

Infineon

Price EUR12.44

FQ2 guidance is not alarming, we see room for good surprise

Fair Value EUR15 (+21%)

BUY

Bloomberg	IFX GY
Reuters	IFXGn.DE
12-month High / Low (EUR)	14.0 / 8.7
Market Cap (EURm)	14,048
Ev (BG Estimates) (EURm)	13,426
Avg. 6m daily volume (000)	7,420
3y EPS CAGR	16.7%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-7.9%	11.1%	21.9%	-7.9%
Semiconductors	-3.3%	-1.9%	-6.5%	-3.3%
DJ Stoxx 600	-6.6%	-9.0%	-13.8%	-6.6%

YEnd Sept. (EURm)	09/15	09/16e	09/17e	09/18e
Sales	5,795	6,558	6,984	7,348
% change		13.2%	6.5%	5.2%
EBITDA	1,658	1,926	2,109	2,298
EBIT	898.0	1,074	1,201	1,343
% change		19.6%	11.9%	11.8%
Net income	680.0	857.5	964.1	1,080
% change		26.1%	12.4%	12.0%

	09/15	09/16e	09/17e	09/18e
Operating margin	15.5	16.4	17.2	18.3
Net margin	11.7	13.1	13.8	14.7
ROE	13.3	13.2	13.5	14.0
ROCE	18.5	15.6	17.3	19.3
Gearing	-4.7	-12.1	-19.8	-27.6

(EUR)	09/15	09/16e	09/17e	09/18e
EPS	0.60	0.76	0.86	0.96
% change	-	26.1%	12.4%	12.0%
P/E	20.6x	16.3x	14.5x	13.0x
FCF yield (%)	0.6%	4.5%	5.2%	6.1%
Dividends (EUR)	0.18	0.20	0.20	0.20
Div yield (%)	1.4%	1.6%	1.6%	1.6%
EV/Sales	2.4x	2.0x	1.9x	1.7x
EV/EBITDA	8.3x	7.0x	6.1x	5.4x
EV/EBIT	15.4x	12.5x	10.8x	9.2x

Yesterday, Infineon reported FQ1 in line with expectations with EPS at EURO.17 vs. EURO.16 expected by the street. However concerns were raised due to low operating margin guidance for FQ2. Following the conference call, we remain confident about Infineon's ability to leverage the International Rectifier acquisition and achieve FY16 guidance for a current operating margin of 16%. Given that this FY16 guidance has been confirmed, management's cautiousness regarding Q2 anticipations (+3% sequential growth in sales and 13% margin) is positive in our view and leaves room for welcome news. Overall, the long term story is unchanged in our view. We reiterate our Buy recommendation.

ANALYSIS

- FQ2 sequential growth of 3% seems conservative.** Concerning the sequential increase in sales for FQ2, we believe the group is really cautious in its guidance. Indeed, historical seasonal patterns point to a sequential increase of +9%. Yesterday, IFX guided for a 3% seq. growth, which was also viewed as conservative by the group and explained by current uncertainty in some markets such as smartphones. Given that 1/ the automotive segment momentum improved recently, 2/ the IPC division is helped by a good traction in DC/DC converters for server and also in Power management products for RF modules, and 3/ traction remains high in the Chip Card and Security business, we believe the guidance is conservative. Additionally, the current Book to Bill ratio of about 1.1 is also a supportive argument.
- Margin guidance for FQ2 is lower than consensus expectations but is not an issue as long as the FY16 current operating margin is not affected.** Q2 margin guidance which is lower than street's expectations and ours, is set to be impacted by 1/ the usual price decline passed on 1st January, and 2/ no significant volume increase at this point. We note that the impact of the price decline on margins was less significant in previous years because it was offset by a stronger rebound in FQ2 sales than anticipated this year. Note that the 5y historical average growth from FQ1 to FQ2 is 9%, and compares to guidance of +3% partly due to a better than expected FQ1 (note also that FQ1 was above expectations and guidance by 340bp). In addition, the group is still digesting the International Rectifier business that usually shows lower volumes in FH1 and higher in FH2. Given that 1/ the anticipation for a low volume in FQ2 impacts the margin, 2/ we understand that the group is conservative in its FQ2 guidance that implies a stability in the current environment, and 3/ we observe recent improvements in the segments where Infineon operates especially in automotive (see above), we believe there is room for welcome news.
- The group has confirmed its 16% margin guidance for FY16, and we consider this achievable.** While the guidance requires a high margin in H2 (about 18%) we believe the group will be able to achieve this margin level thanks to 1/ higher volumes in H2 vs. H1, 2/ no price reductions (all will be passed in H1), 3/ slow but continuous volume ramp-up for the 300mm fab (due to break-even in 2017) leading to a gradual improvement in loading and operating margin, 4/ further work on International Rectifier's margin enhancement, and 5/ further improvements in operating efficiencies that have allowed Infineon to improve organic margin so far.
- Model fine-tuned but no change to EPS.** We have fine-tuned our model to change sequential growth in sales and margins over FY16e with stronger momentum in H2. Overall, there is no change in our EPS.

VALUATION

- We reiterate our Buy recommendation.** We continue to favour Infineon's business model vs. peers (especially STMicroelectronics). The model has proven its resilience, even in a tough environment, and continues to generate profitable growth.
- Infineon's shares are trading on 2016e P/E of 15.8x and 2016e PEG of 0.9x.
- We note that the current 2016e P/E valuation of Infineon is 8% lower than the current IDM average 2016e P/E ratio of 17.6x (based on 15 comparable IDMs, list available on demand).

NEXT CATALYSTS

- 18th February: Annual General Meeting
- 9th May: FQ2-16 results



New vs. Old BG FY estimates – No change in EPS

[EURm]	Old			New		
	2016e	2017e	2018e	2016e	2017e	2018e
Net revenue	6558	6984	7348	6558	6984	7348
% change	13.2%	6.5%	5.2%	13.2%	6.5%	5.2%
Adj. EBIT	1074	1201	1343	1057	1188	1324
Adj. operating margin	16.4%	17.2%	18.3%	16.1%	17.0%	18.0%
Adj. EPS	0.76	0.86	0.96	0.76	0.86	0.96

Source: Bryan, Garnier & Co ests.

Our detailed P&L

[EURm]	1Q16	2Q16e	3Q16e	4Q16e	FY16e	FY17e	FY18e
Total Group	1556	1605	1686	1711	6558	6984	7348
Y/Y growth	15.4%	8.2%	6.3%	7.1%	13.2%	6.5%	5.2%
Q/Q growth	-2.6%	3.1%	5.1%	1.5%	-	-	-
Cost of goods sold	-998	-1037	-1028	-977	-4040	-4218	-4409
Gross margin	35.9%	35.4%	39.0%	42.9%	38.4%	39.6%	40.0%
SG&A	-200	-194	-212	-239	-846	-894	-896
R&D	-198	-193	-204	-206	-800	-859	-882
Other operating income*	60	27	52	45	184	175	163
Adj. EBIT	220	208	293	335	1057	1188	1324
adj. operating margin	14.1%	13.0%	17.4%	19.6%	16.1%	17.0%	18.0%
EBIT	166	168	233	272	839	943	1087
operating margin	10.7%	10.5%	13.8%	15.9%	12.8%	13.5%	14.8%
Net financial result	-12	-13	-12	-4	-41	-40	-42
Income tax	-2	-23	-33	-61	-120	-135	-157
tax rate	-1.3%	-15.0%	-15.0%	-22.9%	-15.0%	-15.0%	-15.0%
Net income (loss)	153	132	188	206	679	767	889
Adj. Net income (loss)	205	166	239	255	863	976	1089
Adj. Dil. EPS	0.17	0.15	0.21	0.23	0.76	0.86	0.96

* includes reintegration of IRF acquisition related D&A and other income & expenses

Source: Bryan, Garnier & Co ests.

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