

FOCUS

22nd June 2016

TMT

Bloomberg	IFX GY
Reuters	IFXGn.DE
12-month High / Low (EUR)	14.0 / 8.7
Market capitalisation (EURm)	14,809
Enterprise Value (BG estimates EURm)	14,249
Avg. 6m daily volume ('000 shares)	5,606
Free Float	99.5%
3y EPS CAGR	15.7%
Gearing (09/15)	-5%
Dividend yield (09/16e)	1.53%

YE September	09/15	09/16e	09/17e	09/18e
Revenue (EURm)	5,795	6,508	6,909	7,274
EBITA EURm)	898.0	1,031	1,166	1,296
Op.Margin (%)	15.5	15.8	16.9	17.8
Diluted EPS (EUR)	0.60	0.80	0.83	0.94
EV/Sales	2.52x	2.19x	1.99x	1.81x
EV/EBITDA	8.8x	7.6x	6.7x	5.9x
EV/EBITA	16.2x	13.8x	11.8x	10.2x
P/E	21.6x	16.3x	15.7x	14.0x
ROCE	18.5	16.4	16.6	18.3



Infineon

Underestimated potential

Fair Value EUR15 (price EUR13.09)

BUY

A year ago, we initiated coverage of Infineon with the strong conviction that the group could integrate International Rectifier faster than expected. This proved to be true and led the group to announce strong guidance for FY16 in a tough environment (back in November 2015). Over one year, the share price has already jumped 17% (vs. Stoxx 600 -14%). However, in view of the group's strong operating performance over the period, we believe the opportunity remains intact. We reiterate our Buy recommendation.

■ **Recently, the share has suffered from the downward revision to FY16 guidance although business is stronger than ever.** When reporting FQ2-16 results in May, management provided an update to FY16 guidance and said it now expects FY16 revenue growth of 12% (at mid-point) and a segment result margin of 15.5% (at mid-point) vs. 13% and 16% respectively beforehand. Some feared the update implied weaknesses in the environment but management was clear in stating that it was only due to forex changes (EUR/USD of 1.15 vs. 1.10 previously). As a result, Infineon's valuation metrics have plummeted from a 52w high 2016e P/E of 22.6x in late 2015 to 16.4x currently (-27%), which is also below the 52w average of 18.3x.

■ **We see room for revenue growth and margin improvement.** The group boasts strong expertise in power semiconductors and leverages this in multiple market segments (especially auto and industrial sector). As a result, it is growing faster than the market (+9.5% 5y avg. growth vs. +2.3% respectively), gains market share continuously and maintains a competitive edge thanks to well selected R&D programmes (R&D FY15: 12% of sales). In addition, Infineon invests in manufacturing technologies and is preparing the transition to 300mm production (vs. 200mm), which is unique among Analog players. The ramp-up in this production should provide an additional tailwind for margins from 2017 and accentuate the group's competitive edge.

■ **We have applied minor changes to our model and in view of current valuation metrics, reiterate our Buy recommendation.** We have updated our model to include the latest FX spot data which has a minor impact on our estimates. Our FV remains unchanged at EUR15 and points to an upside of 15%.



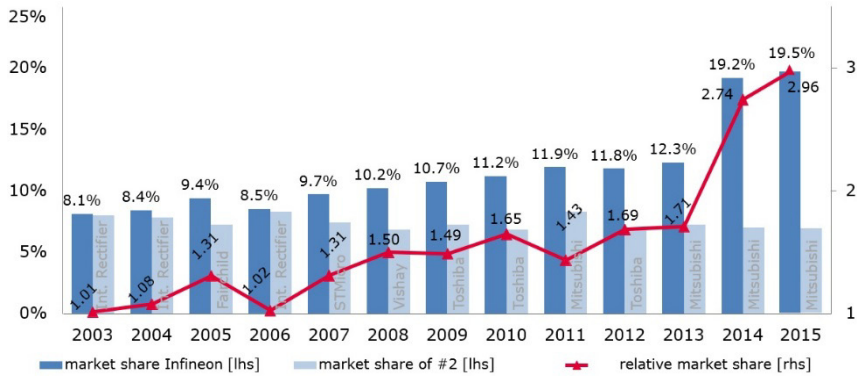
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Infineon major keys to focus on:

1. One Chart

In Power, Infineon significantly outperforms the market



Sources: IHS; Infineon; Bryan, Garnier & Co ests.

Infineon's market share now represents for more than 19% of the worldwide power semiconductor market. From 2003 to 2015, the name of the no. 2 player changed but none of the group's rivals succeeded in outpacing Infineon. Note that **sales of power semiconductors represent more than 60% of Infineon's total revenues** (or about 60% of sales in the ATV division, 100% of IPC and 60% of PMM).

- This dominant position is maintained thanks to a strong portfolio of IGBTs* (27% market share in a USD4.5bn market) and MOSFETs** (28% market share in a USD5.8bn market). Regarding MOSFETs, we would also highlight the strong opportunity thanks to upcoming initiatives in xEV infrastructures. Indeed, MOSFETs are largely used in charging stations to adapt and control the output voltage. As an example, **China just launched an initiative to develop a charging station network (every 50km) limited to major highways so far.** This translates into more than 4.5m charging points of ~100kW per device, i.e. more than 100 MOSFETs per device or a total semiconductor content per charging point of USD200 to USD300. This initiative alone represents an opportunity of USD1.13bn. Assuming a 30% market share, Chinese investments translate into an opportunity of EUR300m for IFX, representing 5% of the group's FY15 revenues.
- **Power is not the only market in which the group outperforms.** Over the last five years, Infineon's average growth was about 9.5% while the overall market grew by only 2.3% over the same period. We think that this outperformance stems from the group's 1/ strong footprint in high growth market segments and 2/ strategic merger and acquisition operations (International Rectifier being the most important contributor to growth). As such, IFX can afford to maintain a leading edge portfolio, which also contributes to growth.

2. One Sentence

"We think that the break-even point [on our 300mm fab] should be reached by the end of 2017."

As we have said before, Infineon has growth potential but **there is also room for margin improvement.** One of the key elements of margin improvement is the production of power components using 300mm wafers. Note that IFX benefited from Qimonda's Chapter 11 in 2011 to buy a 300mm cleanroom and manufacturing equipment for EUR101m.

The group's operating margin is currently impacted by around EUR60m in charges per year from under-utilisation of this Dresden-based 300mm fab. To roll off these charges, **Infineon must ramp up production to achieve loading of c. 25%** compared with 10-15% loading at present. To achieve this target and feed the 300mm fab, IFX is not only counting on revenue growth but also on repatriating International Rectifier's production to this fab and the phase out the IRF manufacturing site in Newport, Wales by the end of calendar year of 2017. **The gradual ramp-up of the 300mm fab should unlock one additional percentage point of operating margin from 2017 and the closing of Newport should also be seen as a tailwind.**

3. One Figure

+12%

The FY16 growth outlook was a hot topic during the latest conference call held in May. Back in November 2015, during its FY15 results conference call, Infineon shared a FY16 outlook for year-on-year revenue growth of 13% (+/- 2ppts) and a segment result margin of 16%. This guidance was based on an exchange rate of EUR/USD of 1.10.

After confirming the outlook in the February conference call (about Q1-FY16 results), **the group revised it downward during the latest Q2-FY16 conference call, on 3rd May 2016.** Management explained that the **new guidance for 12% growth** (+/- 2ppts) only reflected fresh assumptions for the EUR/USD exchange rate from 1.10 to 1.15 (and there was clearly no change in business confidence). The impact of a EUR/USD move in FY16 growth was in line with impacts observed in a similar change to FX in our model.

Some feared that the new guidance was a first warning of softer underlying business. Following the adjustment, Infineon stock dropped 6% in a few days and was down ~15% compared to the November 2015 level (52w high, following the announcement of FY16 guidance). Currently, the stock performance remains negative ytd (about -3%) and it is still trading about 7% lower than the 52w high. **With an EUR/USD exchange rate moving away from 1.15 and sliding slowly back to 1.10, we see potential for a guidance beat and a Buy opportunity at a reasonable valuation (2016e P/E of 16.4x compared with a peer P/E of 18.2x).**

Although we agree that the group is forex-sensitive (albeit limited compared to STMicroelectronics (Neutral, FV EUR6.3)), we believe the most important catalyst remains underlying business. In this regard, **the environment is constantly improving.** During the fourth quarter of 2015 and the first quarter of 2016 (fiscal Q1 and Q2 for Infineon), semiconductor players were impacted by inventory adjustments in the automotive market and an end-market softness in the industrial sector. Inventory adjustments are due to come to an end by late CQ1, early CQ2 according to most industry players. In addition, we note that recent car manufacturers' data suggests that the improvement in car production continued in May despite varied fortunes among "proxy" car manufacturers: Audi sales up 6.7% yoy, BMW was down 6.4% and Daimler sales up by 12.9%. **Overall, car production is set to grow yoy** (the aggregate of Chinese, US and Euro production was up 6.1% yoy over a 4m period Jan-April) **and momentum in the industrial sector is also improving.**

4. Update to our Investment Case

Overall, we remain confident that Infineon has a privileged position to benefit from three of the fastest-growing segments in the semiconductor industry, i.e. automotive, the industrial sector and security. Infineon has a strong footprint in its market segment, providing resources to invest in leading-edge technologies and production infrastructure and accentuating its competitive advantage (e.g. 19.2% market share in a fast growing power semiconductor market today vs. 8.1% in 2003).

We have fine-tuned our model and applied an update to the EUR/USD exchange rate with the latest spot of 1.13. As a result, our FY16e sales estimate is up from EUR6.49bn to EUR6.51bn, or +12.3% yoy compared to +12.1% previously. Also, following the FX update, our FY16 segment result is up slightly from EUR1.021bn to EUR1.031bn, or a segment result margin of 15.8% vs. 15.7% previously. Consequently, we now anticipate 15.7% average growth in EPS over the next three years (vs. 14.9% previously). However, due to rounding, **this fine-tuning has no impact on our Fair Value which remains at EUR15** (our FY16/17/18e EPS estimates are up 1.6% on average).

Note that, beyond the P&L performance, Infineon remains a solid player able to generate more than EUR500m in free cash flow annually (BG ests. 2016e FCF of EUR564m or a FCF Yield of 4%). Furthermore, despite the acquisition of International Rectifier (in a deal worth about EUR2.4bn), the group maintains a positive net cash position (FQ2-16 net cash EUR27m).

As a result, with 1/ **an unjustified YTD share performance of -3% compared with +5% for the SOX** (Phil. Semiconductor Index), 2/ **cautious consensus expectations regarding ST and LT opportunities** and 3/ **a continuously improving environment, we see an opportunity to benefit from a low entry point which is all the more attractive in view of a 2016e P/E multiple of 16.4x** (PEG of 1.0x) compared with a 2016e P/E ratio of 18.2x on average for peers (Logic and Analog IDMs). Our FV of EUR15 points to upside of 15%.

Detailed P&L

[EURm]		FY15	1Q16	2Q16	3Q16e	4Q16e	FY16e	FY17e	FY18e	CAGR
Total Group		5795	1556	1611	1660	1681	6508	6909	7274	+7.9%
	<i>Seq. growth</i>	34.1%	-2.6%	+3.5%	+3.0%	+1.3%	+12.3%	+6.2%	+5.3%	
	<i>Y/Y growth</i>	34.1%	+15.4%	+8.6%	+4.7%	+5.2%	+12.3%	+6.2%	+5.3%	
Cost of goods sold		-3715	-998	-1045	-1074	-1015	-4132	-4242	-4423	
Gross margin		35.9%	35.9%	35.1%	35.3%	39.6%	36.5%	38.6%	39.2%	
SG&A		-778	-200	-195	-199	-206	-800	-871	-887	
R&D		-717	-198	-195	-199	-202	-794	-850	-873	
Other operating income		313	60	52	93	45	250	219	205	
Adj. EBIT		898	220	228	281	302	1031	1166	1296	+13.0%
	<i>adj. operating margin</i>	15.5%	14.1%	14.2%	16.9%	18.0%	15.8%	16.9%	17.8%	
EBIT		555	166	174	191	260	791	930	1074	
	<i>operating margin</i>	9.6%	10.7%	10.8%	11.5%	15.5%	12.2%	13.5%	14.8%	
Net financial result		-34	-12	-18	-17	-20	-67	-57	-53	
Income tax		102	-2	21	-26	-36	-43	-131	-153	
	<i>tax rate</i>	19.6%	-1.3%	13.5%	-15.0%	-15.0%	-6.0%	-15.0%	-15.0%	
Net income (loss)		634	153	180	147	201	681	742	867	
Adj. Net income (loss)		680	194	207	224	282	906	942	1056	
Adj. Dil. EPS (in EUR)		0.60	0.17	0.18	0.20	0.25	0.80	0.83	0.94	+15.7%

Source: Bryan, Garnier & Co ests.

Change in our scenario

[EURm]		Old			New			Old vs. New
		2016e	2017e	2018e	2016e	2017e	2018e	avg. Δ%
Net revenue		6494	6853	7174	6508	6909	7274	1%
<i>% change</i>		12.1%	5.5%	4.7%	12.3%	6.2%	5.3%	
Adj. EBIT		1021	1148	1272	1031	1166	1296	1%
<i>adj. operating margin</i>		15.7%	16.7%	17.7%	15.8%	16.9%	17.8%	
Adj. Dil. EPS (in EUR)		0.79	0.82	0.92	0.80	0.83	0.94	1%

Source: Bryan, Garnier & Co ests.

Next Catalysts

Period	Event
1st July – 1st August	Quiet Period
2nd August	Fiscal Q3-16 results
1st October – 22nd November	Quiet Period
23rd November	Fiscal Year 2016 results

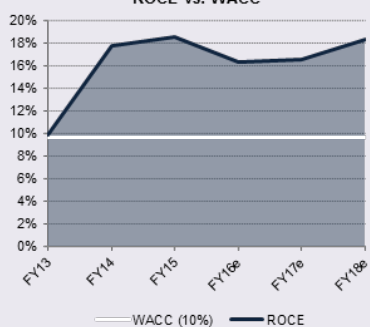
Sources: Company Data; Bryan, Garnier & Co ests.

***IGBT:** Insulated Gate Bipolar Transistor, is a power semiconductor component used as an electronic switch. Compared to MOSFET, IGBTs the advantages of high-current handling and low loss capability (high-voltage) but the disadvantages of a large current tail (relatively slow turn-off characteristics). As a result, they are mostly used for high-voltage and/or low frequency applications (such as Uninterrupted Power Supply).

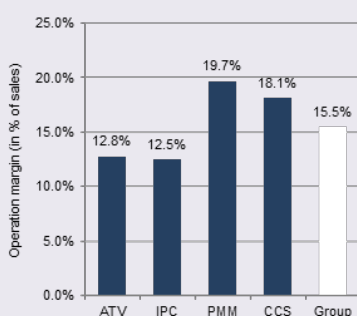
****MOSFET:** Metal Oxide Semiconductor Field Effect Transistor, is also a power semiconductor device used as an electronic switch. Compared to IGBTs, MOSFETs have shorter current tail but they are limited in term of current handling capability (low-voltage). As a result, they are mostly used for high-voltage and/or low frequency applications. As a result, they are mostly used for high-frequency and/or low voltage applications (such as motor control).

Infineon

ROCE vs. WACC



2015 Operating margin per division



Company description

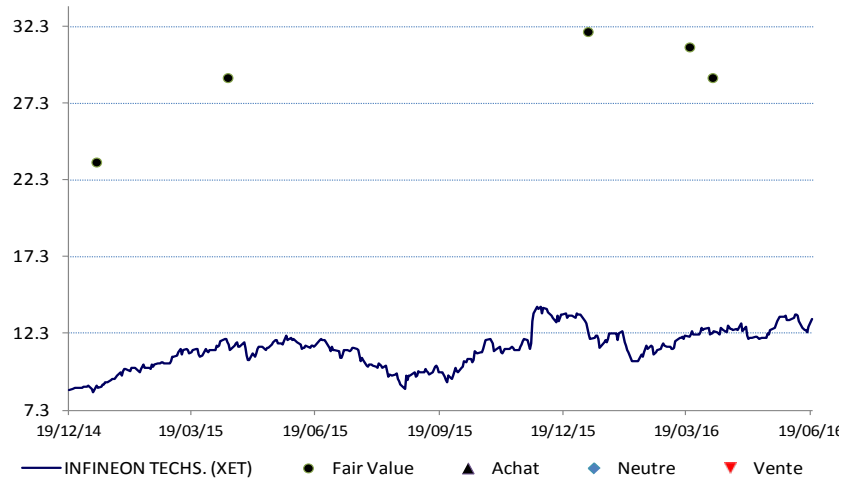
Infineon is a German semiconductor manufacturer active in the automotive sector, electrical power management especially for industry, and security applications such as bank cards. In early 2015, the group completed the acquisition of International Rectifier, a US rival particularly active in power management. Via this acquisition, the group has consolidated its leading position in this segment. Infineon is also the no. 1 player in the automotive segment.

Simplified Profit & Loss Account (EURm)	30/09/13	30/09/14	30/09/15	30/09/16e	30/09/17e	30/09/18e
Revenues	3,843	4,320	5,795	6,508	6,909	7,274
Change (%)	-1.6%	12.4%	34.1%	12.3%	6.2%	5.3%
Adjusted EBITDA	843	1,134	1,658	1,877	2,064	2,241
Adjusted EBIT	377	620	898	1,031	1,166	1,296
EBIT	324	526	555	791	930	1,074
Change (%)	-28.8%	62.3%	5.5%	42.6%	17.5%	15.5%
Financial results	(19.0)	(6.0)	(34.0)	(67.0)	(57.3)	(53.1)
Pre-Tax profits	305	520	521	724	873	1,021
Tax	(22.0)	(30.0)	102	(43.1)	(131)	(153)
Minority interests	(0.07)	(0.06)	0.20	(0.06)	(0.15)	(0.15)
Net profit	283	490	622	681	742	867
Restated net profit	297	539	680	906	942	1,056
Change (%)	-34.0%	81.4%	26.2%	33.3%	3.9%	12.1%
Cash Flow Statement (EURm)						
Depreciation & amortisation	(466)	(514)	(760)	(846)	(898)	(946)
Change in working capital	(230)	(71.0)	(602)	(49.4)	(42.3)	(37.5)
Operating cash flows	601	981	817	1,395	1,598	1,776
Capex, net	(375)	(664)	(728)	(846)	(898)	(946)
Free Cash flow	226	317	89.0	549	699	830
Financial investments, net	46.0	392	(1,865)	0.0	0.0	0.0
Dividends	(129)	(129)	(202)	(225)	(225)	(225)
Issuance of shares	2.0	1.0	11.0	15.0	0.0	0.0
Issuance (repayment) of debt	52.0	4.0	2,398	4.0	0.0	0.0
Other	(154)	(336)	(2,443)	(3.0)	0.0	0.0
Net debt	(1,983)	(2,232)	(220)	(560)	(1,034)	(1,639)
Balance Sheet (€m)						
Tangible fixed assets	1,600	1,700	2,093	1,993	1,893	1,793
Intangibles assets & goodwill	170	250	1,738	1,838	1,938	2,038
Investments	34.0	35.0	33.0	33.0	33.0	33.0
Deferred tax assets	325	378	607	607	607	607
Other non-current assets	153	141	155	155	155	155
Current assets	3,096	2,876	3,442	3,605	3,723	3,829
Cash & equivalents	527	1,058	673	988	1,462	2,067
Total assets	5,905	6,438	8,741	9,218	9,811	10,522
Shareholders' equity	3,776	4,158	4,671	5,142	5,659	6,302
Provisions	292	449	498	498	498	498
Deferred tax liabilities	4.0	5.0	147	147	147	147
Current liabilities	1,530	1,640	1,638	1,727	1,804	1,871
L & ST Debt	303	186	1,793	1,768	1,768	1,768
Total Liabilities	5,905	6,438	8,741	9,218	9,811	10,522
Capital employed	3,552	3,286	5,791	5,923	5,965	6,002
Ratios						
Operating margin	9.81	14.35	15.50	15.84	16.87	17.81
Tax rate	7.21	5.77	(19.62)	5.96	15.00	15.00
Net margin	7.73	12.48	11.73	13.93	13.63	14.52
ROE (after tax)	7.49	11.78	13.32	13.25	13.11	13.77
ROCE (after tax)	9.85	17.78	18.54	16.37	16.61	18.35
Gearing	(52.52)	(53.68)	(4.71)	(10.88)	(18.27)	(26.01)
Pay out ratio	43.41	23.93	29.73	24.82	23.87	21.29
Number of shares, diluted	1,081	1,128	1,126	1,129	1,129	1,129
Data per Share (EUR)						
EPS	0.25	0.48	0.56	0.61	0.66	0.77
Restated EPS	0.26	0.48	0.60	0.80	0.83	0.94
% change	-33.7%	82.2%	25.8%	32.8%	3.9%	12.1%
BVPS	3.49	3.69	4.15	4.55	5.01	5.58
Operating cash flows	0.56	0.87	0.73	1.24	1.41	1.57
FCF	0.21	0.28	0.08	0.49	0.62	0.74
Net dividend	0.12	0.12	0.18	0.20	0.20	0.20

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

Price Chart and Rating History

Infineon



Ratings		
Date	Ratings	Price
11/06/15	BUY	EUR48.598

Target Price	
Date	Target price
27/11/15	EUR15
11/06/15	EUR14

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Stock rating

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SELL	Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 56.5%

NEUTRAL ratings 34%

SELL ratings 9.5%

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