

China / Hong Kong Company Update

SMIC

Bloomberg: 981 HK EQUITY | 688981 CH Equity | Reuters: 981.HK | 688981.SS

Refer to important disclosures at the end of this report

DBS Group Research . Equity

13 Nov 2023

H: BUY

Last Traded Price (10 Nov 2023):HK\$21.80(HSI : 17,203)
Price Target 12-mth: HK\$23.30 (6.9% upside) (Prev HK\$22.00)

A: SELL

Last Traded Price (10 Nov 2023):RMB54.39(CSI300 Index : 3,586)
Price Target 12-mth: RMB21.39 (60.7% downside) (Prev RMB20.20)

Analyst

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What's New

- 3Q23 net profit fell 80% y-o-y due to the persistent weakness in IoT-related products and margin shrinkage, below market expectations
- Earnings forecast cut by 18%/34% in FY23F/FY24F to account for lower gross margins due to low utilisation rate
- Management continued to guide a q-o-q increase c.1-3% in 4Q revenue and gross margin of 16-18%, largely in line
- TP raised to HK\$23.3 based on 1.1x FY24F P/BV, aligned with the bottoming out of the advanced foundry sector; maintain BUY on strong FY25F earnings rebound

Growth to resume in 2024

Investment Thesis

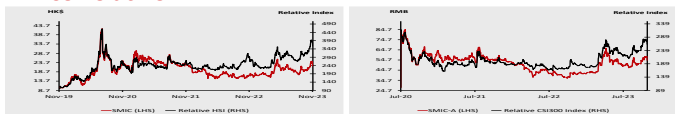
China's largest foundry rides on localisation of mature node wafers. Having the largest mature wafer foundry capacity in China, SMIC's revenue is expected to be boosted by the localisation of microcontroller units (MCUs) and auto chips, growing by 31.5% in FY24F vs. the global foundry market's 9%.

Earnings expected to decline by 39.6% in FY23F due to the company's exposure to the IoT-related products' logic foundry space amid the consumer electronics downturn. We expect earnings growth to recover by 12.6% in FY24F and 25.4% in FY25F, to US\$1.18bn and US\$1.48bn respectively, higher than the consensus estimate, driven by the resumption of demand for consumer electronics and ramp-up of new capacity.

Higher-than-expected utilisation rate is key driver for a re-rating. While the market is concerned about increasing the overall foundry capacity supply in 2024, we forecast the company's utilisation rate to be 4.5% higher vs. the consensus due to strong mature node foundry demand for MCUs and auto chips, as well as growing smartphone SoC demand in China.

Maintain BUY for H-share and raise our TP for H-share at HK\$23.3 based on a 1.1x FY24F P/BV (vs. previous TP of HK\$22.0 and valuation of 1.0x FY24F P/BV), pegged to the historical average. The re-rating will be driven by the recovery in the utilisation rate in 2024. We maintain our SELL recommendation for the A-share and set our TP at Rmb21.39 based on the same target P/BV multiple.

Price Relative



Forecasts and Valuation

FY Dec (US\$m)	2022A	2023F	2024F	2025F
Turnover	7,273	6,315	8,306	9,313
EBITDA	4,262	3,624	3,943	4,312
Pre-tax Profit	2,214	1,174	1,310	1,659
Net Profit	1,818	1,050	1,182	1,639
Net Pft (Pre Ex) (core profit)	1,818	1,050	1,182	1,639
Net Profit Gth (Pre-ex) (%)	6.8	(42.2)	12.6	38.6
EPS (US\$)	0.23	0.13	0.15	0.21
EPS (HK\$)	1.79	1.03	1.16	1.61
EPS Gth (%)	6.8	(42.2)	12.6	38.6
Diluted EPS (HK\$)	1.79	1.03	1.16	1.46
DPS (HK\$)	0.00	0.00	0.00	0.00
BV Per Share (HK\$)	18.93	20.04	21.29	22.85
PE (X)	12.2	21.1	18.7	13.5
P/Cash Flow (X)	4.1	7.5	5.9	6.6
P/Free CF (X)	nm	nm	nm	15.1
EV/EBITDA (X)	6.6	7.8	7.1	6.0
Net Div Yield (%)	0.0	0.0	0.0	0.0
P/Book Value (X)	1.2	1.1	1.0	1.0
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE(%)	10.0	5.3	5.7	7.3
Earnings Rev (%)		(18)	(34)	(37)
Consensus EPS (US\$)		0.11	0.11	0.16
Other Broker Recs:		B:15	S:5	H:10

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Key Risks

Technology ban on mature node foundry from western countries; further material cost surges; and unexpected further weakening of demand for consumer electronics.

At A Glance

Issued Capital - H shares (m shs)	5,972
- Non H shrs (m shs)	1,957
H shs as a % of Total	75
Total Mkt Cap (HK\$/US\$m)	244,261 / 31,276
Major Shareholders (%)	
China Asset Management Co., Ltd.	8.7
China Integrated Circuit Industry Investment	6.5
Fund Phase II Co Ltd	
Major H Shareholders (As % of H shares)	
Datang Telecom Technology & Industry Holdings Co., Ltd.	18.7
China Integrated Circuit Industry Investment	10.3
Fund Co., Ltd.	
H Shares-Free Float (%)	71.0
3m Avg. Daily Val. (US\$m)	114.62
GICS Industry: Information Technology / Semiconductors & Semiconductor	

SMIC**WHAT'S NEW****4Q23 revenue guidance in line; advanced foundry's has already bottomed out****3Q23 result highlights:**

3Q23 revenue decreased 15.0% y-o-y to US\$1.6bn (+3.9% q-o-q), due to persistent weakness in IoT-related products. Segment wise, the 8-inch business revenue decreased by 31.1% y-o-y to US\$384m (+7.4% q-o-q). The 12-inch business revenue decreased by 9.5% y-o-y to US\$1.09bn (+3.6% q-o-q).

The gross margin dropped to 19.8%, down 19.1ppt y-o-y. This decline was mainly due to ASP pressure and a lower utilisation rate y-o-y, which was dragged by the weakness in smart devices. The fab utilisation rate was maintained at 77.1%, vs. 78.3% in 2Q23.

Net profit decreased 80.0% y-o-y to US\$94m, missing market expectations, partly due to higher operating expenses driven by the increase in new fab start-up costs. EPS was US\$0.01.

Management continues to guide a q-o-q increase of 1-3% in 4Q23 revenue and gross margin of 16-18% (vs. 2Q23's 20.3% or 3Q22's 38.9%), largely in line with the 18% market expectations.

Our View

We expect the weak pricing on 300mm wafers and gross margin to persist longer than expected, due to the softness in smart device and home appliances-related products, coupled with a weak utilization rate.

We cut our earnings forecast by 17.8%/33.8% to US\$1.05bn/US\$1.18bn for FY23F/FY24F to account for lower gross

margins. Although recovery may take more time, we still believe the most challenging period for the advanced node foundry business has already passed, in line with the smooth destocking and advanced node chip localization in China.

We maintain our positive outlook on SMIC's earnings recovery, projecting an increase of 12.6% in FY24F, accelerating to 25.4% in FY25F. This growth will be driven by (1) the improving demand from the smartphone end-market, and (2) the increase in new product launches, such as AI and auto chips in China.

SMIC is trading at a 1.03 FY24F P/BV. We raised our H-share TP to HK\$23.3 (previous TP: HK\$22.0), based on a higher multiple of 1.1x FY24F book value (compared to the previous basis of 1.0x FY24 P/BV). This adjustment was driven by the bottoming out of the advanced node foundry sector. Our new target P/BV multiple is aligned with its historical average.

Company Background

Founded in 2000 and listed in 2004, SMIC is the largest semiconductor foundry in China, with a 5.4% global market share in 2021. It provides integrated circuit (IC) manufacturing services covering technology process nodes ranging from 0.35 μ m to 14nm. (1) 8" wafers, (2) 12" wafers, and (3) mask-making, testing, and others accounted for 33.6%, 58.5%, and 8.5% of FY21 gross revenue, respectively. Gao Yonggang is the chief financial officer (CFO) and chairman of SMIC.

SMIC

Quarter Results

Quarterly Income Statement (US\$m)

FY DEC	3QFY22	2QFY23	3QFY23	% chg_yoy	% chg_qoq
Revenue	1,907	1,560	1,621	-15.0%	3.9%
Cost of Goods Sold	(1,165)	(1,244)	(1,299)	11.5%	4.4%
Gross Profit	742	317	322	-56.7%	1.6%
Other Oper. (Exp)/Inc	(264)	(237)	(234)	-11.4%	-1.0%
Operating Profit	478	80	87	-81.7%	9.5%
Other Non Opg (Exp)/Inc	(0)	0	0	nm	nm
Associates & JV Inc	36	34	(48)	nm	nm
Net Interest (Exp)/Inc	71	144	134	89.5%	-7.4%
Exceptional Gain/(Loss)	(0)	238	(5)	5970.1%	nm
Pre-tax Profit	584	496	168	-71.3%	-66.1%
Tax	(10)	(32)	(11)	12.0%	-63.8%
Minority Interest	103.5	61.4	62.4	-39.7%	1.6%
Net Profit	471	403	94	-80.0%	-76.7%
Net profit bef Except.	471	403	94	-80.0%	-76.7%

Margins (%)

Gross Margins	38.9	20.3	19.8
Opg Profit Margins	25.1	5.1	5.4
Net Profit Margins	24.7	25.8	5.8

Source: Company, DBS HK

Historical PE and PB band

Forward PE band (x)



PB band (x)



Source: Thomson Reuters, DBS HK

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Key Assumptions

FY Dec	2021A	2022A	2023F	2024F	2025F
Wafer Shipment (K 8-inch wafer equivalents)	6,747.2	7,098.5	6,563.7	8,439.2	9,132.5
Wafer ASP (US\$)	738.4	948.9	880.2	898.4	931.1
Utilization rate (%)	99.7	92.0	75.4	82.6	85.2
Gross Margin (%)	30.8	38.0	19.7	20.0	24.0

Source: Company, DBS HK

Segmental Breakdown (US\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Revenues (US\$ m)					
Wafer revenue	4,982	6,736	5,777	7,582	8,504
Mask making, testing, others	461	538	538	724	810

Source: Company, DBS HK

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Income Statement (US\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Revenue	5,443	7,273	6,315	8,306	9,313
Cost of Goods Sold	(3,767)	(4,512)	(5,071)	(6,645)	(7,078)
Gross Profit	1,676	2,762	1,244	1,661	2,235
Other Opng (Exp)/Inc	(284)	(925)	(1,137)	(1,000)	(1,230)
Operating Profit	1,392	1,836	108	662	1,005
Other Non Opg (Exp)/Inc	83	33	765	341	330
Associates & JV Inc	253	122	187	187	187
Net Interest (Exp)/Inc	113	224	114	120	136
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	1,840	2,214	1,174	1,310	1,659
Tax	(65)	(16)	(69)	(66)	(98)
Minority Interest	(73)	(380)	(55)	(62)	78
Preference Dividend	0	0	0	0	0
Net Profit	1,702	1,818	1,050	1,182	1,639
Net Profit before Except.	1,702	1,818	1,050	1,182	1,639
EBITDA	3,597	4,262	3,624	3,943	4,312
Growth					
Revenue Gth (%)	39.3	33.6	(13.2)	31.5	12.1
EBITDA Gth (%)	84.2	18.5	(15.0)	8.8	9.4
Opg Profit Gth (%)	345.8	32.0	(94.1)	515.4	51.9
Net Profit Gth (%)	137.8	6.8	(42.2)	12.6	38.6
Margins & Ratio					
Gross Margins (%)	30.8	38.0	19.7	20.0	24.0
Opg Profit Margin (%)	25.6	25.2	1.7	8.0	10.8
Net Profit Margin (%)	31.3	25.0	16.6	14.2	17.6
ROAE (%)	10.6	10.0	5.3	5.7	7.3
ROA (%)	5.0	4.5	2.3	2.5	3.2
ROCE (%)	4.4	5.1	0.3	1.5	2.1
Div Payout Ratio (%)	0.0	0.0	0.0	0.0	0.0
Net Interest Cover (x)	NM	NM	NM	NM	NM

Source: Company, DBS HK

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Balance Sheet (US\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Net Fixed Assets	14,815	19,385	20,793	22,374	21,469
Invt in Associates & JVs	1,877	1,921	1,823	1,852	1,856
Other LT Assets	4,202	5,867	5,932	5,898	5,909
Cash & ST Invt	12,498	12,431	13,977	15,400	18,941
Inventory	1,194	1,911	1,660	2,077	2,328
Debtors	1,259	1,446	1,255	1,651	1,851
Other Current Assets	267	846	846	846	846
Total Assets	36,111	43,808	46,285	50,096	53,200
ST Debt	1,128	1,320	1,818	1,796	1,777
Creditors	2,853	5,194	5,102	6,317	6,425
Other Current Liab	473	511	528	523	533
LT Debt	5,645	7,374	6,842	6,858	6,849
Other LT Liabilities	574	447	432	432	432
Shareholder's Equity	17,150	19,150	20,271	21,533	23,113
Minority Interests	8,288	9,811	11,292	12,638	14,071
Total Cap. & Liab.	36,111	43,808	46,285	50,096	53,200
Non-Cash Wkg. Capital	(606)	(1,502)	(1,870)	(2,267)	(1,933)
Net Cash/(Debt)	5,726	3,737	5,317	6,747	10,315
Debtors Turn (avg days)	76.5	67.9	78.1	63.9	68.6
Creditors Turn (avg days)	450.3	655.5	749.5	535.5	542.3
Inventory Turn (avg days)	191.6	253.0	260.0	175.2	187.5
Asset Turnover (x)	0.2	0.2	0.1	0.2	0.2
Current Ratio (x)	3.4	2.4	2.4	2.3	2.7
Quick Ratio (x)	3.1	2.0	2.0	2.0	2.4
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	60.5	71.2	45.9	50.0	21.8
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

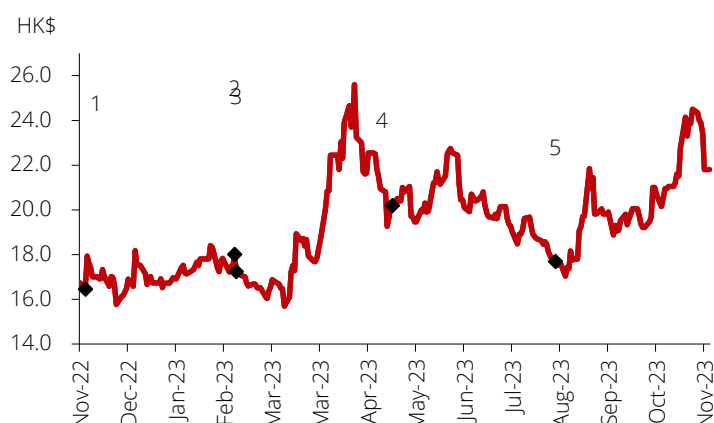
Cash Flow Statement (US\$ m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Pre-Tax Profit	1,840	2,214	1,174	1,310	1,659
Dep. & Amort.	1,869	2,271	2,564	2,753	2,790
Tax Paid	(147)	(165)	(69)	(66)	(98)
Assoc. & JV Inc/(loss)	(253)	(122)	(187)	(187)	(187)
(Pft)/ Loss on disposal of FAs	(341)	13	(765)	(341)	(330)
Chg in Wkg.Cap.	114	894	368	397	(334)
Other Operating CF	(71)	243	(147)	(134)	(154)
Net Operating CF	3,012	5,348	2,937	3,733	3,346
Capital Exp.(net)	(4,097)	(6,189)	(3,977)	(4,329)	(1,881)
Other Invt.(net)	(2,912)	(4,196)	0	0	0
Invt in Assoc. & JV	218	(39)	285	159	183
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	135	33	739	384	333
Net Investing CF	(6,655)	(10,392)	(2,953)	(3,787)	(1,366)
Div Paid	0	0	0	0	0
Chg in Gross Debt	326	2,414	(34)	(7)	(27)
Capital Issues	6	20	32	32	32
Other Financing CF	2,025	1,180	1,564	1,452	1,557
Net Financing CF	2,357	3,614	1,561	1,477	1,561
Currency Adjustments	41	(220)	0	0	0
Chg in Cash	(1,245)	(1,649)	1,546	1,423	3,541
Opg CFPS (US\$)	0.37	0.56	0.32	0.42	0.46
Free CFPS (US\$)	(0.14)	(0.11)	(0.13)	(0.08)	0.18

Source: Company, DBS HK

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H Share - Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	12-mth Target Price	Rating
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1:	14-Nov-22	HK\$16.74	HK\$22.80	Buy
2:	9-Feb-23	HK\$17.42	HK\$22.00	Buy
3:	10-Feb-23	HK\$18.02	HK\$20.70	Buy
4:	12-May-23	HK\$20.15	HK\$26.00	Buy
5:	15-Aug-23	HK\$17.64	HK\$22.00	Buy

Source: DBS HK

Analyst: Jim Au

Tsz Wang Tam

A Share - Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	12-mth Target Price	Rating
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1:	14-Nov-22	RMB40.71	RMB27.36	Sell
2:	9-Feb-23	RMB42.62	RMB26.40	Sell
3:	10-Feb-23	RMB43.60	RMB24.84	Sell
4:	12-May-23	RMB52.96	RMB29.46	Sell
5:	15-Aug-23	RMB47.34	RMB20.20	Sell

Source: DBS HK

Analyst: Jim Au

Tsz Wang Tam

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STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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Sources for all charts and tables are DBS HK unless otherwise specified.

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