, 2016 is likely to see modest growth after years of decline, and the best is yet to come from 2017-18 when 5G networks will start to be developed.
- **Ambitions remain intact, 2019 staff targets poised to be exceeded**. Alten remains confident with an operating margin of at least 10% for 2016 and beyond. H2 2016 is likely to be slightly below H1 (10.2%) due to a 1ppt dent from calendar effects, while acquisitions are dilutive (negative impact: -0.2ppt in H1). Management considers the end-2019 target announced in February (24,000 staff, o/w 21,000 engineers) should be reached ahead of schedule as Alten already employs 22,900 staff, o/w 20,250 engineers. The acquisitions policy is unchanged, with the goal to reach a critical size of 1,500 staff in every country Alten operates. The acquisition made in July and revealed yesterday (EUR13m revenues, 100 staff, margin at breakeven) is in North America with access to all the majors in Oil & Gas in the US, and we understand is has been paid at a very low price.
- **Germany in transformation**. In Germany, acquisitions took a 3ppt toll on lfl sales growth, which would have come in at +1% despite the transformation in progress in Automotive (40% of sales), moving away from staffing to project-based services. Whereas the H1 op. margin in Germany was below 5%, it is expected to increase in 2016 and reach 8-9% in 2017.
- **Free cash flow**. The 61% FCF fall in H1 2016 (to EUR11.1m from EUR28.6m) stemmed from a EUR56.8m WCR surge (vs. a EUR20.5m rise in H1 2015). The EUR36m WCR acceleration was driven by 2.5 more billable days (EUR14m), a EUR9m payment ahead of schedule from a client in Oil & Gas in H1 2015, and an unfavourable geographic mix regarding payment terms - Russia, China, Italy, Spain and Africa (EUR15m). DSOs were up one day to 98 days in H1 2016. Management anticipates that WCR will decline in 2016 vs. 2015 helped by 2.4 fewer billable days in H2.
- **The research tax credit equation**. Alten's French "research tax credit-approved" status for R&D work done on behalf of clients generates an est. 2ppt headwind for operating margin as it limits its ability to benefit from tax credit. The group is reviewing the opportunity of dropping this status like Altran did, but this depends on negotiations with customers and eligibility with the tax administration. As such, it is uncertain whether or not Alten will change its status next year. All other things remaining equal, we estimate abandoning this status could have a EUR7-8 positive impact on our DCF-derived Fair Value, which would then be in line with current share price levels.

VALUATION

- Alten's shares are trading at est. 11.8x 2016 and 10.3x 2017 EV/EBIT multiples.
- Net debt on 30th June 2016 was EUR61.8m (net gearing: 9%).

NEXT CATALYSTS

Q3 2016 sales on 27th October after markets close.

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