

# 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

7 Feb 2024

**H: HOLD** (Downgrade from BUY)

Last Traded Price (7 Feb 2024): HK\$14.12 (HSI : 16,082)

Price Target 12-mth: HK\$17.00 (20.4% upside) (Prev HK\$23.30)

**A: SELL**

Last Traded Price (7 Feb 2024): RMB42.90 (CSI300 Index : 3,344)

Price Target 12-mth: RMB15.61 (63.6% downside) (Prev RMB21.39)

**Analyst**

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**What's New**

- 4Q23 net profit fell 55% y-o-y due to persistent ASP pressure and slow de-stocking of clients' inventories
- Management guides for a dim FY24 revenue guidance of mid-single-digit growth, vs. market expectations of 18%
- Earnings forecast cut by 59%/38% for FY24F/FY25F to account for lower gross margins and a prolonged top-line recovery
- Downgrade to HOLD with a lower TP of HK\$17.0 due to a slower-than-expected recovery profile in the near term

### ASP taking longer to recover

**Investment Thesis**

Earnings expected to decline by 45.7% in FY24F due to prolonged weakness in ASP and gross margin throughout FY24 as clients remain cautious about inventory level due to economic uncertainty. We expect earnings growth to recover by 86.6% in FY25F to US\$914m, driven by (1) the improving smartphone end-market demand and (2) increase in new product launches, such as AI, SoC (System on Chips), and auto chips in China.

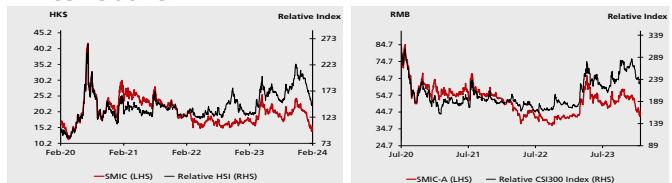
**China's largest foundry rides on localisation of mature node wafers.**

Having the largest mature wafer foundry capacity in China, SMIC's revenue is expected to receive a boost from the localisation of microcontroller units (MCUs) and auto chips, and rebound by 25% in FY25F vs. the global foundry market's 13%.

**Higher-than-expected utilisation rate is key driver for a re-rating.**

SMIC has maintained a utilisation rate of 75% vs. the c.65% of its global peers. We believe the company's utilisation rate has bottomed out, driven by the solid foundry demand for smartphone SoC and auto chips in China.

**Price Relative**



**We downgrade SMIC H-share to HOLD and set our TP at HK\$17.0**

based on a 0.8x FY24F P/BV (vs. previous TP of HK\$23.2 and valuation of 1.1x FY24F P/BV), pegged to the historical average. We maintain our SELL recommendation for the A-share and set our TP at Rmb15.60 based on the same target P/BV multiple.

**Key Risks**

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

**Forecasts and Valuation (H Shares)**

FY Dec (US\$m)	2022A	2023A	2024F	2025F
Turnover	7,273	6,322	6,751	8,444
EBITDA	4,262	3,328	3,101	3,262
Pre-tax Profit	2,214	1,187	543	1,022
Net Profit	1,818	903	490	1,011
Net Pft (Pre Ex) (core profit)	1,818	903	490	1,011
Net Profit Gth (Pre-ex) (%)	6.8	(50.4)	(45.7)	106.2
EPS (US\$)	0.23	0.11	0.06	0.13
EPS (HK\$)	1.79	0.89	0.48	1.00
EPS Gth (%)	6.8	(50.4)	(45.7)	106.2
Diluted EPS (HK\$)	1.79	0.89	0.48	0.90
DPS (HK\$)	0.00	0.00	0.00	0.00
BV Per Share (HK\$)	18.97	19.92	20.66	21.82
PE (X)	7.9	15.9	29.2	14.2
P/Cash Flow (X)	2.7	4.0	3.8	4.2
P/Free CF (X)	nm	nm	11.6	21.3
EV/EBITDA (X)	4.8	7.8	7.7	6.9
Net Div Yield (%)	0.0	0.0	0.0	0.0
P/Book Value (X)	0.7	0.7	0.7	0.6
Net Debt/Equity (X)	CASH	0.0	CASH	CASH
ROAE(%)	10.0	4.6	2.4	4.7
Earnings Rev (%)			(59)	(38)
Consensus EPS (US\$)			0.10	0.15
Other Broker Recs:		B:15	S:4	H:10

**At A Glance**

Issued Capital - H shares (m shs)	5,973
- Non H shrs (m shs)	1,974
H shs as a % of Total	75
Total Mkt Cap (HK\$m/US\$m)	188,172 / 24,055
Major Shareholders (%)	
China Asset Management Co., Ltd.	13.0
China Integrated Circuit Industry Investment Fund Phase II Co Ltd	6.5
Major H Shareholders (As % of H shares)	
Datang Telecom Technology & Industry Holdings Co., Ltd.	18.7
China Integrated Circuit Industry Investment Fund Co., Ltd.	10.3
H Shares-Free Float (%)	71.0
3m Avg. Daily Val. (US\$m)	83.72
GICS Industry: Information Technology / Semiconductors & Semiconductor	

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

**SMIC****WHAT'S NEW****FY24 revenue guidance miss; ASP and gross margin would take longer to recover****4Q23 results highlights**

4Q23 revenue increased 3.5% y-o-y to US\$1.7bn (+3.6% q-o-q), due to the recovery in the smartphone end-market. Segment wise, the 8-inch business revenue decreased by 23.5% y-o-y to US\$402m (+4.8% q-o-q). The 12-inch business revenue, accounting for the majority of advanced node foundry, increased by 21.6% y-o-y to US\$1.16bn (+5.9% q-o-q).

The gross margin dropped to 16.4%, down 15.6ppt y-o-y due to the persistent ASP pressure, in line with the guidance. The fab utilisation rate was maintained at 76.8%, vs. 77.1% in 3Q23.

Net profit decreased 54.7% y-o-y to US\$175m, above market expectations due to better opex control. EPS was US\$0.01.

Management continues to guide for a q-o-q increase of 0-2% in 1Q24 revenue with a y-o-y gross margin contraction of between 9.8ppt to 11.8ppt, steeper than market expectations of a 4.0ppt shrinkage. For FY24, the company expects mid-single-digit y-o-y growth in revenue, vs. the market expectation of c.18%.

**Our View**

The management's pessimistic outlook on its revenue and gross margin was disappointing. We believe this was due to (1) ASP pressure from fierce industrial competition and (2) the slow de-stocking of clients' inventories.

The wafer shipments have bottomed out, showing a 6.4% y-o-y and 9.0% q-o-q increase. However, we anticipate the ASP and gross margin would take longer to recover and remain weak throughout FY24 as clients remain cautious about inventory level due to economic uncertainty.

We cut our earnings forecast by 58.5%/38.3% to US\$490m/US\$915m for FY24F/FY25F to account for lower gross margins and a prolonged top-line recovery.

We expect earnings to resume growth of 86.6% y-o-y in FY25 after a 45.7% y-o-y decline in FY24F, driven by (1) the improving demand from the smartphone end-market and (2) the launch of new products, such as AI, SoC (System on Chips), and auto chips in China.

SMIC is trading at a 0.75 FY24F P/BV. We set our H-share TP to HK\$17.0 (previous TP: HK\$23.3). It is based on a lower multiple of 0.8x FY24F book value (compared to the previous basis of 1.1x FY24 P/BV), pegged to its valuation during the industrial downcycle. We downgrade SMIC to HOLD due to a slower-than-expected recovery profile in the near term.

## SMIC

### Quarterly Income Statement (US\$m)

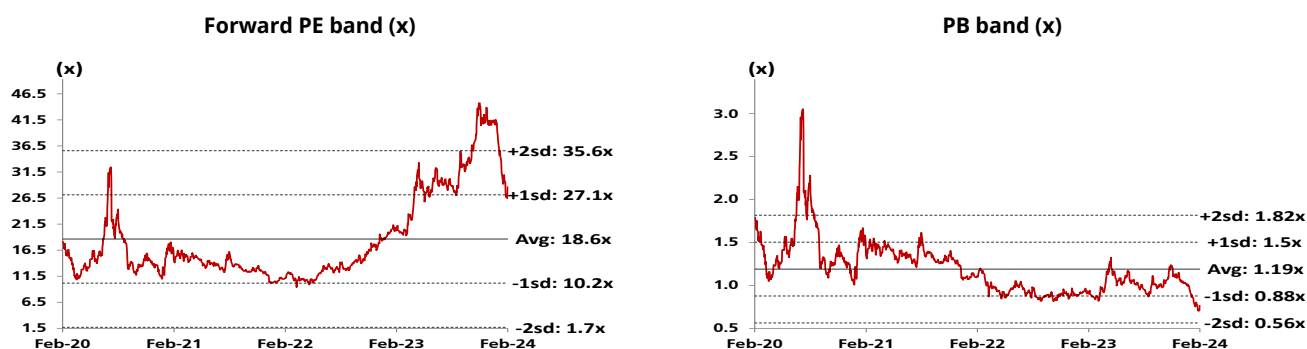
FY DEC	4QFY22	3QFY23	4QFY23	% chg_yoy	% chg_qoq
Revenue	1,621	1,621	1,678	3.5%	3.6%
Cost of Goods Sold	(1,103)	(1,299)	(1,403)	27.3%	8.0%
<b>Gross Profit</b>	<b>519</b>	<b>322</b>	<b>275</b>	-47.0%	-14.5%
Other Oper. (Exp)/Inc	(236)	(234)	(168)	-29.1%	-28.4%
<b>Operating Profit</b>	<b>282</b>	<b>87</b>	<b>107</b>	-62.0%	22.8%
Other Non Opg (Exp)/Inc	-	0	-	nm	nm
Associates & JV Inc	34	(48)	12	-64.1%	nm
Net Interest (Exp)/Inc	81	134	114	40.3%	-14.6%
Exceptional Gain/(Loss)	21	(5)	14	-32.6%	nm
<b>Pre-tax Profit</b>	<b>419</b>	<b>168</b>	<b>248</b>	-40.8%	47.8%
Tax	6	(11)	(11)	nm	-6.3%
Minority Interest	39.9	62.4	62.6	56.7%	0.3%
<b>Net Profit</b>	<b>386</b>	<b>94</b>	<b>175</b>	-54.7%	85.9%
Net profit bef Except.	386	94	175	-54.7%	85.9%
<b>Margins (%)</b>					
Gross Margins	32.0	19.8	16.4		
Opg Profit Margins	17.4	5.4	6.4		
Net Profit Margins	23.8	5.8	10.4		

Source: Company, DBS HK

### 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 $\mu$ 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.

### Historical PE and PB band



Source: Thomson Reuters, DBS HK

## SMIC

### Key Assumptions

FY Dec	2021A	2022A	2023A	2024F	2025F
Wafer Shipment (K 8-inch wafer equivalents)	6,747.2	7,098.5	6,563.7	7,348.1	8,947.5
Wafer ASP (US\$)	738.4	948.9	882.8	820.2	853.2
Utilization rate (%)	99.7	92.0	75.4	75.2	85.3
Gross Margin (%)	30.8	38.0	19.7	13.0	17.5

Source: Company, DBS HK

### Segmental Breakdown (US\$ m)

FY Dec	2021A	2022A	2023A	2024F	2025F
<b>Revenues (US\$ m)</b>					
Wafer revenue	4,982	6,736	5,794	6,027	7,634
Mask making, testing, others	461	538	527	724	810
<b>Total</b>	<b>5,443</b>	<b>7,273</b>	<b>6,322</b>	<b>6,751</b>	<b>8,444</b>
<b>Gross Profit (US\$ m)</b>					
Wafer revenue	1,470	2,494	1,087	595	1,178
Mask making, testing, others	206	267	158	283	300
<b>Total</b>	<b>1,676</b>	<b>2,762</b>	<b>1,245</b>	<b>878</b>	<b>1,478</b>
<b>Gross Profit Margins (%)</b>					
Wafer revenue	29.5	37.0	18.8	9.9	15.4
Mask making, testing, others	44.7	49.7	30.0	39.0	37.0
<b>Total</b>	<b>30.8</b>	<b>38.0</b>	<b>19.7</b>	<b>13.0</b>	<b>17.5</b>

Source: Company, DBS HK

## SMIC

## Income Statement (US\$ m)

FY Dec	2021A	2022A	2023A	2024F	2025F
Revenue	5,443	7,273	6,322	6,751	8,444
Cost of Goods Sold	(3,767)	(4,512)	(5,104)	(5,873)	(6,966)
<b>Gross Profit</b>	<b>1,676</b>	<b>2,762</b>	<b>1,218</b>	<b>878</b>	<b>1,478</b>
Other Opng (Exp)/Inc	(284)	(925)	(861)	(899)	(1,048)
<b>Operating Profit</b>	<b>1,392</b>	<b>1,836</b>	<b>356</b>	<b>(21)</b>	<b>430</b>
Other Non Opg (Exp)/Inc	83	33	275	(214)	(440)
Associates & JV Inc	253	122	29	187	187
Net Interest (Exp)/Inc	113	224	527	592	845
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
<b>Pre-tax Profit</b>	<b>1,840</b>	<b>2,214</b>	<b>1,187</b>	<b>543</b>	<b>1,022</b>
Tax	(65)	(16)	(63)	(27)	(59)
Minority Interest	(73)	(380)	(222)	(26)	48
Preference Dividend	0	0	0	0	0
<b>Net Profit</b>	<b>1,702</b>	<b>1,818</b>	<b>903</b>	<b>490</b>	<b>1,011</b>
Net Profit before Except.	1,702	1,818	903	490	1,011
EBITDA	3,597	4,262	3,328	3,101	3,262
<b>Growth</b>					
Revenue Gth (%)	39.3	33.6	(13.1)	6.8	25.1
EBITDA Gth (%)	84.2	18.5	(21.9)	(6.8)	5.2
Opg Profit Gth (%)	345.8	32.0	(80.6)	(106.0)	(2,107.4)
Net Profit Gth (%)	137.8	6.8	(50.4)	(45.7)	106.2
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	30.8	38.0	19.3	13.0	17.5
Opg Profit Margin (%)	25.6	25.2	5.6	(0.3)	5.1
Net Profit Margin (%)	31.3	25.0	14.3	7.3	12.0
ROAE (%)	10.6	10.0	4.6	2.4	4.7
ROA (%)	5.0	4.5	2.0	1.0	2.0
ROCE (%)	4.4	5.1	0.8	0.0	0.9
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

## SMIC

**Balance Sheet (US\$ m)**

FY Dec	2021A	2022A	2023A	2024F	2025F
Net Fixed Assets	14,815	19,385	24,419	23,793	23,428
Invt in Associates & JVs	1,877	1,921	2,045	2,201	2,165
Other LT Assets	4,202	5,867	7,688	7,560	7,624
Cash & ST Invt	12,498	12,431	9,379	12,282	14,593
Inventory	1,194	1,911	2,736	2,363	2,955
Debtors	1,259	1,446	1,276	1,363	1,705
Other Current Assets	267	846	244	244	244
<b>Total Assets</b>	<b>36,111</b>	<b>43,808</b>	<b>47,787</b>	<b>49,806</b>	<b>52,715</b>
ST Debt	1,128	1,320	1,249	2,087	2,078
Creditors	2,853	5,194	5,781	6,165	7,036
Other Current Liab	473	511	572	567	576
LT Debt	5,645	7,374	8,960	8,109	8,115
Other LT Liabilities	574	447	380	346	346
Shareholder's Equity	17,150	19,150	20,116	20,858	22,034
Minority Interests	8,288	9,811	10,730	11,675	12,530
<b>Total Cap. &amp; Liab.</b>	<b>36,111</b>	<b>43,808</b>	<b>47,787</b>	<b>49,806</b>	<b>52,715</b>
Non-Cash Wkg. Capital	(606)	(1,502)	(2,096)	(2,762)	(2,708)
Net Cash/(Debt)	5,726	3,737	(830)	2,087	4,400
Debtors Turn (avg days)	76.5	67.9	78.6	71.3	66.3
Creditors Turn (avg days)	450.3	655.5	822.1	800.5	620.7
Inventory Turn (avg days)	191.6	253.0	348.1	341.6	250.0
Asset Turnover (x)	0.2	0.2	0.1	0.1	0.2
Current Ratio (x)	3.4	2.4	1.8	1.8	2.0
Quick Ratio (x)	3.1	2.0	1.4	1.5	1.7
Net Debt/Equity (X)	CASH	CASH	0.0	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	0.0	CASH	CASH
Capex to Debt (%)	60.5	71.2	75.3	24.8	26.7
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

**Cash Flow Statement (US\$ m)**

FY Dec	2021A	2022A	2023A	2024F	2025F
Pre-Tax Profit	1,840	2,214	1,187	543	1,022
Dep. & Amort.	1,869	2,271	2,667	3,150	3,085
Tax Paid	(147)	(165)	(63)	(27)	(59)
Assoc. & JV Inc/(loss)	(253)	(122)	(29)	(187)	(187)
(Pft)/ Loss on disposal of FAs	(341)	13	(275)	214	440
Chg in Wkg.Cap.	114	894	594	666	(55)
Other Operating CF	(71)	243	(538)	(598)	(853)
<b>Net Operating CF</b>	<b>3,012</b>	<b>5,348</b>	<b>3,545</b>	<b>3,761</b>	<b>3,393</b>
Capital Exp.(net)	(4,097)	(6,189)	(7,689)	(2,524)	(2,720)
Other Invt.(net)	(2,912)	(4,196)	723	0	0
Invt in Assoc. & JV	218	(39)	(95)	31	223
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	135	33	64	(80)	(496)
<b>Net Investing CF</b>	<b>(6,655)</b>	<b>(10,392)</b>	<b>(6,997)</b>	<b>(2,572)</b>	<b>(2,993)</b>
Div Paid	0	0	0	0	0
Chg in Gross Debt	326	2,414	1,514	(13)	(2)
Capital Issues	6	20	249	249	249
Other Financing CF	2,025	1,180	966	1,479	1,665
<b>Net Financing CF</b>	<b>2,357</b>	<b>3,614</b>	<b>2,730</b>	<b>1,715</b>	<b>1,912</b>
Currency Adjustments	41	(220)	0	0	0
Chg in Cash	(1,245)	(1,649)	(723)	2,903	2,311
Opg CFPS (US\$)	0.37	0.56	0.37	0.39	0.43
Free CFPS (US\$)	(0.14)	(0.11)	(0.52)	0.16	0.08

Source: Company, DBS HK

**SMIC**

**H Share - Target Price & Ratings 12-mth History**



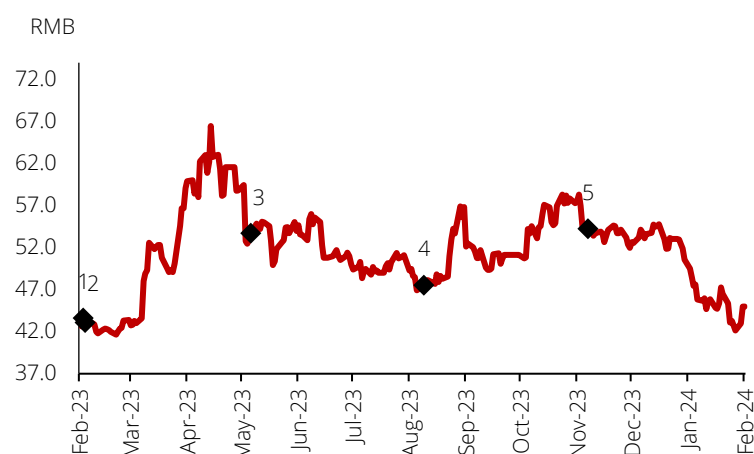
S.No.	Date	Closing Price	Target Price	Rating
1	9-Feb-23	HK\$17.42	HK\$22.00	BUY
2	10-Feb-23	HK\$18.02	HK\$20.70	BUY
3	12-May-23	HK\$20.15	HK\$26.00	BUY
4	15-Aug-23	HK\$17.64	HK\$22.00	BUY
5	13-Nov-23	HK\$21.80	HK\$23.30	BUY

Source: DBS HK

Analyst: Jim Au

Tsz Wang Tam

**A Share - Target Price & Ratings 12-mth History**



S.No.	Date	Closing Price	Target Price	Rating
1	9-Feb-23	RMB42.62	RMB26.40	SELL
2	10-Feb-23	RMB43.60	RMB24.84	SELL
3	12-May-23	RMB52.96	RMB29.46	SELL
4	15-Aug-23	RMB47.34	RMB20.20	SELL
5	13-Nov-23	RMB54.39	RMB21.39	SELL

Source: DBS HK

Analyst: Jim Au

Tsz Wang Tam

DBS Group Research recommendations are based on an Absolute Total Return\* Rating system, defined as follows:

**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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**SMIC**

On 3 June 2021, President J. Biden issued Executive Order 14032 (“the EO”), superseding Executive Order 13959 of 12 November 2020. The EO, which takes effect on 2 August 2021, prohibits US persons from investing in publicly traded securities or derivatives thereof from firms listed as Chinese Military-Industrial Complex Companies (“CMICs”). The list of CMICs can be found on the US Department of the Treasury’s website at <https://home.treasury.gov/policy-issues/financial-sanctions/consolidated-sanctions-list/ns-cmic-list>.

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