Store Electronic Systems

Internationalisation and innovation driving growth

Initiation of coverage

Tech hardware & equipment

Store Electronic Systems (SES) is the leading provider of electronic shelf labels (ESLs) and is starting to use its experience and dominance in one of the largest ESL markets (France) to expand globally. The opportunity is huge, with the market potentially increasing from €200m currently to €1bn in five years. Competition and investment in internationalisation is likely to pressure margins in the short term, but innovative products such as the new NFC labels are proving successful and could help SES maintain its leading market position and improve margins in the longer term. Our valuation is predicated on EBIT margins returning closer to 15%.

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/11	59.0	13.35	76	0.0	19.8	N/A
12/12	63.0	6.36	35	50.0	43.0	3.4
12/13e	80.4	6.58	40	0.0	37.6	N/A
12/14e	100.2	9.48	57	0.0	26.4	N/A
12/15e	119.4	14.78	89	0.0	16.9	N/A

Note: *PBT and EPS are normalised, excluding acquired intangible amortisation, exceptional items and share-based payments.

Innovative products and international opportunity

After 20 years' experience in France, which together with Japan is the largest ESL market globally, SES has shifted its focus to the international market and as a result has seen its international revenues double y-o-y from €15m to €30m for the nine months to September 2013. Product innovation (such as the NFC labels launched in 2013) has encouraged refreshing the installed base, as well as adoption by new customers. This has come at the expense of reduced margins (6% EBIT margins in H113 vs 10% in H112), but as scale is reached, the installed base increases and higher-margin software products are introduced, EBIT margins could move closer towards the 15% on which the reverse DCF valuation is based.

ESL adoption near tipping point in key geographies

Global ESL adoption has so far been relatively limited due to several factors, but management reports that the number of pilots and projects has increased 2-3x over the last three years, and some key geographies such as the UK and Germany are close to hitting the inflection point where market penetration could accelerate rapidly. Other countries such as the US, Australia and Brazil are not too much further behind and should provide significant growth opportunities for a number of years provided SES can penetrate those markets successfully.

Valuation: Growth premium but upside remains

The company is currently trading at 26.4x FY14e earnings and 16.9x FY15e. Given the high growth potential and concentrated market (SES and Pricer combined control 75-80% of the market), we believe there is still room for upside. Using a reverse DCF, the market appears to be pricing in a scenario of 16% CAGR in revenue between FY14 and FY20 at 15% EBIT margins. Internationalisation and upgrading of the installed base is key to achieving this level of growth.

13 January 2014

Price	**€15.05**
Market cap	**€166m**

Net cash (€m) at 30 June 2013	18.5
Shares in issue	11.0m
Free float	66.5%
Code	SESL
Primary exchange	Euronext Paris
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	7.5	37.9	33.4
Rel (local)	3.5	35.8	14.6
52-week high/low		€15.05	€10.18

Business description

Store Electronic Systems (SES) is the leading provider of electronic shelf labels for the retail industry. Its labels enable automated price changes, thereby reducing labelling costs and pricing errors. 49% of Q1-Q3 revenues were from France, but international sales are growing strongly.

Next events

Annual sales	30 January 2014

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Edison profile page

Store Electronic Systems is a research client of Edison Investment Research Limited

Investment summary

Company description: Innovate and internationalise

SES is the leading supplier of ESLs, which are used in the retail environment in place of paper labels. As well as the ESLs themselves, SES provides the fixtures, RF transmitters and software required to interface to the retailer's ERP systems. ESLs bring some of the benefits of online retail to physical stores by lowering the cost of changing prices and allowing more dynamic pricing policies that react to competitor and customer behaviour. After 20 years' experience mainly focused on the French market (which, jointly with Japan, is the largest ESL market globally), SES is shifting its focus towards the international market, which it views as prime for widespread adoption of ESLs.

Financials: International revenues up 202%

International revenue in Q313 was €15.4m, an increase of 202% from the €5.1m in Q312. For the nine months to September 2013, international revenue doubled from €15m to €30m. This demonstrates the successful start of management's I^3 (Internationalisation, Innovation, Industrialisation) strategy, part of which is to boost international sales. EBIT margins for H113 fell to 6% from 10% in H112 due to a product mix of higher-value but lower-margin products and more competitive pricing to drive sales growth, as well as investment in expanding sales teams and offices internationally. Operating costs were up 16.6% in H113 compared to H112, primarily because of this additional international investment. As volume increases and a higher proportion of revenues come from higher-margin software and maintenance, EBIT margins should improve. All manufacturing is outsourced to third parties based in China and the company rents its offices and distribution centre, so capex and amortisation mainly relate to expenditure on research and development, which has averaged 6-7% of revenues per year, but will come down as proportion of revenue as revenue grows. The company had net cash of €18.5m at 30 June 2013, including a €4.5m bank overdraft.

Valuation: Premium rating for high-growth expectations

High-growth expectations have pushed up SES's share price with a 45% increase over the last year. However, there is still room for upside if revenue growth and margins grow as management expects over the next five to six years. With 20% CAGR from FY14-20, EBIT margins returning to 15%, a WACC of 10% and terminal growth of 3%, our DCF valuation produces a share value of €17.39. Given the doubling of international revenues in the nine months to September 2013 and the 29% increase in total revenues over the same period, this level of growth is not unreasonable. Domestic revenue over the same period fell by 6% due to the struggling French economy, but is expected to return to growth in FY14. On a trailing P/E, EV/EBITDA and EV/sales basis, SES trades at a premium to its main peer, Pricer AB, but this is not too meaningful given it does not take into account their respective growth rates and earnings estimates. Forward earnings multiples comparison is not possible because of the lack of estimates available for Pricer.

Sensitivities: Growth rate and margins

There is little doubt that the market potential for ESLs is huge, but the pace of growth and the margins at which that growth can be achieved is less certain. Share price valuation is sensitive to these factors; using the same DCF assumptions as above, but a CAGR of 10% and an EBIT margin of 11%, would produce a valuation of €6.24/share. The two key factors that will drive the growth rates and margins that can be achieved are component and manufacturing costs and competition. Component and manufacturing costs will come down as volume scales, but if more firms are attracted to the industry by its high growth rate, margins could be pressurised by the increased competition. SES's innovation and industrialisation strategy attempts to counter this by introducing new products and reaching efficient scale before its competition.

Company description: Innovate and internationalise

Store Electronic Systems (SES) produces electronic shelf labels (ESLs) for retail stores. Its products replace traditional paper shelf labels, reducing the time and cost required to change prices, but also enabling adaptive pricing to increase sales volume and margins for the retailer through reduced stock waste and competitive pricing. New near-field communication (NFC) shelf labels also provide the opportunity for additional advertising and analysis of consumer behaviour, potentially resulting in increased sales conversions and advertising revenue. After being installed in the first store in October 2012, more than five million of SES's NFC labels are expected to be ordered in 2013, which is equivalent to a third of annual production. Over 100m of SES's ESLs are used in 5,400 stores worldwide. As well as the actual ESLs, SES provides the shelf fixtures, wireless access points and back-end software required to operate the labels.

Internationalisation, innovation, industrialisation

SES's strategy is focused on expanding internationally by opening offices and forming partnerships in key markets such as the UK, Singapore, Scandinavia and the US. 30 of the top 100 retailers globally are already clients of SES, but management is investing to expand this by having dedicated sales for large accounts. In the medium to long term, management's strategy is to grow software sales that enable more advanced features to be implemented using the existing infrastructure. Software typically has 80% margins compared to 35% margins for hardware, so growth in software could contribute significantly to profitability. The adoption of NFC labels is a key stage in this process as it provides the opportunity for more complex customer interaction through smartphone apps. A new sales-focused call centre was also opened this year to focus on existing customers and encourage them to upgrade to new generations of ESLs.

Potential to improve retail margins by 0.5-1.0%

The key selling point for SES's products is the return on investment provided to its customers by reducing labelling costs and pricing errors. The company suggests electronic shelf labelling could result in a 0.5-1.0% improvement in margins for its customers, and have a 1.5- to two-year payback period. This is particularly significant in the retail environment, which typically has low operating margins. The big three listed UK supermarkets, Tesco, Sainsbury's and Morrisons, had an average operating margin of 4.1% in FY13, so a 0.5-1.0% benefit, if achieved, is a significant proportionate gain. SES produces a range of label types suited for varying applications and price points. All can be updated automatically using a proprietary low-frequency RF signal controlled from a back-office computer. Many customers cite the reliability and ease of installation of the systems as key reasons for choosing SES products over those of its competitors.

Lumpy but visible revenue with growing recurring component

Revenue is split into three components: installation fees (60% of FY12 revenue), label replacements (33% FY12) and maintenance and support (7% FY12). For a typical installation, 85% of the fees will be for hardware and the remaining 15% will be for professional services, software and maintenance. Once a store has converted to ESLs, there is a high retention rate, with a cumulative churn of only 5-7%, so label replacements will become an increasingly important revenue stream as the installed base increases. In the long term, as market penetration increases and growth slows, label replacement and maintenance could become the key source of revenue, resulting in a higher-margin, highly visible, recurring revenue stream.

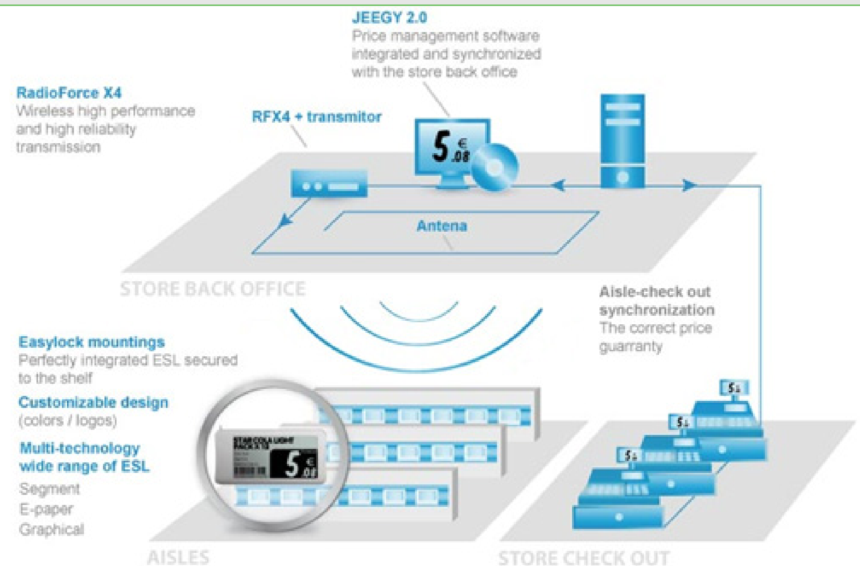
Management

Thierry Gadou was appointed CEO of SES in January 2012. He was previously chairman and CEO of Atos Consulting France for five years and in 2000 founded B2B procurement site Avisium, which was acquired by Hubwoo in June 2003. He was CEO of Hubwoo for two years until 2005 when he left to join NextFund-Capital as managing partner, where he stayed until joining Atos in 2007. Pascale Dubreuil was appointed CFO of SES in April 2013, before which she was CFO of two Materis group subsidiaries: Zolpan Group and Chryso Group. Chryso Group went through a period of rapid growth over the period that Pascale was CFO, with revenues increasing threefold and its international presence increasing to 70 countries. Philippe Bottine (CTO) started his career as a financial analyst for a venture capital fund in Silicon Valley and has been responsible for product development at SES since 2009.

Improving retailers' margins through efficient pricing

The use of ESLs reduces the cost of changing product pricing by reducing staff and material costs. It has the added benefit of improving sales conversions and margins by making it easier to adjust prices in reaction to competitor and supplier price changes. SES offers a range of products for different price points, but the communication mechanism for updating them all is low-frequency RF (kHz), which has the benefit of long-range and low-power consumption. High-frequency and multi-frequency 'plug & play' radio is also being developed to make it easier and more economical for smaller stores such as convenience stores and pharmacies to adopt ESLs.

Exhibit 1: Store Electronic Systems' electronic shelf label system diagram



Source: Store Electronic Systems

Continual product development and innovation

Exhibit 2: SES ESL types

Product name	Description
S-tag/S-tag+	Lower-cost solution with a simple alphanumeric display.
G-tag/G-tag+	These are higher-resolution TFT alphanumeric displays, which can display more information than the S-tag and S-tag+ and are cheaper than the E-tag. The G-tag+ can also display animated sequences.
E-tag	E-paper display, which provides better contrast and wider viewing angles. It can display images as well as text.
NFC tag	The NFC label is the new generation of product introduced in October 2012. The label provides the same functions as those above, but with an NFC interface to communicate with customer phones and provide them with real-time bill information, allergen warnings and other detailed product information. It won an award at the LSA Innovation awards in December 2012 and the Equipmag exhibition in September 2012.

Source: Store Electronic Systems

Exhibit 2 details the current SES product range. The core product is the shelf label, but the pricing software, RF transmitter, shelf fixture and till synchronisation mechanism are also required to implement the complete solution. The back-end components are standard across all label types. SES is also developing colour displays using powered shelves, and software that allows advanced customer interaction and analysis using the new NFC labels.

€1.4bn estimated market opportunity

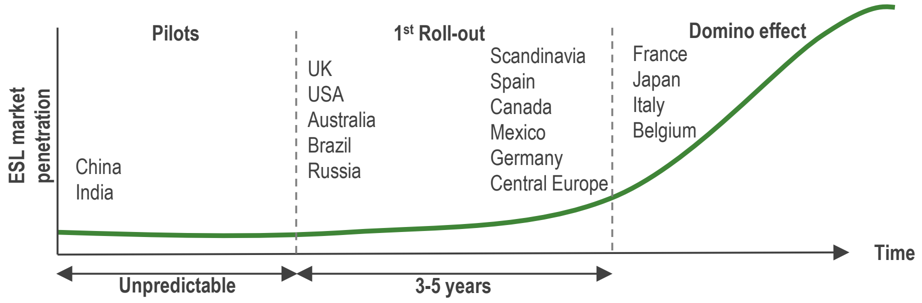
The market opportunity for ESLs is undoubtedly huge. The top 22 listed food retailers alone had c 76,000 retail units at the end of 2012 with an average store size of c 14,000 ft^2 ($1,300m^2$). At the end of 2012 SES products were installed in 5,400 stores (across food, DIY, garden and pharmacy sectors) with over 100m labels in use. Using the simplifying assumptions that the tag density per current SES deployments is similar to what it would be in the rest of the market and that it is commercially viable to have ESLs in 10% of stores (conservative estimate), the potential market size would be c 140m labels in food retail alone. Assuming a label price range of €5-10, the market value could therefore be up to €1.4bn. To put this in context, the total capex for the same group of retail companies in 2012 was c €16bn and the personnel expenditure (for the 18 that disclose it separately) was €190bn, so a €1.4bn possible investment in ESL tags spread over a number of years appears reasonable. Although there is a wide margin of error in these assumptions, there is no doubt that there is a significant opportunity for ESLs.

Regulations and labour cost are key drivers to uptake

Adoption of ESLs tends to be driven by national markets, with the key drivers being local labour cost and regulations. Regulation has been a key driver in France and Japan, where retailers can be heavily fined for pricing errors and incorrect information on labels. Labour cost is also a key driver as the higher the local labour cost, the bigger the savings from switching to ESLs. The size of the store is also a key factor, since the larger the store the bigger the economic benefit and therefore the bigger the incentive to transition to ESLs.

A number of key markets entering growth phase

Exhibit 3: Adoption curve and maturity of national markets



Source: Store Electronic Systems

Exhibit 3 illustrates some of the key markets for ESLs and management's estimate of where they are on the adoption curve. The French and Japanese markets are quite mature already, driven by the strict regulatory environment and high labour costs. The UK and German markets are seen by management as key growth areas over the next year with pilots currently in operation and potential agreements in the pipeline. Tesco, in partnership with Samsung, has developed proprietary ESLs, which they are currently piloting in the UK with a roll-out expected in FY14. This could be the trigger for adoption of ESLs by other big UK supermarket chains. The US is a huge potential market with the largest global retailer (Walmart), but because of the low labour costs and relaxed regulation, so far adoption has been slow. However, management has opened an office in Boston and recruited the former CEO of Pricer to focus on North American sales. Several pilots are in discussion with major retailers as a result and management expects US growth to accelerate over the next two to three years to potentially become SES's largest market. Adoption in Scandinavia has been rapid, with market penetration in Scandinavia reaching in five years what has taken 20 years in France.

Global retail groups starting to pilot and roll out ESLs

Exhibit 4 shows the largest listed global consumer staples retail groups that use ESLs. Although these are probably the biggest opportunities, there are also significant opportunities outside consumer staples in DIY, telecoms, electronics and various other retail environments. Exhibit 5 shows some of the other major retailers that use SES's ESLs.

Exhibit 4: Large listed consumer staples retail groups using ESLs

Chain name	Number of stores 2012	Locations	Comments
Casino Guichard Perrachon SA	12,038	Latin America (53%), France (34%), Asia (12%)	Casino Group owns Monoprix, Casino and Franprix. SES and Pricer have ESL products installed in c 400 Casino group stores each.
Walmart	10,773	US (43%), Mexico (21.8%), central America (6.0%), UK (5.2%), Brazil (5.2%), Japan (4.1%), China (3.6%), Canada (3.5%), Africa (3.5%), Chile (3.1%), Argentina (0.9%), India (0.2%)	In October 2013 Walmart Argentina selected SES solutions to equip 28 of its supercentres with ESLs. This was after two pilot projects conducted in 2009 and 2012.
Carrefour	9,994	France (47%), other Europe (40%), Latin America (7%), Asia (4%), other (2.0%)	SES's ESs are used in 400 Carrefour stores globally. Most Carrefour hypermarkets in France (c 225) use Pricer ESLs.
Tesco	6,984	UK (34.7%), China (8.7%), Malaysia (3.3%), South Korea (11.7%), Thailand (13.0%), Czech Republic (5.0%), Poland (8.0%), Hungary (6.0%), Slovakia (3.2%), Turkey (3.4%), Ireland (2.9%)	Pilots of Samsung developed solutions are currently being conducted in some UK stores with roll-out expected in FY14. They are also currently being deployed in Eastern Europe.
Delhaize Group	3,451	USA (45%), Belgium (24%), South-Eastern Europe, Asia (31%)	SES products are used in 100 Delhaize stores internationally, particularly in Eastern Europe. Delhaize's Belgium stores are in the process of being equipped with Pricer's graphic ESLs. As at 7 March 2012, 30 of its around 800 Belgium stores were equipped with a plan to install a further 50 stores a year.
Metro	2,243	Germany (42%), Western Europe (27%), Eastern Europe (25%), Asia/Africa (6%)	Pricer systems are used in 60 cash and carry stores in 10 different countries across Europe.
Les Mousquetaires	2,242	France (84%), Portugal (8%), Belgium (2%), Poland (6%)	Les Mousquetaires is the group with the largest deployment of ESLs globally. 1,400 of its stores use ESLs, with c 90% being SES solutions and the remaining 10% being Pricer solutions. Les Mousquetaires Group includes Roady, Intermarche and BricoMarche.

Source: Edison Investment Research, company accounts

Exhibit 5: Other major SES customers

Customer name	Number of stores	Stores with SES	Locations	Comment
Bilka	1,345	102	Denmark	
Telcel	1,171	44	Mexico	
U Stores	1,130	500	France	
E.Leclerc	668	350	France, Spain, Italy, Poland, Portugal, Slovenia	Pricer is present in 15 E.Leclerc groups in France and other E.Leclerc stores in Southern Europe.
Kiwi (Norges Gruppen)	620	500	Norway, Denmark	
Tout Faire	480	480	France and Belgium	
Panorama	450	23	Italy	
Mr Bricolage	400	1	France	
Simply (Group Auchan)	300	300	France, Italy, Spain, Poland, Russia	
Auchan (Hypermarkets)	125	125	France, Italy, Spain, Poland, Russia	
Spar (Gran Canaria)	148	30	Canary Islands	
Fairprice (Singapore)	110	90	Singapore	
Grupo Commercial Control	75	75	Mexico	

Source: Edison Investment Research, Store Electronic Systems

Uptake driven by ROI and investment cycle

A retailer's decision to invest in ESLs is likely to come down to cash cost and ROI. The size of the initial investment will depend primarily on the size of the store and the number and type of tags used. The ROI is more judgemental and depends on numerous other factors such as local labour costs, replacement rate of labels, the extent of label use within the store and the extent to which retailers take advantage of the capability to frequently and dynamically update prices. However, typically SES expects a payback period of 1.5 to three years and 0.5-1.0% improvement in margins for retailers that use its ESLs. NFC labels combined with more advanced software could increase the ROI for retailers by providing additional analytics, advertising opportunities, targeted promotions and, in the longer term, potentially check-out and payment at the shelf using a smartphone.

Dominant market share, but increasing competition

The ESL market is dominated by two major players, SES and Pricer AB. Together they account for 75-80% of the market with approximately 40% each (by label volume), but SES leads in terms of revenue with €73.6m for the nine months to September 2013 compared to Pricer's SEK372.7m (€41.8m). The lead also appears to be increasing with Pricer's revenue declining by 8% y-o-y for that period while SES's grew by 25%. The low market penetration of ESLs, combined with the high industry concentration, means there is plenty of room for growth for both companies. However, other firms may be attracted to the industry as adoption increases. The barriers to entry for new firms wishing to enter are the experience and technical expertise required to develop and install business critical systems such as ESLs. In addition, SES has patents protecting the design of its fixtures, ESLs and wireless infrastructure. Despite this, other firms are likely to enter the industry by developing new technologies and therefore SES is likely to lose market share, but still grow strongly overall thanks to the expected rapid growth of the market.

Exhibit 6: Competitors

Name	Description	Customers
Pricer AB	Pricer is a Norway-listed company that produces two-way infrared-based ESLs. The ESLs are cheaper per unit, but the infrastructure tends to be more expensive at larger scales because of the need for a higher density of access points (average of one access point every 100m²) compared to SES (one access point every 3,000m²).	Carrefour, Intermarche, Casino, E.Leclerc (France), Seven and I (Japan), Soriana (Mexico), Coop Norden (Scandinavia), Metro (Germany).
ZBD	ZBD is UK private company that was spun off from QinetiQ in 2000. It had revenue of £12m in FY12, up from £4m in FY11. Its ESL solution is based on two-way, high-frequency RF and uses proprietary low-power display technology. At the moment it does not have the scale to compete with Pricer or SES, but it is growing quickly.	Cyberport (Germany and Austria), Orange Slovakia, University of Amsterdam, Kiddicare, Coop Denmark, Bunnpris (Norway), T-Mobile Austria, Plasma Discounter (Netherlands), Vannis (US), Sisa (Italy), EMT (Estonia).
Digi	Digi is a Singapore subsidiary of Tokyo-listed Teraoka Seisahusho Co, which produces a similar range of products to SES using a two-way RF communication system.	Not disclosed.
Altierre	Altierre is a US-based manufacturer of ESLs. It has clients in France, but most installations are in the US. Their wireless technology requires only one access point for 4,600m².	Kohl (US), Leclerc Hypermarkets (France).
Imagotag	Imagotag is an Austria-based private company producing e-paper based labels in a range of sizes. The labels use a proprietary two-way high-frequency RF solution to communicate to the back office systems. They also have integrated temperature sensors and encrypted communications.	Billa (Austria), Merkur (Germany).

Source: Edison Investment Research, corporate websites

Sensitivities

- **Component and manufacturing cost:** The key to success of ESLs is their pricing. A retailer adopting ESLs requires a positive return on investment within a reasonably short time frame. If the cost of manufacturing increases, margins could fall, or in a worst-case scenario the labels could become commercially unviable. However, this is unlikely, as increased scale and manufacturing efficiencies are resulting in lower unit manufacturing costs. This is being partially offset by the movement to more complicated devices such as NFC, but in the long term the trend is likely to be downwards.
- **Competition:** Although there are not a significant number of competitors currently operating in the market, ESLs need to be priced competitively to be able to compete with traditional paper-based labels. New companies are also entering the industry and therefore margins are likely to

be increasingly under pressure. New technology such as the NFC tags that SES has introduced will help mitigate this risk by increasing the functionality enabling higher prices and increased competitive advantage, but it also costs more so margins may fall. There is also a risk that a new competitor could enter the market with a technology or process that produces significantly cheaper labels with which SES cannot compete.

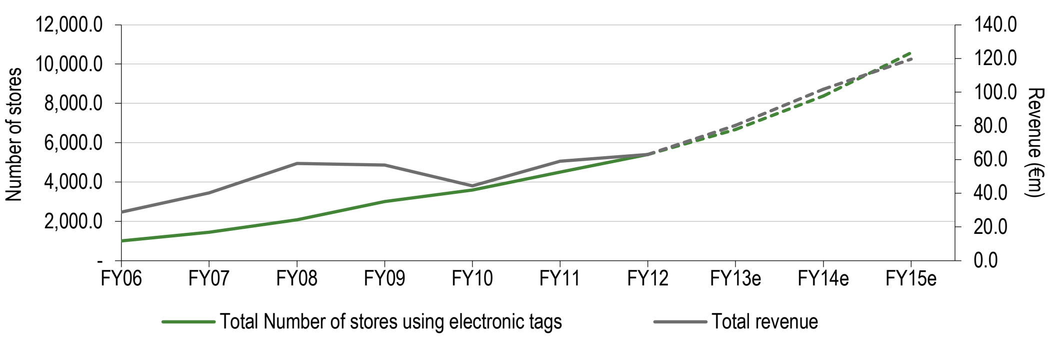
- **International expansion:** SES's domestic French market has performed poorly over the last two years. Management has blamed this primarily on the difficult economic environment and so the focus has shifted to the international market to accelerate growth. It has therefore invested heavily in developing international partnerships and subsidiaries, and international sales have increased rapidly as a result. It is still too early to say whether this is part of a sustained trend or part of the lumpiness that is to be expected, but the early signs are positive.
- **Economic and investment cycle:** Capital expenditure by the big global retail groups fell by c 24% after the worst of the economic crisis in 2008-09. It has subsequently improved, but still remains 13% below its 2008 peak. However, economic sentiment is becoming increasingly positive, so SES could start to see the benefit of increased investment by retailers.
- **Supplier power:** SES's main customers are large retail groups that are typically low-margin, high-volume business and therefore likely to put pressure on SES to minimise ESL cost and maximise ROI. This could put an upper limit on the margins that SES could expect to earn, although the large scale of the big retailers still provides the opportunity for substantial volume.
- **Retention rate:** Maintenance, support and product replacements are becoming an increasingly important component of sales, so the retention of existing clients is important in maintaining profitability. The retention rate has historically been high (5-7% cumulative churn) due to the relatively high cost of installing an alternative system and the high reliability of SES's RF transmission system.

Financials: Investing for international growth

202% y-o-y growth in international revenues

International revenue in Q313 was €15.4m, an increase of 202% from the €5.1m in Q312. For the nine months to September 2013, international revenue doubled from €15m to €30m and total revenue increased 25% from €58.7m to €73.6m. Although much of this growth (an estimated 50%) is due to one large project in Scandinavia and this extreme level of growth is unlikely to be sustained, widespread international uptake of ESLs could drive a high level of growth for a sustained period. Exhibit 7 shows the correlation between historic revenue and the number of stores with ESLs installed. Revenue has closely tracked the number of stores and there has been a consistently strong and stable growth in the number of stores with ESLs installed.

Exhibit 7: Historic and forecast growth in number of stores with installed ESLs and revenue



Source: Edison Investment Research, Store Electronic Systems

Growing recurring revenue

Revenue is broken down into three components: installations, re-stocking of labels, and maintenance and support. Currently 35-40% of revenues are of a recurring nature; this is expected to fall as a percentage of revenue in the short term because of the expected high level of new installations, but the absolute value of recurring revenue will increase as the total installed base increases. ESLs are typically replaced at a rate of 2-4% of the installed base per year. The base of stores ready for renewal is now high, so this could be exceeded over the coming year.

Exhibit 8: Revenue breakdown

	FY11	Y-o-y	FY12	Y-o-y	FY13e	Y-o-y	FY14e	Y-o-y	FY15e	Y-o-y
Installations	36.0	*37%*	37.8	*5%*	51.8	*37%*	67.0	*29%*	80.0	*19%*
Swap/restocking	18.9	*31%*	20.6	*9%*	23.4	*14%*	26.7	*14%*	30.5	*14%*
Maintenance/after sales/misc	4.1	*9%*	4.6	*13%*	5.2	*14%*	6.5	*24%*	8.9	*38%*
Total	59.0	*33%*	63.0	*7%*	80.4	*28%*	100.2	*25%*	119.4	*19%*

Source: Edison Investment Research, company accounts

FY15 forecast – 35% gross margin, 12% EBIT margin

Gross margin has historically been 40-50% and EBIT margin 15-20%. Gross margins fell to 38% in H113 due to a combination of more competitive pricing and an increased proportion of higher-value but lower-margin product sales. There was an additional negative effect on EBIT margins due to the increased expenditure on R&D and hiring more sales staff to focus on direct sales to the key accounts. The EBIT margin therefore fell to 7% in FY12 and 6% in H113. Opex growth is expected to normalise at approximately 7% per year and this should provide the resources for 20-25% revenue growth. We expect gross margin to see continued pressure and have therefore forecast that it will fall to 35% in FY14 and FY15. Operating expenses growth should now start to stabilise, after the strong investment in FY12, resulting in EBIT margin improving from an estimated 7% in FY13 to 9% in FY14 and 12% in FY15.

Partners help accelerate growth and control costs

Currently over 50% of sales are made through partners, which operate on a simple re-seller style agreement whereby they receive a 7-9% discount from SES for ESLs and infrastructure products and then manage the installation projects independently or in partnership with SES. Wincor Nixdorf is a major partner throughout the US and Europe, through which 10-15% of sales are made. Over 50 partners are used globally to expand SES's reach, but the direct sales team is also being expanded to focus on the largest retailers and win large-scale projects.

Balance sheet and cash flow

SES rents all its offices and distribution centres and sub-contracts manufacture to third parties so plant, property and equipment (PPE) is limited. Total R&D expenditure is currently a relatively high 6-7% of revenues to try to ensure that SES continually develops new products to attract new customers and to encourage existing customers to upgrade to new innovative solutions. R&D expenditure will stay stable, but fall as a percentage of revenue as revenues grow. SES currently owns 20-25 patents and generates two to three new patents a year. Net cash (including short-term investments) totalled €24.7m at the end of FY12 falling to €18.5m at the end of H113. €49m of new orders for 860 new stores were received in H113, resulting in a book-to-bill of 1.4x. An exceptional dividend of €5.5m was paid in FY12 by the previous management to return some cash to shareholders. The new management team has no immediate plans to pay another dividend. We expect the high level of R&D to result in a negative cash outflow for FY13, but improvement in working capital management through the implementation of a new ERP system, in combination with a smaller growth in R&D expenditure relative to revenues, means positive cash flows should return from FY14.

Valuation

We have used a multiples-based peer comparison and reverse DCF to value SES. The only comparable listed peer is Pricer AB, but no revenues or earnings estimates are available, so historic financials have to be used as a comparative instead. This approach is limited as it does not take into account the expected growth of either SES or Pricer, which is a key determinant of value. A reverse DCF has therefore also been used to determine a scenario that the market appears to be incorporating into the share price. A sensitivity analysis was then performed on this DCF valuation to obtain a range of potential valuations that could result from a change in assumptions.

Premium to Pricer AB after stronger FY12 performance

SES is at a premium to Pricer AB on a trailing EV/sales, EV/EBITDA and P/E basis, although this could be justifiable given the comparatively poor performance in FY12 by Pricer compared to SES. SES revenue grew by 6.8% in FY12 compared to a decline of 10.5% for Pricer. SES's EPS declined by 53.9% due to the investment in internationalisation and competitive pricing, but Pricer's EPS declined by an even greater 76.3%. The fact that Pricer maintained a 12.2% margin but a fall in revenues may be an indicator of the success of SES's strategy to grow its installed base through competitive pricing. These figures also compare trailing earnings, which do not take into account future growth, public information on which is unavailable for Pricer AB.

Exhibit 9: Peer comparison

	Market cap (€m)	Net debt/ (cash) (€m)	Revenue (€m)		EBITDA margin		Net margin		Revenue growth		EPS growth		FY12		
			FY11	FY12	FY11	FY12	FY11	FY12	FY11	FY12	FY11	FY12	EV/ sales	EV/ EBITDA	P/E
SES	166	(18.5)	59.0	63.0	25.1%	13.0%	14.8%	6.5%	32.7%	6.8%	8.6%	(53.9%)	2.3	18.0	43.0
Pricer	88	(5.18)	68.0	60.9	14.0%	13.9%	12.2%	12.2%	37.1%	(10.4%)	157.4%	(76.3%)	1.3	9.7	21.5

Source: Edison Investment research, company accounts. Note: Priced at 10 January 2014.

Reverse DCF: 16% CAGR to 2020 at 15% EBIT margins

Using a WACC of 10%, terminal growth of 3% and assuming working capital is normalised to 90 days' receivables, 90 days' payables and 180 days' inventory, the market seems to be pricing in a 16% CAGR to 2020 on 15% EBIT margins, with c 6% capex and 33% tax. This is feasible given the currently low rate of ESL penetration in the global market and the higher number of countries that in our view are nearing the tipping point for adoption.

Sensitivity to CAGR and EBIT margin

Exhibit 10 shows the sensitivity of the DCF valuation per share to the assumed CAGR between FY14 and FY20 and the EBIT margin over the same period.

Exhibit 10: Share price sensitivity analysis

		EBIT margin				
		11.00%	13.00%	15.00%	17.00%	19.0%
CAGR (FY14-FY20)	5.0%	5.08	7.03	8.98	10.93	12.89
	10.0%	6.24	8.73	11.22	13.71	16.20
	15.8%	7.95	11.23	14.50	17.78	21.05
	20.0%	9.46	13.43	17.39	21.36	25.32
	25.0%	11.63	16.59	21.54	26.49	31.45

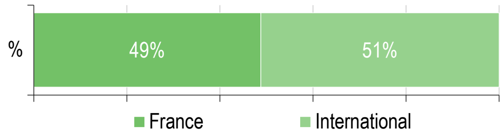
Source: Edison Investment Research

We forecast revenue CAGR of 22% between FY13 and FY15. If 20% revenue CAGR and EBIT margins of 15% can be achieved, the DCF produces a valuation of €17.39, 16% above the current share price. However, the valuation is clearly very sensitive to EBIT margin and CAGR, so while there is potential for upside, a relatively small reduction in growth or margin expectations could produce a proportionally greater reduction in share price.

Exhibit 11: Financial summary

€'000s	2008	2009	2010	2011	2012	2013e	2014e	2015e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS								
Revenue	57,725	56,719	44,408	58,950	62,975	80,446	100,200	119,391
Costs of materials and inventory sold (excluding labour costs)	(31,762)	(29,693)	(23,674)	(35,298)	(37,781)	(51,219)	(65,130)	(77,604)
Profit after materials and inventory cost	25,963	27,026	20,734	23,652	25,194	29,227	35,070	41,787
EBITDA	19,470	19,638	13,641	14,782	8,204	8,931	12,039	17,429
Operating Profit (before amort. and except.)	18,958	18,369	12,106	12,618	5,752	6,054	8,913	14,071
Acquired Intangible Amortisation	0	0	0	0	0	0	0	0
Exceptionals	(505)	(665)	0	0	0	0	0	0
Other	0	0	0	0	0	0	0	0
Operating Profit	18,453	17,704	12,106	12,618	5,752	6,054	8,913	14,071
Net Interest	(58)	1,155	6	729	606	522	567	705
Profit Before Tax (norm)	18,900	19,524	12,112	13,347	6,358	6,576	9,480	14,776
Profit Before Tax (FRS 3)	18,395	18,859	12,112	13,347	6,358	6,576	9,480	14,776
Tax	(6,229)	(6,044)	(4,157)	(4,643)	(2,264)	(2,170)	(3,128)	(4,876)
Profit After Tax (norm)	12,670	13,480	7,955	8,704	4,094	4,406	6,351	9,900
Profit After Tax (FRS 3)	12,166	12,815	7,955	8,704	4,094	4,406	6,351	9,900
Average Number of Shares Outstanding (m)	10.6	10.8	11.0	11.0	11.0	11.0	11.0	11.0
EPS - normalised (c)	119.3	125.1	72.6	79.1	37.2	40.1	57.9	90.2
EPS - normalised and fully diluted (c)	111.5	119.9	69.9	75.9	35.3	39.6	57.0	88.9
EPS - (IFRS) (c)	114.6	118.9	72.6	79.1	37.2	40.1	57.9	90.2
Dividend per share (c)	0.0	0.0	0.0	0.0	50.0	0.0	0.0	0.0
Gross Margin (%)	45.0	47.6	46.7	40.1	40.0	36.3	35.0	35.0
EBITDA Margin (%)	33.7	34.6	30.7	25.1	13.0	11.1	12.0	14.6
Operating Margin (before GW and except.) (%)	32.8	32.4	27.3	21.4	9.1	7.5	8.9	11.8
BALANCE SHEET								
Fixed Assets	26,106	28,793	29,052	31,714	35,227	38,785	42,095	45,172
Intangible Assets	24,809	27,403	27,538	30,021	33,200	36,758	40,068	43,145
Tangible Assets	1,176	1,202	1,076	1,211	1,468	1,468	1,468	1,468
Investments	121	188	438	482	559	559	559	559
Current Assets	49,622	53,736	62,114	75,254	73,137	77,404	84,201	94,141
Stocks	15,183	16,044	12,851	18,976	21,712	25,467	28,042	30,179
Debtors	20,875	15,478	11,113	20,664	22,479	26,815	29,225	31,506
Cash	13,162	21,197	36,183	34,397	24,695	20,870	22,682	28,205
Other	402	1,017	1,967	1,217	4,251	4,251	4,251	4,251
Current Liabilities	(14,036)	(8,116)	(8,119)	(14,204)	(17,337)	(20,757)	(24,511)	(27,629)
Creditors	(14,036)	(8,116)	(8,119)	(14,204)	(17,337)	(20,757)	(24,511)	(27,629)
Short term borrowings	0	0	0	0	0	0	0	0
Long Term Liabilities	(9)	(159)	(1,125)	(2,081)	(2,110)	(2,110)	(2,110)	(2,110)
Long term borrowings	0	0	0	0	0	0	0	0
Other long term liabilities	(9)	(159)	(1,125)	(2,081)	(2,110)	(2,110)	(2,110)	(2,110)
Net Assets	61,682	74,254	81,922	90,683	88,917	93,323	99,674	109,574
CASH FLOW								
Operating Cash Flow	2,219	12,132	20,384	7,654	5,810	4,781	11,376	16,834
Net Interest	0	0	0	0	0	0	0	0
Tax	0	0	(3,723)	(4,134)	(4,012)	(2,170)	(3,128)	(4,876)
Capex	(2,113)	(4,232)	(1,891)	(4,783)	(5,866)	(6,436)	(6,436)	(6,436)
Acquisitions/disposals	2,016	0	0	13	0	0	0	0
Financing	84	136	224	(513)	(115)	0	0	0
Dividends	0	0	0	0	(5,491)	0	0	0
Net Cash Flow	2,206	8,036	14,994	(1,763)	(9,674)	(3,825)	1,812	5,523
Opening net debt/(cash)	(10,958)	(13,162)	(21,197)	(36,183)	(34,397)	(24,695)	(20,870)	(22,682)
HP finance leases initiated	0	0	0	0	0	0	0	0
Other	(2)	(1)	(8)	(23)	(28)	(0)	(0)	(0)
Closing net debt/(cash)	(13,162)	(21,197)	(36,183)	(34,397)	(24,695)	(20,870)	(22,682)	(28,205)

Source: Edison Investment Research, Store Electronic Systems accounts

Contact details	Revenue by geography
Store Electronic Systems 39, Rue de Montigny 95100 Argenteuil +33 1 34 34 61 61 www.store-electronic-systems.com	

CAGR metrics		Profitability metrics		Balance sheet metrics		Sensitivities evaluation	
EPS 11-15e	4.0%	ROCE 14e	8.0%	Gearing 14e	N/A	Litigation/regulatory	◖
EPS 13-15e	49.9%	Avg ROCE 11-15e	9.6%	Interest cover 14e	N/A	Pensions	○
EBITDA 11-15	4.2%	ROE 14e	6.4%	CA/CL 14e	3.4	Currency	◖
EBITDA 13-15e	39.7%	Gross margin 14e	35.0%	Stock days 14e	102.1	Stock overhang	◖
Sales 11-15e	19.3%	Operating margin 14e	8.9%	Debtor days 14e	106.5	Interest rates	◖
Sales 13-15e	21.8%	Gr mgn / Op mgn 14e	3.9x	Creditor days 14e	73.9	Oil/commodity prices	◖

Management team

CEO: Thierry Gadou

Thierry Gadou was appointed CEO of SES in January 2012. Previously he was chairman and CEO of Atos Consulting France for five years and in 2000 founded B2B procurement site Avisium, which was acquired by Hubwoo in June 2003. He was CEO of Hubwoo for two years until 2005 when he left to join NextFund-Capital as managing partner where he stayed until joining Atos in 2007.

CTO: Philippe Bottine

Philippe Bottine started his career as a financial analyst for a venture capital fund in Silicon Valley and has been responsible for product development at SES since 2009.

CFO: Pascale Dubreuil

Pascale Dubreuil was appointed CFO of SES in April 2013, before which she was CFO of two Materis group subsidiaries, Zolpan Group and Chryso Group. Chryso Group went through a period of rapid growth over the period that Pascale was CFO, with revenues increasing threefold and its international presence increasing to 70 countries.

Principal shareholders	(%)
Chequers capital	21.37%
Tikehau Capital Advisors	13.09%
Pechel Industries	7.12%
Phison capital	5.01%
LBPAM	1.20%
MMA Finance	0.63%
Paris Lyon Gestion	0.59%

Companies named in this report

Pricer AB, Samsung, Tesco, Sainsbury's, Morrisons

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