25th October 2016

TMT

ams

Price CHF30.20

Strong Q3, warning on Q4 and an acquisition likely not to be accretive before 2018e

Fair Value (Under Review) CHF29 (-4%) **NEUTRAL**

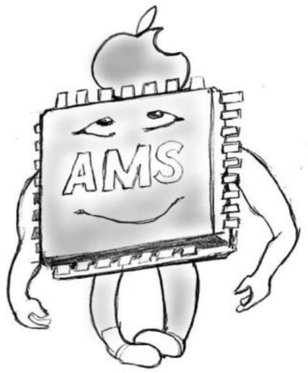
Bloomberg	AMS SW
Reuters	AMS.S
12-month High / Low (CHF)	39.3 / 23.0
Market Cap (CHFm)	2,217
Ev (BG Estimates) (CHFm)	2,401
Avg. 6m daily volume (000)	466.2
3y EPS CAGR	9.4%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-10.9%	8.4%	-1.3%	-10.0%
Semiconductors	0.3%	6.2%	30.8%	24.2%
DJ Stoxx 600	-0.3%	1.2%	-1.2%	-5.9%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	623.1	582.5	688.2	826.7
% change		*-6.5%*	*18.1%*	*20.1%*
EBITDA	195	146	213	276
EBIT	147.3	86.9	154.8	219.1
% change		*-41.0%*	*78.2%*	*41.5%*
Net income	148.7	83.6	142.3	200.1
% change		*-43.8%*	*70.2%*	*40.6%*

	2015	2016e	2017e	2018e
Operating margin	23.6	14.9	22.5	26.5
Net margin	23.9	14.4	20.7	24.2
ROE	21.8	12.2	17.1	19.4
ROCE	17.0	9.4	16.1	21.5
Gearing	19.3	26.8	1.8	-13.3

(EUR)	2015	2016e	2017e	2018e
EPS	2.08	1.14	1.94	2.73
% change	-	*-45.2%*	*70.2%*	*40.6%*
P/E	14.5x	26.5x	15.6x	11.1x
FCF yield (%)	3.3%	NM	7.0%	8.3%
Dividends (EUR)	0.31	0.47	0.26	0.44
Div yield (%)	1.0%	1.6%	0.9%	1.5%
EV/Sales	3.8x	4.1x	3.2x	2.5x
EV/EBITDA	12.0x	16.4x	10.5x	7.5x
EV/EBIT	15.9x	27.6x	14.4x	9.5x



Yesterday, ams reported Q3 revenue of EUR146.7m, with an adj. operating result of EUR28m (adj. op. margin of 19.1%), yielding EPS of EUR0.37, i.e. well above Street's expectations (at EUR0.29). However, the group sees a muted year-end, as such Q4 2016 adj. EBIT revenue and guidance came out well below consensus. But the most important part of the press release is the announcement of the acquisition of Heptagon in a deal worth USD570m (+ possible earn-out consideration of USD285m) that we believe will not be accretive before 2018e. A conference call is to be held today at 9:00am (CET). In the meantime, we set our FV Under Review vs. CHF29.

ANALYSIS

- **ams reported Q3 EPS well above the Street's expectations.** For Q3, ams reported revenues of EUR146.7m, up 10.8% seq. (-4.1% yoy) compared with group's guidance for a revenue of about EUR149.5m (at mid-range, i.e. flat seq.), and consensus expectations for revenue of EUR149.7m or up 13.1% sequentially. Gross margin came in at 55.0%, about 100bps below company's guidance (56.0%) and broadly in line with the street's forecast of GM at 54.6% (BG ests. 55.5%). As a result, EBIT was well above expectations at EUR28m (cons. USD22m/BG ests. EUR27m) (IFRS EBIT of EUR49.7m or a 34% op. margin) and EPS came in at EUR0.37, i.e. well above the consensus (cons. EUR0.29/BG ests. EUR0.32). Finally, backlog on Q3 was EUR132.2m down from EUR146.6m at the end of Q2 2016.

- **A strong Q3 thanks to higher volume demand.** The ams' consumer and communications business played a significant role in the good performance of Q3 with high volume thanks to new smartphone launches and a more attractive market environment driving strong momentum for products such as ambient light sensors. On the other hand, ams' industrial, medical and automotive performed in line with expectations.

- **Company sees a muted year-end, as such Q4 2016 revenue and operating result guidance came out well below expectations.** For Q4, the group sees a muted environment due to a negative impact at a specific customer (i.e. Samsung Galaxy Note7), but especially a production yield issue in an industrial product line which is not expected to be resolved before early 2017. As such, ams expects Q4 2016 sales to decrease sequentially by 11.0% to about EUR130m (at the mid-range of EUR127m to EUR134m), well below (c. 17%) the consensus forecasts for revenue of EUR157.2m (BG ests. EUR160.8m). Margins should also be impacted by the production yield issue. As such, the adjusted operating margin for Q4 2016 is forecast to be around 12% at mid-range (+/-100bp), yielding Adj. EBIT of EUR16m, well below (about 45%) consensus forecasting Adj. EBIT of EUR28m.

- **ams also announces the acquisition of Heptagon for about EUR520m (USD570m) upfront and earn-out consideration of EUR260m (USD285m) maximum.** Heptagon is focusing on optical packaging of components designed for consumer applications. ams sees an opportunity to expand its know-how in optical design and manufacturing while accelerating ams' mid-term growth in optical sensing. We understand that Heptagon won an important design-in lately in the smartphone space (possibly Apple or Samsung). As such, based on the current pipeline and customers engagements, ams forecasts Heptagon revenue to increase significantly (2015/19e CAGR > 30%). The current revenue run rate of Heptagon is about EUR80m (USD90m), but is said to be below the break-even at EBIT level. We understand that ams targets revenue of about EUR180m as of 2019e with EBIT margin of about 30% or 2019e EBIT slightly below EUR54m. The acquisition is said to be financed through 1/ a cash consideration of USD64m (c. EUR59m; note that the group had a net debt position of EUR280m at the end of Q2 2016), 2/ a capital increase of 15% of outstanding shares, and 3/ shares from currently held treasury shares for a deal worth USD570m or EUR520m pointing to deal value to TTM (trailing twelve months) sales ratio of 6.3x. In addition to this upfront transaction, ams might pay an earn-out of maximum EUR260m or USD285m depending on Heptagon performance over FY17. The transaction is expected to close within the next three months.

- **An acquisition likely not accretive before 2018e.** Given the details shared by the group, we estimate that the acquisition has high chance to be accretive from 2018e only. Currently, Heptagon is below break-even at operating result level. Including the impact of the acquisition (mainly the capital increase), we estimate at first take that Heptagon business would require an operating margin of 12% in 2017e to be accretive (implying a 30% revenue growth in 2017e based on current 12m run rate). Given the cautious wording of ams regarding the ramp up of Heptagon revenue, we estimate that 2018e will be the year when this acquisition will finally be accretive (requires an operating margin of 13% minimum to be accretive, based on similar assumptions).

VALUATION

- Before the conference call to be held today at 9:00am, we set our FV Under Review (vs. EUR29).
- Based on our estimates, ams' shares are trading on 2017e P/E and PEG ratios of 15.3x and 1.6x respectively.

NEXT CATALYSTS

- 25 October 2016: Q3 results Conference call (9 am CET: +44 20 3059 5862)
- Early February 2017: FY16 and Q4 results

Reported Q3 2016 vs. estimates

[EURm]	BG ests. 3Q16e	Consensus 3Q16e	3Q16 Actual	Actual vs. Cons.
Net revenue	152.6	149.7	146.7	-2.0%
% change (seq)	*15.3%*	*13.1%*	*10.8%*	-227bp
% change (yoy)	*-0.3%*	*-2.2%*	*-4.1%*	-196bp
Adj. Gross Margin	55.5%	54.6%	55.0%	40bp
Adj. EBIT	26.9	21.7	28.0	29.0%
% of revenue	*17.6%*	*14.5%*	*19.1%*	459bp
EPS (in EUR)	0.32	0.29	0.37	27.6%

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

Guidance Q4 2016 vs. estimates

[EURm]	BG ests. 4Q16e	Consensus 4Q16e	4Q16 Guidance	Guid. vs. Cons.
Net revenue	161.7	157.2	130.5	-17.0%
% change	*5.9%*	*5.0%*	*-11.0%*	-1604bp
Gross Margin	56.5%	54.7%	54.7%	0bp
Adj. EBIT	32.4	28.4	15.7	-44.9%
% of revenue	*20.1%*	*18.1%*	*12.0%*	-607bp
EPS (in EUR)	0.39	0.36		

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

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