

Gemalto

Price EUR56.34

Profit warning both on FY 2016 and FY 2017 is greater than expected

Fair Value EUR50 vs. EUR60 (-11%)

SELL vs. NEUTRAL

Bloomberg	GTO.FP
Reuters	GTO.PA
12-month High / Low (EUR)	65.5 / 49.8
Market Cap (EUR)	5,065
Ev (BG Estimates) (EUR)	5,221
Avg. 6m daily volume (000)	361.9
3y EPS CAGR	16.1%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-4.6%	-3.3%	-4.3%	1.9%
Softw. & Comp.	-3.0%	1.3%	7.5%	4.8%
Ind. & Govt.	0.4%	-0.3%	-1.9%	-6.6%
DJ Stoxx 600	0.4%	-0.3%	-1.9%	-6.6%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	3,122	3,127	3,221	3,350
% change		0.2%	3.0%	4.0%
EBITDA	345	488	530	578
EBIT	313.3	420.6	454.1	495.7
% change		34.3%	8.0%	9.2%
Net income	226.3	300.5	326.4	356.5
% change		32.8%	8.6%	9.2%

	2015	2016e	2017e	2018e
Operating margin	10.0	13.5	14.1	14.8
Net margin	4.2	8.2	8.5	9.4
ROE	5.4	9.5	9.3	9.8
ROCE	7.1	9.5	10.3	11.2
Gearing	13.4	5.8	-2.8	-10.9

(EUR)	2015	2016e	2017e	2018e
EPS	2.53	3.34	3.62	3.96
% change	-	31.8%	8.6%	9.3%
P/E	22.2x	16.9x	15.5x	14.2x
FCF yield (%)	3.4%	4.4%	5.7%	6.9%
Dividends (EUR)	0.47	0.51	0.55	0.59
Div yield (%)	0.8%	0.9%	1.0%	1.0%
EV/Sales	1.7x	1.7x	1.5x	1.4x
EV/EBITDA	15.6x	10.7x	9.4x	8.2x
EV/EBIT	17.2x	12.4x	11.0x	9.5x



Q3 sales fell short of expectations (-5% vs. consensus and -4% vs. BG est.). Management warned both on FY 2016 and FY 2017, because of a very adverse mobile environment and slower than anticipated migration of payment cards. Moreover, it will increase investments to capture growth beyond 2017. GTO now targets a PFO between EUR500m and EUR520m vs. over EUR660m previously (i.e. a miss between of over 21% and 24%). The only hope was if Gemalto guided in line with our last downward revision, but it's much worse than our EUR565m and consensus est. of EUR563m (the new guidance is between 8% and 12% below expectations). This confirms that the stock is often a "value trap". We once again cut our 2016-18 EPS sequence, by 9.3% on average this time. We downgrade our rating from Neutral to Sell and our FV from EUR60 to EUR50.

ANALYSIS

- Q3 sales fell short of expectations: revenue came out at EUR753m, i.e. -2% Y/Y and -1% lfl** (flat lfl over the first 9 months) compared to consensus of EUR793m (+4% lfl) and our estimate of EUR787.1m (+3% lfl). This miss is mainly due to **lower sales of secure software to mobile network operators and to financial institutions**, but also to **client delays in project commencements for Platform and Services** (in Mobile, eGovernment services and Enterprise cybersecurity solutions).
- By business unit: 1) Mobile was down 5% lfl at EUR285m** (cons. at EUR291m; BG est. EUR291.2m) with **a) SIM business -11%** (better conditions in Latam and Asia but some African countries started stricter subscription registration processes similar to China with lower demand), **b) M2M +11%** (growing global demand for connected devices and e-SE for IOT) and **c) -9%** for Platforms & Services (slower project commencements due to longer client decision processes). **2) Payment & Identity** was up 1% lfl at EUR467m (cons. EUR497m ; BG est. EUR493.9m) with **a) flat** for ES&P (payments -3% lfl impacted by a soft market environment in Brazil and high comps in the US related to the EMV liability shift in Oct 2015; e-Government +9% thanks to the deliveries of previously won projects; Enterprise +4% with a ramp-up in authentication and Cybersecurity), and **b) +2%** for P&S. **3) Patents & Others** was up 2% lfl at EUR1m (cons. EUR5m; BG est. EUR2m) with traditional irregularity. **By region:** -1% in EMEA (44% of sales), -10% in Americas (38% of sales) and +16% in Asia (19% of sales).
- New guidance: For 2016**, Gemalto maintains that it expects to generate a 1.5% gross margin increase, adding through an acceleration of revenue growth in Q4 (lower comps) but no longer give indication on the PFO. **For 2017**, from its current planning processes, 2017 PFO is now expected to be between EUR500m and EUR520m (+10% CAGR since 2013) vs. over EUR660m before. This reflects a very adverse mobile environment and slower than anticipated migration of payment cards in 2017. It plans to invest more to capture growth beyond 2017 in Mobile P&S, Enterprise and Government Programs. Platforms & Services revenue of EUR1bn in 2017 is unchanged.
- We expected the company to warn sooner or later, both on FY 2016e and FY 2017e.** It's now reality, but the revision is **much more severe than expected by the market** (we were at EUR565m and cons. at EUR563m). The new guidance of EUR500m-EUR520m (vs. over EUR660m previously) is even far short of the initial guidance of >EUR600m before the acquisition of SafeNet. The appointment of the new CEO as of 1st Sept. (Philippe Vallée, former COO) has with no doubt prompt GTO to slash its guidance with the reality of the business (SIM and payments businesses).
- We revised once again our FY 2016 and FY 2017 estimates. 1) 2016e:** revenue from EUR3,184m to EUR3,127m (+0.2% Y/Y and +0.8% lfl), PFO from EUR475.2m to EUR465m (i.e. +10% Y/Y, margin of 14.9%; no guidance vs. previous vague guidance of "accelerating its PFO expansion towards its 2017 objectives"; cons. EUR477m), underlying EBIT from EUR430.7m to EUR420.6m i.e. a margin of 13.5%; and net profit from EUR264.9m to EUR257.4m i.e. a margin of 8.2%). **2) 2017e:** revenue from EUR3,311.3m to EUR3,220.8m (+3.0% lfl), PFO from EUR565.3m to EUR505.2m (+8.6% Y/Y and margin of 15.7%; cons. EUR563m) i.e. over 23% below the previous guidance and in the low-end of the new one, underlying EBIT from EUR514.3m to EUR454.1m i.e. a margin of 14.1%, and net profit from EUR333.6m to EUR273.3m i.e. a net margin of 8.5%. See table p2 for more details.

VALUATION

- We once again cut our 2016-18 EPS sequence, by 9.3% on average this time:** -2.6% in 2016e, -12.4% in 2017e and -13.0% in 2018e.

- **We downgrade our recommendation from Neutral to Sell and FV from EUR60 to EUR50.** We now only retain our SOTP which seems to be the most reliable method to value Gemalto (vs. DCF, SOTP and 2-year historical multiples previously).
- **The stock is often a “value trap”.** The company warned both regarding FY 2016e and FY 2017e, to a greater extent than expected. Finally, short positions have been reduced (~6% declared but probably ~8% of the capital incl. all positions under 0.5%) since a peak in October 2014 (21-22% of the capital incl. all positions under 0.5%) **but without a rally in the share price.** As such, we believe **this new disappointment could lead short-sellers to attack the stock again.**

NEXT CATALYSTS

- **Conference call:** today at 3pm.
- **FY 2016 sales and earnings:** on 3rd March, 2017 (before trading).

Consensus and BG estimates (old and new) from 2015 to 2017e

EURm	2015 (reported)	BG 2016e (old)	BG 2016e (new)	Cons. 2016e	BG 2017e (old)	BG 2017e (new)	Cons. 2017e
Sales	3,121.6	3,184.0	3,127.0	3,199	3,311.3	3,220.8	3,406
<i>Y/Y change</i>	26.6%	2.0%	0.2%	2.5%	4.0%	3.0%	6.5%
<i>Y/Y change (lfi)</i>	4.0%	2.5%	0.8%		4.0%	3.0%	
PFO¹	422.6	475.2	465.0	477	565.3	505.2	563
<i>Margin</i>	13.5%	14.9%	14.9%	14.9%	17.1%	15.7%	16.5%
EBIT	203.3	379.4	365.9	-	463.2	384.9	-
<i>Margin</i>	6.5%	11.9%	11.7%		14.0%	12.0%	
Current EBIT	313.3	430.8	420.6	438	514.3	454.1	525
<i>Margin</i>	10.0%	13.5%	13.5%	13.7%	15.5%	14.1%	15.4%
Net profit	136.9	264.9	257.4	-	333.6	273.3	-
<i>Margin</i>	4.4%	8.3%	8.2%		10.1%	8.5%	
Rest. attrib. net	226.3	308.5	300.5	340.5	372.6	326.3	404
<i>Margin</i>	7.3%	9.7%	9.6%	10.7%	11.3%	10.1%	11.9%
Net debt	334.7	140.8	156.3	153	-151.0	-81.3	-22
<i>Gearing</i>	13.4%	5.2%	5.8%		-5.0%	-2.8%	

¹PFO (Profit From Operations) is an underlying EBIT before stock options

Sources: Bryan, Garnier & Co ests; Thomson Reuters consensus.

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