

Melexis

Price EUR59.89

A supportive momentum, but yield problems leads to cut in R&D investments

Fair Value EUR48 (-20%)

SELL

Bloomberg	MELE.BB
Reuters	MLXS.BR
12-month High / Low (EUR)	61.0 / 37.7
Market Cap (EURm)	2,420
Ev (BG Estimates) (EURm)	2,360
Avg. 6m daily volume (000)	38.10
3y EPS CAGR	5.3%

During the conference call held yesterday by Melexis, the group said that improving momentum has allowed higher expectations and a guidance revision for 2016 (FY16 rev. growth 13-14% vs. 8-12% before). Nevertheless, we note that the group is experiencing low yield on some product lines, leading to the downward revision of the gross margin (45% vs. 47%) and lower investment in R&D in order to maintain EBIT margin guidance at 25%. Finally, despite Melexis revising its FY16 guidance, it only comes into line with our estimates. As a result, we are making no change to our model for now.

ANALYSIS

- Yesterday, during the conference call following the Q2 2016 results, the group gave details regarding the guidance adjustment.** First regarding the top line, we remind that the group increased its guidance for the full year 2016 from growth of 8%-12% to 13%-14%. Management said that momentum continues to improve, mainly thanks to good traction in China and also in Europe. The positive impact from a higher market dynamic in Europe is that the cars usually produced in this area tend to embed a higher level of content than in the rest of the world. As a result, management said that both volume and content are expected to increase and to contribute to the upward adjustment of the full year guidance. The strong momentum is said not to be related to any restocking impact, but rather to end-market demand which is far healthier. Looking at applications, fuel reduction remains a strong driver and sensors are progressing well. Nevertheless, we note that sensor market in automotive is growing at a slower pace than the overall semiconductor market for automotive (6.7% vs. 7.5% respectively according to the data quoted by the group from ABI Research).
- Regarding the gross margin downward adjustment, the group said that it is mainly due to low yield on some product line, especially (but not only) actuators which is not offset by the success of magnetic sensors.** The group did not provide any timing regarding the resolution of this problem.
- This leads us to question about the way Melexis keeps its guidance of EBIT margin, the answer is the R&D...** Indeed, as we highlighted in our paper yesterday, the group continues to guide to an EBIT margin of 25% for the full year, while lowering gross margin guidance by 200bp. During the conference call, the group said that the target of 15% of sales invested in R&D won't be achieved in 2016 in order to maintain the 25% EBIT margin guidance. This comes in the context of increasing competition on Melexis product portfolio (although limited thanks to high entry barrier in the segment), especially from STMicroelectronics and Micronas. Also, looking at the bottom of the P&L, we highlight that the group now guides to a tax rate of 15% for full year 2016 (vs. 9.5% in 2015) which appears to be significantly higher than consensus expectations. As a result, despite top line higher guidance, estimates on EPS could be cut by few percentage points. We note that we already highlighted this point in our initiation report published on 21st July.
- No sign of a negative impact from Brexit so far.** Finally, the management commented on Brexit and said that there was no discussion about any negative impact of the Brexit with customers. This is reassuring given the noise about Brexit and its impact on the automotive market recently. We add that Melexis comment is much in line with market comments made by ST earlier yesterday.

VALUATION

- Despite Melexis upward revision of its FY16 guidance, it only comes into line with our estimates. As a result, we are making no change to our model for now. We continue to think that Melexis could tick all the right boxes to be one of our favorite plays, but the valuation metrics remains too high, with a PEG of 5.1x.**
- Based on our estimates, Melexis' shares are trading on a 2016e P/E ratio of 26.3x.

NEXT CATALYSTS

- 26th October 2016: Q3 2016 results (before market opening)

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