

STMicroelectronics

Price EUR6.28

A more positive tone for the near term**Fair Value EUR7.0 vs. EUR6.8 (+12%)****NEUTRAL vs. SELL**

Bloomberg	STM FP
Reuters	STM.FR
12-month High / Low (EUR)	9.3 / 5.3
Market Cap (EURm)	5,717
Ev (BG Estimates) (EURm)	5,228
Avg. 6m daily volume (000)	2,212
3y EPS CAGR	54.1%

Yesterday, STMicroelectronics reported Q4 2015 results broadly in line with expectations and announced a plan to stop losses in the digital division. During the conference call, management shared details about the plan and momentum in the coming quarter. Overall, we understand that the long-term EBIT target of 10% remains far off and this prompts us to believe that current street expectations are too high. In addition, the plan to discontinue the Set-Top-Box business is a step in the right direction but we understand it will take time to pay off. Nevertheless, the tone was more positive on the NT regarding the core business and given that the stock underperformed the industry by 300bp over the last six months, we believe the share is now bottoming. Our new FV is EUR7.0 vs. EUR6.8 and we have upgraded our recommendation to Neutral vs. Sell.

ANALYSIS

- **Yesterday, STMicroelectronics reported FY 2015 and Q4 2015 results and its strategic plan to discontinue the Set-Top-Box business responsible for losses.** Among other comments made during the conference call, note that the group confirmed our expectation that Q1 could mark the end to inventory adjustments in automotive, mainly thanks to a recovery in Europe. In addition, the industrial segment and sensors, which are usually in decline in Q1, look flat sequentially thanks to an unusually low level in Q4 2015. We understand that the correction in these segments should come by Q2. Finally, the microcontroller division should decrease slightly during Q1 due to a strong comparison effect (the division benefited from strong momentum over 2015).
- **The plan is a step in the right direction, however it will take time to pay off in our view.** Note that the plan only concerns the Set-Top-Box business and Home Gateway chips representing a portion of the Digital Product Group (less than 15% of sales), indeed STB revenues are currently about USD210m (per year). As for ST-Ericsson products before, sales in this division are to stopped gradually and not in one shot. As a result, sales of STB chips are expected to last until 2018 at least. For FY16, the group expects revenues to erode by USD60-70m due to a wind down in STB products. Regarding costs, STB chips are currently produced by external foundries but R&D is operated internally. This means that the loading of Crolles 300mm, in charge of production of the most advanced chips at STMicroelectronics, will not be impacted significantly due to the plan. Currently, Crolles produces mainly ICs for ADAS, MCUs, Digital ASICs and Imaging products and the group plans to intensify these productions. Back to the STB business, 1,400 people are expected to leave the group, and part of the R&D people will be partly re-affected to Automotive R&D and MCU R&D. Of the anticipated USD170m in restructuring costs, about USD90-100m will be passed during FY 2016 and a large portion of that will be passed in Q1. As a result, OPEX should now be below USD550m (net of grants) while the previous target was USD550-600m.
- **We have updated our model, our new FV is EUR7.0.** Overall, we apply a 4% cut on our previous sales estimates, we now expect 2016e sales to be flat compared to 2015e (vs. +3.1% yoy previously) and 2017e sales to be up +1.7% (vs. +3.7% previously). This is due to the wind down of Set-Top-Box business sales for about USD70m and the adoption of a more cautious scenario regarding the core business. This was motivated by lower Q1 guidance than expected: we anticipated USD1.647bn whereas the group is guiding for Q1 2016 sales of USD1.618bn. As a result, we apply a total cut in FY 2016e revenue of approximately USD200m. Overall, our new scenario leads to a cut in EPS of 5% on average. With 2015 now reported, we have also applied a rollover of our valuation methods. Our new FV is now EUR7.0 vs. EUR6.8 before. With uncertainty regarding the strategy to adopt in the digital division now behind us, we have no reason to maintain our Sell recommendation. As a result, we have upgraded it to Neutral.

VALUATION

- STMicroelectronics shares trade at 2016e EV/Sales ratio of 0.7x and 2016e EV/EBIT ratio of 16.9x.

NEXT CATALYSTS

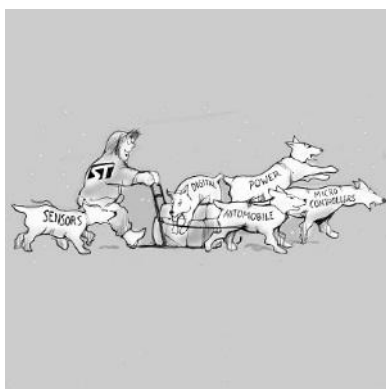
- Q1 2016 results to be announced in late April.

	1 M	3 M	6 M	31/12/15
Absolute perf.	1.8%	-4.5%	-9.8%	1.5%
Semiconductors	-4.7%	-3.3%	-6.9%	-4.4%
DJ Stoxx 600	-7.1%	-8.5%	-11.8%	-7.0%

YEnd Dec. (USDm)	2015	2016e	2017e	2018e
Sales	6,897	6,882	6,998	7,151
% change		-0.2%	1.7%	2.2%
EBITDA	845	1,024	1,210	1,260
EBIT	109.0	308.5	482.2	516.2
% change		NM	56.3%	7.1%
Net income	110.0	227.6	381.5	398.9
% change		106.9%	67.6%	4.6%

	2015	2016e	2017e	2018e
Operating margin	1.6	4.5	6.9	7.2
Net margin	1.6	3.3	5.5	5.6
ROE	2.2	3.0	6.9	8.9
ROCE	3.2	5.1	9.8	11.2
Gearing	-10.5	-10.9	-14.0	-18.7

(USD)	2015	2016e	2017e	2018e
EPS	0.12	0.26	0.44	0.46
% change	-	108.6%	67.7%	4.6%
P/E	50.2x	24.1x	14.4x	13.7x
FCF yield (%)	4.7%	6.3%	8.7%	10.3%
Dividends (USD)	0.40	0.40	0.40	0.40
Div yield (%)	6.3%	6.4%	6.4%	6.4%
EV/Sales	0.8x	0.8x	0.7x	0.7x
EV/EBITDA	6.2x	5.1x	4.2x	3.9x
EV/EBIT	47.9x	16.9x	10.6x	9.5x



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Distribution of stock ratings

BUY ratings 60.2%

NEUTRAL ratings 30.8%

SELL ratings 9%

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