

## Sopra Steria Group

Price EUR115.40

Looking beyond 2017, and no big concerns on SSCL

Fair Value EUR130 vs. EUR121 (+13%)

BUY

Bloomberg	SOP FP
Reuters	SOPR.PA
12-month High / Low (EUR)	119.0 / 78.3
Market Cap (EUR)	2,360
Ev (BG Estimates) (EUR)	2,802
Avg. 6m daily volume (000)	22.50
3y EPS CAGR	15.2%

We reiterate our Buy rating and have raised our DCF-derived Fair Value from EUR121 to EUR130, following the increase in our medium-term assumptions for Ifl revenue growth from 4.5% to 5% (+EUR5/share) and for adj. EBIT margin from 9% to 9.5% (+EUR4/share). While at this stage we are confident that FY17 targets are likely to be achieved, we consider that Sopra Steria has the means to deliver operating margin of 10% or more over the medium-term (barring an economic shock).

## ANALYSIS

- Looking beyond 2017: room for more growth and margins.** In early 2015, management amended 2017 objectives to EUR3.8-4bn in revenues and op. margin of 8-9%, from EUR4bn and 9-10%, respectively when it announced the acquisition of Steria in April 2014. This revision was justified by salary hikes, accelerated investments in Solutions, and the pre-election climate in the UK. We estimate that Sopra Steria is well under way to achieve its amended targets since it is in line with its EUR62m in planned synergies with Steria. However, we consider that 2017 will not be the end of the story, and believe Sopra Steria has the means to approach an op. margin of 10% or above in the medium-term thanks to more business in the Solutions business (Banking Software, HR Software, Real Estate: est. 15% of 2016 sales), more service automation and industrialisation, and more offshoring (currently 17%). In particular, we consider the Solutions business has the means to generate an op. margin of 15% (vs. c. 10%), vs. 10%+ (from 8.7%) for Consulting & Systems Integration in France, and 6-7% (vs. breakeven) for Infrastructure & Security Services (I2S). For Ifl revenue growth, the company's guidance is +3-5% for 2016, and we believe that reaching +5% or above beyond 2016, will depend on some acceleration in Solutions, I2S and in Other Europe.
- NAO highlighting poor governance of an outsourcing contract with the Cabinet Office.** On 18th May, the British National Accounts Office (NAO) published a report which highlighted that the government's share service centres (one outsourced to Arvato, and the other outsourced to SSCL - the JV company 75% owned by Sopra Steria and 25% owned by the Cabinet Office) reported significantly lower cost savings (GBP90m for a cost of GBP94m) than planned (GBP128m per year), due to delays in the migration to a single operating platform (only 2 of the 26 customers have moved so far). On the SSCL side, which accounts for an est. 25% of Sopra Steria's revenues in the UK, the report pointed out the poor governance of the contract by the Cabinet Office.
- No big concerns on SSCL.** This kind of governance issue on SSCL happens often with governments, even in the UK, and the NAO public report may act as an incentive for the Cabinet Office to improve IT governance and help Sopra Steria achieve its objectives. We understand there were some roadblocks which prevented SSCL from relocating some work offshore, for instance. We also understand that if Sopra Steria is more likely to post a low single-digit Ifl decline in the UK in 2016 instead of flat sales (Q1 was at -2.3% Ifl), this is basically due to the inability to absorb volumes on additional contracts. Conversely, 2017 is, in our view, likely to see SSCL revenues picking up again thanks to the onboarding of new customers and the ability to absorb additional volumes.

	1 M	3 M	6 M	31/12/15
Absolute perf.	16.1%	24.1%	6.5%	6.6%
Softw. & Comp.	3.4%	5.6%	-1.0%	-0.6%
DJ Stoxx 600	0.5%	5.2%	-9.2%	-4.6%

YEnd Dec. (€m)	2015	2016e	2017e	2018e
Sales	3,584	3,779	3,981	4,158
% change		5.4%	5.4%	4.4%
EBITDA	295	344	390	420
EBIT	152.6	253.1	296.3	326.2
% change		65.9%	17.1%	10.1%
Net income	150.9	182.7	213.0	231.3
% change		21.1%	16.6%	8.6%

	2015	2016e	2017e	2018e
Operating margin	6.8	7.8	8.5	8.9
Net margin	2.4	4.0	4.5	4.8
ROE	6.8	11.2	12.0	12.0
ROCE	11.0	11.6	13.2	14.1
Gearing	43.0	32.7	20.4	10.5

(€)	2015	2016e	2017e	2018e
EPS	7.38	8.91	10.39	11.29
% change	-	20.9%	16.6%	8.6%
P/E	15.6x	12.9x	11.1x	10.2x
FCF yield (%)	2.1%	4.6%	7.2%	8.0%
Dividends (€)	1.70	1.90	2.10	2.30
Div yield (%)	1.5%	1.6%	1.8%	2.0%
EV/Sales	0.8x	0.7x	0.7x	0.6x
EV/EBITDA	9.8x	8.2x	6.8x	6.0x
EV/EBIT	11.8x	9.5x	7.9x	6.9x



## VALUATION

- Sopra Steria's shares are trading at est. 9.5x 2016 and 7.9x 2017 EV/EBIT multiples.
- Net debt on 31st December 2015 was EUR530.8m (net gearing: 43%).

## NEXT CATALYSTS

- AGM on 22nd June.
- H1 2016 results on 28th July before markets open.

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

**Sector Team :**  
 Richard-Maxime Beaudoux  
 Thomas Coudry  
 Dorian Terral

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NEUTRAL ratings 34,5%

SELL ratings 9,2%

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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
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	resolution (ACPR)			CP 2113
				Genève 1, CH 1211
				Tel +4122 731 3263
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