

11 September 2013 | 36 pages

Health Care Equipment (GICS) | Medical Supplies & Technology (Citi)
Western Europe | Denmark

GN Store Nord (GN.CO)

Made for iPhone could be a game changer; initiate with Buy

■ Initiation of Coverage

- **Conclusion** — We expect GN to outperform its hearing aid competitors over the next 12 months driven by superior products including the launch of a Made for iPhone hearing aid. Furthermore we forecast significant EBITA margin expansion as a result of ongoing restructuring and potential for operational expansion in the hearing aid business beyond the 20% target set for full year 2013.
- **Direct compatibility with iPhone could be a big selling point** — Later this year we expect GN to launch the first hearing aid that can sync directly with the iPhone (competitor products require an intermediary streaming device). The compatibility with the iPhone could be a major driver of share gains, particularly in the US where we estimate that there are already ~6m hearing aid users who also own an iPhone. Our analysis suggests that each 5% increase in GN's share amongst this group will boost group revenue growth by 1 percentage point.
- **Lower contribution from retail leaves room for best in class margins** — GN's hearing aid division is coming to the end of a major restructuring program. The company aims to deliver an EBITA margin of 20% in 2013. However, we see room for further expansion (driven largely by economies of scale) as 20% is still below its main competitors, who have higher proportions of sales from dilutive retail operations (~25% vs. GN 3%).
- **Attractive growth provides further upside, initiate with Buy** — GN currently trades on a one year forward multiple of 19x versus 18% forecast underlying earnings growth (13-16E CAGR). Our DCF-based valuation leads us to a target price of Dkr140.00, equivalent to a 2014E PE multiple of 22x. Admittedly growth is strongest in the earlier forecast years, but our target price actually implies a de-rating over the next twelve months.

Buy	1
Price (10 Sep 13)	Dkr116.80
Target price	Dkr140.00
Expected share price return	19.9%
Expected dividend yield	0.8%
Expected total return	20.7%
Market Cap	Dkr20,245M
	US\$3,598M

Price Performance (RIC: GN.CO, BB: GN DC)



GN Store Nord (DKK)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales (DkrM)	5,564.0	6,251.0	6,820.4	7,406.3	7,903.9
Net Income (DkrM)	341.2	441.7	852.0	1,033.1	1,142.1
Diluted EPS (Dkr)	1.68	2.45	5.02	6.25	6.91
Diluted EPS (Old) (Dkr)	1.68	2.45	5.02	6.25	6.91
PE (x)	69.4	47.8	23.3	18.7	16.9
EV/EBITDA (x)	27.7	21.9	14.5	12.9	11.5
DPS (Dkr)	0.27	0.53	0.93	1.28	1.41
Net Div Yield (%)	0.2	0.5	0.8	1.1	1.2

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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GN.CO: Fiscal year end 31-Dec						Price: Dkr116.80; TP: Dkr140.00; Market Cap: Dkr20,245m; Recomm: Buy					
Profit & Loss (Dkrm)	2011	2012	2013E	2014E	2015E	Valuation ratios	2011	2012	2013E	2014E	2015E
Sales revenue	5,564	6,251	6,820	7,406	7,904	PE (x)	69.4	47.8	23.3	18.7	16.9
Cost of sales	-2,269	-2,522	-2,701	-2,934	-3,126	PB (x)	3.3	3.6	3.5	3.3	2.9
Gross profit	3,295	3,729	4,119	4,472	4,778	EV/EBITDA (x)	27.7	21.9	14.5	12.9	11.5
Gross Margin (%)	59.2	59.7	60.4	60.4	60.4	FCF yield (%)	2.6	15.4	4.8	6.9	7.8
EBITDA (Adj)	769	960	1,419	1,593	1,739	Dividend yield (%)	0.2	0.5	0.8	1.1	1.2
EBITDA Margin (Adj) (%)	13.8	15.4	20.8	21.5	22.0	Payout ratio (%)	16	21	19	20	20
Depreciation	-191	-129	-135	-148	-163	ROE (%)	12.9	5.2	13.9	17.8	17.7
{001763}	-28	-30	-36	-36	-36	Cashflow (Dkrm)	2011	2012	2013E	2014E	2015E
EBIT (Adj)	550	801	1,248	1,409	1,540	EBITDA	769	960	1,419	1,593	1,739
EBIT Margin (Adj) (%)	9.9	12.8	18.3	19.0	19.5	Working capital	-208	2,840	-204	-132	-112
Net interest	-28	-69	-80	-20	-15	Other	141	-447	-156	-14	15
Associates	6	2	0	0	0	Operating cashflow	702	3,353	1,059	1,447	1,642
Non-op/Except	697	-273	-113	0	0	Capex	-82	-103	-112	-122	-130
Pre-tax profit	1,225	461	1,055	1,390	1,525	Net acq/disposals	-81	-37	224	0	0
Tax	-360	-140	-277	-356	-383	Other	-323	-494	-469	-510	-544
Extraord./Min.Int./Pref.div.	0	0	0	0	0	Investing cashflow	-486	-634	-358	-632	-674
Reported net profit	865	321	777	1,033	1,142	Dividends paid	-39	-50	-94	-155	-207
Net Margin (%)	15.5	5.1	11.4	13.9	14.4	Financing cashflow	-147	-2,776	-201	-655	-207
Core NPAT	341	442	852	1,033	1,142	Net change in cash	72	-60	500	160	761
Per share data	2011	2012	2013E	2014E	2015E	Free cashflow to s/holders	620	3,250	946	1,325	1,512
Reported EPS (Dkr)	4.27	1.78	4.58	6.25	6.91	Segment Sales (DKr m)	2011	2012	2013E	2014E	2015E
Core EPS (Dkr)	1.68	2.45	5.02	6.25	6.91	ReSound	3,450	3,896	4,147	4,445	4,700
DPS (Dkr)	0.27	0.53	0.93	1.28	1.41	Netcom	2,106	2,355	2,674	2,961	3,204
CFPS (Dkr)	3.46	18.56	6.24	8.75	9.93						
FCFPS (Dkr)	3.06	17.99	5.58	8.01	9.14						
BVPS (Dkr)	35.64	32.51	32.91	35.13	40.62						
Wtd avg ord shares (m)	201	179	166	162	162						
Wtd avg diluted shares (m)	203	181	170	165	165						
Growth rates	2011	2012	2013E	2014E	2015E						
Sales revenue (%)	8.1	12.3	9.1	8.6	6.7						
EBIT (Adj) (%)	24.2	45.6	55.8	12.9	9.3						
Core NPAT (%)	14.5	29.5	92.9	21.3	10.5						
Core EPS (%)	16.5	45.2	105.3	24.4	10.5						
Balance Sheet (Dkrm)	2011	2012	2013E	2014E	2015E						
Cash & cash equiv.	229	169	669	828	1,590						
Accounts receivables	1,269	1,349	1,501	1,630	1,739						
Inventory	549	471	549	596	636						
Net fixed & other tangibles	987	1,711	1,465	1,439	1,406						
Goodwill & intangibles	4,248	4,234	4,353	4,465	4,559						
Financial & other assets	3,899	265	265	265	265						
Total assets	11,181	8,199	8,802	9,223	10,196						
Accounts payable	486	485	511	555	592						
Short-term debt	124	123	123	123	123						
Long-term debt	1,374	276	783	783	783						
Provisions & other liab	2,319	1,773	1,773	1,773	1,773						
Total liabilities	4,303	2,657	3,190	3,234	3,271						
Shareholders' equity	6,878	5,542	5,611	5,989	6,924						
Minority interests	0	0	0	0	0						
Total equity	6,878	5,542	5,611	5,989	6,924						
Net debt	1,269	230	237	78	-684						
Net debt to equity (%)	18.5	4.2	4.2	1.3	-9.9						

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For definitions of the items in this table, please click [here](#).

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Investment summary

There is some investor debate as to whether GN Store Nord still represents an attractive investment opportunity. In this report we conclude that it does and initiate coverage with a BUY recommendation.

Two key investment points focus on the hearing aid division, which we expect to deliver strong growth despite a more challenging underlying market.

Netcom (communications) business also set to perform strongly as a result of increased penetration of UC systems.

Valuation remains attractive due to high growth on offer. We initiate coverage with a Buy recommendation and a DKK140.00 target price.

GN Store Nord is a major player in both the hearing aid and communication hardware markets. 62% of group sales (15% market share) are generated through hearing aids, and telecommunication headsets account for the rest (38% of group revenues, ~45% share). The share price has performed strongly over the past five years as a result of excellent results achieved through restructuring and product launches implemented by the management team. Investors are now asking if the stock remains an attractive investment opportunity. We conclude that it is, and therefore initiate coverage with a Buy recommendation.

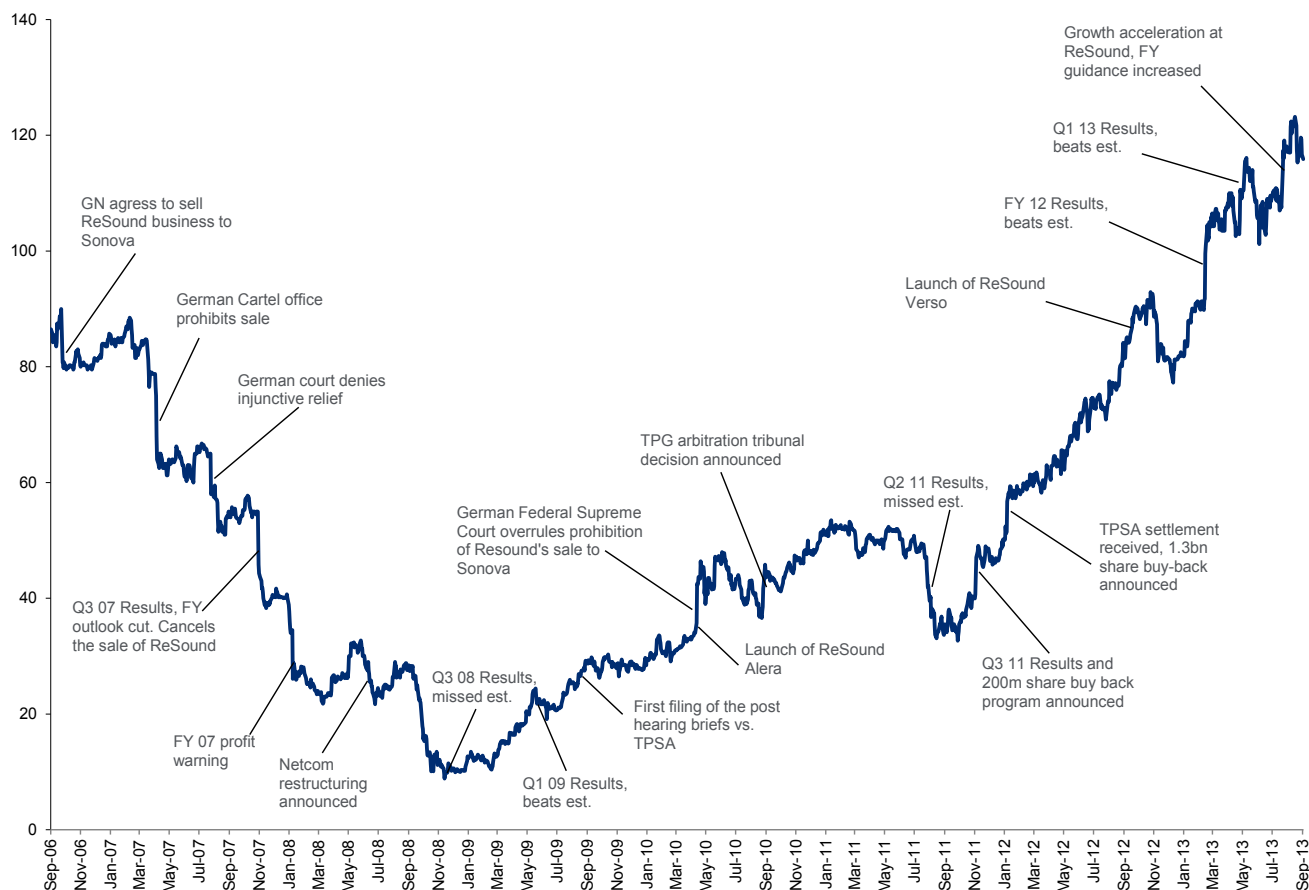
Our investment thesis rests on two key elements which we do not believe to be fully reflected in the current valuation. It is our view that the hearing aid business (GN Resound) will be the key determinant of share price performance over the next 12 months:

- **Made for iPhone hearing aid could be a silver bullet** – Within the next couple of months we expect to see the launch of GN's iPhone compatible hearing aid. This could be a landmark moment for both GN Store Nord and the hearing industry. At present, streaming between any home electronic equipment (Phone, TV, Radio, etc.) and a hearing aid requires an intermediary device. GN's new hearing aid will work directly with the iPhone. Due to different technological approaches, the major competition (such as Sonova and William Demant), are not in a position to be able to do the same. Our estimates suggest that each 5% share gain amongst US hearing aid wearers with iPhones would boost group revenue growth by 1%. We believe that consensus is underestimating the potential impact of this device.
- **Restructuring can lead to ReSound in excess of 20%** - GN is approaching the end of its SMART restructuring program. The initiative is on course to deliver a target EBITA margin of 20% in 2013E. This would bring the hearing aid division profitability close to its key competitors. However, given the lower percentage of revenues from dilutive retail operations (3% vs. 25%+ at William Demant and Sonova), we see potential for significant further margin improvement. We do not believe that this has been fully appreciated by consensus, leaving room for upgrades in the near to mid-term. Our base case assumes a further 80bp of ReSound margin expansion (13-17E), but in our best case scenario analysis we demonstrate that a further 270bp of expansion would increase group earnings growth to 37% (12-17E CAGR).

The Netcom division, which accounts for 28% of sales, is set to deliver resilient growth, driven by the increased penetration of unified communications (UC) solutions in the work place. The division is a major supplier of VoIP headsets to major UC software companies such as Cisco, Avaya, Siemens and Microsoft. We expect growth to be resilient going forward as UC penetration improves (currently at 4%). Barriers to entry in this market are higher than might be expected as the licenses granted by companies such as Microsoft require stringent sound quality testing.

While the stock has had an excellent run in recent years, we still believe the stock is currently undervalued. The strong top line growth and margin recovery story lead us to forecast EPS growth of 18.0% (13-16E CAGR). The stock currently trades on a one year forward PE multiple of 19x, which we do not believe fully values this growth. We use a DCF valuation to arrive at a DKK140.00 target price, equivalent to a 2014E PE of 22x.

Figure 1. GN share price performance – events



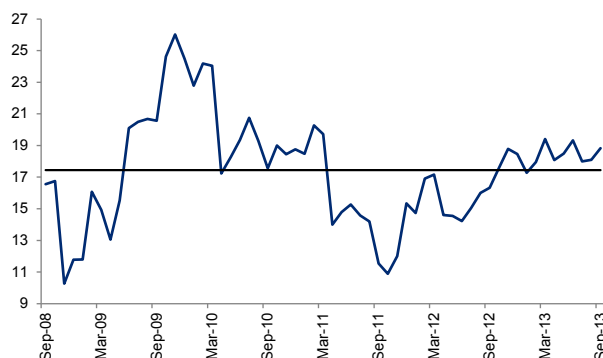
Source: Citi Research and company reports

Valuation

GN Store Nord currently trades on a 2014E PE of 19x and an EV/EBITDA multiple of 13x. While these are above the five year averages, we argue these methods fail to appreciate the strong growth potential over the next five years. We believe that the stock offers further upside and employ a DCF valuation to derive our target price of DKr140.00.

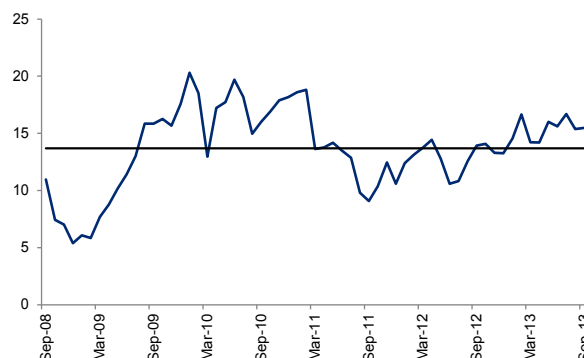
Not cheap but growth justifies multiple

Figure 2. One-year forward PE multiple vs. average for period



Source: Citi Research and FactSet

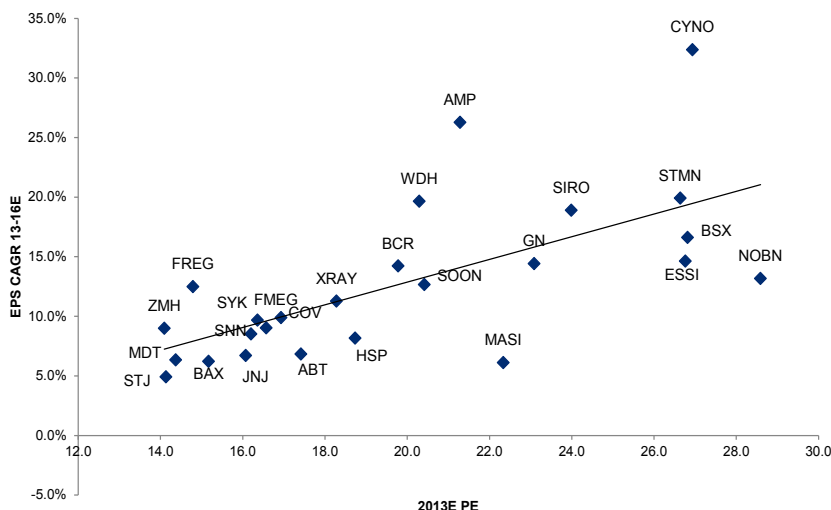
Figure 3. Trailing EV/EBITDA vs. average for period



As these charts show, GN Store Nord is trading above historical averages on both PE and EV/EBITDA metrics. However, we believe this to be justified by the turnaround in business performance that the company has achieved over the past five years. In addition, we believe that there is room for further upside given the strong growth on offer and potential for further margin expansion.

While we use a DCF to arrive at our target price, we believe that a PEG methodology is a useful methodology for testing this valuation. As Figure 4 shows, GN trades broadly inline with the global MedTech sector. It is our view that the stock deserves a premium given improving returns and exceptional growth on offer over the next two years.

Figure 4. Global MedTech PEG valuations



Source: Citi Research

DCF Valuation

We value GN Store Nord using a DCF methodology. We choose to use a DCF as we believe it is the fairest option for comparing companies across the highly differentiated subsectors of the European MedTech universe.

We estimate a WACC of 9.5% using a risk-free rate of 1.4%, a market risk premium of 9.4% and a beta of 0.9.

We apply this WACC to free cash flow which we forecast explicitly to 2017E and then apply a fading growth rate to 2021E. Beyond 2021 we assume a terminal growth rate of 2.0%. Consequently we arrive at a target price of DKr140.00. At our target price the stock would trade on 22x 2014E earnings. We believe this to be a fair multiple given the 18.0% forecast earnings growth on offer (13-16E CAGR).

There is some concern that the front end loaded nature of the growth on offer will lead to a de-rating of the shares over the next 12 months, our target price reflects this, putting the stock on 22x 2014E earnings vs. the current year multiple of 23x.

Figure 5. GN DCF Valuation

December year end (DKr m)	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	TV
EBIT	1134	1445	1576	1692	1794					
Tax Rate	26.3%	25.7%	25.1%	24.6%	24.6%					
Tax	(298)	(371)	(396)	(416)	(441)					
D&A	484.9	546.0	612.4	683.2	758.4					
Δ in Working Cap	(204)	(132)	(112)	(109)	(103)					
Net Capital expenditure	(112)	(122)	(130)	(138)	(146)					
Year count	1	2	3	4	4	6	7	8	9	
FCF	1005	1366	1550	1712	1863	1974	2073	2156	2221	32595
% growth	77.5%	36.0%	13.5%	10.4%	8.8%	6.0%	5.0%	4.0%	3.0%	2.0%
DF	0.91	0.83	0.76	0.70	0.70	0.58	0.53	0.49	0.44	0.44
PV	917.9	1140.4	1182.1	1192.7	1297.6	1148.0	1101.3	1046.4	984.7	14452.7
EV	24463.7									
Net debt	230.0									
Market cap	24233.7									
Number of shares	173.3									
Target price (DKr)	140									

Source: Citi Research

Peer group analysis

Figure 6. GN Peer valuation

Company	Rating	EPS CAGR	Sales CAGR	EBITDA CAGR	EBITDA margin	EBIT margin	PE	PEG Ratio (vs 13-16E EPS CAGR)	Net Debt /EBITDA	EV/EBITDA	FCF Yield	Div. Yield
		13-16E	13-16E	13-16E	2013E	2013E	2013E	2014E	2013E	2013E	2013E	2013E
GN Store Nord	Buy	18.0%	7.1%	9.7%	20.8%	18.3%	23.1	18.6	1.3	1.0	0.2x	14.4x
Other Hearing Aids												
Sonova Hld	Buy	12.7%	9.0%	12.3%	26.2%	21.8%	20.4	17.9	1.6	1.4	-0.6x	14.2x
William Demant	Neutral	19.7%	7.5%	12.4%	22.9%	20.2%	20.3	17.3	1.0	0.9	1.1x	13.9x
Amplifon SpA	Neutral	26.3%	5.0%	10.0%	16.5%	11.7%	21.3	15.2	0.8	0.6	1.7x	8.6x
Average (weighted)		16.2%	8.2%	12.1%	24.3%	20.4%	20.4	17.5	1.3	1.2	0.2x	13.6x
Other European Medtech												
Fresenius SE	Buy	12.5%	6.7%	8.6%	19.4%	15.3%	14.8	13.1	1.2	1.0	2.2x	7.8x
Fresenius Med Care	Neutral	9.9%	5.8%	8.0%	20.3%	15.9%	16.9	15.8	1.7	1.6	2.6x	9.5x
Smith & Nephew	Neutral	8.5%	5.7%	7.4%	27.4%	19.5%	16.2	14.9	1.9	1.7	0.3x	9.4x
Essilor	Buy	14.6%	11.5%	10.3%	23.0%	17.1%	26.8	23.2	1.8	1.6	0.1x	14.8x
Straumann	Buy	19.9%	12.2%	23.3%	23.3%	18.3%	26.6	22.6	1.3	1.1	-1.2x	14.9x
Nobel Biocare	Neutral	13.2%	5.5%	11.9%	17.6%	12.2%	28.6	26.6	2.2	2.0	-0.7x	13.4x
Average (weighted)		12.2%	7.9%	9.4%	21.9%	16.6%	19.7	17.6	1.6	1.5	1.3x	10.8x

Source: Citi Research

Citi versus consensus

Figure 7. Summary of Citi vs. consensus estimates

December year end (DKr m)	2013E	2014E	2015E
Sales			
Resound			
Citi	4147	4445	4700
Consensus	4180	4430	4671
% diff	-0.8%	0.3%	0.6%
Netcom			
Citi	2674	2961	3204
Consensus	2676	2938	3211
% diff	-0.1%	0.8%	-0.2%
Group			
Citi	6820	7406	7904
Consensus	6846	7375	7893
% diff	-0.4%	0.4%	0.1%
Gross Profit			
Citi	4069	4472	4778
Consensus	4137	4532	4861
% diff	-1.6%	-1.3%	-1.7%
Gross Margin			
Citi	59.7%	60.4%	60.4%
Consensus	60.4%	61.5%	61.6%
bp diff.	-76	-107	-114
EBIT			
Citi	1148	1409	1540
Consensus	1140	1409	1561
% diff	0.7%	0.0%	-1.3%
EBIT Margin			
Citi	16.8%	19.0%	19.5%
Consensus	16.7%	19.1%	19.8%
bp diff.	18	-8	-29
Net Income			
Citi	777	1033	1142
Consensus	783	1007	1124
% diff	-0.7%	2.6%	1.6%
EPS (pre-exceps) (diluted)			
Citi	5.02	6.25	6.91
Consensus	5.01	6.28	7.16
% diff	0.2%	-0.5%	-3.6%
EPS (diluted)			
Citi	4.58	6.25	6.91
Consensus	4.61	6.23	7.16
% diff	-0.6%	0.3%	-3.6%

Source: Citi Research and consensus from FactSet

Risks

We believe that the following factors present the greatest risk to GN Store Nord achieving our target price:

Low adoption of the MFi hearing aid

Our forecasts assume a 5% share gain amongst iPhone owners with hearing aids in the US. If the launch were to be less successful and share amongst this group not taken, then our sales forecasts would come under pressure and our estimates could be missed by the company

Reimbursement change in Europe

Over the past year we have seen a number of European governments make changes to reimbursement measures for hearing aids (eg. Switzerland and Holland). This has had a profound effect on these markets, with both pricing and volumes coming under severe pressure. The impact has been greater on retailers such as Amplifon, but if more governments were to follow suit, there is a risk that the volume and mix development of manufacturers such as GN Store Nord will come under pressure, causing the company to miss estimates and the shares to fall in value.

Lack of further margin expansion at ReSound

Our estimates include a further 100bp of EBITA margin expansion between 2013E and 2017E. While we see this as conservative given the potential economies of scale, it is possible that the company fails to improve profitability any further. If this were the case there would be no leverage and the multiple on which GN trades would come under pressure given that earnings growth would be lower.

Key investment themes

1. Made For iPhone hearing aid could be the industry's silver bullet

Figure 8. GN's product will be the only directly compatible MFI hearing aid available



Source: Citi Research and company

We expect GN Resound to launch its hearing aid made specifically for the iPhone later this year (official launch likely to be at the EUHA conference in October). We believe that this could be a significant step for both GN and the hearing aid industry given the marketing power of the Apple brand.

We are likely to see a number of manufacturers launch hearing aids carrying the MFi logo. However, the Resound offering will be differentiated by its direct compatibility, with no need for an additional streaming device. Other manufacturers have said that this will not be a significant advantage, but the majority of audiologists and end users that we have spoken to agree that the convenience of not needing to carry round an extra device is an attractive feature.

In addition to streaming calls/music/media from the phone, the connection will also allow the customer alter settings of the hearing aid to improve the fit and to interact with different environments.

Our market model predicts a 0.9% boost to group revenues in 2014E from sales of the MFI hearing aid in the US alone.

Figure 9. Impact of US sales of GN MFI hearing on group revenues

December year end (m)	2013	2014	2015	2016	2017
Population (+65 years)	44.2	45.5	47.0	48.4	49.9
Penetration of smart phone (%)	13.5%	14.0%	14.5%	15.0%	15.5%
Smart phone users	6.0	6.4	6.8	7.3	7.7
Iphone market share amongst smart phone users	39.5%	40.0%	40.5%	41.0%	41.5%
Iphone users above 65 years	2.4	2.5	2.8	3.0	3.2
% growth	8.4%	8.3%	8.1%	7.9%	7.8%
Prevalence of Hearing loss in US (+65 years)	18%	18%	18%	18%	18%
Number of iPhone users with hearing loss	0.4	0.5	0.5	0.5	0.6
Penetration of Hearing Aids in US (+65 years)	35.0%	35.0%	35.0%	35.0%	35.0%
Number of hearing aid wearers	2.8	2.9	3.0	3.0	3.1
% growth	3.0%	3.1%	3.1%	3.1%	3.1%
Number of hearing aid wearers without iPhone	2.6	2.7	2.8	2.9	2.9
% growth	2.8%	2.8%	2.8%	2.8%	2.7%
Number of hearing aid wearers with iPhone	0.1	0.2	0.2	0.2	0.2
% growth	8.4%	8.3%	8.1%	7.9%	7.8%
GN Users (without iPhone)	0.4	0.4	0.4	0.4	0.4
% growth	3.5%	3.5%	3.5%	3.5%	3.5%
Market share	14.1%	14.2%	14.3%	14.4%	14.5%
GN Users (with iPhone)	0.0	0.0	0.0	0.1	0.1
% growth	18.1%	43.8%	34.8%	29.3%	25.6%
Market share	15.3%	20.3%	25.3%	30.3%	35.3%
Total GN Users	0.4	0.4	0.4	0.5	0.5
% growth	4.2%	5.8%	6.0%	6.1%	6.1%
Market share	14.2%	14.5%	14.9%	15.4%	15.8%
GN Users (assuming no iPhone launch)	0.4	0.4	0.4	0.4	0.5
% growth	3.8%	3.8%	3.8%	3.8%	3.8%
Market share	14.1%	14.2%	14.3%	14.4%	14.5%
Number of GN MFI users)	0.00	0.01	0.02	0.03	0.04
Cost of hearing aids (per pair) (\$)	1200	1200	1200	1200	1200
Total market value (\$ m)	2.0	11.7	22.8	35.7	50.3
GN MFI market value (DKK m)	11.7	66.5	130.2	203.5	287.1
Upside potential from MFI - GN ReSound	0.3%	1.5%	2.8%	4.2%	5.7%
Upside potential from MFI - GN	0.2%	0.9%	1.7%	2.4%	3.3%

Source: Citi Research and Nielsen (assumes 5% additional share of iPhone from 2014E and 1.25% in 2013E)

Figure 9 suggests that this launch has the potential to be a major driver of group revenues. In our model we assume a 5% share gain each year (1.25% in 2013E) amongst US hearing aid users (we see this as conservative) and no price premium. This scenario would boost volume growth by 2% in the US in 2014E and add 1 percentage point to group revenues.

2. Restructuring and scale can take margins beyond 20%

SMART program nearing its end but room for further expansion remains.

In November 2010 GN commenced its SMART program for the ReSound business. The program aimed to deliver a segment EBITA margin of ~20% by the end of this year, which it is on course to do. However, we do not believe that this represents a ceiling for the division's EBITA margin. The lower level of retail sales versus competitors suggests that there is room for further expansion.

Figure 10. GN's EBITA margin has improved - still below the competition

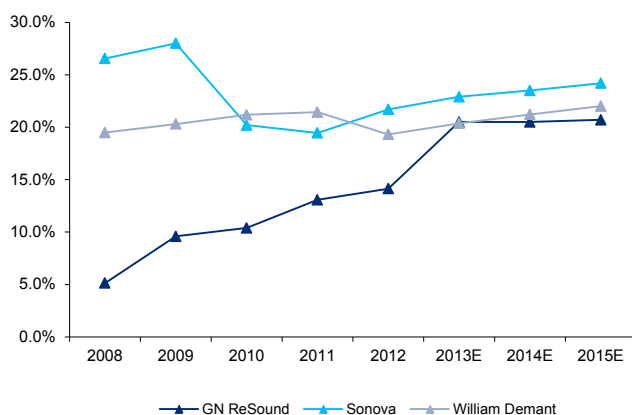
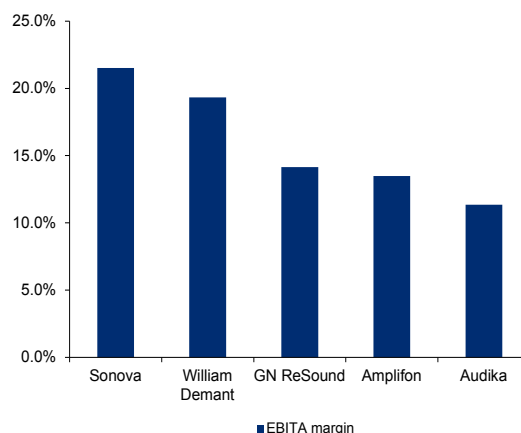


Figure 11. GN has significant potential to improve profitability given that only 3% of revenues come from dilutive retail operations.



Source: Citi Research and company reports

Restructuring up to now has been about merging previous standalone business segments.

As Figure 10 shows, GN's margin remains some way below that of its competitors (William Demant and Sonova) but the final months of the SMART program should go some way to correcting this. SMART has focused on major reductions in both manufacturing and operational costs, through the streamlining of acquired business that had been run on an almost standalone basis historically.

Lower contribution from retail should mean higher margins than competitors are achievable.

The company expects SMART to account for 6 percentage points of EBITA margin expansion in 2013E, bringing the group margin almost in line with the company's major competitors. However, GN generates a significantly lower proportion of hearing aid sales through retail operations (3% vs. ~25% for SOON and WDH). Given the dilutive nature of the retail business at the operating margin, we would expect GN to deliver a superior level of profitability in the medium term.

Consensus expectations for margin expansion beyond 2014 look conservative – leaving potential for upward revisions going forward.

The major driver of further margin expansion is primarily economies of scale, but given the high level of growth we are forecasting for the division, it is possible that this improvement in profitability occurs at a faster rate than consensus expects, at present the street is only forecasting a margin of 19.8% in 2016E which seems overly conservative. Our base case assumes that the ReSound division reaches a margin of 21.3% by 2017E, but if we were to assume a higher rate of efficiency gains resulting in a 2017E margin of 23.2%, this would add Dkr5.00 to our DCF derived target price, while boosting group earnings growth by ~150-200 basis points.

Figure 12. Scenario analysis of impact GN Resound margin expansion on group EPS growth

December year end (DKrm)	2013E	2014E	2015E	2016E	2017E
ReSound EBITA Margin (pre-exceps)					
Bear case	20.5%	19.3%	18.9%	19.0%	19.1%
Base case	20.5%	20.6%	21.1%	21.2%	21.3%
Bull case	20.5%	20.8%	21.4%	21.8%	22.2%
Bullest case	20.5%	21.0%	21.6%	22.4%	23.2%
Group EBITA					
Bear case	1284.2	1389.0	1476.9	1588.0	1685.6
Base case	1284.2	1445.2	1576.3	1692.3	1794.4
Bull case	1284.2	1454.1	1590.4	1721.9	1840.7
Bullest case	1284.2	1464.6	1603.8	1755.7	1896.5
Group EBITA Margin					
Bear case	18.8%	18.8%	18.7%	18.9%	19.1%
Base case	18.8%	19.5%	19.9%	20.2%	20.3%
Bull case	18.8%	19.6%	20.1%	20.5%	20.8%
Bullest case	18.8%	19.8%	20.3%	20.9%	21.4%
Group EPS(DKr)					
Bear case	4.58	5.99	6.45	7.04	7.52
Base case	4.58	6.25	6.91	7.52	8.03
Bull case	4.58	6.29	6.97	7.66	8.24
Bullest case	4.58	6.33	7.03	7.81	8.50
EPS up/(down)side (vs. Base case)					
Bear case	0%	-4%	-7%	-6%	-6%
Bull case	0%	1%	1%	2%	3%
Bullest case	0%	1%	2%	4%	6%
Group EPS growth					
Bear case	157.8%	30.8%	7.7%	9.1%	6.9%
Base case	157.8%	36.3%	10.5%	8.9%	6.8%
Bull case	157.8%	37.2%	10.9%	9.9%	7.7%
Bullest case	157.8%	38.3%	11.0%	11.1%	8.8%
Group EPS CAGR	12-17E	13-16E	13-17E	14-17E	
Bear case	25.5%	15.4%	13.2%	7.9%	
Base case	35.2%	18.0%	15.1%	8.7%	
Bull case	35.9%	18.7%	15.8%	9.5%	
Bullest case	36.8%	19.5%	16.7%	10.3%	

Source: Citi Research

Company description

Through its' Resound and Netcom businesses, GN Store Nord enjoys leading positions within hearing aid and hands free communication markets. A high level of innovation in all business segments has unlocked significant value over recent years and we expect this to continue.

Figure 13. GN Revenue by segments (FY 12)

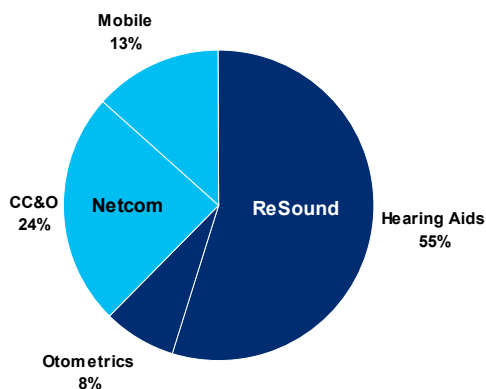
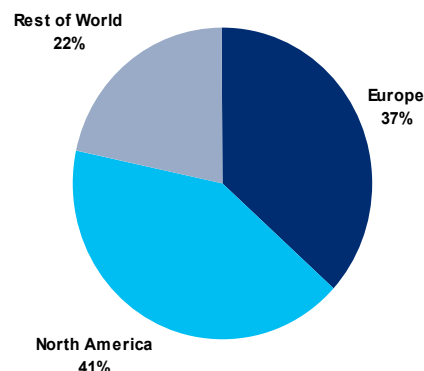


Figure 14. GN Revenue by geography (FY 12)



Source: Company Reports

GN ReSound

Sales of hearing aids and otometric instruments constitute the majority of revenues for GN. The company manufactures and distributes a variety of hearing aids under the ReSound, Beltone and Interton brand names. ReSound has delivered market-beating performance in the hearing aids segment in the recent years led by the Alera and Verso product families. We anticipate that this will be continued with the launch of an MFi product later this year.

GN Otometrics is a leader in manufacturing and supply of audiological diagnostics and hearing instrument fitting equipments for audiologists and hearing care professionals. The company competes with major competitor William Demant in this area. Acquisitions, a complete product portfolio, and an overhaul the of North American distribution setup in the segment have led to impressive growth for Otometrics in the recent years.

GN Netcom

Through the CC&O and Mobile segments, GN Netcom is a leading player in the headsets and hands free communications market globally. Within the CC&O business, GN sells a variety of corded and wireless headsets for office and contact centres. In our view, Unified Communications headsets will continue to be a key growth platform for the segment over the coming years.

The Mobile business manufactures and supplies corded, and Bluetooth headsets for voice and music as well as in-car speaker phones for mobile users. GN has recently focused on the realignment of this business unit, disposing of segments that do not fit with the rest of the group.

North America represents the largest market for GN's products (41% of sales) followed by Europe (37% of sales) while revenues from Rest of the World represent 22% of group sales.

GN ReSound

Hearing aids

The launch of ReSound Alera in April 2010 marked the return of GN ReSound to the premium hearing aid market. The Alera family of products adopted 2.4GHz wireless technology for intra-device communication for the first time. Since the launch GN has regained share and the next generation of premium devices (the Verso family) has continued this trend.

Figure 15. GN ReSound current product portfolio – Hearing Aids and accessories

	Segment	Performance	Life style / Design	Tinnitus	Super power / High power	Pediatrics
Premium	Top	ReSound Verso 9	ReSound Verso 9 IIC	ReSound Verso TS 9	ReSound Verso 9 BTE	ReSound Up 9
	Plus	ReSound Verso 7	ReSound Verso 7 IIC	ReSound Verso TS 7	ReSound Verso 7 BTE	ReSound Up 7
	Basic	ReSound Verso 5		ReSound Verso TS 5		
	ReSound Unite accessories TV 2 Airlink fitting Phone Clip+ Remote control 2Mini microphone Control App					
Essentials	Basic	ReSound Vea 3			ReSound Sparx	
	Budget	ReSound Vea 1+2			ReSound Sparx Lite	

Source: Citi Research and company reports

Divergence in R&D is now paying off and leaves company best placed

Different choice of intra-aid communication is starting to come good for GN.

When GN chose to use 2.4GHz technology (similar to that used in Bluetooth connections) for intra-device communication, it was suggested that the power consumption and the wave length would limited the complexity of communication between devices and constrain battery life.

Figure 16. NFMI vs. 2.4GHz technology

	Advantages	Disadvantages
NFMI	Ease of implementation due to existence of RF chips Longer battery life Lot of transmission options	Short distance transmission A "gateway device" needed Sound quality can be compromised by the placement of "gateway device". Interference with magnetic sources possible
2.4GHz	No "gateway device" needed Long distance transmission Reliable connectivity with low interference High data transmission Low process delay	Requires specially designed antenna Streamer device for Bluetooth needed

Source: Citi Research and company reports

Of the most recent set of high end launches, GN's Verso had the greatest incremental improvement. We believe that this will lead to the greatest market growth outperformance.

Initially these concerns seemed to be justified as functionality of GN's products was behind that of Sonova/William Demant and battery life was less. However, with the latest launch (Verso), the company has made a major step forward. Between October 2012 and April 2013, all three manufacturers launched new high end products. The consensus view amongst independent audiologists that we have spoken is that the largest incremental improvement was delivered by GN's Verso, with some claiming that it was superior to the offerings from Sonova and William Demant.

Figure 17. Hearing Aids premium product comparison

Company Model	GN ReSound Verso 9	Phonak Audeo Q	Oticon Alta Pro
Platform	Range II	Quest	INIUM
Features			
Binaural capability	Yes - without a supporting device	Yes	Yes
TV Integration - Bluetooth	Unite TV	TVLink S	ConnectLine
Feedback Cancellation	Enhanced DFS Ultra	Whistel/Wind Block	Feedback Shield
Natural hearing	Environmental Optimizer II	Real Ear sound	Spatial Sound premium
Directional Zoom	Binaural Directionality	Auto Zoom Control	TriMode
Speech Enhancement - Noise Reduction	NoiseTracker II	NoiseBlock	Binaural TriState noise management
Water Resistant	Yes	Yes	Yes
Channels	17	20	10
Wireless Capable	Yes second generation 2.4GHz technology	Yes	Yes
Listening Programs	4	5	4
Price Range (per ear)	\$2399-2899	\$1849-2999	\$1995-2395

Source: Citi Research, company reports and pricing information from hearingplanet.com

2.4GHz technology paves the way for direct compatibility – GN's Made For iPhone device will not require an intermediate streamer.

At present, linking a hearing aid with a television, a phone or an MP3 player requires an intermediary device. This is part due to the battery consumption constraints and also a result of the incompatible communication pathways used. GN's adoption of 2.4 GHz technology changes this as the protocol used is compatible with the latest iPhone operating system. It is for this reason that the company will have the competitive edge over devices that require an intermediate to connect with an iPhone. We believe that this is a major advantage for the company and could result in significant share gains.

Otometrics

Otometrics is the hearing related diagnostic equipment arm of GN ReSound. Otometrics manufactures and supplies audiological testing and hearing aid fitting equipment globally under the MADSEN, AURICAL, HORTMANN and ICS brand names. The division has been built through a number of acquisitions and is well placed in the diagnostics market.

Figure 18. GN Otometrics current product portfolio

Hearing Assessment	Audiometers	Astera Aurical Aud Midimate Itera II Xeta Micromate
	OAE Diagnostics Immitance	Capella OTOflex 100 Zodiac 901
Screening Fitting	Newborn Hearing Screening Fitting System	AccuScreen Aurical Aurical Plus
	Video Otoscopy HI Programming	OTOCam 300 HI-PRO 2
Balance Assessment	Head Impulse Testing	ICS Impulse
	Evoked Potential (VEMP)	ICS Chartr EP 200
	Caloric Irrigators	ICS AirCal ICS NCI-480
	VNG/ENG Testing	HORTMANN Aquamatic II ICS Chartr 200 HORTMANN Vestlab 100
	Frenzel Lenses	ICS FL-15 Frenzel Lenses
Software	Balance Platform	ICS Balance Platform
	Audiometry and Fitting Software	OTOSuite

Source: Citi Research, Company Reports

In-ear 3D scanner technology

In November 2012, GN announced the acquisition of the global rights for manufacturing and distribution of the 3D ear scanner technology from 3DM systems. This ear scanner technology represents a breakthrough process vs. the current the standard of diagnostics. While it is still in development, it is hoped that 3DM technology will considerably reduce the processing time for hearing moulds for the patients. The full potential of this area is not yet fully understood but we believe that embracing the technology and being an early mover in this space could be important in years to come.

GN Netcom

Contact Centre & Office headsets - CC&O

GN Netcom currently holds 25% share of the global Contact Centre & Office headsets market. While traditional CC&O headsets occupy 80% of the market with low growth, the division is benefitting from the adoption of Unified Communication (UC) systems in the office place. UC systems bring together all communication methods in the workplace on to one platform – email, messaging, telephony, conference calls, etc. The growth is being driven by big software companies that are promoting this platform, including Microsoft, Cisco, Siemens and Avaya.

The penetration of UC systems remains low, with only 4-5% of headsets being connected to such a system worldwide, but growth is high, accounting for ~50% of CC&O growth in 2012 and 25% of the Netcom division. Barriers to entry are also high, as the software companies license headsets for their systems after extensive sound quality testing. There are currently only two major players in the market GN and Plantronics, but companies such as Logitech and Seinnheiser are increasing activity in this space.

Figure 19. CC&O market estimates

DKK bn	2011	2012	2013E	2014E	2015E
Total CC&O market value	6.0	6.5	7.8	9.3	11.2
% growth		8%	20%	20%	20%
Market split					
Office without UC					
Base of users (millions)	410	414	422	431	439
% growth		1.0%	2.0%	2.0%	2.0%
Attachment rate	4%	4%	4%	4%	4%
Number of users	16.4	16.6	16.9	17.2	17.6
Value per user	16.8	16.7	16.5	16.3	16.2
ASP		-1.0%	-1.0%	-1.0%	-1.0%
Value	2.76	2.76	2.79	2.81	2.84
% growth		0.0%	1.0%	1.0%	1.0%
Share of the total CC&O market	46%	43%	36%	30%	25%
Office with UC					
Base of users (millions)	8	13	20	31	48
% growth		60.0%	55.0%	55.0%	55.0%
Attachment rate	45%	45%	45%	45%	45%
Number of users	3.6	5.8	8.9	13.8	21.4
Value per user	18.3	18.2	18.0	17.8	17.6
ASP		-1%	-1%	-1%	-1%
Value	0.66	1.05	1.60	2.46	3.78
% growth		58.4%	53.5%	53.5%	53.5%
Share of the total CC&O market	11%	16%	21%	26%	34%
Contact Centers					
Base of users (millions)	12.0	12.2	12.5	12.7	13.0
% growth		2.0%	2.0%	2.0%	2.0%
Attachment rate	90%	90%	90%	90%	90%
Number of users	10.8	11.0	11.2	11.5	11.7
Value per user	12.2	12.2	12.2	12.2	12.2
ASP		0%	0%	0%	0%
Value	1.32	1.35	1.37	1.40	1.43
% growth		2.0%	2.0%	2.0%	2.0%
Share of the total CC&O market	22%	21%	18%	15%	13%
Business PC headsets					
ASP Pressure		-2%	-2%	-2%	-2%
Value	1.26	1.33	2.01	2.65	3.15
% growth		5.4%	51.4%	32.0%	18.6%
Share of the total CC&O market	21%	21%	26%	28%	28%

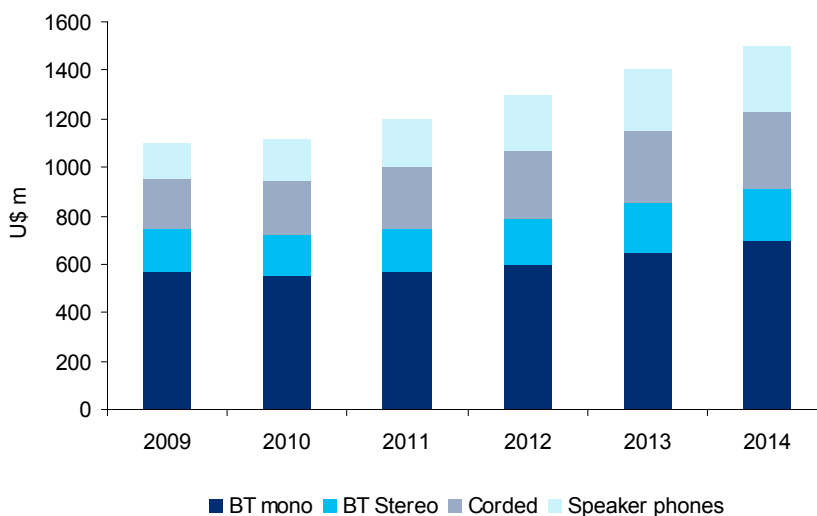
Source: Citi Research and company reports

Mobile

JABRA (GN's brand) currently enjoys a leadership position in the highly fragmented mobile hands free market. The company has concluded that the traditional hands free market (mono headsets and car speakerphones) does not offer the attractive growth it once did. Subsequently GN has directed its efforts into voice and music integration recently. This segment offers superior growth opportunities in the near term

The barriers to entry in this division are not as high as in UC, and low cost Chinese players already account for a significant portion of the Bluetooth headset market. However the music device market is highly attractive, with the recent success of Dr Beats being a perfect example of the growth on offer. GN expects this market to grow from DKK5bn last year to DKK8bn in 2015E (17% CAGR).

Figure 20. Mobile headsets market estimates



Source: Citi Research and company reports

Figure 21. GN Netcom current product portfolio

Bluetooth Headsets	Wired Headsets	Wireless Office Headsets	Speakerphones	Accessories
Jabra BT	Jabra BIZ	Jabra GN	Jabra CRUISER	Jabra LINK
Jabra CLEAR	Jabra GN	Jabra GO	Jabra DRIVE	Jabra GN
Jabra CLIPPER	Jabra UC	Jabra MOTION	Jabra FREEWAY	
Jabra EASYCALL	Jabra ACTIVE	Jabra PRO	Jabra JOURNEY	
Jabra EASYGO	Jabra CHILL	Jabra EASYGO	Jabra SPEAK	
Jabra EXTREME	Jabra REVO	Jabra HANDSET		
Jabra HALO	Jabra RHYTHM			
Jabra REVO	Jabra VOX			
Jabra SPORT				
Jabra STONE				
Jabra STREET				
Jabra SUPREME				
Jabra TALK				
Jabra WAVE				
Jabra MOTION				

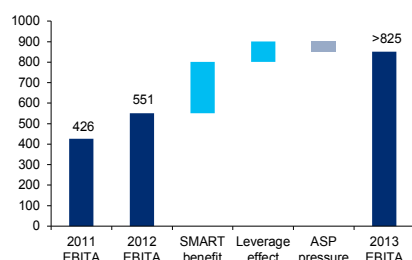
Source: Citi Research and company reports

Operational efficiency improvements

GN's ability to improve operating performance in the both the ReSound and Netcom businesses is key to our investment thesis. Management is approaching the end of an extensive restructuring program at ReSound, which will bring segment margins in line with the industry peers. Within Netcom, the recent re-alignment of the business provides potential for improved operational performance in the future.

GN ReSound – The SMART restructuring program

Figure 22. ReSound – 2013 EBITA guidance



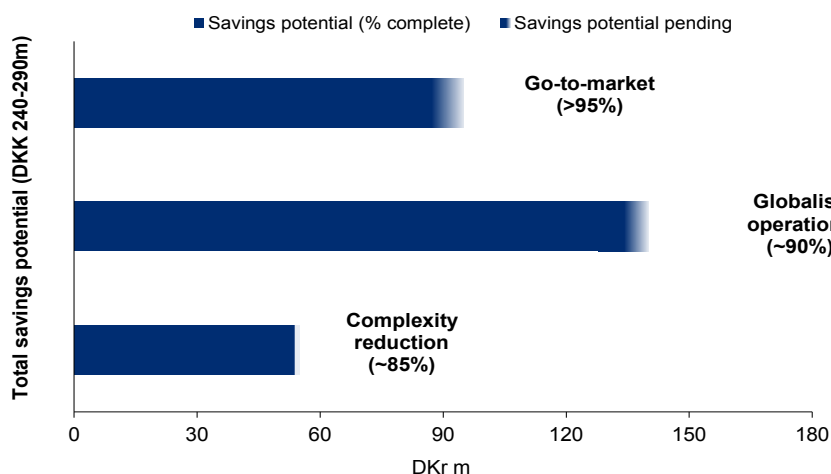
Source: Citi Research and company reports

In early 2012, GN launched a comprehensive restructuring program to improve operating performance for ReSound. The program aims to deliver DKK240-290m of EBITA improvement by close of 2013, compared to 2011. GN ReSound aims to achieve an EBITA margin of ~20% in 2013, thereby closing the operating performance gap vs. its competitors.

The SMART program is based on three fundamental pillars of operational improvement and is focused on reducing complexity and legacy issues within ReSound (issues that arose largely as a result of the company being a based on a number of acquisitions allowed to operate independently for some time).

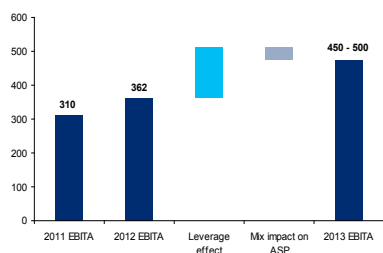
- **Complexity reduction (DKK50-55m)** – Simplification of the product portfolio, packaging process, and elimination of task duplication
- **Globalise operations (DKK110-140m)** – Reduction of cost of sales and returns management through offshoring. Reduction of freight costs through centralization of logistics operations.
- **Go-to-market (DKK 80-95m)** – Reduce inefficiencies in sales subsidiaries and internal price management processes. Divestiture of non-core assets (as discussed in the following sections) and improve the performance of underlying core businesses.

Figure 23. SMART program – savings potential and progress update



Source: Citi Research and company reports

Figure 24. Netcom – 2013 EBITA guidance



Source: Citi Research and company reports

GN Netcom – Operational improvement through realignment and mix

In conjunction with the start of the SMART program at ReSound, GN Netcom also set targets for improved revenues and EBITA margins for 2013. Netcom aims to deliver an 18% EBITA margin for 2013 led by operational improvement in the mobile business (previously less profitable) and mix effect of higher sales from Unified Communications.

Strategic re-alignment

GN has directed significant efforts in the past and recent times to align both the ReSound and Netcom businesses with the company's core competencies. We believe that this strategy of divesting non-core assets is commendable and has improved the momentum of the group. In particular we believe that the decision to keep hearing aid retail activities to a minimum makes this business more attractive.

GN ReSound

- **Sale of retail stores in India to Amplifon** – In July 2012, GN announced the sale of its 38 retail stores in India to Amplifon for an undisclosed amount. The sale, not meaningful financially, was in line with GN's strategy not to have retail operations in APAC region, in order to avoid competition with key customers such as Amplifon.

GN Netcom

- **Divestment of North American Hello Direct reseller business** – Earlier this year, GN announced a strategic decision to divest its North America direct reseller business, Hello Direct, to Synergy Communications Management. The divestment freed up operational capacity to focus on Jabra, CC&O and Unified Communications markets in the region.
- **Reduction of Mobile OEM business** – Netcom has significantly reduced its presence (currently <5% of Netcom sales) in the mobile OEM business since Q4 09. The lower profitability of the segment has been a drag on the Netcom EBITA margins over past several years. This re-alignment coupled with improved growth in the segment has led to improved EBITA margins for the segment in recent quarters.

Financials

We believe GN will continue to deliver above market growth in both ReSound and Netcom, led by its innovative product offering and market strategy. We anticipate a 7.1% revenue CAGR (13-16E) driven by the MFi and Verso hearing aids, Otometrics and Unified Communications. In addition the SMART restructuring program at ReSound and mix benefits from higher sales in UC at Netcom are expected to deliver substantial operating leverage. Consequently, higher operating margins and declining financial expenses lead to our forecast EPS growth of 18.0% (CAGR 13-16E).

Sales

Despite soft growth in the underlying Hearings aid market, we expect ReSound to deliver outperformance led by Verso and the MFi hearing aid in the near term. Within Otometrics, we continue to see higher growth led by new product launches and the recent realignment of distribution. Consequently, we forecast a 5.2% revenue growth (13-16E CAGR) for ReSound.

For the NetCom segment we anticipate strong revenue growth driven by the increased penetration of UC and attractive non-traditional mobile markets. We forecast 8.9% revenue growth (13-16E CAGR) for Netcom.

Figure 25. GN sales detail

December Year end (DKr m)	FY 11	FY 12	FY 13E	FY 14E	FY 15E	FY 16E	FY 17E	13-16E CAGR
ReSound								
Hearing Instruments	3060.0	3423.0	3593.5	3809.1	3999.6	4179.5	4346.7	5.2%
% growth y-o-y	9.4%	11.9%	5.0%	6.0%	5.0%	4.5%	4.0%	
% growth CER	9.0%	5.0%	8.0%	6.0%	5.0%	4.5%	4.0%	
Otometrics	390.0	473.0	553.3	636.3	700.0	752.4	797.6	10.8%
% growth y-o-y	6.6%	21.3%	17.0%	15.0%	10.0%	7.5%	6.0%	
% growth CER	5.0%	13.0%	20.0%	15.0%	10.0%	7.5%	6.0%	
ReSound	3450.0	3896.0	4146.8	4445.4	4699.5	4932.0	5144.3	6.0%
% growth y-o-y	9.0%	12.9%	6.4%	7.2%	5.7%	4.9%	4.3%	
% FX Effect		4.9%	-3.4%	-0.1%	0.0%	0.0%	0.0%	
% growth CER		8.0%	9.9%	7.3%	5.7%	5.0%	4.3%	
% growth acquisitions		2.0%	0.3%	0.0%	0.0%	0.0%	0.0%	
% organic growth	9.0%	6.0%	9.6%	7.3%	5.7%	5.0%	4.3%	
Netcom								
CC&O	1400.0	1530.0	1624.4	1754.4	1877.2	2008.6	2139.1	7.3%
% growth y-o-y	10.7%	9.3%	6.2%	8.0%	7.0%	7.0%	6.5%	
% growth CER	12.0%	5.0%	9.0%	8.0%	7.0%	7.0%	6.5%	
Mobile	706.0	825.0	1049.2	1206.5	1327.2	1446.6	1562.4	11.3%
% growth y-o-y	-0.3%	16.9%	27.2%	15.0%	10.0%	9.0%	8.0%	
% growth CER	3.0%	11.0%	30.0%	15.0%	10.0%	9.0%	8.0%	
Netcom	2106.0	2355.0	2673.6	2960.9	3204.4	3455.2	3701.5	8.9%
% growth y-o-y	6.7%	11.8%	13.5%	10.7%	8.2%	7.8%	7.1%	
% FX Effect		4.8%	-0.7%	-0.1%	0.0%	0.0%	0.0%	
% growth CER		7.0%	14.2%	10.9%	8.2%	7.8%	7.1%	
% growth acquisitions		0.0%	-3.0%	0.0%	0.0%	0.0%	0.0%	
% organic growth	9.0%	7.0%	17.2%	10.9%	8.2%	7.8%	7.1%	
Total	5556.0	6251.0	6820.4	7406.3	7903.9	8387.2	8845.8	7.1%
% growth y-o-y	8.2%	12.5%	9.1%	8.6%	6.7%	6.1%	5.5%	
% FX Effect		5.5%	-2.5%	-0.1%	0.0%	0.0%	0.0%	
% growth CER		7.0%	11.6%	8.7%	6.8%	6.1%	5.5%	
% growth acquisitions		1.0%	-1.0%	0.0%	0.0%	0.0%	0.0%	
% organic growth	9.0%	6.0%	12.6%	8.7%	6.8%	6.1%	5.5%	

Source: Citi Research and company reports

EBITA margin development

Led by the SMART restructuring initiative, ReSound is set to deliver a 600bp EBITA margin expansion in 2013E, we forecast a 2013E EBITA margin (pre-exceptionals) of 20.5%. We also anticipate a 200bp improvement in Netcom EBITA margin for 2013E. This improvement is driven by higher sales of UC headsets, which are accretive to the EBITA margin despite having a lower gross margin.

Net Income

Led by the EBITA margin improvement and lower net financials we forecast Net Income (pre-exceps) growth of 13.4% (CAGR 13-16E). This translates to forecast EPS (pre-exceps) growth of 14.4% (CAGR 13-16E). The higher EPS growth is due to the share buyback.

Figure 26. GN Store Nord income statement

December Year end (DKr m)	FY 11	FY 12	FY 13E	FY 14E	FY 15E	FY 16E	FY 17E	13-16E CAGR
Revenues	5564.0	6251.0	6820.4	7406.3	7903.9	8387.2	8845.8	7.1%
% growth y-o-y	8.1%	12.3%	9.1%	8.6%	6.7%	6.1%	5.5%	
Production Costs	(2269.0)	(2623.0)	(2751.0)	(2934.2)	(3126.3)	(3323.0)	(3510.4)	
% of sales	40.8%	42.0%	40.3%	39.6%	39.6%	39.6%	39.7%	
Gross Profit (pre-exceps)	3295.0	3729.0	4119.4	4472.1	4777.6	5064.2	5335.4	7.1%
% growth y-o-y	12.3%	13.2%	10.5%	8.6%	6.8%	6.0%	5.4%	
Gross Margin (%)	59.2%	59.7%	60.4%	60.4%	60.4%	60.4%	60.3%	
Gross Profit	3295.0	3628.0	4069.4	4472.1	4777.6	5064.2	5335.4	7.6%
% growth y-o-y	12.3%	10.1%	12.2%	9.9%	6.8%	6.0%	5.4%	
Gross Margin (%)	59.2%	58.0%	59.7%	60.4%	60.4%	60.4%	60.3%	
Expensed development costs	(510.0)	(541.0)	(534.3)	(564.5)	(607.8)	(634.9)	(659.1)	5.9%
% of sales	9.2%	8.7%	7.8%	7.6%	7.7%	7.6%	7.5%	
Selling and distribution costs	(1635.0)	(1909.0)	(1856.2)	(1949.4)	(2061.8)	(2183.1)	(2301.0)	5.6%
% of sales	29.4%	30.5%	27.2%	26.3%	26.1%	26.0%	26.0%	
Management and administrative expenses	(609.0)	(581.0)	(494.6)	(512.9)	(531.6)	(553.9)	(580.9)	3.8%
% of sales	10.9%	9.3%	7.3%	6.9%	6.7%	6.6%	6.6%	
Other operating income	12.0	4.0						
% of sales	0.2%	0.1%						
Exceptional Income/ expense	731.0	15.0						
EBITDA (pre-exceps)	769.0	960.0	1418.8	1593.3	1739.0	1870.6	1989.3	9.7%
% growth y-o-y	26.1%	24.8%	47.8%	12.3%	9.1%	7.6%	6.3%	
EBITDA margin (%)	13.8%	15.4%	20.8%	21.5%	22.0%	22.3%	22.5%	
EBITDA	1475.0	745.0	1318.8	1593.3	1739.0	1870.6	1989.3	12.4%
% growth y-o-y	-46.1%	-49.5%	77.0%	20.8%	9.1%	7.6%	6.3%	
EBITDA margin (%)	26.5%	11.9%	19.3%	21.5%	22.0%	22.3%	22.5%	
Depreciation	(191.0)	(129.0)	(134.5)	(148.0)	(162.7)	(178.3)	(194.9)	
EBITA (pre-exceps)	578.0	831.0	1284.2	1445.2	1576.3	1692.3	1794.4	9.6%
% growth y-o-y	23.2%	43.8%	54.5%	12.5%	9.1%	7.4%	6.0%	
EBITA margin (%)	10.4%	13.3%	18.8%	19.5%	19.9%	20.2%	20.3%	
EBITA	1284.0	616.0	1184.2	1445.2	1576.3	1692.3	1794.4	12.6%
% growth y-o-y	-50.5%	-52.0%	92.2%	22.0%	9.1%	7.4%	6.0%	
EBITA margin (%)	23.1%	9.9%	17.4%	19.5%	19.9%	20.2%	20.3%	
Amortization of other intangible assets acquired	(28.0)	(30.0)	(36.0)	(36.0)	(36.0)	(36.0)	(36.0)	
Operating Profit / Loss (EBIT) (pre-exceps)	550.0	801.0	1248.2	1409.2	1540.3	1656.3	1758.4	9.9%
% growth y-o-y	24.2%	45.6%	55.8%	12.9%	9.3%	7.5%	6.2%	
Operating margin (%)	9.9%	12.8%	18.3%	19.0%	19.5%	19.7%	19.9%	
Operating Profit / Loss (EBIT)	1256.0	586.0	1148.2	1409.2	1540.3	1656.3	1758.4	13.0%
% growth y-o-y	-51.1%	-53.3%	95.9%	22.7%	9.3%	7.5%	6.2%	
Operating margin (%)	22.6%	9.4%	16.8%	19.0%	19.5%	19.7%	19.9%	
Gains (losses) on disposal of assets	(9.0)	(58.0)	(13.0)					
Share of profit(loss) in associates	6.0	2.0						
Financial Items	(28.0)	(69.0)	(80.4)	(19.7)	(15.1)	(6.9)	2.4	
Profit (loss) before tax (pre-exceps)	519.0	676.0	1154.9	1389.6	1525.2	1649.4	1760.8	12.6%
% growth y-o-y	26.6%	30.3%	70.8%	20.3%	9.8%	8.1%	6.8%	
Profit (loss) before tax	1225.0	461.0	1054.9	1389.6	1525.2	1649.4	1760.8	16.1%
% growth y-o-y	-51.7%	-62.4%	128.8%	31.7%	9.8%	8.1%	6.8%	
Tax on profit (loss)	(360.0)	(140.0)	(277.4)	(356.5)	(383.2)	(405.6)	(432.7)	
Tax rate	29.4%	30.4%	26.3%	25.7%	25.1%	24.6%	24.6%	
Net Profit (loss) (pre-exceps)	341.2	441.7	852.0	1033.1	1142.1	1243.8	1328.1	13.4%
% growth y-o-y	14.5%	29.5%	92.9%	21.3%	10.5%	8.9%	6.8%	
Net Profit (loss)	865.0	321.0	777.5	1033.1	1142.1	1243.8	1328.1	17.0%
% growth y-o-y	-53.4%	-62.9%	142.2%	32.9%	10.5%	8.9%	6.8%	
Basic EPS (pre-exceps)	1.70	2.47	5.12	6.38	7.05	7.68	8.20	14.4%
% growth y-o-y	15.6%	45.3%	107.4%	24.5%	10.5%	8.9%	6.8%	
Diluted EPS (pre-exceps)	1.68	2.45	5.02	6.25	6.91	7.52	8.03	14.4%
% growth y-o-y	16.5%	45.2%	105.3%	24.4%	10.5%	8.9%	6.8%	
Basic EPS	4.31	1.80	4.67	6.38	7.05	7.68	8.20	18.0%
% growth y-o-y	-52.9%	-58.3%	160.4%	36.4%	10.5%	8.9%	6.8%	
Diluted EPS	4.27	1.78	4.58	6.25	6.91	7.52	8.03	18.0%
% growth y-o-y	-52.6%	-58.4%	157.8%	36.3%	10.5%	8.9%	6.8%	

Source: Citi Research and company reports

Figure 27. GN Store Nord balance sheet

December Year end (DKr m)	FY 11	FY 12	FY 13E	FY 14E	FY 15E	FY 16E	FY 17E
Assets							
Intangible assets	4248.0	4234.0	4353.1	4464.9	4559.1	4631.5	4676.9
Property, plant and equipment	262.0	254.0	231.9	205.9	173.5	133.4	84.3
Investments in subsidiaries							
Investments in associates	16.0	17.0	17.0	17.0	17.0	17.0	17.0
Other securities	175.0						
Deferred tax assets	569.0	563.0	563.0	563.0	563.0	563.0	563.0
Other non-current assets	2.0	670.0	670.0	670.0	670.0	670.0	670.0
Total non-current assets	5272.0	5738.0	5834.9	5920.7	5982.6	6014.9	6011.2
Inventories	549.0	471.0	549.2	596.4	636.5	675.4	712.3
Trade receivables	1269.0	1349.0	1500.8	1629.8	1739.2	1845.6	1946.5
Tax receivable	13.0	34.0	34.0	34.0	34.0	34.0	34.0
Prepayments	178.0						
Other receivables	3517.0	214.0	214.0	214.0	214.0	214.0	214.0
Cash and cash equivalents	229.0	169.0	668.7	828.3	1589.6	2463.6	3443.2
Total current assets	5755.0	2237.0	2966.8	3302.4	4213.3	5232.6	6350.0
Assets classified as held for sale	154.0	224.0					
Total assets	11181.0	8199.0	8801.7	9223.2	10195.9	11247.5	12361.2
Equity and Liabilities							
Share Capital	833.0	775.0	775.0	775.0	775.0	775.0	775.0
Other Reserves	906.0	(648.0)	(648.0)	(648.0)	(648.0)	(648.0)	(648.0)
Proposed dividends for the year	57.0	94.0	155.5	206.6	228.4	248.8	265.6
Retained earnings	5082.0	5321.0	5329.0	5655.4	6569.1	7564.1	8626.5
Equity	6878.0	5542.0	5611.5	5989.1	6924.5	7939.8	9019.2
Bank Loans	1374.0	276.0	783.0	783.0	783.0	783.0	783.0
Pension obligations	110.0	100.0	100.0	100.0	100.0	100.0	100.0
Provisions	130.0	152.0	152.0	152.0	152.0	152.0	152.0
Deferred tax liabilities	825.0	373.0	373.0	373.0	373.0	373.0	373.0
Other non-current liabilities	59.0	185.0	185.0	185.0	185.0	185.0	185.0
Total non-current liabilities	2498.0	1086.0	1593.0	1593.0	1593.0	1593.0	1593.0
Bank Loans	124.0	123.0	123.0	123.0	123.0	123.0	123.0
Trade payables	486.0	485.0	511.2	555.1	592.4	628.7	663.0
Tax payable	36.0	11.0	11.0	11.0	11.0	11.0	11.0
Provisions	260.0	225.0	225.0	225.0	225.0	225.0	225.0
Liabilities classified as held for sale							
Other payables	899.0	727.0	727.0	727.0	727.0	727.0	727.0
Total current liabilities	1805.0	1571.0	1597.2	1641.1	1678.4	1714.7	1749.0
Total equity and liabilities	11181.0	8199.0	8801.7	9223.2	10195.9	11247.5	12361.2
Net Debt	1269.0	230.0	237.3	77.7	(683.6)	(1557.6)	(2537.2)

Source: Citi Research and company reports

Figure 28. GN Store Nord cash flow statement

December Year end (DKr m)	FY 11	FY 12	FY 13E	FY 14E	FY 15E	FY 16E	FY 17E
Operating activities							
Operating profit (loss)	1256.0	586.0	1148.2	1409.2	1540.3	1656.3	1758.4
Depreciation, amortization and impairment	484.0	442.0	484.9	546.0	612.4	683.2	758.4
Other adjustments	(735.0)	201.0	(13.0)				
Cash flow from operations before Δ in WC	1005.0	1229.0	1620.1	1955.3	2152.7	2339.5	2516.8
Changes in inventories	(89.0)	(26.0)	(78.2)	(47.2)	(40.1)	(38.9)	(36.9)
Changes in receivables	(267.0)	(81.0)	(151.8)	(128.9)	(109.5)	(106.4)	(100.9)
Change in trade payables and other payables	150.0	(24.0)	26.2	43.9	37.3	36.2	34.4
Restructuring/ non-recurring costs	(2.0)	2971.0					
Changes in WC and non-recurring costs	(208.0)	2840.0	(203.8)	(132.2)	(112.3)	(109.0)	(103.5)
Cash flow from operations before Fin. and Tax	797.0	4069.0	1416.3	1823.1	2040.4	2230.4	2413.3
Interest and dividends, etc., received	16.0	18.0	29.2	7.5	12.1	20.3	29.5
Interest paid	(88.0)	(91.0)	(109.6)	(27.2)	(27.2)	(27.2)	(27.2)
Financial items, net	(72.0)	(73.0)	(80.4)	(19.7)	(15.1)	(6.9)	2.4
Tax paid, net	(23.0)	(643.0)	(277.4)	(356.5)	(383.2)	(405.6)	(432.7)
Cash flow from operating activities	702.0	3353.0	1058.6	1446.9	1642.2	1817.9	1983.0
Investing activities							
Investments in intangible assets, excluding development projects	(54.0)	(139.0)					
Development projects	(265.0)	(296.0)					
Investments in intangible assets, net	(319.0)	(435.0)	(469.4)	(509.8)	(544.0)	(577.3)	(608.9)
Investments in property, plant and equipment, net	(82.0)	(103.0)	(112.4)	(122.0)	(130.2)	(138.2)	(145.8)
Investments in other non-current assets, net	(21.0)	(81.0)					
Disposal of intangible assets	1.0	--					
Disposal of plant, property and equipment	14.0	2.0					
Disposal of other non-current assets	2.0	20.0					
Company acquisitions	(82.0)	(42.0)					
Company disposals	1.0	5.0	224.0				
Cash flow from investing activities	(486.0)	(634.0)	(357.8)	(631.8)	(674.3)	(715.5)	(754.6)
Free cash flow	216.0	2719.0	700.7	815.1	967.9	1102.4	1228.4
Financing activities							
Paid dividends	(39.0)	(50.0)	(94.0)	(155.5)	(206.6)	(228.4)	(248.8)
Share-based payment (exercised)	137.0	23.0					
Purchase/sales of treasury shares and other equity	(641.0)	(1614.0)	(614.0)	(500.0)			
Increase of long term loans	327.0						
Increase of short term loans	62.0						
Decrease of long term loans		(1109.0)	507.0				
Decrease of short term loans							
Other adjustments	7.0	(26.0)					
Increase/decrease in bank loans and other adj.	396.0	(1135.0)	507.0				
Cash flow from financing activities	(147.0)	(2776.0)	(201.0)	(655.5)	(206.6)	(228.4)	(248.8)
Net cash flow	69.0	(57.0)	499.7	159.6	761.3	874.0	979.6
Cash and cash equivalents, beginning of period	157.0	229.0	169.0	668.7	828.3	1589.6	2463.6
Adjustments foreign currency	3.0	(3.0)					
Cash and cash equivalents, end of period	229.0	169.0	668.7	828.3	1589.6	2463.6	3443.2
Source: Citi Research and company reports							

Figure 29. Companies mentioned

Company	RIC	Rating	TP Currency	Target Price	Current Price
Abbott Labs	ABT.N	3	USD	31.00	34.00
Amplifon SpA	AMPF.MI	2	EUR	4.10	4.08
Baxter Intl	BAX.N	2	USD	75.00	71.10
Boston Scient	BSX.N	2	USD	11.00	12.05
C.R. Bard Inc	BCR.N	2	USD	123.00	119.04
Covidien	COV.N	1	USD	74.00	61.55
Cynosure	CYNO.O	1	USD	41.00	23.30
DENTSPLY	XRAY.O	1	USD	49.00	43.52
Essilor	ESSI.PA	1	EUR	95.80	80.74
Fresenius Med Care	FMEG.DE	2	EUR	58.70	48.74
Fresenius SE	FREG.DE	1	EUR	109.00	87.50
Hospira	HSP.N	3	USD	28.00	39.84
Johnson&Johnson	JNJ.N	1	USD	101.00	88.17
Masimo	MASI.O	2	USD	24.00	25.68
Medtronic Inc	MDT.N	1	USD	62.00	54.07
Nobel Biocare	NOBN.S	2	CHF	10.60	14.10
Sirona	SIRO.O	1	USD	83.00	67.75
Smith & Nephew	SN.L	2	GBP	8.30	7.69
Sonova Hld	SOON.VX	1	CHF	107.00	113.00
St Jude Medical	STJ.N	3	USD	37.00	53.21
Straumann	STMN.S	1	CHF	200.00	180.90
Stryker Corp	SYK.N	2	USD	78.00	69.85
William Demant	WDH.CO	2	DKK	516.00	479.20
Zimmer Hldgs	ZMH.N	3	USD	77.00	81.27

Source: Citi Research. Sept 10th

GN Store Nord

Company description

Through its' Resound and Netcom businesses, GN Store Nord enjoys leading positions within hearing aid and hands free communication markets. A high level of innovation in all business segments has unlocked significant value over recent years and we expect this to continue. Hearing aids account for 62% of group sales (15% market share), and telecommunications are 28% of group revenues (~45% share).

Investment strategy

We rate GN Store Nord Buy. GN has seen a successful turnaround over the past 5 years, but growth still looks attractive. We believe that there is room for further upside given the potential for margin improvement beyond the current restructuring program, and a likely boost to revenue growth from new innovative launches.

Valuation

We value GN Store Nord using a DCF methodology. We choose to use a DCF as we believe it is the fairest option for comparing companies across the highly differentiated subsectors of the European MedTech universe.

We estimate the company's WACC using a risk-free rate of 1.4%, a market risk premium of 9.4% and a beta of 0.9 to arrive at a WACC of 9.5%.

We apply this WACC to free cash flow which we forecast explicitly to 2017E and then apply a fading growth rate to 2021E. Beyond 2021 we assume a terminal growth rate of 2.0%. Consequently we arrive at a target price of DKr140.00. At our target price the stock would trade on 22x 2014E earnings. We believe this to be a fair multiple given the 18.0% forecast earnings growth on offer (13-16E CAGR).

Risks

We believe that the following factors present the greatest risk to GN Store Nord achieving our target price:

Low adoption of the MFi hearing aid

Our forecasts assume a 5% share gain amongst iPhone owners with hearing aids in the US. If the launch were to be less successful and share amongst this group not taken, then our sales forecasts would come under pressure and our estimates maybe missed by the company

Reimbursement change in Europe

Over the past year we have seen a number of European governments make changes to reimbursement measures for hearing aid (eg. Switzerland and Holland). This has had a profound effect on these markets with both pricing and volumes coming under severe pressure. The impact has been greater on retailers such as Amplifon, but if more governments were to follow suit, it is a risk that the volume and mix development of manufacturers such as GN Store Nord will come under pressure, causing the company to miss estimates and leading to the shares falling in value.

Lack of further margin expansion at ReSound

Our estimates include a further 100bp of EBITA margin expansion between 2013E and 2017E. While we see this as conservative given the potential economies of scale, it is possible that the company does fail to improve profitability any further. If this were the case there would be no leverage and the multiple on which GN trades would come under pressure given that earnings growth would be in the high single digit range.

Notes

Notes

Appendix A-1

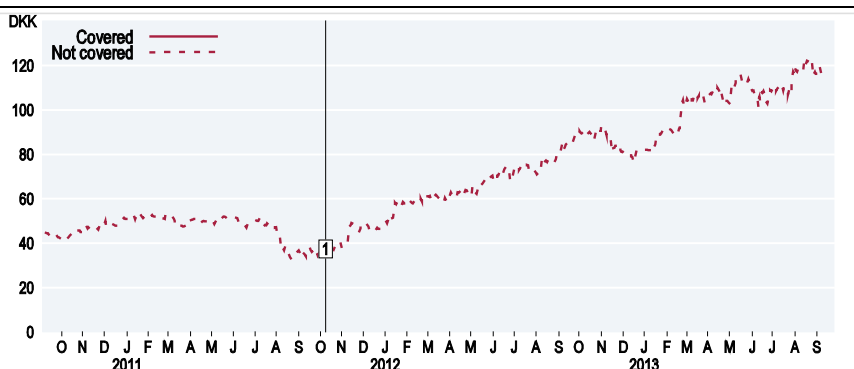
Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

GN Store Nord (GN.CO)

Ratings and Target Price History Fundamental Research



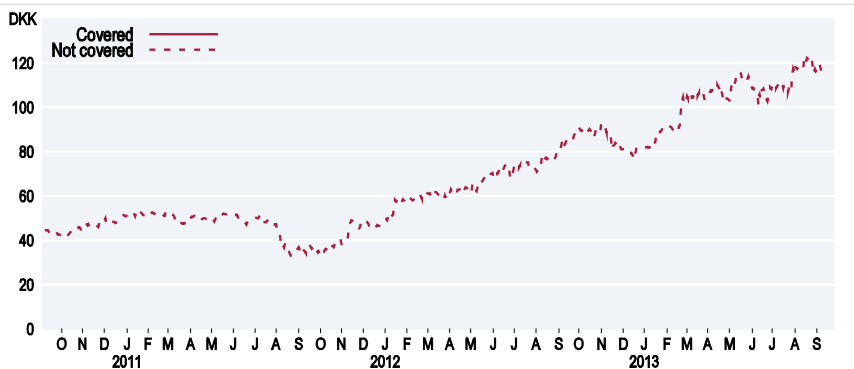
	Date	Rating	Target Price	Closing Price
1	8-Oct-11	Stock rating system changed		

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

GN Store Nord (GN.CO)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)



* Indicates change

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