

## Infineon

Price EUR16.80

Investment case intact, best positioned to benefit from Auto/Industrial secular trends

Fair Value EUR18.5 vs. EUR17.5 (+10%)

BUY

|                            |             |
|----------------------------|-------------|
| Bloomberg                  | IFX GY      |
| Reuters                    | IFXGn.DE    |
| 12-month High / Low (EUR)  | 16.8 / 10.5 |
| Market Cap (EURm)          | 19,030      |
| Ev (BG Estimates) (EURm)   | 18,141      |
| Avg. 6m daily volume (000) | 4,264       |
| 3y EPS CAGR                | 12.2%       |

|                | 1 M   | 3 M   | 6 M   | 31/12/15 |
|----------------|-------|-------|-------|----------|
| Absolute perf. | 3.8%  | 9.1%  | 32.6% | 24.4%    |
| Semiconductors | 4.8%  | 8.8%  | 36.8% | 30.4%    |
| DJ Stoxx 600   | -1.0% | -0.8% | 1.2%  | -6.8%    |

| YEnd Sept. (EURm) | 09/16 | 09/17e | 09/18e | 09/19e |
|-------------------|-------|--------|--------|--------|
| Sales             | 6,473 | 6,877  | 7,520  | 8,154  |
| % change          |       | 6.2%   | 9.4%   | 8.4%   |
| EBITDA            | 1,823 | 1,945  | 2,269  | 2,489  |
| EBIT              | 982.0 | 1,120  | 1,291  | 1,429  |
| % change          |       | 14.0%  | 15.3%  | 10.7%  |
| Net income        | 854.0 | 929.8  | 1,082  | 1,208  |
| % change          |       | 8.9%   | 16.4%  | 11.6%  |

|                  | 09/16 | 09/17e | 09/18e | 09/19e |
|------------------|-------|--------|--------|--------|
| Operating margin | 15.2  | 16.3   | 17.2   | 17.5   |
| Net margin       | 13.2  | 13.5   | 14.4   | 14.8   |
| ROE              | 14.8  | 14.5   | 15.5   | 15.5   |
| ROCE             | 16.8  | 15.4   | 17.5   | 19.1   |
| Gearing          | -9.4  | -15.8  | -24.4  | -32.2  |

| (EUR)           | 09/16 | 09/17e | 09/18e | 09/19e |
|-----------------|-------|--------|--------|--------|
| EPS             | 0.76  | 0.82   | 0.96   | 1.07   |
| % change        | -     | 8.9%   | 16.4%  | 11.5%  |
| P/E             | 22.2x | 20.4x  | 17.5x  | 15.7x  |
| FCF yield (%)   | 2.5%  | 3.4%   | 4.8%   | 5.5%   |
| Dividends (EUR) | 0.20  | 0.20   | 0.22   | 0.24   |
| Div yield (%)   | 1.2%  | 1.2%   | 1.3%   | 1.4%   |
| EV/Sales        | 2.9x  | 2.6x   | 2.3x   | 2.0x   |
| EV/EBITDA       | 10.2x | 9.3x   | 7.7x   | 6.7x   |
| EV/EBIT         | 18.9x | 16.2x  | 13.5x  | 11.7x  |

Yesterday, Infineon reported FY16 results in line with expectations but also came out with surprisingly low growth guidance for FY17 (+6% vs. cons. at +8%). Nevertheless, the message shared during the conference call was reassuring and we believe this guidance is full of caution. We update our model and lift our FV to EUR18.5. We reiterate our Buy recommendation since our investment case remains intact: Infineon 1/ is one of the best players worldwide to play secular trends including the pervasion of electronic content in cars (electric vehicle + autonomous driving) and industrial automation, 2/ has potential to improve its adj. EBIT margin by 200bps over the next two years, and 3/ trades at virtually no premium vs. IDM peers with IFX 2017e P/E of 19.9x.

## ANALYSIS

- Yesterday, IFX reported FQ4 in line but came out with disappointing FY17 growth guidance of 6%** (vs. 8% expected, see our [first take](#)). However, we continue to see IFX as a long term growth story and remain confident that the current stock price is an opportunity.
- During the conference call, the message was reassuring and confirmed a solid outperformance story (vs. peers) over the LT.** Note that the group forecasts 6% growth for FY16 but is maintaining its 8% through-cycle growth target (i.e. normative). While the semiconductor industry is decreasing in 2016, Infineon has posted 12% growth over FY16 (7% organically). And the 6% growth anticipated for FY17 should be compared with low single digit growth expected for the overall market in 2017. Again, this is mainly due to a strong footprint in the Automotive (electromobility and autonomous driving) and Industrial sectors (smart factories, industrial automation, renewables).
- EV and ADAS should become more visible through FY17:** The car market is said to be strong in America, Western Europe and China but the anticipated strong growth in Automotive (c. 40% of group sales) will stem from strong demand and a strong leadership in power components for EV but also a strong technology lead in radar/lidar sensors for ADAS (autonomous driving systems). Regarding sensors, the group expects shipments for 24Ghz radars (used for blind spot detection) to more than double over FY17 while 77Ghz radars are also expected to show a very strong traction. In addition to that, the group also recently strengthened its position with the introduction of Lidar (from Innoluce) making IFX a strong leader on behalf of STMicroelectronics (Neutral, FV EUR7.3) and NXP. In Electric cars, IFX continues to benefit from its leading position in power and we expect FY17 to benefit from the numerous recent design wins of FY16 : over EUR750m worth of IGBT design wins in FY16 including a three-digit million business (IGBT) for mass deployment of (H)EV at a leading Tier 1 and EUR500m for low voltage MOSFET. In addition, the group also secured a position for its AURIX MCU family with a leading Japanese Tier 1 for engine management system.
- Industrial business keeps going, no bumps ahead.** In the Industrial sector (IPC: 17% of total sales) the group continues to see strong traction in renewables, especially IGBT modules for solar investors. We understand that demand for home appliances also helps momentarily although segment remains volatile in relative terms. Chinese overstocking, impacting previous quarters, is said to be cleared. As such, we expect to see this division progress in line with the group average growth over FY17.
- PMM is a mixed view.** Note that the Power Management & Multimarket division (c. 32% of sales) is a mix of many products designed for very different applications and markets. However, it is fair to assume that 35-45% stems from the mobile phone market. Here, the group sees solid traction in some specific devices such as barometric sensors and RF components thanks to the new smartphone ramp up, but this is offset by the decline in other product lines, which does not prevent IFX from broadening its customer portfolio with Chinese OEMs. We also believe IFX is losing ground in chargers due to high competition (collateral of DLG new rapid charging ASIC's success?). In addition, in other product lines including RF power amplifier for cellular base station which was particularly disappointing in FQ3 2016, visibility remains low. Hopefully, this is balanced by good momentum in Power MOSFET for xEV charging, low to medium voltage MOSFETs and DC/DC converters for server platforms. As such, we expect the division to grow at a slower pace than the overall group.
- IoT Security to help Chip Card & Security business** (c. 11% of sales). Despite returning to growth,



chip card traction and growth patterns should be lower in FY17 than previously observed, impacting negatively the business of this division. Nevertheless, traction for embedded security controllers for IoT is strong and we have heard that the group has secured a strategic project win at a leading device manufacturer for smart home devices. As such, and as for PMM, we expect the division to grow at a slower pace than the overall group.

- **Margin improvement as 300mm fab ramps-up and the group continues to improve operating efficiency.** During FY17, the group should continue to improve its operating margin thanks to 1/ the continuous ramp up of the 300mm fab which is expected to break even by end-2017, 2/ further benefits from integration of IR and the acquisition of Wolfspeed, 3/ higher volumes triggering higher margins. As such, the target of 16% for FY17 appears to be easily achievable to us (given the current supportive environment) and we believe the group has the chance of beating this target, closing the gap with the new 17% through-cycle target. Note that the 300mm fab weight alone is equal to about 100bps on current operating margin.

## VALUATION

- **We update our model.** We have updated our model and the EUR/USD exchange rate. Indeed last time we updated our model (28/09/2016), the spot rate was at 1.11 whereas it is now at 1.06. Finally, we have also applied a roll-over of our valuation (DCF and SOTP). Our new FV is EUR18.5 vs. EUR17.5.
- **We reiterate our Buy recommendation.** Overall, we see the group's low guidance as additional room for IFX to positively surprise over FY17, especially since the details given during the conference call confirm our view regarding the strong leadership of IFX in the Auto and Industrial sectors (which remain two of the most dynamic end-markets) and should be increasingly visible catalysts. We continue to see Infineon as a very attractive story while valuation metrics remain at decent levels. Based on our estimates, IFX trades on 2017e P/E of 19.9x and PEG of 1.6, i.e. a very limited premium compared to IDM peers trading at 2017e P/E 18.7x on average.

## NEXT CATALYSTS

- 2nd February 2017, FQ1 2017 results (preliminary date).
- 16th February 2017, Annual General Meeting.

## Detailed P&L

| [EURm]                        | 1Q17e        | 2Q17e        | 3Q17e        | 4Q17e        | FY17e        | FY18e        | FY19e        | CAGR          |
|-------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|
| <b>Total Group</b>            | <b>1616</b>  | <b>1690</b>  | <b>1782</b>  | <b>1787</b>  | <b>6877</b>  | <b>7520</b>  | <b>8154</b>  | <b>+8.0%</b>  |
| Seq. growth                   | -3.5%        | +4.6%        | +5.4%        | +0.3%        | +6.2%        | +9.4%        | +8.4%        |               |
| Y/Y growth                    | +3.9%        | +4.9%        | +9.2%        | +6.7%        | +6.2%        | +9.4%        | +8.4%        |               |
| Cost of goods sold            | -1031        | -1068        | -1091        | -1097        | -4287        | -4557        | -4942        |               |
| <b>Gross margin</b>           | <b>36.2%</b> | <b>36.8%</b> | <b>38.8%</b> | <b>38.6%</b> | <b>37.7%</b> | <b>39.4%</b> | <b>39.4%</b> |               |
| SG&A                          | -204         | -201         | -228         | -225         | -858         | -902         | -938         |               |
| R&D                           | -186         | -186         | -178         | -179         | -729         | -865         | -938         |               |
| Other operating income*       | 36           | 29           | 16           | 37           | 117          | 96           | 92           |               |
| <b>Adj. EBIT</b>              | <b>232</b>   | <b>264</b>   | <b>301</b>   | <b>323</b>   | <b>1120</b>  | <b>1291</b>  | <b>1429</b>  | <b>+13.3%</b> |
| adj. operating margin         | 14.3%        | 15.6%        | 16.9%        | 18.1%        | 16.3%        | 17.2%        | 17.5%        |               |
| EBIT                          | 192          | 232          | 282          | 282          | 990          | 1182         | 1322         |               |
| operating margin              | 11.9%        | 13.7%        | 15.8%        | 15.8%        | 14.4%        | 15.7%        | 16.2%        |               |
| Net financial result          | -14          | -12          | -10          | -16          | -51          | -48          | -41          |               |
| Income tax                    | -23          | -29          | -35          | -35          | -122         | -147         | -167         |               |
| tax rate                      | -13.0%       | -13.0%       | -13.0%       | -13.0%       | -13.0%       | -13.0%       | -13.0%       |               |
| Net income (loss)             | 155          | 191          | 237          | 232          | 815          | 987          | 1115         |               |
| Adj. Net income (loss)        | 190          | 219          | 254          | 268          | 930          | 1082         | 1208         |               |
| <b>Adj. Dil. EPS (in EUR)</b> | <b>0.17</b>  | <b>0.19</b>  | <b>0.22</b>  | <b>0.24</b>  | <b>0.82</b>  | <b>0.96</b>  | <b>1.07</b>  | <b>+12.2%</b> |

Source: Bryan Garnier & Co. ests.

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|         |   |
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