Daily comment

Monday 27 October 2014

Thales, Bowleven, technology – Apple Pay

Thales HO:FP €38.0 Mkt cap €7.8bn Analyst: Sash Tusa

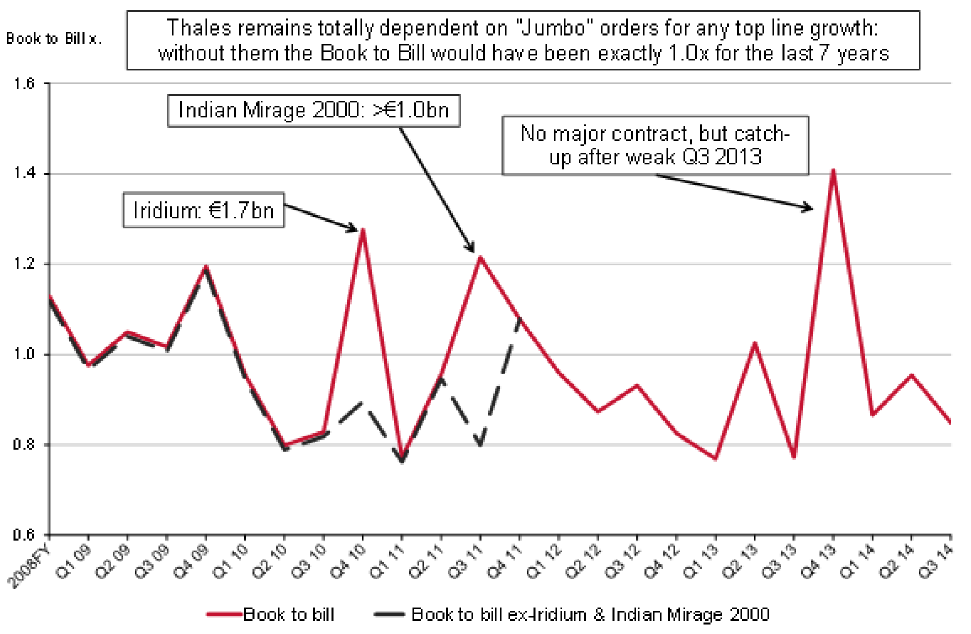
Our view

Thales' announcement of 2014 nine-month order intake and sales was hardly the strongest set of numbers for outgoing chairman and CEO Jean-Bernard Lévy. Order intake was strong in both Aerospace (+28% organic 9M/9M) and from emerging markets (+10%), but this continues to be all but outweighed by declining orders in Transport (-11%) and Defence & Security, by far Thales' largest division (-13%). Thales' record over the tenures of both Levy and his predecessor Luc Vigneron has been for a book to bill that, excluding very occasional €1bn+ 'jumbo' orders, has been exactly 1.0x. So, all the gains of the civil aerospace upcycle to date have been traded away by a continued shrinking of the core European defence activities.

The shares do not look expensive, but this, in our view, is a function of the risk of a 'political' appointee as chairman, and hence the possibility of losing the company to yet another 12+ month strategy review on assuming control. There is also the possibility, highlighted by Safran's warning on 23 October, of payment delays from the French state in Q4.

Against this, the possibility of a larger than expected 'special'/interim dividend in December to help the French state with its finances (as has been seen with other State-owned companies in recent years) is a clear attraction. But this should, arguably, be balanced by the risk of a further sell-down of the state's 26%/€2.0bn shareholding.

Exhibit 1: Another poor quarter for book to bill: there is an increasing risk that, absent a blowout Q4, Thales' 2015 revenues may be little better than flat



Source: Edison Investment Research, derived from Thales announcements

Forecasts and valuation

We have made c 2% changes to the divisional details of our forecasts, specifically to recognise Thales' comments that the DCNS contribution in 2014 is likely to be far worse than expected earlier in the year, but that this has not affected overall guidance for "stable" sales and 5-7% EBIT growth.

Exhibit 2: Thales earnings record, forecasts and valuation

€m		2012	2013	2014E	2015E	2016E
Share price (€)	37.7					
Shares in issue (m.)	203					
Mkt Cap €m	7,514					
Group revenues		14,158	12,698	12,735	13,005	13,515
EBIT mn.		927	1,011	1,080	1,130	1,235
EBIT margin (including DCNS)		6.5%	8.0%	8.5%	8.7%	9.1%
Net income - Group share		570	573	657	701	786
EPS - Group share, €		2.86	2.85	3.24	3.43	3.81
DPS €		0.88	1.12	1.25	1.35	1.50
Shareholders' Funds		3,477	3,847	4,250	4,675	5,152
Depreciation & amortisation		481	367	377	382	387
Reported net cash		930	1,077	1,058	1,139	1,198
Adjusted net (debt) incl pension deficit		-954	-781	-809	-728	-675
Adjusted net debt: equity		27%	20%	19%	16%	13%
EV		8,467	8,294	8,323	8,242	8,189
PE		13.2	13.2	11.6	11.0	9.9
Dividend yield		*2.3%*	*3.0%*	*3.3%*	*3.6%*	*4.0%*
EV/Sales		*60%*	*65%*	*65%*	*63%*	*61%*
EV/EBITDA		6.0	6.0	5.7	5.5	5.0

Source: Thales historical data, Edison research estimates

Looking into 2015-16, we believe Thales may not have much more margin upside since, excluding the now deconsolidated DCNS, the company is actually performing relatively well. The c 8% EBIT margins (excluding DCNS) we forecast for Thales for 2014-16e actually compare well with the following:

- **Finmeccanica** (averaging 6.8% over the same time period).
- The defence activities of Airbus (5.9% average).
- Only BAE Systems averages higher margins (10%+ to 2016e), although it benefits from US Electronics Systems margins of 13%+.

So the risk is that there is little additional margin upside absent an acceleration of revenue growth that is not, on the 9M numbers, supported by recent order trends.

Q4 could see a round of 'special dividends' as France pressurises state-owned companies to help fund its budget deficit.

One interesting possibility, however, is that in prior years when French spending has been under pressure, state-controlled companies have been "encouraged" to announce special (or larger than expected interim) dividends in November-December to help the state's revenues. We could, in our view, see both Safran and Thales deliver such a surprise this year.

Thales paid an interim dividend in €0.27 in 2013. We think that, based upon our €1.25 FY dividend forecast for 2014, Thales is likely to announce €0.30 on 10 December (to give €0.95 for the FY, vs €0.85 in 2013). But we accept there could be upside to this forecast.

Against this, the pressures on the budget could well encourage France to sell down stakes wherever possible:

- Its 11% shareholding in Airbus has a value of c €3.9bn.
- The 22% shareholding in Safran (carrying nearly 26% of the votes, due to double-voting rights for long-term shareholders) is worth €4.4bn.
- The 26% shareholding in Thales (37% of the votes) is worth €2.0bn.

Next events:

10 December 2014: Interim ex-dividend date (paid 12 December)

10-11 December 2014: Airbus capital markets day(s)

26 February 2015: Thales 2014 annual results

Bowleven BLVN:LN 31p Mkt cap £103m Analyst: Will Forbes

Bowleven has announced it has received the approval from the Cameroon government for its farm-out to Lukoil/New Age. This is the penultimate step in the process – only the gazetting of the presidential decree remains. With regard to this, the company is looking to extend the transaction longstop date with all sides to 31 December 2014. **Once the deal is complete, BVLN will receive $170m in cash, more than its current market capitalisation.**

Technology – Apple vs MCX: Richard Windsor

Apple Pay is the victim of a much bigger conflict.

It looks like mobile-based payments are at last about to see some traction, catalysed by Apple Pay, but the battle lines are being drawn already.

CVS and Rite Aid, the number two and three pharmacy chains in the US, have both decided to withdraw support for Apple Pay and Google Wallet, despite already having all the hardware installed to support them. Users have already used Apple Pay in both pharmacies since the system launched, as it generally works with all retail NFC systems despite neither (CVS and Rite Aid) being a launch partner for Apple Pay. Both companies have decided to switch off support for NFC-based payments entirely, we suspect, at MCX's request.

MCX is the Merchant Customer Exchange, which is an alliance of retailers who have created an alternative to Visa and MasterCard for processing consumer purchases. Each time a consumer pays with a card, the retailer pays a fee to have the transaction processed and this has a meaningful impact on the wafer-thin margins of the retailers. This is a constant problem for the retailers, who are very keen to find an alternative where there is a much lower fee just to cover the real cost of the transaction. MCX has created its own mobile-based payments system called CurrentC and there is a preference that consumers use that. It is a system that has been clearly designed to meet the needs of the retailer to the detriment of the user experience. Consequently, using CurrentC is more cumbersome than paying with a credit card and I think consumers will refuse to use it.

By contrast, Apple Pay is fast and easy but it uses the established processing infrastructure. This means that if Apple Pay becomes a standard method of payment in the US, the retailers will be even more locked into paying away a big portion of their profits for payments processing. However, Walgreens, the biggest pharmacy in the US, has embraced Apple Pay, with many users reporting success. The crunch will come if users start going to Walgreens rather than CVS or Rite Aid for their pharmacy products due to this issue. Should this happen, CVS and Rite Aid will have no choice but to return to supporting the NFC-based mobile payment systems.

If MCX is smart, it will quickly move its payment processing infrastructure to support Apple Pay because it can achieve its own aims while keeping consumers happy. Unfortunately, we suspect there are all sorts of vested interests that will keep this from happening, putting the success of MCX at risk. The consumer is king and there will always be alternatives where he/she can use whatever payment system he/she desires. The sooner MCX realises that the financial wellbeing of its members depends on happy consumers, the better its chance of breaking Visa's and MasterCard's strangleholds on payments processing.

Best regards,
Jeremy Silewicz

For further information please contact:

Jeremy Silewicz +44 (0)20 3077 5704
Head of institutional team
jsilewicz@edisongroup.com

Sohil Chotai +44 (0)20 3077 5733
Institutional analyst
schotai@edisongroup.com

Sash Tusa +44 (0)20 3077 5757
Aerospace & defence analyst
stusa@edisongroup.com

Richard Windsor +44 (0)20 3239 9904
Tech, mobile & internet analyst
rwindsor@edisongroup.com

View disclaimer