

ASM Pacific: Near term uncertainties cloud outlook

Recommendation: SELL (downgraded from HOLD) Hong Kong Semiconductors

Price	HK\$45.60	Year to Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gear.	
Target price	HK\$40.00 (-12%)	Dec	HK\$m	HK\$	Δ %	x	x	x	%	%	%	
12 mth range	HK\$34.30-50.15	05A	850.5	2.207	(15.4)	20.7	7.4	16.1	4.4	37.2	39.6	Cash
Market cap.	US\$2,273.2m	06A	1149.5	2.969	34.5	15.4	7.0	11.6	6.0	46.4	48.8	Cash
Daily t/o, 3 mth	US\$3.2m	07F	1139.4	2.943	(0.9)	15.5	6.1	11.9	4.8	41.8	44.2	Cash
Free float %	34.3%	08F	1372.8	3.546	20.5	12.9	5.5	9.9	6.1	44.8	47.2	Cash
Ticker	0522.HK/522 HK	09F	1422.7	3.675	3.6	12.4	4.9	9.5	6.4	41.7	44.1	Cash

Relative to Hang Seng Index (1 mth, 3 mth, 12 mth): +7.8%, -3.5%, +5.3%

Actual price changes (1 mth, 3 mth, 12 mth): -4.8%, -5.0%, +6.5%

Consensus EPS (07F-08F): HK\$2.971, HK\$3.394

Previous forecasts (07F-08F): HK\$1,233.5m (\$3.187), HK\$1,423.9m (\$3.679)

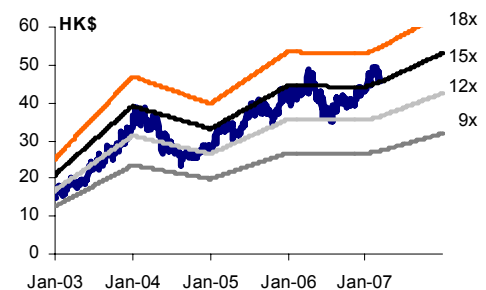
Key points:

- Record net profit of HK\$1,149.5m, up 35.2% YoY, and turnover of HK\$4,556.0m, up 28.8% YoY, in line with expectations. Full year HK\$2.75 dividend per share represents 92.6% payout ratio.
- 2H FY06 equipment sales slowed markedly as expected due to inventory build-up in the supply chain and digestion of newly installed capacity.
- Timing and extent of demand rebound is uncertain. Demand outlook is further blurred by private equity-led industry consolidation. Global assemblers and packagers may potentially hold off significant capacity upgrades until industry outlook clears up.
- ASMPT expected to navigate through this period with its diversified product range and growth momentum in its leadframe business. Strong cash reserves (HK\$914.7m) will sustain R&D expenditure and allow the company to launch new products and explore new markets.
- Trading at 15.5x FY12/07F P/E, ASMPT appears overvalued, as market may have priced in too much of the expected rebound in FY12/08F. Without any major catalysts, near term uncertainties will weigh heavily on ASMPT. We downgrade our target price to HK\$40.00 (from HK\$47.80), representing 13.6x FY12/07F and 11.3 FY12/08F P/E, supported by an estimated 5.5% yield.

FY06 results in-line. The FY06A net profit of the world's largest back-end semiconductor equipment supplier ASMPT increased 35.2% YoY to HK\$1,149.5m, as turnover jumped 28.8% to HK\$4,556.0m. Both top and bottom lines were record highs in the company's history, exceeding those recorded in the previous industry peak in 2000. The strong results were driven by broad-based revenue increases in equipment sales and leadframes, as well as margin gains from its expanding operating scale. Though the gross margin remained essentially steady at 45.6%, the operating margin widened 2.5 pcp YoY to 28.1%. A higher effective tax rate in 2H FY12/06A, due to the company's changing geographical sales mix partially eroded some of the operating gains as the net margin improved a lesser 1.2 pcp YoY to 25.2%.

Payout ratio at 92.6% for FY12/06A, healthy cash position. Its strong cash generating business allowed ASMPT to pay healthy dividends as usual. Including the interim dividend of HK\$1.45 (HK\$0.70 dividend plus HK\$0.75 special dividend), ASMPT paid a full year dividend of HK\$2.75 (including a HK\$0.30 special dividend in 2H FY12/06A). This represented a payout ratio of 92.6%, and a yield of 6.0% based on the closing price on 9 Mar 2007. The company's net cash position improved to HK\$914.7m from HK\$728.9m from a year ago.

Chart 1: P/E bands



Source: SBI E2-Capital

Equipment sales in 2H slowed markedly as expected. After the aggressive capex build-out by global assemblers and packagers in 1H FY06, equipment sales slowed markedly in 2H due to inventory build up along the value chain and digestion of newly installed capacity. In 2H FY12/06A, equipment sales revenue was HK\$1,777.1m, down 1.5% HoH. The book-to-bill ratio contracted to 1.0 in 2H FY12/06A after reaching a high of 1.2 in 1H. However, the quarterly booking backlog of HK\$803.4m is still relatively healthy, exceeding the HK\$624.0m during the previous cyclical downturn in 2Q FY12/05A. With demand for back-end equipment remaining soft in 1Q FY07, we see FY07 as a correction year for the company. Though we expect demand to rebound in 2H FY07, the timing and extent remains uncertain. According to VLSI, an independent third party industry researcher, the global assembly and packaging equipment market will contract 6.3% in 2007, after expanding 18.9% YoY in 2006.

Private equity-led industry consolidation further adds to uncertainty. Since 2H 2006, there has been a series of acquisitions/privatizations led by private equity consortiums. In Aug 2006, a consortium including Kohlberg Kravis Roberts & Co. (KKR) and Silver Lake Partners purchased a majority stake in Philips Semiconductors (now NXP Semiconductors). In Dec 2006, Freescale Semiconductors was acquired by a consortium led by Blackstone Group and included other heavyweights such as Carlyle Group and Texas Pacific Group. The back-end space was no exception as Carlyle Group commenced acquisition discussions with Taiwanese testing and assembly house ASE in Nov 2006. The consolidating environment will add near-term uncertainty to the overall semiconductor industry in our view. While we expect demand for semiconductors to remain largely the same (Gartner forecasts the semiconductor industry will grow 9.2% YoY in 2007), we believe some IDMs and contract assemblers and packagers may hold off significant capacity upgrades until the industry outlook clears up.

Malaysia plant start-up temporarily eroded leadframe profitability in 2H FY06. ASMPT's leadframe business continued its strong growth momentum with a 44.8% YoY revenue growth to HK\$974.0m. However, EBIT profitability fell to 6.1% in 2H, compared with 19.2% in 1H, as a result of one-off start up costs for the company's new Malaysian etch leadframe plant. ASMPT's horizontal extension into the higher growth QFN packaging will allow the company to sustain growth in this business segment going forward. We also expect its profitability to normalize in 1H FY07.

No reduction in R&D expenses, continuing to launch new products/explore new markets. Though the industry's outlook is on the bearish side, we expect ASMPT to be able to navigate through this period with its diversified back-end equipment product range and growth momentum in its leadframe business. With strong cash reserves, the company is able to maintain R&D expenditure and it has recently launched new gold wire bonders and multi-chip module die bonders onto the market. Furthermore, it is looking to further diversify into semiconductor testing by manufacturing and supplying test handling units. The industry sub-sector is currently quite fragmented and we believe that ASMPT, with its automation expertise and ability to offer total solutions, should have no trouble gaining a foothold in the market.

Expecting a flat FY12/07F and a recovery in FY12/08F. With softening demand and an uncertain industry outlook, we are projecting a flat FY07F for ASMPT followed by a recovery in FY08F. We revise down our FY12/07F net profit to HK\$1,139.4m (cf. HK\$1,233.5m), representing a drop of 0.9% YoY before a recovery in FY12/08F with a net profit growth of 20.5% YoY to HK\$1,372.8m on the back of a rebound in demand by IDMs and contract assembly and packaging companies.

Acquisitions unlikely. Though ASMPT is cash rich (HK\$914.7m with no debt), we do not see the company being a play on the acquisition front. The company has traditionally preferred to grow organically to preserve its corporate culture and it has recently entered into a management succession period in Jan 2006 after the retirement of CEO and co-founder, Mr. Patrick Lam. We expect the company to maintain its policy of returning excess cash to shareholders.

Overvalued given uncertainties, downgrade to SELL. Currently trading at 15.5x FY12/07F P/E, we consider ASMPT to be overvalued as we think the market has priced in too much of the expected industry rebound in FY08. Without any acquisition catalysts, the near term uncertainties of the industry are likely to weigh heavily on ASMPT. We downgrade the stock's target price to HK\$40.00 (from HK\$47.80), representing 13.6x FY12/07F and 11.3 FY12/08F P/E. Our target price is supported by an estimated yield of 5.5%.

Table 1: P&L

Year to Dec (HK\$m)	2005A	2006A	2007F	2008F	2009F
Turnover					
Equipment sales	2,864.4	3,581.9	3,529.4	3,947.0	4,142.8
Leadframes	672.5	974.0	1,149.4	1,496.4	1,676.0
Turnover	3,536.9	4,556.0	4,678.7	5,443.4	5,818.8
% chg	(7.6)	28.8	2.7	16.3	6.9
Cost of sales	(1,926.1)	(2,476.6)	(2,599.1)	(3,000.2)	(3,264.6)
Gross profit	1,610.8	2,079.4	2,079.7	2,443.1	2,554.2
Other revenues and gains	21.3	34.3	36.0	40.5	42.5
Selling and distribution costs	(317.0)	(375.8)	(381.3)	(429.9)	(459.9)
Administrative expenses	(143.5)	(172.0)	(177.8)	(198.8)	(209.3)
R&D expenses	(267.6)	(286.9)	(290.1)	(329.2)	(346.1)
Operating profit	903.9	1,279.0	1,266.5	1,525.8	1,581.4
Finance costs	(0.0)	(0.2)	(0.2)	(0.2)	(0.2)
Share of profits and losses of jointly controlled entities	-	-	-	-	-
Share of profits of an associated	-	-	-	-	-
Profit before taxation	903.9	1,278.8	1,266.3	1,525.6	1,581.2
Taxation	(53.4)	(129.3)	(126.9)	(152.7)	(158.5)
Minority interests	-	-	-	-	-
Profit attributable to shareholders	850.5	1,149.5	1,139.4	1,372.8	1,422.7
% chg	(15.2)	35.2	(0.9)	20.5	3.6
Dividends	(772.9)	(1,064.4)	(851.7)	(1,084.0)	(1,122.7)

Source: SBI E2-Capital

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