

Gemalto

Price EUR56.85

Safran selects Oberthur/Advent for its Identity and Security arm

Fair Value EUR62 (+9%)

NEUTRAL

Bloomberg	GTO FP
Reuters	GTO.PA
12-month High / Low (EUR)	65.5 / 49.8
Market Cap (EUR)	5,110
Ev (BG Estimates) (EUR)	5,190
Avg. 6m daily volume (000)	369.1
3y EPS CAGR	23.8%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-7.3%	4.4%	-11.1%	2.9%
Softw. & Comp.	3.2%	17.3%	11.3%	8.1%
DJ Stoxx 600	-0.1%	5.0%	1.8%	-6.3%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	3,122	3,244	3,406	3,610
% change		3.9%	5.0%	6.0%
EBITDA	345	513	609	677
EBIT	313.3	438.9	529.0	588.5
% change		40.1%	20.5%	11.3%
Net income	226.3	329.7	396.7	432.8
% change		45.7%	20.3%	9.1%

	2015	2016e	2017e	2018e
Operating margin	10.0	13.5	15.5	16.3
Net margin	4.2	8.9	10.5	11.1
ROE	5.4	10.5	11.7	11.8
ROCE	7.1	10.0	12.1	13.4
Gearing	13.4	2.9	-7.5	-16.7

(EUR)	2015	2016e	2017e	2018e
EPS	2.53	3.66	4.41	4.81
% change	-	44.6%	20.3%	9.1%
P/E	22.4x	15.5x	12.9x	11.8x
FCF yield (%)	3.3%	6.1%	7.4%	8.3%
Dividends (EUR)	0.47	0.51	0.55	0.59
Div yield (%)	0.8%	0.9%	1.0%	1.0%
EV/Sales	1.7x	1.6x	1.4x	1.3x
EV/EBITDA	15.8x	10.1x	8.0x	6.7x
EV/EBIT	17.4x	11.8x	9.2x	7.7x



Safran yesterday announced it is entering exclusive negotiations with Advent, associated with Bpifrance, for the sale of its Identity and Security activities (Morpho). Morpho is to be combined with Oberthur Technologies to create a world champion in identification technologies. The EUR2,425m deal is expected to close in 2017. The complementary nature of the business combination was an essential criteria for choice. We maintain our Neutral recommendation and FV of EUR62 on Gemalto.

ANALYSIS

- Safran yesterday announced that it had received a firm and irrevocable offer from Advent to acquire its Identity and Security activities (Morpho) for EUR2,425m** and has entered into exclusive negotiations on this basis. The industrial project consists of **bringing together Safran I&S and Oberthur Technologies with combined revenues of EUR2.8bn**. Its headquarters will remain in France, as will its leading R&D activities and key production capacities. **Bpifrance will take a stake and join the board**. The transaction would result in a pre-tax capital gain for Safran. It is to be submitted to the employee representative bodies and is subject to regulatory approval notably in Europe and in the US. **The transaction is expected to close during 2017**. According to the information we have, Gemalto is thought to have proposed EUR2.4bn.
- This official announcement from Safran is in line with our expectation**. We considered that the sale of Morpho to a direct competitor with an industrial background (Gemalto or Oberthur) would make sense. We expected a somewhat better chance for Oberthur Technologies/Advent over Gemalto and had a probability of success rate of 55% for Oberthur/Advent and 45% for Gemalto. **The slight advantage in favour of Oberthur/Advent was related to its French roots and its US touch, and also to its high industrial complementarity with Morpho**. As a reminder, the US is Morpho's first market in terms of sales (it has served the FBI since 1974, when it first offered the intelligence agency its automated fingerprint identification system). And the French ministry was also closely monitoring the sale (it holds 15.4% of Safran's capital and 24.0% of its voting rights), as the division supplies a critical criminal identification system for police officers that enables terrorism prevention. **Philippe Petitcolin (Safran's CEO) expected to sell the whole of Morpho for a minimum of EUR2bn**. As such, the EUR2.425bn offered by Oberthur/Advent is far higher (a 21% premium). **According to our estimates, the final price means ~1.3x sales and ~19.2x EBIT in 2017e** (1.6x and 25.5x respectively in 2015). **That's clearly not cheap given the profitability of Morpho** (EBIT margin we estimate at only 6%, namely half of that of Gemalto...). However, given the intensity of the competition (there were 12 bidders at the beginning), we were betting on a price above EUR2bn.
- We consider that in embedded software & Products, 78% of the market is currently owned by four players** (Gemalto 40%, Giesecke & Devrient 15%, Oberthur Technologies 15%, and Morpho 8%) **and the remaining 22% breaks down between small local players** (especially Asian such as Eastcompeace Technology, Watchdata, Datang Telecom Technology & Industry Group, Wuhan Tianyu Information Industry and Kona). **Moreover, the combination of Morpho and Oberthur Technologies will give birth to a strong world competitor to Gemalto in the technology, industrial and commercial domains**. Indeed, Morpho's best-in-class technologies and world-leading positions in identification (notably in biometrics) are complementary to Oberthur.

Player trends in each main vertical and their market shares

Sectors	Gemalto	Giesecke & Devrient	Oberthur Tech	Morpho	TOP 4	Local players
Telecoms	✓✓✓	✓✓✓	✓✓	✓		
eGovernment	✓✓✓	✓	✓	✓✓✓		
Banks	✓✓✓	✓✓	✓✓✓			
Enterprise	✓✓✓					
M2M	✓					
Total market share	40%	15%	15%	8%	78%	22%

✓✓✓ Excellent; ✓✓ Good; ✓ Weak

Source: Bryan, Garnier & Co ests

VALUATION

- **We maintain our Neutral recommendation and FV of EUR62 on Gemalto. We do not see a positive risk/reward.** The current year is very back-end loaded, visibility is poor, we still see too many risks in the SIM and related services business, Oberthur combined with Morpho will be a serious global competitor. **Last but not least, we expect momentum to be unattractive as long as management maintains its unreachable 2017 PFO target.**

NEXT CATALYSTS

- **Gemalto's Q3 revenue:** on 28th October (before trading).

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Analyst :

Richard-Maxime Beaudoux
33(0) 1.56.68.75.61
rmbeaudoux@bryangarnier.com

Sector Team :

Thomas Coudry
Gregory Ramirez
Dorian Terral

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London	Paris	New York	Munich	New Delhi
Beaufort House	26 Avenue des Champs Elysées	750 Lexington Avenue	Widenmayerstrasse 29	The Imperial Hotel Janpath
15 St. Botolph Street	75008 Paris	New York, NY 10022	80538 Munich	New Delhi 110 001
London EC3A 7BB	Tel: +33 (0) 1 56 68 75 00	Tel: +1 (0) 212 337 7000	Germany	Tel +91 11 4132 6062
Tel: +44 (0) 207 332 2500	Fax: +33 (0) 1 56 68 75 01	Fax: +1 (0) 212 337 7002	+49 89 2422 62 11	+91 98 1111 5119
Fax: +44 (0) 207 332 2559	Regulated by the	FINRA and SIPC member		Fax +91 11 2621 9062
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Financial Conduct Authority (FCA)	Autorité de Contrôle prudentiel et de			rue de Grenus 7
	resolution (ACPR)			CP 2113
				Genève 1, CH 1211
				Tel +4122 731 3263
				Fax+4122731 3243
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