

Temenos Group

Price CHF61.20

Large deal with a major European bank

Fair Value CHF71 vs. CHF54 (+16%)

BUY vs. NEUTRAL

Bloomberg	TEMN SW
Reuters	TEMN.SW
12-month High / Low (CHF)	62.2 / 40.8
Market Cap (CHFm)	4,257
Ev (BG Estimates) (CHFm)	4,389
Avg. 6m daily volume (000)	205.9
3y EPS CAGR	19.6%

We upgrade the stock to Buy from Neutral and increase our DCF-derived fair value to CHF71 from CHF54 as we reduce our company beta to 1.2 from 1.4 given the rise of the market cap year-to-date (+CHF13/share), a change in our medium-term tax rate to 18% from 22% (+CHF4). This morning Temenos announced that a major European bank has selected Temenos' front-to-back solution for commercial and corporate lending. We deem this "material transaction" will lead to a raise in company guidance after Q3 results.

	1 M	3 M	6 M	31/12/15
Absolute perf.	7.1%	26.2%	16.3%	17.8%
Softw. & Comp.	2.8%	17.2%	10.8%	8.3%
DJ Stoxx 600	-0.2%	4.0%	1.6%	-6.3%

ANALYSIS

YEnd Dec. (US\$m)	2015	2016e	2017e	2018e
Sales	542.5	616.7	679.4	749.2
% change		13.7%	10.2%	10.3%
EBITDA	212	249	279	310
EBIT	96.8	147.1	178.2	207.7
% change		52.0%	21.2%	16.6%
Net income	121.0	155.3	180.3	207.1
% change		28.3%	16.1%	14.9%

	2015	2016e	2017e	2018e
Operating margin	30.8	32.4	33.5	34.3
Net margin	12.2	17.8	20.1	21.8
ROE	17.7	24.1	24.4	22.6
ROCE	23.9	29.9	36.7	46.2
Gearing	71.2	29.9	-3.6	-33.6

(US\$)	2015	2016e	2017e	2018e
EPS	1.82	2.33	2.70	3.11
% change	-	28.3%	16.1%	14.9%
P/E	34.8x	27.1x	23.3x	20.3x
FCF yield (%)	3.8%	4.1%	4.7%	5.5%
Dividends (US\$)	0.45	0.50	0.55	0.60
Div yield (%)	0.7%	0.8%	0.9%	1.0%
EV/Sales	8.6x	7.3x	6.4x	5.5x
EV/EBITDA	22.0x	18.2x	15.7x	13.4x
EV/EBIT	27.9x	22.7x	19.2x	16.1x

- A material transaction.** This morning Temenos announced that a major European bank has selected UniversalSuite, its front-to-back solution for retail, commercial and corporate banking. According to the management, this is a "material transaction", about which Temenos will provide more details in due course, i.e. within the next few weeks or at the time of the publication of Q3 2016 results on 19th October. At this stage, neither the name of the bank nor the amount of the deal can be mentioned as part of the non-disclosure agreement that Temenos has with the bank. That said, as the transaction is said to be material, we understand it is a licence deal above USD5m. In addition, we understand the bank has chosen Temenos for its domestic operations, and for undertaking its digital transformation.
- Room for upgrading company guidance after Q3 results?** Following recent agreements with institutions such as Nordea Bank, signed in September 2015, and Standard Chartered Bank, signed in July 2016, this new deal demonstrates that Temenos is seen by banks as their major transformation partner, driven by the digitalisation of the banking industry. The deals with Standard Chartered and BIL announced in July have led the management to consider reaching the high-end of company guidance (USD593-612m for revenues and USD180-185m for the non-IFRS operating margin). With a new deal supposed to reach at least USD5m - yet at this stage it is unclear whether it will bring revenues in Q3 or Q4 -, we consider company guidance will be raised. Consequently, we raise our 2016 revenue forecast to USD617 from USD614m.
- Temenos is the choice for "growth stocks" in the IT universe in Europe.** Our upgrade to Buy is justified by the fact that, although the stock is expensive, it is one of the rare companies in Software & IT Services in Europe which is capable to deliver a 20% EPS CAGR over 2015-2018e in our view. Temenos looks to be in a spiral of success, driven by the digital transformation of banks as the latter want to reduce IT costs and make their core banking systems more flexible in a low ROE environment since 2008 (ROE below 10%). As Temenos has made the right IT architectural and technology choices and has built a compelling ecosystem of partners over time (Accenture, Cagemini, Deloitte, Cognizant...), bank have little choice when they decide to change.

VALUATION

- Temenos' shares are trading at est. 22.7x 2016 and 19.2x 2017 EV/EBIT multiples.
- Net debt on 30th June 2016 was USD288.4m (net gearing: 78%).

NEXT CATALYSTS

Q3 2016 results on 19th October after markets close.

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Analyst :
 Gregory Ramirez
 33(0) 1 56 68 75 91
gramirez@bryangarnier.com

Sector Team :
 Richard-Maxime Beaudoux
 Thomas Coudry
 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
Authorised and regulated by the	Financial Conduct Authority (FCA) and the			Geneva
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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