

15th May 2019

## STMICROELECTRONICS

Technology  
Semiconductors

## BUY

Fair Value EUR19.5 vs. EUR19 (+29%)  
Share price EUR15.09  
EPS 3Y Cagr 7.8%

## Compelling business development and good margin improvement in the near-term

## Automotive offers the most compelling opportunities for the ST

ST's SAM in automotive provides the highest potential growth (8% CAGR18-21) for the company, including digitalisation (ADAS) and car electrification that are set to grow by 16% and 20% CAGR18-23 to USD7.7bn and USD6.5bn, respectively. We learnt that ADG grew at double the pace of the automotive TAM in 2018 and ST experienced the highest growth among the top 10 semiconductor automotive vendors. It was interesting to see that ST's success in car electrification was not only a factor of its leadership in SiC but also since it benefits from significant traction in traditional silicon power semiconductors that grew by more than 2.5 times in 2018. Customers that are more price sensitive will not adopt SiC in the near future and ST continues to innovate in IGBT with a new trench technology entering production in 2019 for more than 19 OEMs. The company targets more than 30% growth over the next five years for the product category whereas Infineon has been an undisputed leader so far.

## Leveraging STM32 leadership to power edge computing

Industrial application is the second key area of focus for ST with a SAM expected to grow by 6% on average over the next three years to USD50.4bn. Similar to automotive, robotisation and IoT in industrial will increase the power requirements and the need for more efficient semiconductor solutions. While most of ST's SiC revenue currently stems from automotive applications, ST believes SiC has greater potential in industrial applications and ST is already witnessing a strong push from Chinese customers to convert some key power semiconductors to SiC. There is also increasing demand for manufacturing & process automation applications for which ST's SAM is expected to increase by 7.2% CAGR to USD12bn in 2021. ST has developed two interesting solutions to address industrial OEM needs for higher accuracy, more automation and predictive maintenance: 1/ its first MPU product launched in Q1 2019 on a 16nm process manufacturing will give more performance and development flexibility than its STM32 MCU, and an AI software tool called STM32 CubeAI that helps developers to run inference models from a broad range of trained neural networks directly on a traditional STM32.

## ST to enter volume production for eSIM + NFC in H2 2019

The company reiterated its commitment to developing direct and indirect, SPAD & fast photo diode with an increasing resolution to address 3D sensing for smartphones both for front facing and rear facing, however this should not come before end-2020 or first half 2021. In our view, the most interesting information on smartphones for the near term concerned ST's integrated eSIM solution (secure element + NFC controller). So far, ST's eSIM has been integrated in the latest iPhone Xs and Apple Watch without the NFC controller, still provided by NXP. We understand the company will enter volume production in H2 2019 for an eSIM that will include the NFC controller, with no indication on the related customer.

## Market Data

Bloomberg / Reuters	STM FP/STM.FR
Market Cap.	EUR13,750m
E.V.	EUR14,575m
Free Float	70.3
Avg. Daily volume (6m)	3,723
12m high / low	22.6 / 10.7
Ytd Perf.	20.9%

USDm	12/18	12/19e	12/20e	12/21e
Sales	9,664	9,677	10,423	11,090
% Change		0.1%	7.7%	6.4%
EBITDA	2,212	2,051	2,405	2,766
% Change		-7.3%	17.3%	15.0%
EBIT	1,400	1,209	1,540	1,879
% Change		-13.7%	27.4%	22.0%
Net Income	1,322	1,015	1,294	1,580
% Change		-23.3%	27.6%	22.1%
ROE	0.20	0.14	0.16	0.17

	12/18	12/19e	12/20e	12/21e
EV/Sales	1.4x	1.3x	1.1x	1.0x
EV/EBITDA	5.9x	6.0x	5.0x	4.1x
EV/EBIT	9.3x	10.2x	7.8x	6.0x
EPS	1.45	1.13	1.47	1.82
% change		-22.0%	29.9%	23.8%
P/E	10.4x	13.3x	10.3x	8.3x
Div Yield	1.6%	1.5%	1.9%	2.4%

Next Catalyst: End of July: Q2 2019 results

Last rating Change:

[2018-4-11, Full steam ahead](#)

Last FV Change:

[2019-4-25, Solid design wins are expected to fuel growth in H2 and beyond](#)

Last Reports:

[2019-4-25, Solid design wins are expected to fuel growth in H2 and beyond](#)

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### ST expanding its outsourcing to mitigate capex and improve flexibility

ST is set to invest between USD1.1bn and USD1.5bn over the near/mid-term to underpin revenue growth. As part of its mid-term plan, ST will increase its outsourcing from 20% to 30% not only as a consequence of the increased share of advanced nodes currently manufactured at foundries but also as ST will gradually move some technologies such as eNVM 40nm and IGBT to outsourcing in order to mitigate capex spending. Concerning its new 300mm fab for power semiconductors in Agrate, ST plans to enter volume manufacturing in 2021. ST also plans to keep increasing its SiC capacity by establishing a new production line in Asia and the company aim to move to 200mm SiC wafer after 2021. GaN is also an important pillar of the company's investment programs with RF GaN-on-Si that should start production by the end of 2019 to serve the first 5G base stations, while GaN for power conversion applications should enter production later in 2021.

### More details about 2019 operating profitability

ST reaffirmed the positive signs of recovery it has seen in Q2 at POS in China, rest of Asia, and America, resulting in a positive trend in bookings compared with Q1 and making the company confident about its H2 guidance. ST previously said that 25% of the growth expected in H2 versus H1 (i.e. around USD315m) should come from an expected improvement in the market conditions. **In view of the better trend observed so far, ST believes only USD70-90m are at risk on that portion.** In addition, ST provided additional information about its Q2 and 2019 guidance. **H1 2019 operating margin should land at around 10% for H1 2019 (i.e. around 9.9% considering 10.2% EBIT margin in Q1 and Q2 guidance at mid-range) and slightly above 14% at mid-point of the guidance for Q2 and H2 2019, respectively.** This results in full year operating profit that should come out at USD1.185bn or 12.3% operating margin, 4.4% below our estimates at 1.239bn or 12.8% margin. **We have decreased our 2019 EPS by 2.6% to USD1.13 vs. USD1.16.**

### A new mid-term financial model, accretive for margins but offset by higher capex

The company also shared a mid-term financial model that should materialize by the second half of 2021 or 2022 if ST's SAM grows at an expected average rate of 4-5% going forward. Based on this plan, ST revenue should reach USD12bn, gross margin should remain between 40 and 41%, while operating margin is expected to range between 17 and 19%. **The revenue target is a year ahead of our previous expectations** as we expected revenue to reach that level by 2023. On top of that, **the mid-point of the operating margin is also above our expectations as our 2022 estimates were around 16% and our long-term operating margin in our DCF did not exceed 17%.** ST believes it would be difficult to achieve higher gross margin than the range indicated and most of the profitability improvements should come from operating leverage. **We would also like to point out the fact that, in our view, gross margins should be restricted after 2021 when the new 300mm fab in Agrate starts to ramp-up.** In terms of capex outlook, ST expects USD1.1-1.5bn over the near/mid-term. **The company did not clearly expose the ins and outs of the range but taking the mid-range of this capex estimate results in cumulative capex c. 10% above our estimates between 2020 and 2022.**

### We raise our Fair Value to EUR19.5

After factoring in the new financial information shared by the company, we have lifted our 3-year EPS sequence by an average of 3.2%. We nonetheless note that **guidance for operating margin seems aggressive** and we have preferred to adopt a conservative approach with revenue reaching USD11.8bn by 2022 and operating margin at the low-end of the guidance around 17.2% by that time. **While the capex model negatively affected our DCF and offset the positive effect on margins by 2021, our DCF has moved up a little as we increase our long-term operating margin target from 17% to 19%.** As a result, we increase our FV from EUR19 to EUR19.5. ST still provides a compelling investment case around automotive, industrial and smartphone applications, and the current stock price fails to reflect this in our view. We maintain our Buy recommendation.

**Bryan Garnier new estimates**

[in USDm]	1Q19	2Q19e	3Q19e	4Q19e	2019e	2020e	2021e	CAGR 18/21e
<b>Sales</b>	<b>2076</b>	<b>2132</b>	<b>2541</b>	<b>2928</b>	<b>9677</b>	<b>10423</b>	<b>11090</b>	<b>4.7%</b>
Seq. growth	-21.6%	2.7%	19.2%	15.3%	0.1%	7.7%	6.4%	
<b>Gross profit</b>	<b>818</b>	<b>824</b>	<b>967</b>	<b>1110</b>	<b>3719</b>	<b>4107</b>	<b>4469</b>	
Gross margin	39.4%	38.6%	38.1%	37.9%	38.4%	39.4%	40.3%	
SG&A	-272	-285	-280	-283	-1120	-1136	-1142	
R&D	-368	-365	-365	-372	-1470	-1491	-1508	
Other exceptional gains	33	15	15	17	80	60	60	
<b>Adjusted EBIT</b>	<b>211</b>	<b>189</b>	<b>337</b>	<b>472</b>	<b>1209</b>	<b>1540</b>	<b>1879</b>	
EBIT margin	10.2%	8.9%	13.3%	16.1%	12.5%	14.8%	16.9%	
D&A	206	210	210	216	842	865	887	
Adjusted EBITDA	417	399	547	688	2051	2405	2766	
Net interest expenses	2	-5	-5	-2	-10	-10	-11	
Gain from investments	0	0	0	0	0	0	0	
Gain from investments	1	0	0	-1	0	0	0	
<b>Adj. pre-tax profit</b>	<b>214</b>	<b>184</b>	<b>332</b>	<b>469</b>	<b>1199</b>	<b>1530</b>	<b>1868</b>	
Adjusted tax	-32	-28	-51	-73	-185	-236	-288	
Tax rate	-15.0%	-15.4%	-15.4%	-15.6%	-15.4%	-15.4%	-15.4%	
Non-control. interest	1	-2	-2	-2	-5	-8	-8	
<b>Adj. net profit</b>	<b>183</b>	<b>154</b>	<b>279</b>	<b>394</b>	<b>1015</b>	<b>1294</b>	<b>1580</b>	
% of revenue	8.8%	7.2%	11.0%	13.5%	10.5%	12.4%	14.2%	
<b>Adj. EPS (in USD)</b>	<b>0.20</b>	<b>0.17</b>	<b>0.31</b>	<b>0.46</b>	<b>1.13</b>	<b>1.47</b>	<b>1.82</b>	<b>7.8%</b>
Seq. growth	-56.9%	-15.7%	+82.2%	+48.5%	-22%	30%	24%	

Source: Company data; Bryan, Garnier & Co ests.

## STMICROELECTRONICS

### BUY

<b>Fair Value</b>	EUR19.5 vs. EUR19 (+29%)
<b>Share price</b>	EUR15.09
<b>Market Cap.</b>	EUR13,750m
<b>EPS 3Y CAGR</b>	7.8%

<b>Simplified Profit &amp; Loss Account (USDm)</b>	2017	2018	2019e	2020e	2021e
Revenues	8,347	9,664	9,677	10,423	11,090
<i>Change (%)</i>	19.7%	15.8%	0.1%	7.7%	6.4%
<i>Change LFL (%)</i>					
EBITDA	1,692	2,212	2,051	2,405	2,766
Depreciation & amortisation	650	791	842	865	887
Adjusted EBIT	1,042	1,421	1,209	1,540	1,879
EBIT	997	1,400	1,209	1,540	1,879
<i>Change (%)</i>	365.9%	40.4%	-13.7%	27.4%	22.0%
Financial results	-37	-8	-10	-10	-11
Pre-Tax profits	1,003	1,421	1,199	1,530	1,868
Tax	-148	-99	-185	-236	-288
Profits from associates	-2	8	0	0	0
Minority interests	-7	-6	-5	-8	-8
Net profit	807	1,287	1,010	1,286	1,572
Restated net profit	847	1,322	1,015	1,294	1,580
<i>Change (%)</i>	233.5%	56.1%	-23.3%	27.6%	22.1%
<b>Cash Flow Statement (USDm)</b>					
Operating cash flows	1,799	2,098	2,027	2,159	2,467
Change in working capital	-94	-254	-1	-76	-68
Capex. net	-1,307	-1,312	-1,152	-1,199	-1,275
Financial investments. net	0	101	0	0	0
Dividends	-230	-216	-202	-257	-314
Issuance of shares	0	0	0	0	0
Issuance (repayment) of debt	0	0	0	0	0
Other	0	94	301	0	0
Net debt	-489	-686	-1,392	-1,769	-2,391
Free Cash flow	338	532	875	885	1,124
<b>Balance Sheet (USDm)</b>					
Tangible fixed assets	3,094	3,495	3,805	4,138	4,526
Intangibles assets & goodwill	332	333	333	333	333
Investments	532	513	513	513	513
Deferred tax assets	624	672	672	672	672
Current assets	2,909	3,258	3,091	3,310	3,506
Cash & equivalents	2,190	2,596	3,302	3,679	4,301
Total assets	9,681	10,867	11,715	12,645	13,851
Shareholders' equity	5,467	6,424	7,288	8,074	9,153
Provisions	660	605	605	605	605
Deferred tax liabilities	11	14	14	14	14
L & ST Debt	1,701	1,910	1,910	1,910	1,910
Current liabilities	1,842	1,914	1,916	2,060	2,188
Total Liabilities	9,681	10,867	11,733	12,663	13,869
Capital employed	4,978	5,738	5,896	6,305	6,762
<b>Ratios</b>					
Operating margin	12.5%	14.7%	12.5%	14.8%	16.9%
Tax rate	14.8%	7.0%	15.4%	15.4%	15.4%
Net margin	10.1%	13.7%	10.5%	12.4%	14.2%
ROE (after tax)	14.8%	20.0%	13.9%	15.9%	17.2%
ROCE (after tax)	17.7%	23.0%	17.3%	20.7%	23.5%
Gearing	-9%	-11%	-19%	-22%	-26%
Pay out ratio	27.9%	16.6%	20.0%	20.0%	20.0%
Number of shares, diluted	906.1	911.0	896.0	880.2	868.4
<b>Data per Share (USD)</b>					
EPS	0.91	1.43	1.13	1.46	1.81
Restated EPS	0.94	1.45	1.13	1.47	1.82
<i>% change</i>	227.3%	54.7%	-22.0%	29.9%	23.8%
EPS bef. GDW					
BVPS	6.03	7.05	8.13	9.17	10.54
Operating cash flows	1.99	2.30	2.26	2.45	2.84
FCF	0.37	0.58	0.98	1.00	1.29
Net dividend	0.25	0.24	0.23	0.29	0.36

Source: Company Data; Bryan, Garnier & Co ests.

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