

Semiconductor Manufacturing International Corporation (981.HK)

1Q15 results are better than guidance

Hong Kong | Telecom | Company report

In 1Q15, SMIC's net profit registered US\$55.48million, representing a significant growth of 174% yoy and 95% qoq, which was profit for the consecutive 12 quarters. The gross margin of 29.4% represented the highest over the past 10 years, higher than the expected range of 27-29%. The sustained good results can be attributed to its implementation of the short-term strategy which attached much importance to mature technology and maximized use of existing assets. Meanwhile, it has also upgraded the product portfolio. Furthermore, with depreciation drawn sufficiently with some equipment, the depreciation declined by nearly 10 ppts yoy and qoq, which also improved the profitability.

According to the guidance given by the management, the revenues for Q2 continued to grow by 2%-5% qoq standing at US\$520 million to US\$535 million and with gross margin between 27% and 29%, still better than expected. We attribute this to the optimistic demand for wafer foundry. In the mainland, the industry will grow more rapidly due to the import substitution.

SMIC's introduction of 28nm technology is going well, for it has received orders and risk production is scheduled to begin in Q2. It is likely that the new technology contributes to revenues next quarter. This helps further optimize the Company's product portfolio and improve gross margin structurally.

China Integrated Circuit Industry Investment Fund announced its participation in SMIC issuing additional stock with HK\$3.1 billion, which will be used for capital expenditure, debt repayment and overall operation expenditure. We understand that the government is beginning to lend substantial support to the semiconductor industry, which is beneficial for the Company to improve its manufacturing capability and ease the pressure on its capital expenditure. Moreover, we believe that the government will issue more supportive policies to drive IC industry. As the leading company, SMIC will definitely benefit from the move.

The sustained profit may improve investors' expectation

Thanks to its implementation of sustainable profit strategy, SMIC has experienced sustained stable results, with both capacity utilization and profitability reaching a high level, which may help improve investors' expectation. In the future, the Company will continue to benefit from import substitution and products upgrading, the positive progress in introducing more sophisticated technology and the new industry-supporting policies are likely to become catalyst. We fix the target price at HK\$ 0.99 with 1.3X 2015BVPS and maintain it "Accumulate" rating. (Closing price as at 25 May 2015)

Historical P/B valuation



Source: Bloomberg, Phillip Securities (HK) Research

27 May 2015

Accumulate (Maintain)

CMP: HKD 0.84

(Closing price as at 25 May 2015)

TARGET: HKD 0.99 (+17.9%)

COMPANY DATA

O/S SHARES (MN) :	36,011
MARKET CAP (HKDMN) :	30,250
52 - WK HI/LO (HKD):	0.98/ 0.59

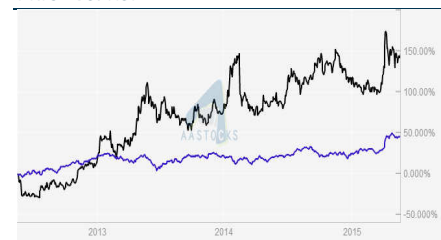
SHARE HOLDING PATTERN, %

Datang Holdings (Hongkong) Investment Limited :	19.44
Country Hill Limited :	11.12

PRICE PERFORMANCE, %

	1M	3M	1Y
SMIC	-2.33	21.74	27.27
HSI	-2.92	9.03	5.38

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

US\$ mn	FY13	FY14	FY15E	FY16E
Net Sales	2069	1970	2238	2596
Net Profit	173	153	211	257
EPS, US\$	0.005	0.004	0.005	0.006
PER, x	21.94	27.10	20.26	16.99
BVPS, US\$	0.076	0.090	0.098	0.104
P/BV, x	1.42	1.20	1.10	1.04
ROE, %	7.10	5.20	5.80	6.30
Debt/Equity (%)	74.43	74.40	73.91	73.91

Source: Company reports, Phillip Securities Est.

Research Analyst

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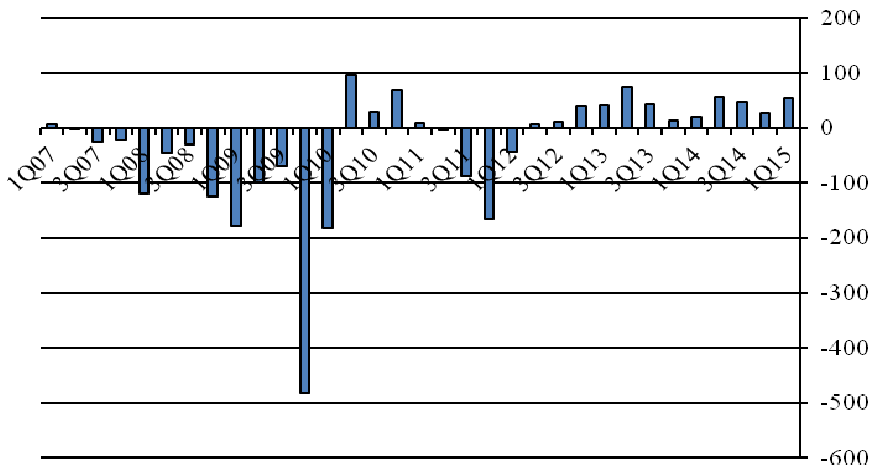
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1Q15 results are better than guidance

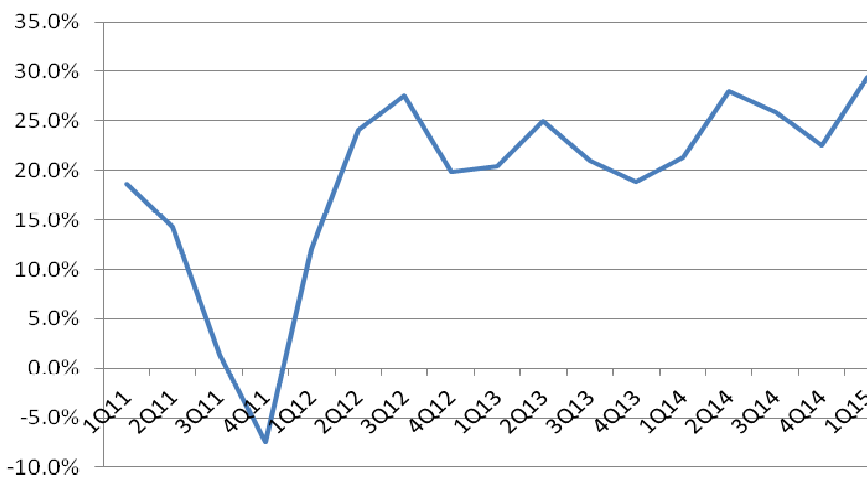
According to the latest Q1 report, SMIC recorded revenues of US\$510 million in the quarter, representing a growth of 13.02% yoy or 4.92% qoq, close to the upper limit of what is expected. Its net profit registered US\$55.48million, representing a significant growth of 174% yoy and 95% qoq, which was profit for the consecutive 12 quarters. The gross margin of 29.4% represented the highest over the past 10 years, higher than the expected range of 27-29%.

SMIC has achieved positive gains for consecutive 12 quarters (US\$: mn)



Source: Company reports, Phillip Securities (HK) Research

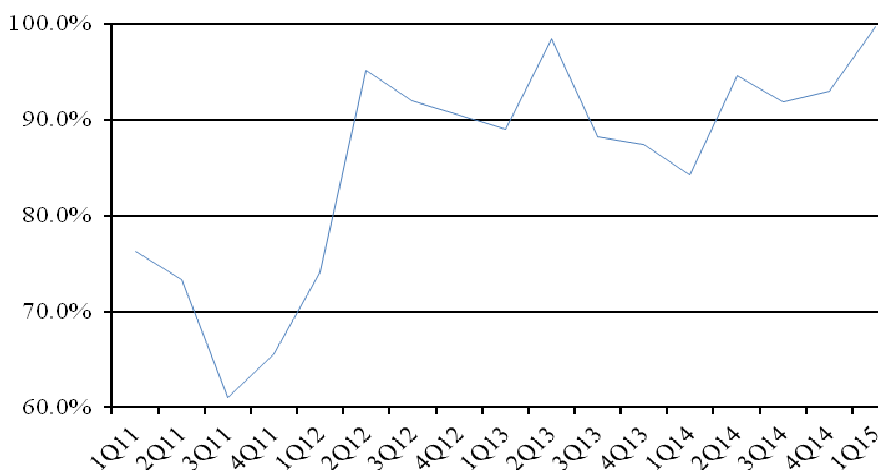
Higher earning capabilities of SMIC



Source: Company reports, Phillip Securities (HK) Research

We think that, compared to the previous unstable performance, the sustained good results can be attributed to its implementation of the short-term strategy which attached much importance to mature technology and maximized use of existing assets. Meanwhile, due to the growth of IC ecological chain in the mainland, the revenues from Chinese customers accounted for 40% of its total over the past eight quarters and even 47% of the total registered over the first quarter. All factors helped to take its capacity utilization up to historical high of 99.7%.

The utilization rate keeps high



Source: Company reports, Phillip Securities (HK) Research

In addition, SMIC implemented the upgrading of its product portfolio. Its sales of 40/45nm wafers accounted for 16%, up by 6.2 pts yoy and 5.1 pts qoq. The combined revenues generated from 40nm and 65nm wafers increased by 25% qoq and 58% yoy. Furthermore, with depreciation drawn sufficiently with some equipment, the depreciation declined by nearly 10 pts yoy and qoq, which also improved the profitability.

2Q15 results guidance continue to be better than expected

According to the guidance given by the management, the revenues for Q2 continued to grow by 2%-5% qoq standing at US\$520 million to US\$535 million and with gross margin between 27% and 29%, still better than expected. We attribute this to the optimistic demand for wafer foundry. It is forecast that the global semiconductor industry will still be in booming cycle and grow by 6% or so in 2015, while in the mainland, the industry will grow more rapidly due to the import substitution. Currently, SMIC has a lower market share compared to comparable international companies such as TSMC. But with the fast development of China-based design companies like HiSilicon Technologies and Spreadtrum Communications, which are gaining an increasing market share, Chinese wafer foundries including SMIC will benefit. It is worth mentioning that according to the management, the demand for 40/45nm wafer is promising and will help the Company maintain high-level profitability.

28nm technology advances smoothly

SMIC's introduction of 28nm technology is going well, for it has received orders and risk production is scheduled to begin in Q2. It is likely that the new technology contributes to revenues next quarter. It is worth noting that 28nm products are priced significantly higher than the current integrated product price. Therefore, its contribution to revenues is expected to rise up to 10%. This helps further optimize the Company's product portfolio and improve gross margin structurally.

Substantial support by the sector fund aims for long-term development

China is active in developing IC industry but is relatively backward in the key manufacturing section which relies on huge investment. On Feb.13, 2015, China Integrated Circuit Industry Investment Fund announced its participation in SMIC issuing additional stock with HK\$3.1 billion, which will be used for capital expenditure, debt repayment and overall operation expenditure. We understand that the government is beginning to lend substantial support to the semiconductor industry, which is beneficial for the Company to improve its manufacturing capability and ease the pressure on its capital expenditure. Considering such factors as Prism program scandal and national information security, it is believed that the government is expected to issue more supportive policies to drive IC industry. As the leading company, SMIC will definitely benefit from the move.

Catalyst

More industry-supporting policies;
Advanced technology implementation is better than expected.

Risks

Intensified industry competition;
Lower-than expected growth in mainland customers;
Accrued depreciation drags down the rising of profitability.

Financials

Periodicity:	2012	2013	2014	2015F	2016F
Valuation Ratios					
Price Earnings	108.387	21.937	27.097	20.264	16.992
Price to Book	1.52	1.42	1.20	1.10	1.04
Per share data(US\$)					
EPS Adjusted	0.001	0.005	0.004	0.005	0.006
Book Value Per Share	0.071	0.076	0.090	0.098	0.104
Growth & Margin					
Revenue growth	29.0%	21.6%	-4.8%	13.6%	16.0%
Operating profit growth	-	1040.5%	-30.5%	51.5%	18.7%
Net profit growth	-	991.1%	-11.6%	37.6%	21.9%
Key ratios					
Return on Assets	0.6%	4.0%	3.0%	3.3%	3.6%
Return on Equity	1.0%	7.1%	5.2%	5.8%	6.3%
Liability ratio	44.11%	42.67%	42.66%	42.50%	42.50%
Effective Tax Rate	0.0%	2.2%	8.7%	9.0%	9.0%
Income Statement(US\$: mn)					
Revenue					
	1,702	2,069	1,970	2,238	2,596
- Cost of Goods Sold	1,353	1,631	1,487	1,638	1,895
Gross Income					
	349	438	484	600	701
- Selling, General & Admin Expense	332	319	353	403	467
Operating Income					
	16	187	130	197	234
Pretax Income					
	13	179	138	204	244
- Income Tax Expense	-9	4	12	18	22
Net Income Adjusted*					
	16	173	153	211	257

Source: Company reports, Phillip Securities (HK) Research Estimates
(Financial figures as at 25 May 2015)

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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