

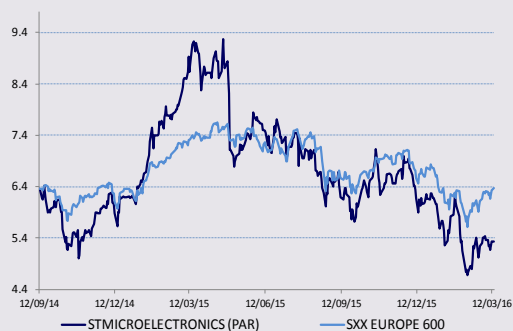
FOCUS
TMT CONFERENCE

15th March 2016

TMT

Bloomberg	STM FP
Reuters	STM.FR
12-month High / Low (EUR)	9.3 / 4.7
Market capitalisation (EURm)	4,864
Enterprise Value (BG estimates EURm)	4,425
Avg. 6m daily volume ('000 shares)	2,319
Free Float	70.3%
3y EPS CAGR	54.1%
Gearing (12/15)	-11%
Dividend yield (12/16e)	6.71%

YE December	12/15	12/16e	12/17e	12/18e
Revenue (USDm)	6,897	6,882	6,998	7,151
EBITA USDm)	109.0	308.5	482.2	516.2
Op.Margin (%)	1.6	4.5	6.9	7.2
Diluted EPS (USD)	0.12	0.26	0.44	0.46
EV/Sales	0.72x	0.72x	0.69x	0.64x
EV/EBITDA	5.8x	4.8x	4.0x	3.6x
EV/EBITA	45.3x	16.0x	10.0x	8.9x
P/E	47.7x	22.9x	13.6x	13.0x
ROCE	3.2	5.1	9.8	11.2



STMicronics


Prepares for higher margin

Fair Value EUR7 (price EUR5.34)

NEUTRAL

In late January 2016, the group presented its strategic plan to discontinue its set-top box business and improve the operating margin. Our TMT conference was a chance to come back on this plan while investors were also curious about current market conditions. Overall, we believe that this refocus is a step in the right direction and a mandatory operation to achieve decent operating margins but we also continue to believe that this will take time. We keep our Neutral recommendation.

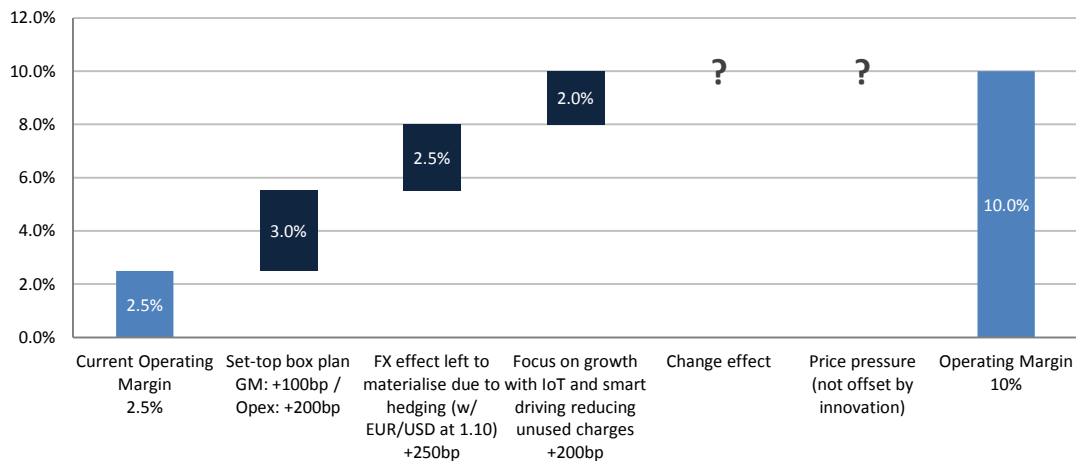
- **Q1-16 guidance maintained: the group continues to see soft market conditions but it also sees some light in Automotive.** One of the first questions during the meetings was about current market conditions. We remind that STM guides for Q1 sales to decrease sequentially by -3% (+/-350bp) to about USD1.6bn. Friday's talks confirmed Q1-16 guidance with a healthier sequential dynamic in the Automotive market, improving after some correction seen in the second half of last year.
- **The group's focus is on growth areas.** Another important topic was about the long-term view of the company. We remind that during the Q4-15 results, the group introduced a new organisation with 4 divisions (vs. 5 previously). This implies a refocus on areas with the highest growth and the discontinuation of the highly competitive set-top box business. The focus is now on everything about Smart Driving and IoT. However, except for the information that has already been published (see details in this report), no additional details were shared at the conference.
- **A double-digit operating margin seems to be achievable... but we believe this will take time.** Another topic on the table was the improvement in the operating margin. The group was very clear on the different levers to activate in order to achieve a double-digit operating margin, however, no timing was given. We remind that a 10% margin target was shared for the first time in late 2013, but the group never communicates on timing. The three main levers are: 1/ positive FX impact to come thanks to hedging, 2/ reduce unused charges thanks to higher activity (at least USD1.8bn per quarter is seen as optimum), and 3/ the discontinuation of the highly competitive set-top box business.
- **Finally, the group made no comment regarding rumours about a management transition.**

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STMicroelectronics Major Keys to Focus on from the BG TMT conference

1. One Chart

A bridge to a double-digit operating margin



Source: Company Data; Bryan, Garnier & Co ests.

The group continues to see a strong recovery of its operating margin due to multiple effects:

- The strategic focus on two market segments, Smart Driving and the Internet of Things.** As a result, the group announced in January that it will discontinue development of new platforms and standard products for set-top boxes and home gateways. The set-top box business represented USD209m of sales, out of USD6.90bn in FY15 (or 3% of the group's total revenue), down by c.37% yoy. This division was responsible for significant losses with an operating result of c.USD250m. As a result, STM should see an improvement in its operating margin of about 250bp/300bp, however this is dependent on the lifespan of the residual products. We note that despite the pruning of this activity, STM's addressable market remains large: about USD150bn, about the half of worldwide semiconductor sales in 2015.
- More positive effect to come from FX due to hedging.** STM derives almost 85% of sales in US dollars whereas about 46% of its costs are in euros. To reduce the sensitivity, STM maintains a 12-month yoy hedging policy, which significantly limits the impact of EUR/USD changes in the short term. The group's effective exchange rate was 1.17 in FY15 and this should gradually go to 1.10 and boost the operating margin by about 250bp.
- A production tool optimised from USD7.2bn of revenue.** Given the current production capacities of STM, the group's margin would be optimal with sales over USD1.8bn per quarter. Below this level, the group must record unused capacities and under-saturation charges, while wafer costs are also higher. With sales above USD7.2bn per year, the operating margin would gain another 200bp.
- Unknown FX changes in FY16 and price pressure.** While the previous impacts are mechanical impacts expected over the coming years, uncertainties remain about FX and the competitive environment. Regarding price pressure, we would note that the group is used to dealing with a 5% decrease in price on a comparable product portfolio. However, the strong innovation and R&D at STM usually helps to offset any negative effects of price pressure.

Overall, the group holds the tools to improve its operating margin significantly (x4) and meet the LT view of 10%, however, we continue to believe this will take time. As a result, we make no change in our estimates at this point.

2. One Sentence

« *We now focus on areas with highest growth.* »

Over the following years, the main growth contributors to the semiconductor market will be **Automotive, Industrial and the Internet of Things applications**. This translates into Smart Driving, Smart Industry, Smart Home & City and Smart Things at STM. To fit in better with these market trends, the group will be re-organised into 4 divisions from Q1-16:

- **Automotive & Discrete Group** (FY15 revenue equivalent: USD2.7bn, 40% of sales, ~7.5% operating margin): The group sees the evolution of cars is now in electronics. It also sees significant similarities between cars and smartphones despite large discrepancies between them both. The group will focus on: 1/ Advanced Driver Assistance Systems (ADAS), 2/ Infotainment, and 3/ Connectivity. We note that STM expects to gain market share in the overall automotive market over the coming years with a particularly strong ambition and confidence in the ADAS segment. This market is hard to penetrate due to high barriers of entry, indeed the qualification process for automotive grade requires a strong expertise and industrial know-how. However, companies already in this field (such as STM) should benefit from a strong momentum with auto semiconductor sales expected to be up by 7% from 2015 to 2018e on average.
- **Microcontrollers & Digital ICs Group** (FY15 revenue equivalent: USD2.0bn, 29% of sales, ~7% operating margin): The group expects to continue to leverage on its strong 32bit-MCUs portfolio (brand name STM32) which is seen as a standard in the industry. In addition, management sees MCU embedding more and more security and connectivity features which fall right into STM's expertise. From 2008 to 2015, 32bit-MCUs revenues jumped from 0 to USD700m at STM thanks to a strong portfolio and technological lead. For the next few years, the group continues to expect market share gains, while the overall MCUs market is seen to increase by 3.2% between 2015 and 2018e.
- **Analog & MEMS Group** (FY15 revenue equivalent: USD1.67bn, 24% of sales, ~6% operating margin): STM is extending to new market areas, especially the automotive market which will be a large consumer of MEMS in the future. Currently, this market is ruled by Bosch Sensortec but STM holds: 1/ the expertise and industrial know-how to enter the automotive market with MEMS and 2/ the commercial network in this segment thanks to its strong footprint in infotainment and the body area. We believe that the group targets MEMS revenues of about USD800m for FY18 which implies a Mobile MEMS revenue of about USD450m, or a stability in this business (BG ests.).
- The remaining revenue stream will come from the **Imaging Group** (about 3% of FY15 sales equivalent) and Discontinued businesses (about 4% of FY15 sales equivalent), i.e. mainly set-top box products, legacy camera modules and some remaining products after ST-Ericsson was abandoned.

3. One Figure

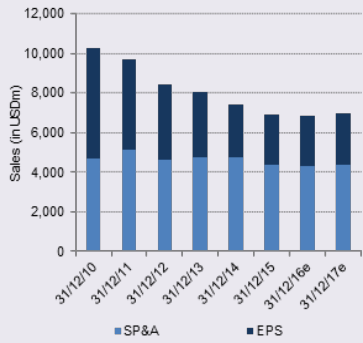
USD170m

This is STM's estimated annualised savings thanks to the discontinued development of set-top box products. While this is not news, the plan for the set-top box business was an important topic at our Conference. Overall, we remind that this plan includes a global workforce reduction of 1,400 employees, leading to an annualised savings of USD170m and restructuring costs also at about USD170m.

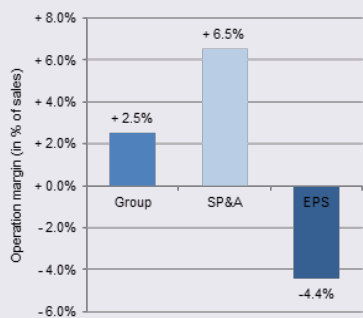
4. How does the Conference impact our Investment Case

STM is one of the most difficult companies on which to build a model because it has a very broad portfolio, implying many different subsectors, and being involved in the very volatile consumer segment adds to the complexity. Right now, the company is in a transition mode and many investors are looking forward to hearing the investors day speech. We expect the company to share a longer term view and more details about the new organisation. Overall market conditions (improving automotive segment, slowdown of the smartphone market and the industrial segment set to rebound) remain the same as when we commented in late January (when the company published Q4-15 results). As a result, we maintain our estimates.

Sales



FY15 - Adj. operating margin



Company description

STMicroelectronics is a Franco-Italian manufacturer of semiconductors. The group has a broad product portfolio that spans from power management components to integrated circuits for the industrial sector, automotive and consumer applications. Having been in decline for several years, the group is currently executing a transformation plan to restore growth and improve margins.

Simplified Profit & Loss Account (USDm)	31/12/13	31/12/14	31/12/15	31/12/16e	31/12/17e	31/12/18e
Revenues	8,082	7,404	6,897	6,882	6,998	7,151
Change (%)	-4.8%	-8.4%	-6.8%	-0.2%	1.7%	2.2%
Change LFL (%)	-%	-%	-%	-%	-%	-%
EBITDA	501	994	845	1,024	1,210	1,260
Depreciation & amortisation	910	812	736	716	728	744
Adjusted EBIT	(409)	182	109	309	482	516
EBIT	(465)	168	109	214	407	516
Change (%)	-%	-%	-40.0%	183%	56.3%	7.1%
Financial results	(5.0)	(19.2)	(22.0)	(16.5)	(16.8)	(17.2)
Pre-Tax profits	(470)	149	87.0	197	390	499
Tax	(37.0)	23.0	21.0	(67.5)	(87.0)	(103)
Profits from associates	(122)	(43.0)	2.0	3.1	3.2	3.2
Minority interests	129	(0.60)	(6.0)	0.0	0.0	0.0
Net profit	(500)	128	104	133	307	399
Restated net profit	(573)	143	110	228	382	399
Change (%)	-%	-%	-23.1%	107%	67.6%	4.6%

Cash Flow Statement (USDm)

Operating cash flows	333	791	846	848	1,034	1,143
Change in working capital	33.0	(76.0)	(122)	12.7	(29.9)	(39.4)
Capex, net	(531)	(505)	(467)	(516)	(525)	(536)
Financial investments, net	96.0	(341)	0.0	0.0	0.0	0.0
Dividends	(350)	(357)	(350)	(349)	(349)	(349)
Issuance of shares	0.0	1.0	0.0	0.0	0.0	0.0
Issuance (repayment) of debt	(34.0)	774	0.0	0.0	0.0	0.0
Other	(17.0)	(168)	(13.0)	0.0	0.0	0.0
Net debt	(741)	(546)	(494)	(490)	(620)	(838)
Free Cash flow	(165)	210	257	345	480	567

Balance Sheet (USDm)

Tangible fixed assets	3,156	2,647	2,321	2,121	1,918	1,711
Intangibles assets & goodwill	307	275	242	242	242	242
Investments	676	649	516	516	516	516
Deferred tax assets	227	386	436	436	436	436
Current assets	2,913	2,700	2,570	2,565	2,606	2,661
Cash & equivalents	1,894	2,351	2,106	2,106	2,236	2,454
Total assets	9,173	9,008	8,191	7,986	7,955	8,020
Shareholders' equity	5,717	5,055	4,693	4,476	4,433	4,483
Provisions	524	574	509	509	509	509
Deferred tax liabilities	11.0	10.0	12.0	12.0	12.0	12.0
L & ST Debt	1,153	1,805	1,612	1,616	1,616	1,616
Current liabilities	1,768	1,564	1,365	1,372	1,384	1,400
Total Liabilities	9,173	9,008	8,191	7,986	7,955	8,020
Capital employed	4,976	4,509	4,199	3,987	3,814	3,646

Ratios

Operating margin	(5.06)	2.45	1.58	4.48	6.89	7.22
Tax rate	6.25	21.80	0.30	(33.74)	(22.11)	(20.57)
Net margin	(7.09)	1.92	1.59	3.31	5.45	5.58
ROE (after tax)	(8.75)	2.54	2.22	2.96	6.91	8.90
ROCE (after tax)	(8.87)	4.65	3.22	5.09	9.82	11.23
Gearing	(12.96)	(10.80)	(10.53)	(10.94)	(13.98)	(18.68)
Pay out ratio	NM	287	336	263	114	87.48
Number of shares, diluted	890	882	873	873	873	873

Data per Share (USD)

EPS	(0.56)	0.14	0.12	0.15	0.35	0.46
Restated EPS	(0.64)	0.16	0.12	0.26	0.44	0.46
% change	-%	-%	-22.3%	109%	67.6%	4.6%
EPS bef. GDW	(0.64)	0.16	0.12	0.26	0.44	0.46
BVPS	6.43	5.73	5.37	5.13	5.08	5.13
Operating cash flows	0.37	0.90	0.97	0.97	1.18	1.31
FCF	(0.19)	0.24	0.29	0.39	0.55	0.65
Net dividend	0.40	0.40	0.40	0.40	0.40	0.40

Source: Company Data; Bryan, Garnier & Co ests.

Price Chart and Rating History

STMicroelectronics



Ratings

Date	Ratings	Price
28/01/16	NEUTRAL	EUR6.28
30/10/15	SELL	EUR6.2
26/02/15	NEUTRAL	EUR7.86

Target Price

Date	Target price
28/01/16	EUR7
30/10/15	EUR6.8
24/07/15	EUR7.2
04/05/15	EUR7.8
24/03/15	EUR9
04/03/15	EUR8
26/02/15	EUR7.6

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NEUTRAL	Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
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NEUTRAL ratings 0%

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