Check Point Software Technologies

Isin / FactSet Code	**IL0010824113 / CHKP-US**	Market cap (in EUR mn)	**14 493**	52-week high	**119.20**	Rating	**BUY**
Sector	**Information Technology**	Market cap (in local curr. mn)	**16 836**	52-week low	**80.78**	12-month target price	**115.00**
Industry	**Software**	Local currency	**USD**	YTD return%	**21.96**	Last price (01/11/17)	**103.01**
Benchmark	**MSCI AC World / Industrials -SEC**	Free-float	**78%**	12-month return%	**23.96**	Potential upside	**12%**

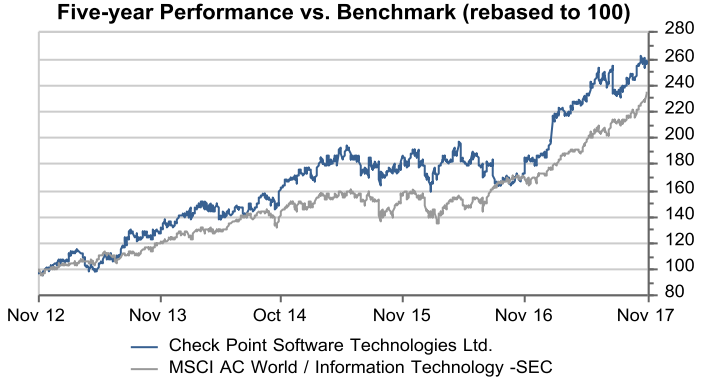
Investment Case:

- Being the largest pure player in network cyber security, we believe CHKP has strong growth prospects. We see several growth drivers, including higher enterprise-security budgets, ever-evolving malwares and the increasing prevalence of mobile computing.
- While maintaining its leadership in traditional firewall and intrusion-prevention, CHKP has also been focussing on expanding sales into cloud, mobile and datacentre security, through the introduction of new products such as Check Point Infinity and the 44000 and 64000 Appliance Series, bundled with richer software blades. This should facilitate market share gains and accelerate subscriptions growth, while keeping its operating margin in the mid-50% range.
- Although we expect near-term revenue headwinds to persist due to execution issues from sales organisation changes in the US, healthy end-market demand, new product refresh cycle and best-in-class profitability should, in our view, lead to resilient growth for CHKP in the long term. We lower our target price to USD 115.00 (from USD 125.00), valuing the stock at an FY18E P/E of 20.1x.

Company Description:

Check Point Software Technologies (CHKP) develops and markets IT security products, software and services for enterprises. It offers a platform to deploy independent, modular and interoperable security applications (software blades) such as firewalls, anti-virus software, intrusion-prevention systems and data-loss prevention systems.

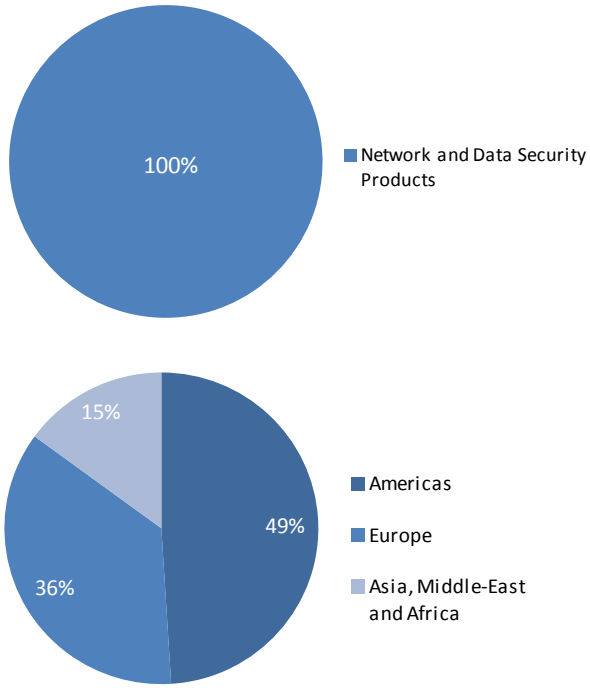
Five-year Performance vs. Benchmark (rebased to 100)



Sources: SGPB, FactSet

Revenue by Key Segments & Geographies: FY16

(FY ending December)



Sources: SGPB, FactSet

Recent Developments Analysis:

- CHKP posted solid 3Q17 results with revenues of USD 454.6 mn (+6.3% YoY) above the mid-point of guidance. This was driven by a strong growth in software blade subscriptions (+22%), partially offset by weaker revenues from the US (down 2%), due to sales execution issues. Non-GAAP EPS grew 15% to USD 1.30, above the higher end of guidance. Deferred revenues improved 17% to USD 1.04 bn and cash flow from operations increased 21.5% to USD 260 mn.
- Management expects 4Q17 revenues of USD 485–525 mn with the mid-point being well below consensus of ~USD 530 mn. It attributed the lower-than-expected sales guidance to execution issues in the US due to sales force reorganisation with new people in key positions. However, non-GAAP EPS guidance of USD 1.45–1.55 was in line with consensus due to lower commission expenses from slower bookings growth.
- In our view, the sales execution challenges in the US should be short lived. We continue to remain positive of CHKP's model of bundling richer software blades with its next-gen products, which has increased the proportion of recurring revenues (71.7% of 3Q17 revenues). This should lead to a higher long-term value-add and drive a more stable revenue stream for the company.

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Check Point Software Technologies

DESCRIPTION			VALUATION					GROWTH				PROFITABILITY			BALANCE SHEET		
FactSet Code	Company	Cap (mn€)	EV/EBITDA (e)		P/E (e)		Div. Yield	Sales Growth		EPS Growth		EBITDA Margin	Net Margin	ROE	Net Debt/ EBITDA		Net Debt/ Equity
			FY1x	FY2x	FY1x	FY2x	FY1%	FY1%	FY2%	FY1%	FY2%	FY1%	FY1%	FY1%	FY0x	FY1x	FY0x
CSCO-US	**Cisco Systems, Inc.**	147 575	8.0	7.4	14.2	13.5	3.5	0.5	2.0	1.7	5.3	35.0	25.1	17.8	-2.4	-2.1	-0.56
PANW-US	**Palo Alto Networks, Inc.**	11 401	21.5	15.9	43.5	35.0	0.0	22.0	19.2	22.1	24.4	24.6	14.9	32.5	na	-3.5	-1.12
JNPR-US	**Juniper Networks, Inc.**	8 139	5.7	5.3	11.8	11.6	1.6	0.7	0.6	0.4	2.5	25.8	16.1	15.4	-0.4	-1.6	-0.09
FTNT-US	**Fortinet, Inc.**	5 866	17.6	13.4	38.1	32.5	0.0	16.6	14.0	39.3	17.5	20.7	12.2	19.2	-11.3	-4.5	-1.30
		Average:	**13.2**	**10.5**	**26.9**	**23.1**	**1.3**	**10.0**	**9.0**	**15.9**	**12.4**	**26.5**	**17.1**	**21.2**	**-4.7**	**-2.9**	**-0.77**
CHKP-US	**Check Point Software Tech.**	14 493	12.6	11.6	19.6	18.0	0.0	6.7	6.2	11.3	8.8	55.3	47.2	23.7	-1.6	-3.8	-0.39

na=Not available,nm=Not meaningful
Financial terms detailed in glossary
Sources: SGPB, FactSet

Risks To Our Investment Case:

- Network security revenues are directly related to enterprise IT spending. Any macroeconomic weakness could initiate cost-cutting at corporations, which in turn would lower CHKP's subscription renewals.
- Pricing pressure due to increased competition and potential share loss to comparable products from new entrants and established players (such as Juniper, Fortinet and Palo Alto Networks), may pose a major threat to CHKP.
- Lack of traction in the newly launched high-end datacentre appliances and slower adoption of advanced software blades would negatively impact CHKP's revenues.
- Customer adoption of CHKP's latest high-end products depends to a large extent on efficient execution by the sales team. Any prolonged inefficiencies (resulting from the recent sales reorganisation in the US) could lead to market share losses to competitors.
- CHKP's franchise could get impacted if any of its products fail to secure clients against security breaches.

Business Quality Review:

- CHKP commands the best margins among its peers and has consistently generated FCF >50% of its revenues since 2011.
- It has a solid balance sheet with a FY17E net cash position of USD 3.91 bn. This should allow it to comfortably pursue external growth opportunities through bolt-on acquisitions in the areas of cloud, Internet of Things and national security.
- It has over 100 000 customers that allow it to up-sell new high-end product launches to a large installed base.

Dividend Policy:

- At present, the company is not paying dividends.
- It repurchased shares worth ~USD 250 mn in 3Q17. During the quarter, the management announced an extension of its share repurchase programme by USD 1 bn with a limit of up to USD 250 mn per quarter.

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Financial Terms And Acronyms

BV (Book Value): is the total value of net assets of a company.

BV/S (Book Value Per Share): is the total value of the net assets of a company divided by the total number of outstanding shares.

C/I (Cost Income Ratio): is used for valuing banks. It shows a company's costs in relation to its income.

CAGR (Compound Annual Growth Rate): is a term used for the geometric progression ratio that provides a constant rate of return over a specific time period.

CAPEX (Capital Expenditure): is the fund used by the company to acquire or upgrade the physical assets such as property, industrial buildings or equipment. The most capital intensive industries include oil, telecom and utilities.

CAR (Capital Adequacy Ratio): is a measure of a bank's capital. It is expressed as a percentage of a bank's risk-weighted credit exposures.

CET I (Common Equity Tier I Ratio) : is a measure of the bank's common equity capital as a percentage of risk-weighted assets. It is generally compared to a defined benchmark stipulated by the regulatory authority to determine whether a bank is sufficiently capitalised.

COMBINED RATIO: It represents the total of acquisition and administrative expenses, and claims and insurance benefits incurred, divided by net premiums earned.

DIVIDEND PER SHARE (DPS): Dividend per share or DPS (total dividend paid out divided by the total number of shares) expressed as a percentage of current stock price.

EBIT (Earnings Before Interest and Taxes): profit before taking into account interest payments and income taxes.

EBIT Margin: Ratio that expresses EBIT as a percentage of total sales (EBIT/Sales*100)

EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortisation): profit before taking into account interest payments, income taxes and non-cash operating expenses (depreciation and amortisation).

EPS (Earnings Per Share): is the division of total net profit by the number of shares.

EQUITY is the difference between the value of the assets and the cost of the liabilities.

EV (Enterprise Value) is a measure of a company's value, often used as an alternative to straightforward market capitalisation. It is calculated as (market cap + debt + minority interest + preferred shares) − total cash − cash equivalents.

FCF (Free Cash Flow): represents the difference between operating cash flow and capital expenditures.

FFO (Funds from Operations): measures a REIT's operating performance. It is net income plus gains (minus losses) from property sale and purchase. FFO per share is often used in place of earnings per share when analysing REITs.

FY0: Realised year, **FY1**: Current unrealised year, **FY2**: next year, **FY17E:** Fiscal year 2017 estimation

GOODWILL: is an intangible asset that arises as a result of the acquisition of one company by another company for a premium value.

GROSS INCOME: gross profit calculated as a company's total sales minus its cost of goods sold (COGS) that corresponds to labour and production costs.

GROSS MARGIN: expresses gross income as a percentage of total sales.

LIKE FOR LIKE (LFL) GROWTH: is a measure of growth in sales, adjusted for new or divested businesses.

Loan-to-deposit (L/D) ratio: Loans/Deposits. This helps in assessing a bank's liquidity, lending capacity and balance sheet quality.

LTV (Loan-To-Value Ratio): is a financial term used to express the ratio of a loan to the value of an asset purchased.

NAV (Net Asset Value): is similar to book value and is also called per investment unit. NAV is the marked-to-market value of the company's property investments less liabilities.

ND (Net Debt): is calculated as a company's total debt minus cash and other similar liquid assets.

NET MARGIN: is a financial ratio which measures the profitability of the net income of a company.

NI (Net Income or Bottom Line): represents a company's total earnings (or profit) which is calculated by adjusting revenues for the costs, depreciation, interest, taxes and other expenses.

NIM: Net Interest Margin

NON-PERFORMING LOANS (NPL) RATIO: NPLs/Loans. This indicates the percentage of the loans that are non-performing or are in stressed segments.

OPERATING MARGIN: See definition of EBIT Margin.

ORGANIC GROWTH: is the growth rate that a company can achieve by increasing its output and enhancing sales, excluding any profits or growth from takeovers or M&A activities.

P/E or PER (Price Earnings Ratio): reflects the trading price of a share in relation to the expected earnings.

P/BV (Price To Book Value): expresses the share price with regard to the accounting value of the company.

PAYOUT RATIO: is the proportion of earnings paid out as dividends to shareholders and typically expressed as a percentage.

PROFIT WARNING: is the announcement made by the company before its earnings release indicating the investors that its earnings would not meet the analysts' expectations.

RWA (Risk Weighted Assets): is a measure of the bank's assets, weighted according to their risk. It involves the risk weighting of both on and off-balance-sheet exposures.

REVENUE GROWTH: Illustrates the growth of sales over a given period.

ROA (Return on assets): a financial ratio that is calculated as net income divided by total assets and shows how profitable a company is relative to its total assets.

ROC (Return on invested capital): a profitability ratio which is calculated as net income minus dividends divided by total invested capital.

ROE (Return On Equity): The amount of net income returned as a percentage of shareholders' equity. Return on equity measures a corporation's profitability by disclosing how much profit a company generates with the money shareholders have invested.

TBV (Tangible Book Value): is the book value excluding intangible assets.

TBV/S (Tangible Book Value Per Share): allows to estimate the accounting value of a company by measuring its stockholders' equity per share. Formula: Re-valued Net Assets/Total Shares of Company.

WACC (Weighted Average Cost of Capital): also referred to as the firm's cost of capital, it is the rate that a company is expected to pay on an average to all its security holders to finance its assets.

WORKING CAPITAL: is the difference between a company's current assets and current liabilities and shows whether the company has sufficient short-term assets to cover its short-term debts.

Appendix

Investment Rating Definitions:

Buy Stock that is expected to outperform its MSCI sector index over a 12-month investment horizon.

Neutral Stock that is expected to perform in line with its MSCI sector index over a 12-month investment horizon.

Sell Stock that is expected to underperform its MSCI sector index over a 12-month investment horizon.

Restricted Covered stock that is not rated or assigned a target price as the Societe Generale group has a capital market transaction with that company.

Termination Stock is subject to be deleted from the SGPB recommended universe and will no longer be followed. In this case, a coverage termination alert is issued.

Recommended Universe Principle:

The Recommended Universe is made of companies from the Investment Universe as defined by Societe Generale Private Banking guidelines. Members are chosen by Equity Solutions. There are no lower nor upper limits on the number of stocks in the Recommended Universe. There is no specific constraint in term of geographical or industry representation. A company from the recommended universe can be subject to a rating change, as decided by the Equity Solutions expert covering the company. When a stock is downgraded to a Sell rating, it is still followed for at least 3-month, after which Equity Solutions issues a coverage termination alert.

Product Risk Rating:

The product category of single equity, stock, share is rated at '4'.

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Risk Levels	Losses
0 - Lowest Risk	There is a 95% probability that the product will not depreciate in value in one year.
1 - Low Risk	There is a 95% probability that the product will not lose more than 5% of its value in one year.
2 - Medium Risk	There is a 95% probability that the product will not lose more than 15% of its value in one year.
3 - High Risk	There is a 95% probability that the product will not lose more than 30% of its value in one year.
4 - Highest Risk	There is a minimum of 5% probability that the product will lose more than 30% of its value in one year.

1Y Target Price:

Equity Note Timeline: First disseminated: 22-Apr-16 | Last updated: 4pm Paris time, 02-Nov-17

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R1: Low Risk
R2: Medium Risk
R3: High Risk
R4: Highest Risk

These internal indicators are based on the Value at Risk 95% 1 year (VaR). The VaR corresponds to the maximum amount that the portfolio being considered could lose in normal market conditions over a given period with a given probability (past performances and simulations of performance shall not be considered as a reliable indicator of future performance). If the VaR 95% 1 year is y%, this means that there is a 95% probability that the portfolio will not lose more than y% of its value in one year.

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