

Indra Sistemas

Price EUR10.75

Q3 2016 results below consensus due to "one-offs", 2016 targets reiterated

Fair Value EUR12 (+12%)

NEUTRAL

Bloomberg	IDR SM
Reuters	IDR.MC
12-month High / Low (EUR)	12.3 / 7.7
Market Cap (EURm)	1,764
Ev (BG Estimates) (EURm)	2,456
Avg. 6m daily volume (000)	693.5
3y EPS CAGR	

Yesterday evening Indra reported Q3 2016 results below consensus due to the loss of a BPO contract in Spain and a "one-off" election deal in Brazil. However, restructuring is advancing according to plan, net debt is stable, and management reiterated 2016 expectations and 2018 targets. We cannot rule out the prospect of a negative share price reaction short term, but the turnaround is confirmed.

ANALYSIS

	1 M	3 M	6 M	31/12/15
Absolute perf.	-7.3%	-7.4%	8.4%	24.0%
Softw. & Comp.	-6.6%	-5.9%	3.8%	-1.5%
DJ Stoxx 600	-0.5%	-2.3%	1.1%	-7.5%

YEnd Dec. (€m)	2015	2016e	2017e	2018e
Sales	2,850	2,737	2,802	2,909
% change		-4.0%	2.4%	3.8%
EBITDA	107	223	309	371
EBIT	-641.0	160.0	238.0	296.0
% change		NS	48.8%	24.4%
Net income	-73.0	88.0	152.0	195.0
% change		NS	72.7%	28.3%

	2015	2016e	2017e	2018e
Operating margin	1.6	5.9	8.5	10.2
Net margin	-22.5	3.1	5.3	6.6
ROE	-208.1	21.5	27.5	26.1
ROCE	-11.7	11.7	17.9	22.0
Gearing	227.0	177.0	96.0	40.0

(€)	2015	2016e	2017e	2018e
EPS	-0.40	0.46	0.79	1.01
% change	-	NS	71.7%	27.8%
P/E	NS	23.4x	13.6x	10.6x
FCF yield (%)	NM	0.7%	8.6%	10.8%
Dividends (€)	0.00	0.00	0.00	0.00
Div yield (%)	NM	NM	NM	NM
EV/Sales	0.9x	0.9x	0.8x	0.7x
EV/EBITDA	23.0x	11.0x	7.4x	5.5x
EV/EBIT	53.6x	15.4x	9.6x	7.0x

• **Q3 2016 results below consensus due to Vodafone.** For Q3 2016, Indra has reported sales down 6.3% (-5.4% lfl) to EUR618.7m, or 7% above our EUR580.7m estimate and only 1% below consensus (EUR624.7m). Non-IFRS operating profit was up 45.7% to EUR34.1m (5.5% of sales, +2ppt) while we expected EUR34.6m or 6% of sales (consensus: EUR37.8m or 6.1% of sales). Net profit was EUR17.4m (vs. a net loss of EUR125.1m in Q3 2015), 19% above our EUR14.6m estimate but 10% below consensus (EUR19.3m). The rise in profitability was the result of higher direct margins on projects, efficiency plans and fewer onerous projects; 1) personnel costs were down only 2.5% in Q3 (vs. -10% in H1) due to a one-time Elections project completed in late October with the Regional Court of Justice in Brazil (c. 3,600 staff) and extra costs linked to the cancellation of a BPO contract with Vodafone in Spain; 2) materials consumed and other opex were down 14.7%; 3) Brazil had an EBIT at breakeven (vs. a loss of EUR33m in Q3 2015) with sales down 4% and opex down 17%.

• **Net debt stable.** Net debt on 30th September 2016 was EUR666.4m (net gearing: 187%) or 3.1x EBITDA, in line with the level as of 30th June. Free cash flow was a negative EUR4.6m (vs. a negative EUR23.2m in Q3 2015). Excluding restructuring cash-outs (EUR12m) and onerous projects (EUR9m), net debt would have reached EUR646m and free cash flow EUR16m. Assuming the same level of non-recourse factoring as in Q3 2015, free cash flow would have been a negative EUR19m. Net working capital fell to EUR198m from EUR232m in December 2015, or to 26 days of sales from 30, o/w +1 day on inventory, -5 days for accounts receivables, and 0 days for accounts payables.

• **Details on Q3 2016 lfl growth. By geography,** Spain (42% of sales) was down 1% with double-digit falls in Telecoms & Media, Government and Transport & Traffic and double-digit growth in Defence & Security (F110 frigate, 8x8 armoured vehicle, NH90 simulator), America (25%) down 16% due to Argentina and Mexico, Europe (19%) up 1%, and AMEA (13%) down 5%. **By vertical,** Transport/Traffic (22%) was down 13% due to delays in some projects, Defence/Security (22%) was up 14%, Energy/Industry (15%) was down 4%, Financial Services (18%) was up 1%, Government/Healthcare (15%) was down 19% due to a lower contribution from the Elections business, and Telecom/Media (8%) was down 14% due to the loss of the Vodafone BPO deal.

• **FY16 outlook reiterated.** Indra reiterates expectations for 2016 on sales (a decline), margins (significant improvement) and free cash flow (significant improvement as well with a positive Q4). Order intake in Q3 2016 was up 9% lfl and the book-to-bill ratio was 0.78x (vs. 0.66x in Q3 2015). On costs, 90% of 1,750 layoffs planned within the efficiency plan have been completed in Spain (Brazil completed in Q4 2015), Indra is in line with the EUR90m in cost savings expected for 2016, and year-to-date restructuring cash-outs (EUR38m) are on track with the EUR45-55m projected for the year. In addition, "one-off" costs (Vodafone, election project in Brazil) will no longer be seen in Q4. Finally, management reiterates its FY18 operating margin target (10-11%).

VALUATION

- Indra's shares are trading at est. 15.4x 2016 and 9.6x 2017 EV/EBIT multiples.
- Net debt on 30th September 2016 was EUR666.4m (net gearing: 187%).

NEXT CATALYSTS

FY16 results in February 2017.

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