

## STMicroelectronics

Price EUR5.70

The environment is improving but execution remains the key

Fair Value EUR6.3 (+11%)

NEUTRAL

Bloomberg	STM FP
Reuters	STM.FR
12-month High / Low (EUR)	8.8 / 4.6
Market Cap (EURm)	4,742
Ev (BG Estimates) (EURm)	4,226
Avg. 6m daily volume (000)	2,379
3y EPS CAGR	29.6%

Following the publication of ST's Q1 results yesterday (see our [first take](#)), the conference call held by ST had a positive tone. However, in our view, it is not enough to justify a recommendation change. We believe risks remain high regarding 1/ execution of the restructuring process, 2/ growth while the group is faces a dynamic competition and 3/ a gradual improvement in margin which depends on restructuring, growth and FX. We reiterate our Neutral recommendation and keep our FV of EUR6.3.

## ANALYSIS

	1 M	3 M	6 M	31/12/15
Absolute perf.	6.1%	-13.5%	-23.2%	-15.8%
Semiconductors	-2.0%	-1.5%	-6.0%	-5.4%
DJ Stoxx 600	3.6%	2.4%	-7.6%	-5.1%

YEnd Dec. (USDm)	2015	2016e	2017e	2018e
Sales	6,897	6,882	6,998	7,151
% change		-0.2%	1.7%	2.2%
EBITDA	910	972	1,083	1,245
EBIT	174.0	256.7	355.0	500.9
% change		45.8%	40.3%	37.8%
Net income	175.0	178.0	262.2	386.0
% change		3.4%	51.6%	37.6%

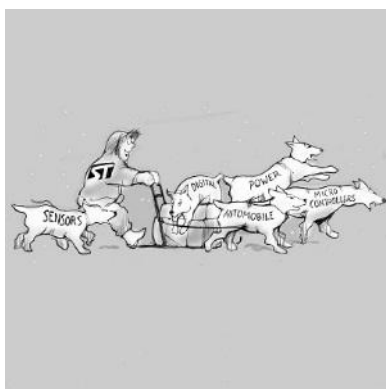
	2015	2016e	2017e	2018e
Operating margin	2.5	3.7	5.1	6.9
Net margin	2.5	2.6	3.9	5.3
ROE	2.2	1.9	4.4	8.3
ROCE	5.1	3.7	6.9	10.6
Gearing	-10.5	-12.8	-15.4	-19.6

(USD)	2015	2016e	2017e	2018e
EPS	0.20	0.20	0.30	0.44
% change	-	2.0%	46.3%	49.0%
P/E	29.6x	28.4x	18.7x	13.6x
FCF yield (%)	5.0%	5.8%	7.2%	10.6%
Dividends (USD)	0.40	0.24	0.30	0.40
Div yield (%)	6.7%	4.1%	5.1%	6.8%
EV/Sales	0.7x	0.7x	0.7x	0.6x
EV/EBITDA	5.3x	4.9x	4.3x	3.6x
EV/EBIT	28.0x	18.8x	13.1x	9.1x

- Bookings are strong and provide confidence for Q2 – Automotive and Industrial sector as main catalysts.** Firstly, the improving demand seen in all regions is worth noting. Secondly, the group seems to be finally taking advantage of its positioning and seeing the benefits of improvements said to be mainly driven by the automotive and industrial segments. Note that the group's guidance for sequential growth of +5.5% in Q2 is above the usual seasonal pattern. In addition, the group states that distribution is well oriented and should positively impact the Q2 performance.
- But weaknesses remain in PC and Wireless.** As expected, the group continued to see weakness in the PC segment which should remain flattish in 2016. Overall, we estimate that PC applications represent about 20% of total group sales. The group is mainly exposed to PC peripherals and chargers (rather than PC boards). Finally, while the Wireless segment (incl. smartphones) is also set to be weak in coming months, the group has observed an improving trend lately.
- All product lines are expected to contribute to growth.** Note that this comment from management excluded the STB business. We forecast sequential increases of 6.1%, 8.0% and 1.5% for ADG, MDG and AMG respectively, leading to an overall sequential increase of +5.5%.
- STB plan is on track.** Regarding the Set-Top Box plan (which includes a gradual step down from this activity in order to generate costs saving of about USD170m annually) management said that it is "on track". Savings from this plan appear to be low in Q1 but we understand that the initial discussions take time and we should see positive impacts to come over Q2 to Q4. Overall, the group confirmed its target of USD100m of savings (at EBIT level) in 2016. We see the following sequence of USD8/18/28/48m in savings over Q1/Q2/Q3/Q4 2016e.
- Overall, management's comments during the conference call confirmed what other industry players' have been saying recently.** The inventory correction in the Automotive and Industrial sectors is complete. Booking trends are encouraging but softness remains in PC and Wireless. The target of achieving a better H2 compared to H1, both in terms of sales and EBIT, seems feasible (BG ests. H1 sales at USD3.3bn and H2 sales at USD3.6bn, up seq. by 7.6%). However, we continue to think that, given the soft start in FY16, it will be challenging to grow by more than a few percent and we are maintaining our FY16 sales estimates of USD6.9bn implying flat growth. In our view, the most challenging (and uncertain) part will come from market share gains in MEMS and particularly the pace of the penetration of the Automotive MEMS market. Finally, we remind that the group should face headwind due to FX from Q2-16 compared to Q1-16 since EUR/USD is now at about 1.13 while it was at 1.10 in average over the first three months.

## VALUATION

- While we note the improvement in the market environment, we continue to see headwinds and risks on the case, namely 1/ the execution of the restructuring process, 2/ growth while the group is competing with dynamic competitors such as Infineon and NXP and 3/ gradual improvement in margin which depends on restructuring, growth and FX. We apply few changes in our model. **We are maintaining our Neutral recommendation and our FV of EUR6.3.**
- Based on our estimates, STMicroelectronics' shares are trading on a 2016e P/E ratio of 31.8x, yielding a PEG ratio of 1.0x. This compares to the peer group (Logic & Analog IDMs) trading on 2016e P/E ratio of 18.0x.



## NEXT CATALYSTS

- 19th May 2016: Capital Market Day.

### Detailed P&L

[USDm]	Q1 16	Q2 16	Q3 16	Q4 16e	2016e	2017e	2017e
<b>Net revenue</b>	<b>1613</b>	<b>1702</b>	<b>1767</b>	<b>1796</b>	<b>6882</b>	<b>6998</b>	<b>7151</b>
<i>% change</i>	-3.3%	5.5%	3.8%	1.6%	-0.2%	1.7%	2.2%
COGS	-1075	-1121	-1137	-1098	-4431	-4476	-4526
<b>Gross Margin</b>	<b>33.4%</b>	<b>34.1%</b>	<b>35.6%</b>	<b>38.8%</b>	<b>35.6%</b>	<b>36.0%</b>	<b>36.7%</b>
SG&A	-229	-231	-226	-234	-920	-963	-937
R&D	-342	-335	-332	-327	-1336	-1276	-1260
Other exceptional gains	0	18	19	26	63	72	74
Recurring restructuring charges	0	0	0	0	0	0	0
<b>Adjusted EBIT</b>	<b>-33</b>	<b>32</b>	<b>89</b>	<b>169</b>	<b>257</b>	<b>355</b>	<b>501</b>
<i>% of revenue</i>	-2.0%	1.9%	5.0%	9.4%	3.7%	5.1%	7.0%
D&A	-184	-180	-180	-172	-716	-728	-744
EBITDA	151	212	269	341	972	1083	1245
Cost of net debt	-5	-5	-5	-2	-17	-17	-17
Profit from associates	0	0	0	3	3	3	3
Gain from investments	0	0	0	0	0	0	0
Profit before tax	-38	27	84	171	243	341	487
Income taxes	-2	-11	-20	-33	-65	-79	-101
Tax rate	5%	-41%	-23%	-19%	-27%	-23%	-21%
<b>Consolidated net profit</b>	<b>-40</b>	<b>16</b>	<b>64</b>	<b>138</b>	<b>178</b>	<b>262</b>	<b>386</b>
<i>% of revenue</i>	-2.5%	0.9%	3.6%	7.7%	2.6%	3.7%	5.4%
<b>Adjusted EPS (in USD)</b>	<b>-0.02</b>	<b>0.02</b>	<b>0.07</b>	<b>0.16</b>	<b>0.20</b>	<b>0.30</b>	<b>0.44</b>

Source: Bryan Garnier & Co. ests.

### P&L changes highlights

[USDm]	Old			New			Old vs. New avg. Δ%
	2016e	2017e	2018e	2016e	2017e	2018e	
<b>Net revenue</b>	<b>6882</b>	<b>6998</b>	<b>7151</b>	<b>6882</b>	<b>6998</b>	<b>7151</b>	<b>0%</b>
<i>% change</i>	-0.2%	1.7%	2.2%	-0.2%	1.7%	2.2%	
EBIT	254	356	491	257	355	501	1%
<i>Operating margin</i>	3.7%	5.1%	6.9%	3.7%	5.1%	7.0%	
<b>Adj. EPS</b>	<b>0.21</b>	<b>0.31</b>	<b>0.43</b>	<b>0.20</b>	<b>0.30</b>	<b>0.44</b>	<b>-2%</b>

Source: Bryan Garnier & Co. ests.

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