

Gemalto

Price EUR52.31

Integration of 3M's Identity Management Business in our model

Fair Value EUR52 vs. EUR50 (-1%)

SELL

Bloomberg	GTO.FP
Reuters	GTO.PA
12-month High / Low (EUR)	65.5 / 47.0
Market Cap (EUR)	4,702
Ev (BG Estimates) (EUR)	4,859
Avg. 6m daily volume (000)	431.2
3y EPS CAGR	19.0%

	1 M	3 M	6 M	31/12/15
Absolute perf.	8.4%	-17.8%	-3.9%	-5.4%
Softw. & Comp.	1.7%	-2.9%	5.6%	3.5%
DJ Stoxx 600	4.6%	2.9%	4.1%	-2.9%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	3,122	3,127	3,332	3,595
% change		0.2%	6.6%	7.9%
EBITDA	345	488	561	641
EBIT	313.3	420.6	482.0	552.2
% change		34.3%	14.6%	14.6%
Net income	226.3	300.5	332.4	383.8
% change		32.8%	10.6%	15.5%

	2015	2016e	2017e	2018e
Operating margin	10.0	13.5	14.5	15.4
Net margin	4.2	8.2	8.3	9.5
ROE	5.4	9.5	9.4	10.5
ROCE	7.1	9.5	8.6	9.8
Gearing	13.4	5.8	25.0	14.5

(EUR)	2015	2016e	2017e	2018e
EPS	2.53	3.34	3.69	4.26
% change	-	31.8%	10.6%	15.5%
P/E	20.7x	15.7x	14.2x	12.3x
FCF yield (%)	3.6%	4.8%	5.8%	7.5%
Dividends (EUR)	0.47	0.51	0.55	0.59
Div yield (%)	0.9%	1.0%	1.1%	1.1%
EV/Sales	1.6x	1.6x	1.6x	1.4x
EV/EBITDA	14.6x	10.0x	9.7x	8.1x
EV/EBIT	16.1x	11.6x	11.3x	9.4x



During the conference call, management said it expects a decline in profitability in the 3M Identity Management Business over coming years via investments in core technologies and R&D bricks. Even if we believe this is a good acquisition (smaller than Mopho and with a far better profitability), it is expensive and the accretion we expect is lower than the market reaction last Friday. We have raised our 2016-18e EPS sequence by 3.2% on average. We maintain our Sell recommendation and raise our SOTP-derived FV from EUR50 to EUR52. The stock is often a "value trap". We advise investors to closely monitor the EUR50/share threshold because, other things being equal, both the SIM and Mobile Platforms & Services would be valued at zero in our SOTP.

ANALYSIS

- Last Friday, Gemalto announced that it has entered into agreements to acquire 3M's Identity Management Business** (the transaction includes 3M Cogent Inc., Document Reader and Secure Materials Businesses). This entity is a partner to governments, law enforcement, border control and civil identification bodies worldwide. According to Frost & Sullivan, **3M is the no. 4 in the Identification market** with 4% market share worldwide (Gemalto is no. 3 with 6%) and is a direct competitor to Morpho (no. 1 with a MS of 29%). **In 2017, its contribution to financials is expected to be limited to H2.** After this transaction for USD850m (an expensive 4x sales and 14.7x PFO, financed by cash and existing credit facilities), we estimate GTO's net debt/adjusted EBITDA ratio at 1.3x. The business acquired will be part of Gemalto's **Government Programmes business, which represented 12.5% of its sales in 2015 and should now represent 18% on a pro forma basis.** After the conference call, we understand that there is very little difference between its EBITDA and its PFO. GTO expects the business acquired to grow at +10% CAGR **with EBITDA margins above 20% by 2020 vs. a PFO margin currently at 27%. This means that management expects a decline in profitability over coming years** via investments in core technologies and R&D bricks.
- As a reminder, **the recent sharp downward revision in Gemalto's PFO 2017 target** (between EUR500m and EUR520m) **did not integrate any new M&A.** As a result, the acquisition of 3M's Identity Management Business come on top of this guidance. As management is not able to give visibility on the topline to justify its PFO target in a fixed cost business, we were at the low end of the guidance range (EUR505m). **With a consolidation as of 1st July 2017, we update our PFO estimate from EUR505m to EUR533.1m to integrate 3M's Identity Management Business vs a guidance that should now be seen at EUR530-550m** (vs. EUR500-520m prior to the acquisition). We therefore remain at the bottom of the range and we reiterate our scenario.
- Our view remains the same. **For the first time Gemalto is forced to invest at the end of its mid-term plan to capture growth beyond 2017** (whereas it usually reaps the benefits of past investments during this final phase). **Moreover, management will announce a new multi-year development plan at the end of next year** (a PFO guidance for 2020 or 2021), **which will require other new investments** (the first years of a new plan are somewhat sluggish in view of reorganisations, investments in operating expenses and/or M&A). As a result, **we see no strong leverage for the years to come as we expect poor lfl topline growth and strong investments, while the key activities are experiencing difficulties** (SIM & related services and Payments: ~60% of its sales). There is a risk on our current valuation in the event of a fresh deterioration in these verticals.

VALUATION

- This is a good acquisition** (smaller than Mopho and with far better profitability), **but it is expensive and the accretion we expect is lower than the market reaction last Friday.**
- We have raised our 2016-18 EPS sequence by 3.2% on average this time:** 0% in 2016e, 1.8% in 2017e and 7.7% in 2018e.
- We maintain our Sell recommendation and raise our SOTP-derived FV from EUR50 to EUR52** (the best way to value GTO's different activities). The stock is often a "value trap". **We advise investors to closely monitor the EUR50/share threshold** because, other things being equal, both the SIM and mobile Platforms & Services divisions would be valued at zero in our SOTP. **However, a new deterioration in the payment business could negatively impact this latter.**

NEXT CATALYSTS

- FY 2016 sales and earnings:** on 3rd March, 2017 (before trading).

3M's Identity Management Business financials

USDm	12 months ending June 2016
Sales	215
Gross profit	100
Margin	46%
PFO	58
Margin	27%

Source: Company.

3M's Identity Management Business revenue split per activity

3M's Identity Management Business	Revenue breakdown
Biometrics	61%
Document readers	13%
Secure materials	26%
Total	100%

Source: Company.

3M's Identity Management Business revenue split

3M's Identity Management Business	Revenue breakdown
Platforms & Services	60-65%
Embedded software & Products	35-40%
Total	100%

Source: Company.

3M's Identity Management Business revenue split per geography

	Revenue breakdown
Americas	54%
EMEA	32%
Asia	14%
Total	100%

Source: Company.

BG estimates (old and new) from 2015 to 2018e

EURm	2015 (reported)	BG 2016e	BG 2017e (old)	BG 2017e (new)	BG 2018e (old)	BG 2018e (new)
Sales	3,121.6	3,127.0	3,220.8	3,332.2	3,349.6	3,594.6
Y/Y change	26.6%	0.2%	3.0%	6.6%	4.0%	7.9%
Y/Y change (fl)	4.0%	0.8%	3.0%	3.0%	4.0%	4.5%
PFO ¹	422.6	465.0	505.2	533.1	554.5	610.9
Margin	13.5%	14.9%	15.7%	16.0%	16.6%	17.0%
EBIT	203.3	365.9	384.9	410.7	440.5	493.3
Margin	6.5%	11.7%	12.0%	12.3%	13.2%	13.7%
Current EBIT	313.3	420.6	454.1	482.0	495.7	552.2
Margin	10.0%	13.5%	14.1%	14.5%	14.8%	15.4%
Net profit	136.9	257.4	273.3	277.7	315.4	339.9
Margin	4.4%	8.2%	8.5%	8.3%	9.4%	9.5%
Rest. attrib. net profit	226.3	300.5	326.3	332.4	315.1	383.8
Margin	7.3%	9.6%	10.1%	10.0%	9.4%	10.7%
Net debt	334.7	156.3	-81.3	735.3	-348.4	467.6
Gearing	13.4%	5.8%	-2.8%	25.0%	-10.9%	14.5%

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

Sources: Bryan, Garnier & Co ests.

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Analyst :
Richard-Maxime Beaudoux
33(0) 1.56.68.75.61
rmbeaudoux@bryangarnier.com

Sector Team :
Thomas Coudry
Gregory Ramirez
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
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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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