

## Infineon

Price EUR12.75

Current share price weakness is a Buy opportunity

Fair Value EUR15 (+18%)

BUY

|                            |            |
|----------------------------|------------|
| Bloomberg                  | IFX GY     |
| Reuters                    | IFXGn.DE   |
| 12-month High / Low (EUR)  | 14.0 / 8.7 |
| Market Cap (EURm)          | 14,422     |
| Ev (BG Estimates) (EURm)   | 13,822     |
| Avg. 6m daily volume (000) | 6,162      |
| 3y EPS CAGR                | 15.5%      |

|                | 1 M   | 3 M  | 6 M   | 31/12/15 |
|----------------|-------|------|-------|----------|
| Absolute perf. | 1.4%  | 8.7% | 11.4% | -5.6%    |
| Semiconductors | -3.9% | 1.1% | -5.4% | -5.5%    |
| DJ Stoxx 600   | 2.4%  | 2.0% | -9.4% | -6.7%    |

| YEnd Sept. (EURm) | 09/15 | 09/16e | 09/17e | 09/18e |
|-------------------|-------|--------|--------|--------|
| Sales             | 5,795 | 6,494  | 6,853  | 7,147  |
| % change          |       | 12.1%  | 5.5%   | 4.3%   |
| EBITDA            | 1,658 | 1,876  | 2,044  | 2,206  |
| EBIT              | 898.0 | 1,031  | 1,153  | 1,277  |
| % change          |       | 14.9%  | 11.8%  | 10.8%  |
| Net income        | 680.0 | 842.6  | 946.9  | 1,051  |
| % change          |       | 23.9%  | 12.4%  | 11.0%  |

|                  | 09/15 | 09/16e | 09/17e | 09/18e |
|------------------|-------|--------|--------|--------|
| Operating margin | 15.5  | 15.9   | 16.8   | 17.9   |
| Net margin       | 11.7  | 13.0   | 13.8   | 14.7   |
| ROE              | 13.3  | 13.1   | 13.3   | 13.7   |
| ROCE             | 18.5  | 14.9   | 16.6   | 18.3   |
| Gearing          | -4.7  | -11.7  | -19.3  | -27.1  |

| (EUR)           | 09/15 | 09/16e | 09/17e | 09/18e |
|-----------------|-------|--------|--------|--------|
| EPS             | 0.60  | 0.75   | 0.84   | 0.93   |
| % change        |       | 23.4%  | 12.4%  | 11.0%  |
| P/E             | 21.1x | 17.1x  | 15.2x  | 13.7x  |
| FCF yield (%)   | 0.6%  | 4.1%   | 5.0%   | 5.8%   |
| Dividends (EUR) | 0.18  | 0.20   | 0.20   | 0.20   |
| Div yield (%)   | 1.4%  | 1.6%   | 1.6%   | 1.6%   |
| EV/Sales        | 2.5x  | 2.1x   | 1.9x   | 1.8x   |
| EV/EBITDA       | 8.6x  | 7.4x   | 6.5x   | 5.8x   |
| EV/EBIT         | 15.8x | 13.4x  | 11.6x  | 10.0x  |

Following the conference call held yesterday by Infineon, we are maintaining our strong positive view on the case. In addition to our first take on FQ2-16 results yesterday, note that management's tone was reassuring. We had confirmation that FY guidance adjustments are only due to FX effects and that business fundamentals remain solid. We see current share price weakness as a Buy opportunity given 1/ low valuation ratios, 2/ a leading position in buoyant markets, and 3/ operational leverage still to be activated (300mm fab, phase out of Newport fab, deeper synergies with International Rectifier).

## ANALYSIS

- **Confirmation that lower guidance is only due to FX effects.** As we commented in our "first take", management now uses a EUR/USD exchange rate of 1.15 (compared to 1.10 in FQ1), meaning that both sales and operating margin have been slightly impacted negatively. This led management to adjust guidance for sales growth to +12% (+/-2ppts) vs. +13% previously and Segment result margin in the range of 15-16%. Note that these FX impacts were included in our estimates, as a result the new guidance is in line with our expectations. For Q2 16, the group is guiding for growth of 2%, whereas this would have stood at 5% adjusted for FX, i.e. in line with seasonal.
- **Positive comments about Automotive market in China.** During yesterday's conference call, management shared positive comments from multiple players in the Auto supply chain in China. We believe this is mainly due to government incentives which started by late 2015. Overall, Automotive business (c. 41% of sales) is seen to grow at about 12% over FY16. The main catalysts for Infineon remain ADAS (autonomous driving) and xEV (electric cars). In xEV, China is said to remain a key area and Infineon could benefit from its strong positions there. For ATV and IPC division, we use a 12% growth rate over FY16.
- **The smartphone market is weak but IFX's comparison base should play positively.** Given the small penetration of Infineon in the Smartphone market, the group sees opportunities (PMM division) thanks to higher contents per phone and market share gains. We remind that the PMM division represent about 30% of group's sales and is the division the most exposed to consumer market which is the most volatile. For PMM, our model uses a 14% growth (H1-16 is up by 35% yoy, but down 4% sequentially).
- **Payment is no more a tailwind, catalysts are to come from other applications.** As expected, payment is expected to reach a plateau anytime soon but we continue to expect growth for CCS division (c. 11% of sales) thanks to a good momentum in Government ID business over H2-16 and growing opportunities in Security for IoT while Infineon remains a major player in this field (#2 worldwide with 24% market share, NXP being #1 with 31% market share). We forecast an 8% increase of CCS revenue over FY16 given that the division shows a 12% yoy performance in H1-16.
- **Technology portfolio maintains a competitive edge.** We understand that an announcement should be made soon regarding Silicon Carbide (SiC), probably about a product targeting drive train in Automotive. Regarding production technology, we believe that 300mm fab should continue to weight on margin until the end of 2017 before to add operational leverage at margin level.
- Finally on M&A, the group continues to scan the market but we believe that it remains selective and that valuable targets at a good price remain rare in 2016.

## VALUATION

- **We apply only minor changes to our model.** We have updated our model to include Fiscal Q2 data and applied slight changes with minor impacts on our EPS sequence (+1% on average over the next 3y).
- **In our view, the current share price weakness should be seen as a Buy opportunity.** The group's profile remains intact and IFX continues to outperform the market thanks to leading positions in buoyant markets (Auto, Industry and Security). Valuation remains attractive in our view with a 2016e P/E ratio of 16.7x, compared to 17.8x on average for Logic and Analog IDMs (players owning and operating fabs). We remind that our FV of EUR15 points to a potential upside of +21%.

## NEXT CATALYSTS

- 2nd August 2016: Fiscal third quarter results.



### Detailed P&L

| [EURm]                        | 1Q16         | 2Q16         | 3Q16e        | 4Q16e        | FY16e        | FY17e        | FY18e        |
|-------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| <b>Total Group</b>            | <b>1556</b>  | <b>1611</b>  | <b>1645</b>  | <b>1683</b>  | <b>6494</b>  | <b>6853</b>  | <b>7174</b>  |
| Seq. growth                   | -2.6%        | +3.5%        | +2.1%        | +2.3%        | +12.1%       | +5.5%        | +4.7%        |
| Y/Y growth                    | +15.4%       | +8.6%        | +3.7%        | +5.3%        | +12.1%       | +5.5%        | +4.7%        |
| Cost of goods sold            | -998         | -1045        | -1064        | -1017        | -4124        | -4208        | -4362        |
| <b>Gross margin</b>           | <b>35.9%</b> | <b>35.1%</b> | <b>35.3%</b> | <b>39.6%</b> | <b>36.5%</b> | <b>38.6%</b> | <b>39.2%</b> |
| SG&A                          | -200         | -195         | -197         | -206         | -799         | -864         | -875         |
| R&D                           | -198         | -195         | -197         | -202         | -792         | -843         | -861         |
| Other operating income        | 60           | 52           | 77           | 53           | 242          | 209          | 195          |
| <b>Adj. EBIT</b>              | <b>220</b>   | <b>228</b>   | <b>263</b>   | <b>310</b>   | <b>1021</b>  | <b>1148</b>  | <b>1272</b>  |
| adj. operating margin         | 14.1%        | 14.2%        | 16.0%        | 18.4%        | 15.7%        | 16.7%        | 17.7%        |
| EBIT                          | 166          | 174          | 189          | 261          | 790          | 922          | 1059         |
| operating margin              | 10.7%        | 10.8%        | 11.5%        | 15.5%        | 12.2%        | 13.5%        | 14.8%        |
| Net financial result          | -12          | -18          | -17          | -20          | -67          | -57          | -52          |
| Income tax                    | -2           | 21           | -26          | -36          | -43          | -130         | -151         |
| tax rate                      | -1.3%        | 13.5%        | -15.0%       | -15.0%       | -5.9%        | -15.0%       | -15.0%       |
| Net income (loss)             | 153          | 180          | 146          | 201          | 680          | 736          | 856          |
| Adj. Net income (loss)        | 194          | 207          | 209          | 288          | 898          | 927          | 1036         |
| <b>Adj. Dil. EPS (in EUR)</b> | <b>0.17</b>  | <b>0.18</b>  | <b>0.18</b>  | <b>0.25</b>  | <b>0.79</b>  | <b>0.82</b>  | <b>0.92</b>  |

Source: Bryan Garnier & Co. ests.

### P&L changes highlights

| [EURm]                        | Old         |             |             | New         |             |             | Old vs. New<br>avg.<br>Δ% |
|-------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|---------------------------|
|                               | 2016e       | 2017e       | 2018e       | 2016e       | 2017e       | 2018e       |                           |
| <b>Net revenue</b>            | <b>6494</b> | <b>6853</b> | <b>7147</b> | <b>6494</b> | <b>6853</b> | <b>7174</b> | <b>0%</b>                 |
| % change                      | 12.1%       | 5.5%        | 4.3%        | 12.1%       | 5.5%        | 4.7%        |                           |
| Adj. EBIT                     | 1031        | 1153        | 1277        | 1021        | 1148        | 1272        | -1%                       |
| Adj. operating margin         | 15.9%       | 16.8%       | 17.9%       | 15.7%       | 16.7%       | 17.7%       |                           |
| <b>Adj. Dil. EPS (in EUR)</b> | <b>0.75</b> | <b>0.84</b> | <b>0.93</b> | <b>0.79</b> | <b>0.82</b> | <b>0.92</b> | <b>1%</b>                 |

Source: Bryan Garnier & Co. ests.

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|         |   |
|---------|---|
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## Distribution of stock ratings

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