27th September 2016

TMT

Infineon

Price EUR15.34

Heading to the right direction - we are increasingly confident about the mid-term

Fair Value EUR17.5 vs. EUR16 (+14%) **BUY**

Bloomberg	IFX GY
Reuters	IFXGn.DE
12-month High / Low (EUR)	15.6 / 9.4
Market Cap (EURm)	17,366
Ev (BG Estimates) (EURm)	17,609
Avg. 6m daily volume (000)	4,455
3y EPS CAGR	17.4%

	1 M	3 M	6 M	31/12/15
Absolute perf.	1.6%	18.0%	25.2%	13.6%
Semiconductors	3.2%	26.3%	27.1%	22.6%
DJ Stoxx 600	-1.1%	5.6%	1.5%	-7.1%

YEnd Sept. (EURm)	09/15	09/16e	09/17e	09/18e
Sales	5,795	6,496	7,045	7,622
% change		*12.1%*	*8.4%*	*8.2%*
EBITDA	1,658	1,840	2,114	2,331
EBIT	898.0	995.4	1,199	1,341
% change		*10.8%*	*20.4%*	*11.9%*
Net income	680.0	912.0	991.8	1,105
% change		*34.1%*	*8.7%*	*11.4%*

	09/15	09/16e	09/17e	09/18e
Operating margin	15.5	15.3	17.0	17.6
Net margin	11.7	14.0	14.1	14.5
ROE	13.3	14.1	14.1	14.7
ROCE	18.6	14.4	15.3	16.7
Gearing	-4.7	4.8	-4.6	-14.2

(EUR)	09/15	09/16e	09/17e	09/18e
EPS	0.60	0.81	0.88	0.98
% change	-	*33.6%*	*8.8%*	*11.4%*
P/E	25.4x	19.0x	17.5x	15.7x
FCF yield (%)	0.5%	3.4%	4.2%	5.0%
Dividends (EUR)	0.18	0.20	0.20	0.20
Div yield (%)	1.2%	1.3%	1.3%	1.3%
EV/Sales	3.0x	2.7x	2.4x	2.2x
EV/EBITDA	10.3x	9.6x	8.1x	7.1x
EV/EBIT	19.1x	17.7x	14.3x	12.3x

Today, we take advantage of a better visibility on FQ4 2016e/FY17e to adjust our mid-term estimates of model, and take into account the solid momentum on both Automotive and Industrial sector. Overall, we raise our top-line growth estimates which leads to FY17e and FY18e EPS estimates to increase by 2%. We continue to think that the profile of Infineon is slowly but continuously improving from an investor perspective while the valuation metrics remain attractive. Following adjustments to our model, we reiterate our Buy recommendation and raise our FV from EUR16 to EUR17.5.

ANALYSIS

- **Fundamentals remain very supportive in Automotive. We raise our FY17e and FY18e estimates for the ATV division**. This branch represents about 40% of the overall business of Infineon. Despite automotive volumes might be seen as a concern by some investors in the short term, we remind that most of the growth in the automotive sector comes from content increase (more semiconductor devices per car) while higher volume of cars remain a small part of that. With the current visibility we have so far, we remain confident about a short term growth in this market segment while, on the longer term, we believe that 1/ the current footprint of Infineon in this segment, 2/ the strong and leading product portfolio in autonomous driving (ADAS) and Electric Vehicles (xEV), and 3/ the right R&D strategy with a solid IP portfolio in the next generation power semi materials of Gallium Nitride (GaN) and Silicon Carbide (SiC) that will be used in xEV, will help to consolidate a leading position and allow the group to gain market share. As such, we raise our FY17e and FY18e growth estimate for the Automotive division (~40% of sales) to +9.5% and +9% respectively (vs. previous conservative growth estimates of +5.3% and +4.3%), i.e. an outperformance of more than 2ppts compared to the automotive semiconductor market.
- **Industrial power control: Infineon is set to remains the leader. We also adjust higher our IPC growth estimates for FY17e and FY18e**. Following the acquisition of International Rectifier, Infineon is now a clear market leader in power semi-conductors. The group boasts a market share of almost 19.5% (in 2015) while the second player has only one-third of it. Again, the R&D effort in GaN and SiC will help the group to consolidate its leading position and be boosted by the strong momentum. As such, we also expect Infineon to gain market share in this segment. The acquisition of Wolfspeed during summer 2016 was also a sign that the group is actively investing in future technologies in order to maintain its competitive hedge. While we have a 2015/2018e CAGR of +7.3% for industrial sector market, we now apply a FY17e and FY18e growth of 8%/8.5% respectively (vs. +4.2%/+4.2% previously) for the IPC division (c. 18% of sales). We recall, that in Power semiconductor, Infineon is uninterruptedly gaining market share since 2006. At that time, the German group had a market share of 8.5% which increased to 12.3% before the acquisition of IRF, the one helping Infineon to achieve the 19.5% level today.
- **However, we adopt a slightly more cautious scenario regarding Power Management (PMM) and Chip Card & Security (CCS) divisions**. While we are convinced that the group will now be able to gain market share in Automotive and Industrial sector, we also believe Chip Card business (13% of sales) will slow down due to current high penetration rate of Chip Cards in the US and in China, two of the most dynamic regions so far. As such, we now apply a 6.0% and 5.0% growth for FY17e and FY18e for CCS division (vs. +6.9% and +6.2% previously). Similarly, we adopt a more cautious scenario for the PMM division (c. 31% of sales) which includes a "consumer" share of Infineon business as well as network infrastructure revenue and sales of power supply components for servers. We were previously using growth rate of +7.0% and +6.0% for FY17e/FY18e respectively, we now apply growth rate of 6.0% for both FY17e and FY18e.
- **A 2015/2018e CAGR of 9.6% on revenue and margin improvement to come**. Following the adjustments we detailed previously, our top-line estimates shows a growth pattern of +12.1%/+8.4%/+8.2% over FY16e/ FY17e/FY18e or an average growth rate of +9.6% over the period. Regarding margins, we continue to believe that there will be an improvement thanks to 1/ the Dresden 300mm fab reaching break-even during Q4 2017 (we estimates this should help to improve operating margin by about 100bp), 2/ the pruning of legacy IRF activity/assets (mainly the Wales fab to be sold in FY17, we estimates that it should help by at least 50bp), and 3/ the positive impacts of higher volumes since Infineon is an IDM (it owns the fabs) and is sensitive to volume variations (BG ests. c. +60bp on operating margin by 2018e). As such, our FY18e operating margin comes out at 17.6%, or 210bp higher than 15.5% achieved in FY15. Overall, our new EPS estimates

are 2% higher on average compared to our previous estimates. As such, our model now points to a 17.4% EPS growth on average over FY16e to FY18e (vs. +16.8% previously).

VALUATION

- **In our view, the profile of Infineon is slowly but continuously improving from an investor perspective.** The group is now mainly focused on the two most growing market segments among a sluggish semiconductor industry: Automotive and Industrial sector. It owns strong footprint in these segments and outpaces competitors thanks to a clear strategy and rigorously selected investments in technology development. As such, the group is now a clear leader in Power Semiconductor and perfectly positionned to respond to the high demand of Electric vehicle and robotization of the industrial sector with investments in next generation power semi materials of GaN and SiC. In addition, the group also re-engineered some of its Cellular Infrastructure technology (77 GHz P2P connection) to accelerate the development of radars for ADAS, as such it is also a leader in ADAS components, another strong catalyst of automotive market. While an exposition to the Automotive market might be seen as a sign of cyclicality on the top line, we think that with most of the growth coming from content increase (vs. car production) makes it more stable than before. Finally, the group also managed to afford operational leverage with the continuous development of the 300mm fab which will be soon at breakeven.
- **And yet, with this improving profile and strong momentum, Infineon's share performance remains below SOX Index' performance over a 6 months period (25.2% vs. 27.1% respectively) leading to current attractive valuation.** Based on our estimates, Infineon's shares trade at a 2016e/2017e P/E ratios of 19.0x/18.3x respectively and a **2016e/2017e PEG ratios of 1.1x/1.1x**.
- **Following the previously mentioned adjustments in our model and updates of our valuation methods (we uses both a DCF and SOTP based on peer ratios), we raise our FV from EUR16 to EUR17.5.**

NEXT CATALYSTS

- 23 November 2016: FY16 results

New detailed P&L

[EURm]	1Q16	2Q16	3Q16	4Q16e	FY16e	FY17e	FY18e	CAGR
Total Group	**1556**	**1611**	**1632**	**1697**	**6496**	**7045**	**7622**	**+9.6%**
Seq. growth	*-2.6%*	*+3.5%*	*+1.3%*	*+4.0%*	*+12.1%*	*+8.4%*	*+8.2%*	
Y/Y growth	*+15.4%*	*+8.6%*	*+2.9%*	*+6.2%*	*+12.1%*	*+8.4%*	*+8.2%*	
Cost of goods sold	-998	-1045	-1034	-1048	-4125	-4318	-4619	
Gross margin	**35.9%**	**35.1%**	**36.6%**	**38.2%**	**36.5%**	**38.7%**	**39.4%**	
SG&A	-200	-195	-200	-204	-799	-888	-938	
R&D	-198	-195	-197	-203	-793	-866	-930	
Other operating income*	60	52	53	51	216	226	205	
Adj. EBIT	**220**	**228**	**254**	**293**	**995**	**1199**	**1341**	**+14.3%**
adj. operating margin	*14.1%*	*14.2%*	*15.6%*	*17.3%*	*15.3%*	*17.0%*	*17.6%*	
EBIT	166	174	193	257	790	969	1133	
operating margin	*10.7%*	*10.8%*	*11.8%*	*15.1%*	*12.2%*	*13.8%*	*14.9%*	
Net financial result	-12	-18	-12	-25	-67	-58	-56	
Income tax	-2	21	3	-35	-13	-118	-151	
tax rate	*-1.3%*	*13.5%*	*1.7%*	*-15.0%*	*-1.8%*	*-13.0%*	*-14.0%*	
Net income (loss)	153	180	186	191	710	792	926	
Adj. Net income (loss)	194	207	246	265	912	992	1105	
Adj. Dil. EPS (in EUR)	**0.17**	**0.18**	**0.19**	**0.23**	**0.81**	**0.88**	**0.98**	**+17.4%**

*Source: Bryan Garnier & Co. ests. * Reintegration of IRF acquisition related D&A and other income & expenses*

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