

Equity Research | China | Semiconductor

4 October 2018

Compelling entry opportunities

- Our update with the management reaffirms our positive view on Hua Hong Semi (“HHS”). As a majority of its products were shipped to destinations outside the U.S., the escalating China-U.S. trade war will have a limited impact on its growth prospects.
- In our view, the 8-inch market is a safe haven of the jittery global semiconductor industry amid the global trade disputes.
- We trimmed our FY18E/19E revenue and earnings estimates by 1.4%/3.3% and 3.3%/4.7% respectively and lowered our DCF-based price target to HKD30.0. HHS’ share price has come down by more than 50% in the past three months, which was unwarranted given its intact solid growth prospects and instead presents a compelling entry opportunity, in our view. **Maintain Buy.**

Trade disputes cloud global semiconductor industry. The semiconductor industry has been vulnerable to global economic downturn and financial crisis, as suggested by historical experience. The escalating China-U.S. trade war and persisting trade disputes between the U.S. and its major trading partners have raised the stakes of a slowdown in global economic growth, as we see a rising number of global institutions lowering their global economic growth forecasts. In addition, the lukewarm demand of the three new iPhone models also added to the gloom of the global semiconductor industry.

8-inch market remains resilient. Nonetheless, we see continued strong demand in the 8-inch semiconductor market, underpinned by 1) strong demand from IOT and emerging industry applications, and 2) sluggish capacity growth due to the difficulty in sourcing 8-inch foundry equipment. As one of the leading global pure 8-inch plays, HHS’ leading global position in many specialty products (like MCU for IOT and home appliance, IGBT, PMIC and RF) makes it resilient. Our update with its management suggests continued solid order flow, as its projects destined for the U.S. being insignificant.

Compelling entry opportunities. Taking into account of the potential impacts from the escalating China-U.S. trade war and global economic downturn, we trimmed our FY18E/19E revenue and earnings estimates by 1.4%/3.3% and 3.3%/4.7% respectively and lowered our DCF-based price target to HKD30.0 (from HKD32.0). HHS’ share price has come down by more than 50% along with a global-wide selloff in technology names in the past three months. However, in our view, the deep selloff in HHS’ shares was unwarranted and presents a compelling entry opportunity in light of its intact solid growth prospects.

Hua Hong Semi (1347 HK)

Buy

(unchanged)

Price Target	HK\$30.0
(Revision)	(-6.3%)
(upside)	(83.6%)

EPS	2018E	2019E
revision	(-3.3%)	(-4.7%)
Close price	HKD16.34	
Market cap.	USD2,180mn	
Free float	38.1%	
52-week range	HKD10.24–HKD30.8	
3-mth ave. T/O	HKD187.3mn	

Price as of 4 October 2018

Stock rel HSI performance (%)


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Income statement (USDm)

Year end: Dec	2016	2017	2018E	2019E	2020E
Revenue	721	808	916	1005	1087
COGS	(50)	(54)	(61)	(674)	(730)
Gross profit	220	267	305	331	357
Selling and marketing	(7)	(7)	(7)	(8)	(8)
R&D	(4)	(50)	-	-	-
Admin	(97)	(109)	(116)	(130)	(136)
Operating profit	75	102	182	194	213
Other income	63	57	9	18	18
EBIT	138	158	191	212	231
Net interest	1	5	6	7	9
Associates and JVs	7	10	2	3	3
Exceptional items	7	-	(5)	-	-
Pretax profit	153	172	194	222	244
Taxation	(25)	(27)	(32)	(41)	(45)
Net profit	129	145	162	181	199
Net profit (adjusted)	129	145	162	181	199
Basic EPS (USD)	0.12	0.14	0.16	0.17	0.19
EPS (adjusted) (USD)	0.12	0.14	0.16	0.17	0.19
DPS (USD)	-	-	100	2.00	3.00

Cash flow statement (USDm)

Year end: Dec	2016	2017	2018E	2019E	2020E
EBIT	138	158	191	212	231
Depreciation & amortisation	84	104	115	126	136
Net interest	(1)	(5)	(6)	(7)	(9)
Taxes paid	(18)	(20)	(32)	(41)	(45)
Changes in working capital	(6)	10	(3)	(3)	(3)
Others	15	11	6	14	18
Cash flow from operations	212	258	272	301	329
Capex	(169)	(136)	(150)	(150)	(150)
Acquisitions	(4)	(2)	(2)	(2)	(3)
Disposals	0	0	-	-	-
Others	(6)	(59)	-	-	-
Cash flow from investing	(233)	(197)	(152)	(152)	(153)
Dividends	-	-	-	-	-
Issue of shares	-	3	-	-	-
Change in debt	(86)	(2)	(14)	(11)	(9)
Others	(40)	(42)	(41)	(49)	(54)
Cash flow from financing	(125)	(41)	(55)	(60)	(64)
Change in cash	(147)	20	64	89	112
Free cash flow	43	122	122	151	179

Balance sheet (USDm)

Year end: Dec	2016	2017	2018E	2019E	2020E
Cash	341	375	428	505	605
Short term investments	-	-	-	1	2
Accounts receivables	106	112	115	117	119
Inventory	95	116	119	122	125
Other current assets	172	251	265	279	294
Total current assets	715	853	926	1,024	1,145
PP&E	657	733	771	797	812
Intangible Assets	8	7	7	7	8
Associates and JVs	45	58	60	62	65
Other long term assets	402	426	438	451	464
Total long term assets	1,112	1,225	1,276	1,317	1,351
TOTAL ASSETS	1,827	2,078	2,202	2,341	2,496
Short term debt	2	61	55	49	44
Accounts payables	65	68	73	77	82
Other current liabilities	171	208	219	232	245
Total current liabilities	238	337	347	358	372
Long term debt	91	32	24	18	14
Deferred tax	9	14	15	16	18
Convertible bonds	-	-	-	-	1
Other long term liabilities	-	-	-	-	(1)
Total long term liabilities	100	46	39	35	31
TOTAL LIABILITIES	338	383	386	393	403
Shareholders' funds	1489	1695	1816	1948	2,093
Minority Interests	-	-	-	-	-
TOTAL LIAB AND EQUITY	1,827	2,078	2,202	2,341	2,496
Net cash / (debt)	249	282	349	438	547

Key ratios

Year end: Dec	2016	2017	2018E	2019E	2020E
Operating ratios					
EBIT margin (%)	19.1	19.6	20.8	21.1	21.3
EBITDA margin (%)	30.8	32.4	33.4	33.6	33.8
Effective tax rate (%)	16.1	15.8	16.5	16.5	16.3
Revenue growth (%)	11.0	12.0	13.4	9.7	8.2
Net income growth (%)	14.5	12.8	11.3	11.7	10.2
EPS growth adj (%)	14.5	12.7	11.0	11.7	10.2
DPS growth (%)	-	-	-	-	-
Efficiency ratios					
ROE (%)	8.7	8.6	8.9	9.3	9.5
ROCE (%)	12.4	12.9	15.0	16.1	17.1
Asset turnover (x)	0.4	0.4	0.4	0.4	0.4
Op cash / EBIT (x)	15	16	14	14	14
Depreciation / CAPEX (x)	0.5	0.8	0.8	0.8	0.9
Accounts receivable days	53.1	49.3	45.2	42.0	39.6
Accounts payable days	47.7	44.8	42.0	40.6	39.9
Leverage ratios					
Net gearing (%)	(16.7)	(16.6)	(19.2)	(22.5)	(26.1)
Net debt / EBITDA (x)	(1)	(1)	(1)	(1)	(1)
Interest cover (x)	(90.0)	(25.9)	(23.6)	(20.2)	(17.4)
Current ratio (x)	3.0	2.5	2.7	2.9	3.1
Valuation					
PER (x)	16.9	15.0	13.5	12.1	11.0
EV/EBITDA (x)	8.2	7.1	5.9	5.0	4.3
PBR (x)	15	13	12	11	10
Dividend yield (x)	18	19	2.2	2.5	2.7

Source: Company, Bloomberg, CSCI Research estimates

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Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

Buy	12-month absolute total return: $\geq 10\%$
Hold	12-month absolute total return: $> -10\%$ but $< 10\%$
Sell	12-month absolute total return: $\leq -10\%$

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