

Spain

# INDRA

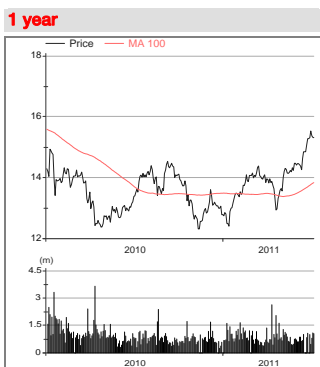
## Indra's profit should bottom out in H1 11. Upgrade to Buy with new TP of €17

**Buy (12m)**  
(from Hold)  
**Price 05/05/11** €15.3  
**12m target** €17.0

**Sector**  
Weighting  
**Neutral**  
Preferred stock  
**Capgemini**  
Least preferred stock  
**Infosys**

**Type of Investment**

Undervalued	✓
Cost reduction programme	✓



■ **Update** Indra reports Q1 earnings on 12 May after the market close. We expect a slow growth quarter with revenue up 2% to €656m and a 10.4% EBIT margin. We think Latin America, Finance and Telecom/Media should be the main growth drivers, offsetting the persistent weakness in Spain and Defence. **Positives: 1/ Strong sustainable growth in Latin America** (16%e group sales) with double-digit growth expected for 2011 driven by the expansion of Indra's main clients (Telefonica, BBVA, Banco Santander) in underpenetrated markets (Mexico, Brazil, Chile); **2/ Robust growth in Finance and Telecom/Media** (32%e, combined) with high single-digit growth expected; **3/ Dynamics in Services** (30%e) on the back of strong order intake in 2010 (+33%). **Negatives: 1/ Continued weakness in Spain and Defence**, respectively 60%e and 22% group sales, and **2/ Potential additional restructuring charges**.

■ **Impact** For FY11, we have upgraded our estimates on EBIT and EPS by 2% and 6% respectively while our revenue forecast is unchanged. On EBIT, we now expect €275m (margin 10.6%), up from €269m (10.4%) previously as we now assume there will be no additional restructuring charges for 2011 (vs. SGe €5m before). We also lower our effective tax rate to 23% from 26%, to be in line with Indra's guidance (23-24%). Overall, we now forecast for FY11 €2.6bn (+2%) in revenue, 10.6% in EBIT margin, and €1.23 in EPS. For FY12, we raise our EPS estimates by 5% to €1.32.

■ **Target price & rating** Our new FY11-12 estimates and a shift in valuation methodology lead us to raise our TP from €14.3 to €17 and to upgrade our rating to Buy from Hold. As we now do for the rest of the sector, we use a blend of 12m forward EV/EBIT (10x vs. 11.5x historically) and DCF (WACC 10%, EBIT margin 11%) instead of the EV/EBIT multiple as we did previously. We believe Indra's profits should trough in H1-11 and begin trending upwards in following quarters. **Risks** The main risk is Indra's exposure to Spain (60% of revenues, and half of that in government contracts).

■ **Next events & catalysts** Q1 results due 12 May after the market close. There is no conference call scheduled for this publication.

Indra on [www.sgresearch.com](http://www.sgresearch.com)

**Share data**

<b>RIC IDR.MC, Bloom IDR SM</b>			
52-week range	15.5-12.3		
EV 11 (€m)	2,721		
Market cap. (€m)	2,489		
Free float (%)	54.3		
<b>Performance (%)</b>	<b>1m</b>	<b>3m</b>	<b>12m</b>
Ordinary shares	7.9	10.4	7.2
Rel. Eurofirst 300	9.1	13.7	-3.1

<b>Financial data</b>	12/10	12/11e	12/12e	12/13e	<b>Ratios</b>	12/10	12/11e	12/12e	12/13e
Revenues (€bn)	2.63	2.61	2.72	2.85	P/E (x)	12.2	12.4	11.6	10.8
EBIT margin (%)	10.8	10.5	11.0	11.2	FCF yield (/EV) (%)	2.8	7.4	5.4	6.7
Rep. net inc. (€m)	189	200	215	230	Dividend yield (%)	4.6	4.4	4.7	5.1
EPS (adj.) (€)	1.17	1.23	1.32	1.42	Price/book value (x)	2.3	2.2	2.1	1.9
Dividend/share (€)	0.66	0.68	0.73	0.78	EV/revenues (x)	0.98	1.04	1.02	0.98
Payout (%)	56.7	55.0	55.0	55.0	EV/EBIT (x)	9.7	9.9	9.3	8.8
Interest cover (x)	14.9	21.1	22.0	22.4	EV/IC (x)	2.1	2.0	1.8	1.7
Net debt/equity (%)	27.0	21.0	24.0	23.1	ROIC/WACC (x)	2.1	1.8	1.8	1.8
Prev. EPS change (06/05/11)		1.18	1.29	1.35	CAGR 10-13e: +6.7%				

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## Latin America, Finance and Telecoms/Media are the drivers

Indra reports Q1 results on 12 May after the market close. We expect a slow growth quarter with revenue up 2% to €656m and EBIT up 6% to €68m (margin 10.4%). We believe that H1 11 should be the trough for Indra and that profit should begin to recover steadily in the following quarters thanks to past restructuring measures and easy comps.

### Indra: Q1 and FY11 forecasts

(In €m)	Q1 11e		FY11e		Comment
	SGe	Consensus	SGe	Consensus	
Revenue	656	653.4	2,608	2,619	Small decline expected in Spain, offset by Latin America (double digit growth)
EBIT	68	67.1	275	277	Management guided for no restructuring charges
EBIT margin (%)	10.4	10.3	10.6	10.6	
Net income	50	48.1	200	196	Effective tax rate 23-24% guided (vs. 20% in 2010)
Net margin (%)	7.6	7.4	7.7	7.5	
EPS (€)	0.31	0.30	1.23	1.20	

Source: SG Cross Asset Research, consensus figures provided by Indra

- By business line, we expect Services (30%e group sales) to remain the main growth driver with a 5% growth given the strong order intake (+33%) seen in 2010. Solutions (70%e) should remain practically flat despite easy comp (Q1 10: 0%).
- By geography, we estimate that Spain (60%e group revenue) will continue to struggle with a 2% decline in sales. This weakness should be offset by the continued strength seen in International (40%e), +8% in Q1 revenue, with Latin America being the main driver.
- By sector, Finance and Telecom/Media should deliver double-digit growth and offset the persistent weakness seen in Defence.

### Indra: Q1 revenue estimates by segment

(In €m)	Q1 10	Q1 11e	Growth (%)	Comment
Solutions	453	457	+1	
Services	190	199	+5	Strong order intake in 2010 should fuel growth in 2011
Transport and Traffic	129	138	+7	International's strength should offset Spain's sluggish growth
Telecoms and Media	93	105	+13	Latin America is the main growth catalyst
Public Administration and Healthcare	74	72	-2	Easy comp in Q1 10 (-16%)
Finance and Insurance	89	102	+14	Growth driven by both Spain and International
Energy and Industry	170	159	-6	
Defense	89	80	-10	Important pressure from the Eurofighter's delay (albeit no cancellation)
Spain	391	383	-2	
International	252	273	+8	Latin America is the main driver while Europe remains sluggish
Total revenue	643	656	+2	

Source: SG Cross Asset Research, Indra

## 2011 is geared towards H2

For FY11, we now forecast €2.6bn in revenue (+2%), €275m (+9%) in EBIT (margin 10.6%) and €1.23 in EPS (+6%), compared to €2.6bn/€269/€1.16 previously.

These changes stems mainly from two elements:

- We now assume that there would be no restructuring charges in 2011 following Indra's guidance at end-February, compared to €5m expected previously.
- We lower the tax rate to 23% from 26%, to be more in line with Indra's guidance (23-24%).

**Indra: change of SGe estimates for 2011**

Elements	New	Old	Difference (%)	Comment
Revenue (€m)	2,608	2,608	0	
EBIT (€m)	275	269	+2.0	No restructuring charges now vs. €5m previously
EBIT margin (%)	10.6	10.3	30bp	
Effective tax rate (%)	23.0	26.0		In line with Indra's guidance of 23/24%
EPS (€)	1.23	1.16	+6.0	

Source: SG Cross Asset Research

- In Spain (60%e group revenue), we expect a small decline in revenue (1%) due to persistent weakness in Defence (delay in the Eurofighter programme), Energy and Transport.
- In International (40%e group sales), Latin America should remain dynamic with double-digit growth and offset any weakness in Europe.

In Latin America (16%e), Indra has signed several important contracts in this region thanks to its strategic partnerships with Telefonica, BBVA and Banco Santander. Moreover, the group has also secured contracts with local customers in underpenetrated markets like Brazil, Mexico and Chile. Although competition is likely to heighten in Latin America due to stronger interest of global players like Capgemini (with the acquisition of CPM Braxis), Accenture or IBM, as well as offshore vendors like Tata Consultancy Services or Infosys, we believe that Indra should be able to protect and expand its market share.

In Asia Pacific and Middle-East, Indra should benefit from the strength of its solutions in Transport (metro in Malaysia, air traffic control in China and India, etc.).

On the other hand, Europe (16%), with a large percentage in the UK, should remain under pressure with a small decline in revenue in our view as Indra is still struggling to expand its presence outside its existing clients.

- Financial Services (16%e group revenue) should deliver in our view high single-digit growth (FY10: +10%) driven by work on the core banking system at BBVA, shortening of the suppliers list in Spain, development of Banco Santander and BBVA in Latin America...
- Thanks to several contracts with Telefonica in Latin America and Prisa in Spain, Telecoms/Media (16%e group sales) should also deliver high single-digit revenue growth.
- In the Transport sector (21%e group sales), we forecast mid-single digit growth. Indra should see its dynamics in International markets (46% of this segment's revenue) offset Spain's weakness.
- In the Public sector (12%e group revenue) should benefit from Spanish election scheduled for May 2011 to deliver mid-single digit growth in our view. Note that Spain represents 75% of public sector revenue and International 25%.
- The Energy sector (13%e group sales) should report a little decline in revenue.
- Given the delay in the Eurofighter programme (no cancellation though) and reduction in the Spanish military budgets, the Defence sector (22%e group sales) should continue to be weak with high single digit or low double digit decline in revenue.

For 2011, Indra estimates that order intake should slightly exceed that of 2010 (FY10: €2.9bn, +8%, with Solutions €1.9bn, -3% and Services €1bn, +33%).

As Indra has continued to invest in R&D efforts during the recession for its Solutions division, we believe that it would provide the group with a solid leverage on growth potential going into 2012. Note that R&D expenses should represent 7% of 2011 revenue according to Indra, in line with 2010 (7%) and 2009 (7%), and up from 6.4% in 2008 and 6.3% in 2007.

This continued investment effort should differentiate Indra further from its competitors in key sectors like Defence and Transport. These end-markets are geared to highly sophisticated products where pricing is generally not a big issue for mission critical solutions. This R&D-driven strategy would also expand Indra's growth opportunities in international markets, especially in emerging markets like India or China, where the build-up of infrastructure is still in full swing.

We will closely monitor the DSO (Days Sales Outstanding) level which should remain above 90 days (FY10: 93, FY09: 80) due to lower prepayments from clients in the Defence sector. This constraint on working capital would stretch the balance sheet a bit, but we believe that this is manageable for the group as its client base is largely composed of blue chips.

**Indra: SGe forecasts for FY11**

	Q1 10	Q2 10	Q3 10	Q4 10	2010	Q1 11e	Q2 11e	Q3 11e	Q4 11e	2011e
Revenue	643	686	550	678	2,557	656	706	561	685	2,608
Change (%)	3	-3	1	7	2	2	3	2	1	2
Other income	12	21	14	27	74	1	1	1	1	5
Change (%)	-8	37	14	39	23	-89	-93	-92	-95	-93
<b>Total income</b>	<b>655</b>	<b>707</b>	<b>564</b>	<b>705</b>	<b>2,631</b>	<b>657</b>	<b>707</b>	<b>562</b>	<b>687</b>	<b>2,613</b>
Change (%)	3	-2	1	8	2	0	0	0	-3	-1
Materials consumed	-314	-339	-261	-342	-1,256	-315	-346	-260	-319	-1,239
Personnel costs	-263	-280	-234	-271	-1,049	-262	-286	-226	-277	-1,052
EBITDA	78	87	69	92	327	80	76	76	90	322
EBITDA margin (%)	12.0	12.4	12.3	13.0	12.4	12.2	10.7	13.6	13.2	12.3
Change (%)	4	-11	-6	16	0	2	-14	10	-2	-2
Depreciations	-9	-11	-10	-13	-42	-12	-13	-10	-12	-47
Change (%)	6	-22	-3	30	0	33	18	6	-4	12
Operating profit (IFRS)	70	77	60	79	285	68	63	66	78	275
Operating margin (%)	10.8	11.2	10.9	11.7	11.2	10.4	8.9	11.8	11.4	10.6
Change (%)	3	-9	-6	13	0	-2	-18	10	-1	-3
Extraordinary items	-5	-6	-4	-18	-33	0	0	0	0	0
EBIT	64	70	56	61	252	68	63	66	78	275
EBIT margin (%)	10.0	10.2	10.3	9.0	9.8	10.4	8.9	11.8	11.4	10.6
Change (%)	-5	-17	-12	-12	-12	6	-10	17	28	9
Finance results	-4	-4	-5	-7	-19	-3	-4	-3	-3	-13
Share of profit of associates	0	0	0	1	1	0	0	0	0	1
Other non-current gains	0	0	0	0	0	0	0	0	0	0
Earnings before taxes	61	66	52	55	234	65	60	64	75	264
Change (%)	-3	-18	-12	-5	-10	8	-10	23	36	13
Tax	-14	-12	-11	-10	-46	-14	-14	-15	-18	-61
Tax rate (%)	22	18	20	26	20	22	23	23	24	23
Profit for period	47	54	41	45	188	51	46	49	57	203
Change (%)	-1	-11	-9	3	-5	8	-16	19	26	8
Minority interests	-1	0	1	0	1	-1	-1	-1	-1	-3
Net income	47	55	42	45	189	50	45	48	56	200
Net margin (%)	7.1	7.8	7.4	6.4	7.2	7.6	6.4	8.6	8.2	7.7
Change (%)	0	-10	-7	5	-4	8	-18	16	24	6
Diluted EPS	0.29	0.34	0.26	0.28	1.16	0.31	0.28	0.30	0.35	1.23
Change (%)	-1	-12	-8	4	-5	8	-18	16	24	6

Source: SG Cross Asset Research, Indra

## APPENDIX

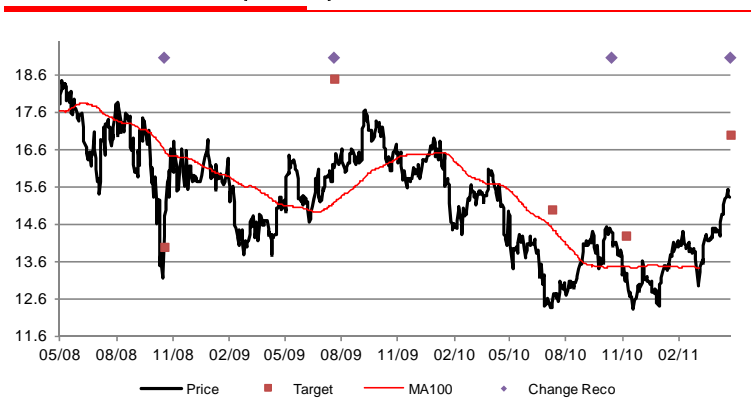
### COMPANIES MENTIONED

Accenture (ACN.N, Hold)  
 BBVA (BBVA.MC, Hold)  
 Capgemini (CAPP.PA, Buy)  
 Crédit Agricole SA (CAGR.PA, Buy)  
 IBM (IBM.N, Hold)  
 Indra Sistemas SA (IDR.MC, Buy)  
 Infosys Technologies Limited (INFY.OQ, Sell)  
 Santander (SAN.MC, Sell)  
 Telefonica SA (TEF.MC, No Reco)

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### Historical Price: Indra (IDR.MC)



2008/2009		Change	2010/2011		Change
28/10/08	New Rating: Hold		20/07/10	New Target: 15.0	
28/10/08	New Target: 14.0		25/10/10	New Rating: Hold	
31/07/09	New Rating: Buy		17/11/10	New Target: 14.3	
31/07/09	New Target: 18.5		06/05/11	New Rating: Buy	
			06/05/11	New Target: 17.0	

Source: SG Cross Asset Research

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**BUY:** expected total return of 10% or more over a 12 month period.

**HOLD:** expected total return between -10% and +10% over a 12 month period.

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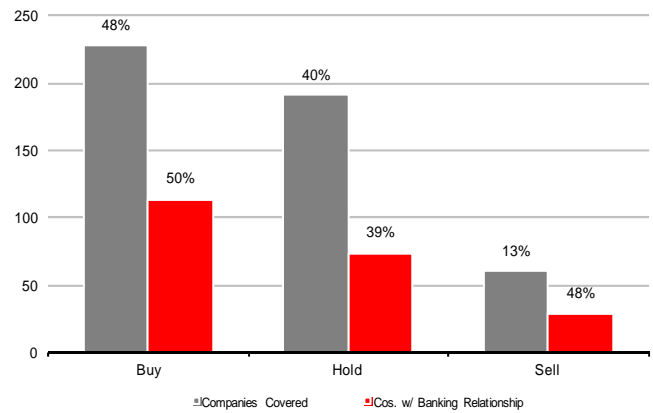
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**Equity rating and dispersion relationship**



Source: SG Cross Asset Research

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- BBVA SG acted as joint bookrunner of BBVA's bond issue.
- Crédit Agricole SA SG acted as joint book runner in Credit Agricole's covered bond issue.
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- Metro SG is advisor to HTM Group for the potential acquisition of 'Saturn' stores in France owned by Metro Group.
- Santander SG acted as joint lead manager in Santander's senior bond issue (4.125% 04/10/17 EUR).
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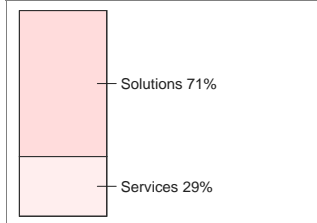
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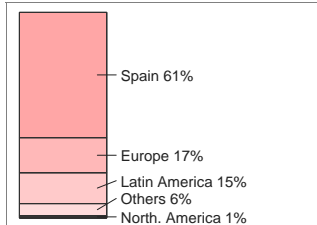
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**Sales/division 10**



**Sales/region 10**



**Major shareholders (%)**

Caja Madrid	20.0
Corporacion Alba	10.0
Casa Grande de Cartagena	5.7

**Normalised data**

EBITDA margin (%)	11.6
Normalised growth (%)	3.9

Margin improvement stems from better market demand, stronger growth in Solutions with a higher margin, expansion in low cost markets (Latin America) and cost control

IT Services (Spain)

**Indra**

**BUY**

Price (05/05/11)

12m target

**€15.3**

**€17.0**

Valuation* (€m)	12/06	12/07	12/08	12/09	12/10	12/11e	12/12e	12/13e
Nb. of shares basic year end/outstanding	143.6	161.4	160.1	161.1	162.4	162.4	162.4	162.4
Share price (average)	16.49	18.74	16.93	15.75	14.18	15.32	15.32	15.32
Average market cap. (SG adjusted) (1)	2,367	3,025	2,711	2,537	2,304	2,489	2,489	2,489
Restated net debt (-)/cash (+) (2)	-59	-150	-149	-135	-274	-232	-290	-304
Value of minorities (3)								
Value of financial investments (4)								
Other adjustment (5)								
EV = (1) - (2) + (3) - (4) + (5)	2,426	3,175	2,860	2,672	2,577	2,721	2,779	2,792
P/E (x)	20.7	20.4	14.9	12.9	12.2	12.4	11.6	10.8
Price/cash flow (x)	18.2	17.3	12.5	10.5	12.4	9.1	10.8	9.3
Price/free cash flow (x)	25.6	29.6	17.8	15.7	23.7	13.3	18.1	14.4
Price/book value (x)	6.4	4.1	3.3	2.6	2.3	2.2	2.1	1.9
EV/revenues (x)	1.72	1.46	1.19	1.04	0.98	1.04	1.02	0.98
EV/EBITDA (x)	13.2	12.3	9.3	8.2	7.9	8.4	8.0	7.5
Dividend yield (%)	3.0	4.3	3.0	4.0	4.6	4.4	4.7	5.1
<b>Per share data (€)</b>								
SG EPS (adj.)	0.79	0.92	1.14	1.22	1.17	1.23	1.32	1.42
Cash flow	0.91	1.08	1.35	1.50	1.15	1.69	1.42	1.65
Book value	2.59	4.57	5.14	6.07	6.24	6.81	7.42	8.08
Dividend	0.49	0.80	0.51	0.63	0.66	0.68	0.73	0.78
<b>Income statement (€m)</b>								
Revenues	1,413	2,176	2,399	2,574	2,631	2,613	2,718	2,854
Gross income	643	1,114	1,266	1,334	1,376	1,374	1,439	1,516
EBITDA	184	258	308	327	327	322	347	370
Depreciation and amortisation	-21	-34	-38	-42	-42	-47	-49	-51
EBIT	164	224	271	285	285	275	299	319
Impairment losses	0	0	0	0	0	0	0	0
Net interest income	-1	-13	-23	-25	-19	-13	-14	-14
Exceptional & non-operating items	0	0	0	0	-33	0	0	0
Taxation	-44	-57	-65	-63	-46	-61	-69	-74
Minority interests	-4	-7	-4	-2	1	-3	-3	-3
Reported net income	114	148	183	196	189	200	215	230
SG adjusted net income	114	148	183	196	189	200	215	230
<b>Cash flow statement (€m)</b>								
EBITDA	184	258	308	327	327	322	347	370
Change in working capital	-11	-39	-65	-50	-106	24	-36	-16
Other operating cash movements	-43	-44	-26	-37	-36	-72	-81	-86
Cash flow from operating activities	130	175	217	241	186	274	230	268
Net capital expenditure	-38	-73	-65	-80	-89	-87	-92	-96
Free cash flow	92	102	153	161	97	187	138	172
Cash flow from investing activities	-128	-40	-20	-20	-49	-30	-30	-30
Cash flow from financing activities	-82	-82	-116	-62	89	-110	-118	-127
Net change in cash resulting from CF	-118	12	17	80	134	47	-10	16
<b>Balance sheet (€m)</b>								
Total long-term assets	374	690	734	787	925	965	1,009	1,053
of which intangible	29	63	87	134	220	220	220	220
Working capital	132	296	305	419	492	489	616	693
Employee benefit obligations	0	0	0	0	0	0	0	0
Shareholders' equity	346	697	781	932	991	1,081	1,178	1,281
Minority interests	26	42	42	45	23	26	28	31
Provisions	5	9	3	17	20	19	20	21
Net debt (-)/cash (+)	-59	-150	-149	-135	-274	-232	-290	-304
<b>Accounting ratios</b>								
ROIC (%)	35.2	24.8	21.6	20.4	17.5	15.5	15.6	15.1
ROE (%)	36.3	28.4	24.7	22.8	19.6	19.3	19.0	18.7
Gross income/revenues (%)	45.5	51.2	52.8	51.8	52.3	52.6	52.9	53.1
EBITDA margin (%)	13.1	11.8	12.9	12.7	12.4	12.3	12.8	13.0
EBIT margin (%)	11.6	10.3	11.3	11.1	10.8	10.5	11.0	11.2
Revenue yoy growth (%)	17.1	53.9	10.3	7.3	2.2	-0.7	4.0	5.0
Rev. organic growth (%)	10.0	11.0	11.0	5.0	2.0	2.0	4.0	4.0
EBITDA yoy growth (%)	15.4	39.7	19.6	6.2	0.0	-1.5	7.8	6.6
EBIT yoy growth (%)	14.9	36.7	21.0	5.4	0.0	-3.4	8.4	6.9
EPS (adj.) yoy growth (%)	-43.8	15.3	23.8	7.3	-4.3	5.8	7.3	7.0
Dividend growth (%)	-34.2	62.0	-35.5	21.8	4.8	3.1	7.3	7.0
Cash conversion (%)	82.3	64.7	59.8	69.3	46.2	94.8	73.7	81.5
Net debt/equity (%)	15.8	20.4	18.1	13.8	27.0	21.0	24.0	23.1
FFO/net debt (%)	235.7	124.8	147.7	178.0	95.9	107.2	91.4	93.1
Dividend paid/FCF (%)	60.8	126.2	53.9	62.7	110.6	58.8	85.8	73.4

In red: IFRS Data

\* Valuation ratios for past years are based on average historical prices and market capitalisations