

# SMIC (981.HK)

## Growth Prospects Remaining Optimistic in H2

### Hong Kong | TMT | Company report

28 September 2016

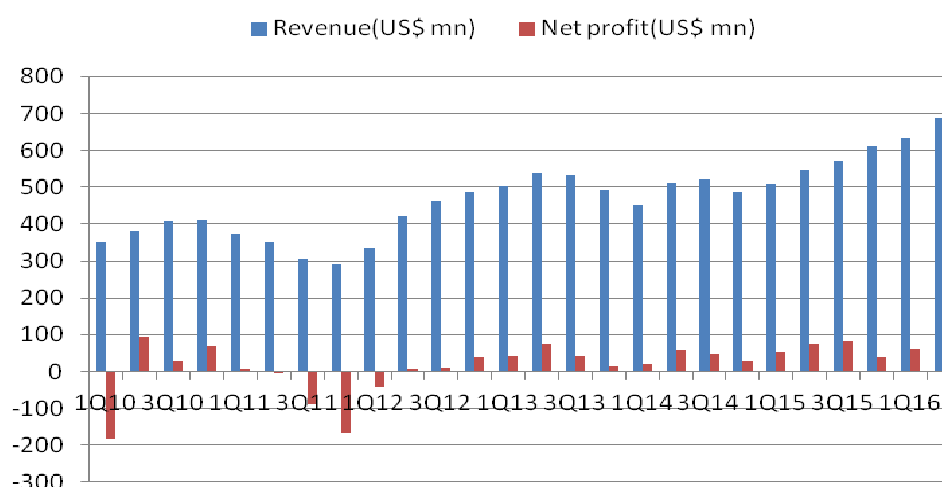
### Q2 Results Surpasses Expectation

In H1, SMIC's revenue and net profit reached USD1.33 billion and USD160 million, respectively, representing y-o-y increase of 25.4% and 20.3%, respectively. In Q2, its revenue was USD690 million, increased by 26.3% y-o-y and by 8.8% q-o-q. Its net profit amounted to USD97.64 million, up by 27.3% y-o-y and by 59% q-o-q. Revenue and net profit both went up to a new peak and surpassed the market expectation.

### Accumulate (Downgrade)

CMP: HKD 0.86  
(Closing price as at 26 Sep 2016)  
TARGET: HKD 1.00 (+16.3%)

### Quarterly performance of SMIC (US\$: mn)



Source: Company reports, Phillip Securities (HK) Research

Domestic market growth is the main reason why the company could surpass its expectation. In Q2, the revenue from China increased by 28.7% y-o-y and by 20.1% q-o-q. Meanwhile, the company has its profitability rising. In Q2, gross profit margin was 31.6%, up by 7.3% q-o-q and by 2.2% y-o-y. This was due to the improved overall operational efficiency and the increase of the proportion of 40/45nm product. Besides, the outage of Beijing plant dragged down the gross profit margin in Q1.

### COMPANY DATA

O/S SHARES (MN) :	42,238
MARKET CAP (HKDMN) :	36,749
52 - WK HI/LO (HKD):	0.91/ 0.58

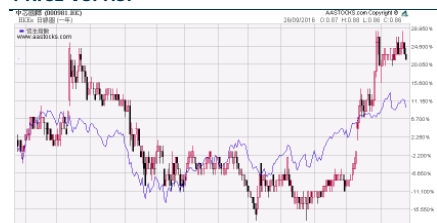
### SHARE HOLDING PATTERN, %

Datang Holdings (Hongkong) Investment Limited :	18.30
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### PRICE PERFORMANCE, %

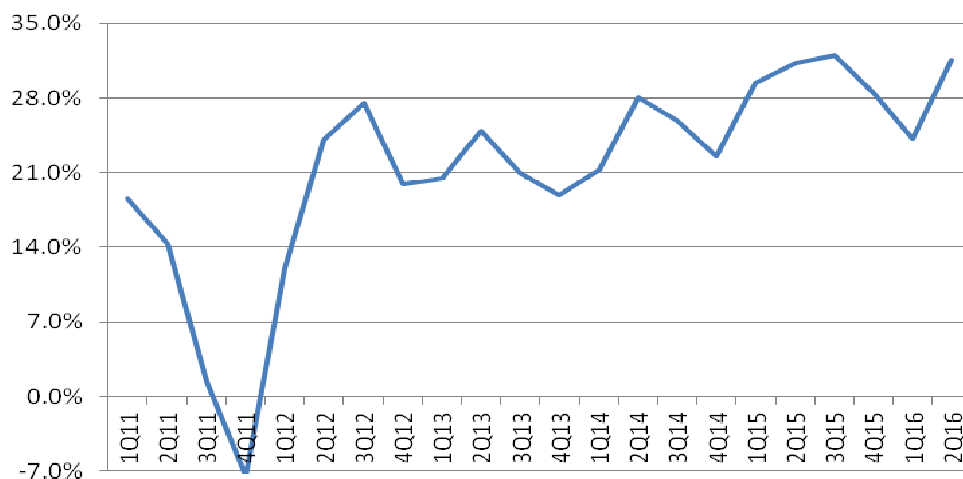
	1M	3M	1Y
SMIC	11.54	42.62	22.54
HSI	7.74	25.71	10.26

### PRICE VS. HSI



Source: Phillip Securities (HK) Research

### Gross margin keeps high



Source: Company reports, Phillip Securities (HK) Research

### KEY FINANCIALS

US\$ mn	FY14	FY15	FY16E	FY17E
Net Sales	1970	2236	2817	3473
Net Profit	153	253	326	379
EPS, US\$	0.004	0.006	0.008	0.009
PER, x	27.71	17.85	13.85	12.31
BVPS, US\$	0.09	0.10	0.11	0.12
P/BV, x	1.23	1.11	1.01	0.92
ROE, %	5.20	6.70	7.50	8.10
Debt/Equity (%)	74.40	69.81	72.41	72.41

Source: Company reports, Phillip Securities Est.

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## Growth Prospects Remaining Optimistic in H2

It is expected that in Q3, the company will continue to see an increase of revenue by 8%-11%, and gross profit margin at 28%-30%. Revenue in Q4 will also continue to grow against the head wind. We believe that the growth of Chinese market and the enhancement of competitive edge in semiconductor are the main force which drives the development of the company. Currently, Chinese system companies have gained much market share in the end market. Chip design companies surge rapidly. SMIC leads domestic integrated circuit production and is bound to be favored by the trend of growth in the integrated circuit industry in China.

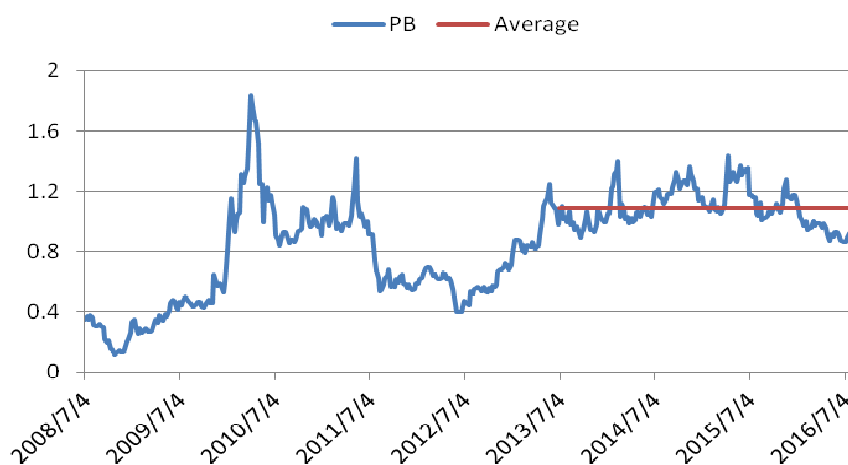
## Acquisition of LFoundry to Complement Each Other

SMIC acquired 70% of the shares of LFoundry at EUR49 million. Both will complement each other's advantages in terms of technology, product, talent, and market. The transaction has been completely closed in the end of July. It is the first transnational production base made by an integrated circuit wafer manufacturer in China. LFoundry is a wafer OEM in Italy. The capacity of 8-inch equivalent wafers surpassed 40,000 pieces. After merger, SMIC's capacity is expected to be increased by 13%. Meanwhile, LFoundry is committed to automotive and industrial application. Compared with the market positioning of SMIC in telecommunication and consumption market, its market application will be expanded.

## Valuation

The company has been making money for 17 consecutive quarters. The migration of the electronics to the mainland, the capacity expansion, and the merger with LFoundry will support the company's continuing growth. Also, the advanced processing and integrated layout will sharpen the company's competitive edge. Therefore, we give a valuation of 1.2x BVPS in 2016 and the target price of HK\$1, with the "Accumulate" rating. (Closing price as at 26 Sep 2016)

### Historical P/B valuation



Source: Bloomberg, Phillip Securities (HK) Research

## Risks

- 28nm mass production schedule falls short of expectation;
- Growth of domestic customers falls short of expectation;
- International integration falls short of expectation.

## Financials

Periodicity:	2013	2014	2015	2016F	2017F
<b>Valuation Ratios</b>					
Price Earnings	22.43	27.71	17.85	13.85	12.31
Price to Book	1.45	1.23	1.11	1.01	0.92
<b>Per share data(US\$)</b>					
EPS Adjusted	0.005	0.004	0.006	0.008	0.009
Book Value Per Share	0.076	0.090	0.100	0.110	0.120
<b>Growth &amp;Margin</b>					
Revenue growth	21.6%	-4.8%	13.5%	26.0%	23.3%
Operating profit growth	1040.5%	-30.5%	70.8%	30.0%	16.5%
Net profit growth	991.1%	-11.6%	65.4%	28.7%	16.5%
Gross Margin	21.2%	24.6%	30.5%	28.0%	27.5%
Operating Margin	9.0%	6.6%	9.9%	10.2%	9.7%
Net Profit Margin	8.4%	7.8%	11.3%	11.6%	10.9%
<b>Key ratios</b>					
Return on Assets	4.0%	3.0%	3.9%	4.4%	4.7%
Return on Equity	7.1%	5.2%	6.7%	7.5%	8.1%
Liability ratio	42.67%	42.66%	41.11%	42.00%	42.00%
Effective Tax Rate	2.2%	8.7%	3.9%	3.9%	4.2%
<b>Income Statement(US\$: mn)</b>					
<b>Revenue</b>	2,069	1,970	2,236	2,817	3,473
- Cost of Goods Sold	1,631	1,487	1,554	2,028	2,518
<b>Gross Income</b>	438	484	683	789	955
- Selling, General & Admin Expense	319	353	492	535	660
<b>Operating Income</b>	187	130	222	289	336
<b>Pretax Income</b>	179	138	231	306	359
- Income Tax Expense	4	12	9	12	15
<b>Net Income Adjusted*</b>	173	153	253	326	379

Source: Company reports, Phillip Securities (HK) Research Estimates  
(Financial figures as at 26 Sep 2016)

**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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