29th November 2016

TMT

Capgemini

Price EUR75.45

Feedback from investors lunch in Paris

Fair Value EUR95 vs. EUR93 (+26%) **BUY**

Bloomberg	CAP FP
Reuters	CAPP.PA
12-month High / Low (EUR)	89.1 / 69.0
Market Cap (EUR)	12,945
Ev (BG Estimates) (EUR)	14,297
Avg. 6m daily volume (000)	667.3
3y EPS CAGR	11.9%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-0.1%	-14.1%	-12.3%	-11.9%
Softw.& Comp.	-1.2%	-1.5%	3.7%	3.4%
DJ Stoxx 600	-0.3%	-1.1%	-2.8%	-7.1%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	11,915	12,564	13,065	13,596
% change		*5.4%*	*4.0%*	*4.1%*
EBITDA	1,577	1,711	1,854	1,975
EBIT	1,022	1,190	1,392	1,513
% change		*16.4%*	*17.0%*	*8.7%*
Net income	796.9	956.5	1,044	1,129
% change		*20.0%*	*9.2%*	*8.1%*

	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	12.2	12.5
ROCE	17.2	13.7	14.6	16.1
Gearing	25.3	19.7	9.6	0.0

(EUR)	2015	2016e	2017e	2018e
EPS	4.64	5.58	6.01	6.50
% change	-	*20.4%*	*7.7%*	*8.1%*
P/E	16.3x	13.5x	12.5x	11.6x
FCF yield (%)	6.3%	6.8%	7.7%	8.2%
Dividends (EUR)	1.35	1.50	1.60	1.70
Div yield (%)	1.8%	2.0%	2.1%	2.3%
EV/Sales	1.2x	1.1x	1.0x	1.0x
EV/EBITDA	9.3x	8.4x	7.4x	6.6x
EV/EBIT	11.6x	10.0x	8.6x	7.6x

We reiterate our Buy rating, but raise our DCF-derived fair value to EUR95 from EUR93 as we increase our adj. EPS ests. by 1% for 2016 and 2% for 2017-18 on updated fx assumptions. Last week we hosted an investors lunch in Paris with Capgemini's Head of IR, Vincent Biraud. The key takeaways from the event were reassuring: 1) harsh conditions in Oil & Gas in the US took Capgemini by surprise in Q3, but IT spending offers upside from H2 2017 as it has been cut to the bone; 2) the situation in Brazil is under control; 3) potential restrictions to H-1B visas in the US is less a concern than for Indian peers.

ANALYSIS

- **Harsh conditions in Oil & Gas in North America took Capgemini by surprise**. In North America, the strong 2-digit fall in Energy/Utilities in 2016 in a context of low oil prices - tens of drilling companies went bankrupt, no new project is underway, and IT spending in shale gas has been cut to the bone - is the backlash of an explosive surge in demand in 2014 and H1 2015 (add-ons on top of SAP ERP). Capgemini made a late entry in Oil & Gas, gained market share in a booming market, and paid the price for it. The situation was so dire that the company even stopped working with some customers given the risk of not being paid. Management does not bank on a sales recovery in Energy/Utilities for North America as long as there is no improved visibility for Oil & Gas customers over several quarters - even though Trump's campaign speech looked to be favourable to oil firms -, so the YoY sales decline in this area will decelerate until Q2 2017 as comps will ease over time.
- **Brazil under control**. In LatAm, pure IT Services revenues have been flattish year-to-date. As in Brazil some large customers ask Capgemini to be "prime contractor", pass-through revenues (i.e. hardware reselling from the likes of IBM or HP with a very low gross margin) can be volatile. The lack of visibility in the economic environment and the weakness of the Brazilian real against the US dollar - hardware prices surging up to 40% - led these customers to delay their orders. As H1 2016 revenues in Brazil included a bit of sell-through, Capgemini is likely face another decline in that country in H1 2017 – even though at a lesser extent than for Q3 2016. Anyway, the implementation from 2017 of the IFRS 15 rule on sales recognition will remove pass-through revenues.
- **Downplaying the H-1B visa concern**. Capgemini is moderately exposed to H-1B visas in the US. The concern is that under Donald Trump's administration, the limit of visas (85,000) could be lowered and/or visa fees (USD2,000 per visa) could be raised. Based on US Department of Labor data, we estimate 1,400 Capgemini staff work in the US with an H-1B visa - or an est. 8% of staff in North America, which is low compared to TCS (c. 5,600), Cognizant (c. 4,300), Infosys (c. 3,500), Wipro (c. 3,000) and Accenture (c. 2,300). Companies pay their H-1B visa holder wages on par with those paid to their US employees. Consequently, restrictions put to H-1B visas may oblige Indian IT Services firms to hire more US citizens, which would have a negative impact to their margins.
- **No need to accumulate cash: M&A will resume**. For 2016, Capgemini is likely to spend more than 50% of its free cash flow in dividends, share buy-backs and acquisitions (BG est.: 58% after EUR229m of dividends and EUR265m of share buy-backs). For 2017, we estimate the free cash flow will reach EUR1bn and that 43% of it will be spent on dividends and share buy-backs. As such, while we consider Capgemini, all things being equal, may cut its net debt to zero by end 2018 and as the company has no need to accumulate cash, we cannot rule out more cash will be used for M&A, up to 50% of the free cash flow if some opportunities arise.

VALUATION

- Capgemini's shares are trading at est. 10.0x 2016 and 8.6x 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.

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