27th October 2016

TMT

Capgemini

Price EUR76.62

Q3 2016 conference call feedback: “normative” growth remains decent

Fair Value EUR93 vs. EUR94 (+21%) **BUY**

Bloomberg	CAP FP
Reuters	CAPP.PA
12-month High / Low (EUR)	89.1 / 69.0
Market Cap (EUR)	13,145
Ev (BG Estimates) (EUR)	14,502
Avg. 6m daily volume (000)	600.2
3y EPS CAGR	11.2%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-12.1%	-8.0%	-2.5%	-10.5%
Softw.& Comp.	-2.4%	2.6%	9.5%	5.3%
DJ Stoxx 600	0.5%	0.1%	-1.6%	-6.6%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	11,915	12,545	12,905	13,433
% change		*5.3%*	*2.9%*	*4.1%*
EBITDA	1,577	1,706	1,836	1,956
EBIT	1,022	1,185	1,374	1,494
% change		*15.9%*	*16.0%*	*8.7%*
Net income	796.9	953.0	1,031	1,116
% change		*19.6%*	*8.2%*	*8.2%*

	2015	2016e	2017e	2018e
Operating margin	10.6	11.4	12.1	12.5
Net margin	9.4	6.1	6.8	7.2
ROE	16.3	11.1	12.1	12.4
ROCE	17.2	13.6	14.5	15.9
Gearing	25.3	19.8	9.7	0.2

(EUR)	2015	2016e	2017e	2018e
EPS	4.64	5.52	5.89	6.38
% change	-	*19.0%*	*6.8%*	*8.2%*
P/E	16.5x	13.9x	13.0x	12.0x
FCF yield (%)	6.2%	6.6%	7.5%	8.0%
Dividends (EUR)	1.35	1.50	1.60	1.70
Div yield (%)	1.8%	2.0%	2.1%	2.2%
EV/Sales	1.2x	1.2x	1.1x	1.0x
EV/EBITDA	9.4x	8.5x	7.5x	6.7x
EV/EBIT	11.8x	10.1x	8.9x	7.8x

We reiterate our Buy rating and trim our DCF-derived fair value to EUR93 from EUR94 post the conference call held yesterday. Our lfl sales growth ests. are cut to +2.7% from +3.3% for 2016, are unchanged for 2017 (+2.9%) and raised to +4.1% from +3.9% for 2018. Ex-headwinds (Energy & Utilities, Brazil, Aspire), Q3 2016 “normative” growth was +4% lfl. As these elements will fade over time and market conditions remain buoyant with solid bookings, we believe that yesterday’s share price fall was overdone.

ANALYSIS

- **Heading to the low-end of FY16 lfl growth guidance**. Management now expects revenue growth at cc in H2 2016 to be similar to that of Q3 2016 (+2.2%), given expected headwinds - re-insourcing of Aspire (-0.4ppt in Q3 2016, est. -0.9ppt for Q4 2016, -1.3ppt for H1 2017 and -1.1ppt for H2 2017) - and unexpected ones - persistent weakness in Energy & Utilities in North America (-0.9ppt for Q3 2016, est. -1.1ppt for Q4 2016 and less in Q1 2017) and the fall in hardware reselling in Brazil (-0.6ppt in Q3 2016 and less in Q4 2016 and Q1 2017). This translates into lfl growth at the low-end of company guidance (+2.5%/+4.5% lfl), while in July management implied to be close to the mid-point. That said, restated for unexpected headwinds, lfl revenue growth would have been +3.6% in Q3 2016 and restated from unexpected headwinds and Aspire it would have been +4% - not very far from the low-end of the 5-7% medium-term growth guidance (2019). With strong momentum in Central Europe, Nordic countries, France, the commercial sector in the UK, and many areas in North America, there is no change in market conditions, which remain buoyant and driven by Digital and new projects. This is underpinned by bookings up 14% at cc in Q3 2016 (book-to-bill ratio: 0.92x vs. 0.82x in Q3 2015) and expected to be strong in Q4 2016 too.
- **No concern on the operating margin**. Management estimates that, based on current rates, fx headwinds will dent revenue growth by c. 3ppt for 2016. Despite the depreciation of the British pound versus the Indian rupee, no significant fx headwind to the operating margin is expected as Capgemini has hedged the GBP for 2016-17 and is starting to do so for 2018-19. The absence of hardware reselling in Brazil benefits the margin as this is “pass-through” revenues. The persistent weakness of the business in Energy & Utilities is not expected to generate a material impact on Capgemini’s profitability as, at the same time, countries like France and The Netherlands are significantly increasing their offshore exposure (offshore leverage has reached 30% in France, having stalled between 15 and 20% for a time), while group offshore headhount rose by 8%.
- **Acquisitions in the US becoming a top priority**. Capgemini identified Digital & Cloud for Consumer & Retail as an area where it has to improve its competitiveness. As such, it is now in active search for acquisitions in this area in North America. It could translate into 2ppt of additional revenue growth per year in the coming 2-3 years, even though it could be more expensive than previous acquisitions while it looks necessary to accelerate the customer transition towards Digital & Cloud. On top of this, Capgemini continues to invest in Digital & Cloud and is reaping the benefits of this, with revenues up 33% in Cloud, new offers in Digital Manufacturing and vertical initiatives (SAP, Valeo…), and a lot of opportunities in North America. At the same time, Capgemini maintains its investment in service automation (3,900 experts globally with 200+ customers) leading to significant productivity gains, and the leverage of offshore production centres (55% of staff).

VALUATION

- Capgemini’s shares are trading at est. 10.1x 2016 and 8.9x 2017 EV/EBIT multiples.
- Net debt on 30th June 2016 was EUR2,270m (net gearing: 36%).

NEXT CATALYSTS

FY16 results on 16th February 2017 before markets open.

Click here to download document

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