

Sector View

Semiconductors

	1 M	3 M	6 M	31/12/15
Semiconductors	2.5%	28.3%	32.2%	18.6%
DJ Stoxx 600	0.8%	1.9%	4.2%	-7.0%

*Stoxx Sector Indices

Companies covered

ARM HOLDINGS Tender to the offer 1410p

Last Price 1688p Market Cap. GBP23,771m

ASML SELL EUR81

Last Price EUR94.51 Market Cap. EUR40,954m

DIALOG BUY EUR37

Last Price EUR32.29 Market Cap. EUR2,514m

INFINEON BUY EUR16

Last Price EUR15.325 Market Cap. EUR17,350m

MELEXIS SELL EUR48

Last Price EUR58.44 Market Cap. EUR2,361m

SOITEC NEUTRAL EUR0.5

Last Price EUR0.78 Market Cap. EUR473m

STMICROELECTRONICS NEUTRAL EUR6.5

Last Price EUR6.733 Market Cap. EUR6,134m

u-blox BUY CHF265

Last Price CHF239.8 Market Cap. CHF1,632m

Q2 mostly positive for the majority of European semi players and the way ahead is clear

With the Q2 2016 earnings season coming to an end, we note that 1/ a vast majority of players reported in-line or better-than-expected Q2 results (five out of six), 2/ players active in the automotive and industrial sectors remain particularly confident on short term growth, and 3/ Brexit is not an issue so far (the recent EUR/USD move is more of a tailwind). In this context, we recommend Dialog, Infineon and u-blox, which continue to offer an attractive entry point given their respective growth prospects.

ANALYSIS

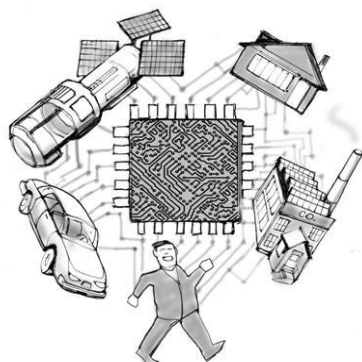
- **Overall, Q2 2016 results were better than expected...** During the Q2 2016 earnings season, the majority of the stocks we cover reported strong earnings momentum. Indeed, out the six Semiconductors stocks we cover and that have already reported calendar Q2 2016 results, five came out with better than expected data (4-6% above consensus expectations) or in line, namely ARM Holdings, ASML, Dialog, Infineon and STMicroelectronics. Melexis was the only group to report Q2 results below expectations despite being in a similar market segment to Infineon and STMicroelectronics.

- **... and Q3 is set to show sequential growth, as expected.** In addition to Q2 2016 results, most of the groups shared positive momentum for Q3 with forecasts for sequential growth. The expected growth range spans from 22% for Dialog (helped by a usual strong seasonal effect) to a potential decrease for ASML. Note that ASML is an equipment manufacturer and has different market momentum to other players, plus it currently suffers from an unfavourable comparison basis due to a strong Q2 with the beginning of the 10nm production ramp. Note also that ARM did not provide guidance for Q3 due to the tender offer underway.

Q2/Q3 surprise and Q3 anticipated growth among BG coverage

BG Coverage (8)	Q2 results vs. cs.	Q3 Sales guidance	Q3 guidance vs. cs.
ARM Holdings	6% above	n.c.	n.s.
ASML	4% above	slow decrease	below
Dialog Semiconductor	6% above	+22% seq.	in line
Infineon	6% above	+3% seq.	in line
Melexis	7% below	+3% seq.	3% above
Soitec	n.c.	n.c.	n.s.
STMicroelectronics	in line	+5.5% seq.	1% above
u-blox	n.c.	n.c.	n.s.

Sources: Thomson Reuters I.B.E.S.; Bryan, Garnier & Co ests.



- **Overall, semiconductor players remain confident regarding automotive and industrial sectors.** From the various conference calls and contacts with management we have had recently, we understand that there is no fear of a Brexit impact. STMicroelectronics made it clear, the group “does not have material operations in the UK and has not experienced any material impact from Brexit on [the] underlying business to date”. A similar statement was also found in other groups’ comments including Infineon and Melexis, which nevertheless raised its FY16 guidance in view of the supportive environment in the automotive sector. However, the tone was more cautious in the consumer market, especially PCs and smartphones. Dialog, which derives 80% of sales from Apple, again lowered its FY16 guidance and now expects a 15% decline in volumes yoy (stable price).
- **In this context, we continue to favour Dialog, Infineon and u-blox.** These groups boast strong positions in their respective markets and offer growth prospects over the next three years (including Dialog which should benefit from better momentum from 2017). In addition, valuations for these groups remain attractive with PEG levels of respectively 1.7x, 1.1x and 1.2x. Conversely, we recommend staying away from Melexis, due to high valuation metrics (PEG of 4.9x) and ASML due to an unattractive risk/reward profile.

VALUATION

- Valuations in the semiconductor industry have enjoyed a positive impact from by the healthy set of results and the EUR/USD move, as well as supportive news flow. Indeed, the acquisition of ARM Holdings by Soft Bank announced in July fuelled hopes of M&A deals in the industry. As a result, most of the stocks show a positive YTD performance (50 out of the 60 companies we monitor actively). Foundry group was the worst performer with an average YTD average performance of 10%. Among our coverage, ARM Holdings' has the best YTD performance (+62.4%) while Dialog's has the worst (+1.3%).

BG semiconductor sub-sector valuation table

Subsector	YTD stocks perf.		2016e			
	Avg. / Median	Higher / Lower	EV/Sales	EV/EBITDA	EV/EBIT	P/E
Fabless (14)	20.1% / 12.7%	91.1% / -18.2%	2.7x	10.8x	14.4x	22.8x
Logic & Analog IDM (16)	11.8% / 12.4%	38.9% / -20.9%	3.2x	9.5x	12.4x	16.7x
Memory IDM (4)	15.1% / 14.1%	22.6% / 9.7%	0.9x	3.7x	7.3x	15.2x
Foundry (5)	10.2% / 1.3%	29.2% / -2.1%	1.6x	4.3x	13.5x	12.6x
Semi Equipmt & Materials (11)	12.2% / 10.5%	47.1% / -6.6%	2.3x	8.9x	9.9x	15.8x
Intellectual Property & EDA (10)	36.4% / 36.4%	62.4% / 9.1%	5.5x	16.1x	20.7x	23.3x

Numbers between brackets represent the # of companies in each group; green/red numbers are higher/lower value per data point.

Sources: Thomson Reuters I.B.E.S.; Bryan Garnier & Co.

NEXT CATALYSTS

- 26th August 2016: u-blox H1 2016 results

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