SAMSUNG SECURITIES

Company Update

2015. 11. 12

Simmtech (222800)

Industry conditions weighing on shares

*** Simmtech's 3Q operating margin of 3.9% topped its pre-spinoff 2Q figure of 3.4%, but missed the company's target of 7% because of product mix deterioration.**
*** We expect Simmtech's profits to keep improving but top-line growth to slow in 4Q.**
*** Though Simmtech is not immune to sluggish industry conditions, we believe several factors set it apart from its peers and will hold it in good stead from 1Q16. We believe the stock deserves attention for its valuation—Simmtech is trading at just 4.3x 2016 P/E, deeply discounted to the industry average of 12.5x.**

WHAT'S THE STORY?

3Q review—Product-mix deterioration hits margin: Simmtech recently reported 3Q sales and operating profit of KRW187.2b and KRW7.4b, the former in line with the consensus but the latter missing. We blame a worsening product mix for the miss—while sales of PC-use module PCBs and BOCs recovered y-y, ASPs declined with lower sales of server- and SSD-use module PCBs, MCPs, and FC-CSP.

4Q preview—Solid margin, not so much growth: Simmtech is targeting 4Q sales of KRW200b and an operating margin of 7%. Sales should recover slightly q-q as customers finishing adjusting inventories, but growth is unlikely to impress. We believe the company will beat its margin guidance thanks to product-mix improvement.

Bad industry conditions: Investors worry that competition among package subset makers will intensify as growth in the global smartphone market slows and PC and server shipments decline. Simmtech has to face these same conditions, and its recent share performance reflects this.

Low valuation: Simmtech is trading at just 4.3x 2016 P/E, deeply discounted to the industry average of 12.5x. When the firm starts growing profits faster than its rivals, investors will take notice. We believe mobile device- and PC makers will start building DDR4 inventories in 1Q16, and that will be a good time to accumulate the shares.

Summary of 3Q results

(KRWb)	3Q15	2Q15	3Q14	Change	
				(% q-q)	(% y-y)
Sales	187.2	186.0	167.9	0.6	11.5
Operating profit	7.4	6.3	4.8	17.0	54.6
Pre-tax profit	3.0	n/a	2.0	n/a	51.9
Net profit	2.3	n/a	0.8	n/a	200.0
Margins (%)					
Operating profit	4.0	3.4	2.9		
Pre-tax profit	1.6	n/a	1.2		
Net profit	1.2	n/a	0.5		

Source: Company data, Samsung Securities estimates

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AT A GLANCE

NOT RATED

Target price	n/a
Current price	**KRW7,470**
Market cap	KRW163.93b/USD141.7m
Shares (float)	21,945,415 (61.9%)
52-week high/low	KRW13,650/KRW7,470
Avg daily trading value (60-day)	KRW4.7b/ USD4.0m

ONE-YEAR PERFORMANCE

	1M	6M	12M
SIMMTECH Co., Ltd. (%)	-33.3	0.0	0.0
Vs Kosdaq (%pts)	-77.5	0.0	0.0

KEY CHANGES

(KRW)	New	Old	Diff
Recommend.	Not Rated	Not Rated	
Target price	n/a	n/a	n/a
2015E EPS	0	n/a	n/a
2016E EPS	0	n/a	n/a

SAMSUNG vs THE STREET

No of estimates	2
Target price	16,500
Recommendation	4.5

BUY★★★: 5 / BUY: 4 / HOLD: 3 / SELL: 2 / SELL★★★: 1

3Q review: Product-mix deterioration hits margins

Simmtech recently reported 3Q sales and operating profit of KRW187.2b and KRW7.4b, the former in line with the consensus but the latter missing. The figures fell short of guidance announced on Aug 7 (sales of around KRW200b and operating profit of KRW14b), and Simmtech cut its 4Q guidance to KRW200b in sales and a 7% operating margin (from KRW210b and 11%). We blame a worsening product mix for the miss—while sales of PC-use module PCBs and BOCs recovered y-y, ASPs declined with lower sales of server- and SSD-use module PCBs, MCPs, and FC-CSP.

- Including results from Simmtech Holdings for the purpose of an apples-to-apples (pre- and post-spinoff) comparison, Simmtech's consolidated sales and operating profit grew a respective 2% and 45% q-q in 3Q to KRW190b and KRW9b.
- We attribute the drop in server- and SSD-use module PCB sales to inventory adjustments at clients. Earlier this month, Gartner lowered its full-year global SSD and server shipments estimates by 4.5% and 1.7%, respectively, from those released in August. We believe sluggishness in PC and server markets lowered clients' expectations in 3Q, prompting them to scale back inventories. But Gartner also revised up its SSD penetration assumption for this year to 25% (vs 23% in August), which implies an accelerated technology migration. Consequently, we believe module PCB sales will normalize from 4Q15 after inventory adjustments come to an end.
- Weak demand, client delays in launching products, and intensifying competition weighed on MCP sales. While rivals are heavily marketing CSPs to SK Hynix, we believe business conditions will improve from 1H16, with mobile DRAM gradually employing LPDDR4 technology (in which Simmtech has an edge over its rivals).
- We believe weak FC-CSP sales were the result of inventory adjustments at Chinese clients. Simmtech's FC-CSP shipments to them are unlikely to rebound for the time being.
- Technology migration to DDR4 has spread from server- and mobile-use memory to PC applications, and Simmtech's sales should increase in earnest from 1Q16 as a result.
- The largest shareholder in the old (pre-spinoff) Simmtech owned 25.7% of the company. Post-spinoff, he now owns 56% of Simmtech Holdings, which owns 43% of Simmtech. We do not expect any further changes in ownership structure.

4Q preview: Solid margin, not so much growth

Simmtech is targeting 4Q sales of KRW200b and an operating margin of 7%. Sales should recover slightly q-q as customers finishing adjusting inventories, but growth is unlikely to impress. We believe the company will beat its margin guidance thanks to product-mix improvement.

- Slow demand hurt sales in 3Q, and the market environment is unlikely to be reversed in 4Q. With the beginning of the year typically a slow time, Simmtech's earnings are unlikely to gain momentum in the near term.
- That said, Simmtech's clients largely competed inventory adjustments in September, so demand should from them normalize from 4Q. In turn, Simmtech's profits should keep trending up gradually, we believe through 1H16.

Going through tough times now, but has three advantages

Investors worry that competition among package subset makers will intensify as growth in the global smartphone market slows and PC and server shipments decline. Simmtech has to face these same conditions, and its recent share performance reflects this. That said, we believe the company has three advantages over its rivals.

- Competitors are struggling as low-margin CSPs and MCPs contribute more of their sales, eroding product mixes. Simmtech, however, should see its product mix improve from 4Q15 as FC-CSPs and DDR4 account for more of its sales.
- Simmtech ships most of its FC-CSPs to clients in China (not the US), which should bode well in the long run.
- Simmtech's sales are generally stable, as it supplies all three of the world's top-three memory manufacturers. It also supplies significantly more of Micron's needs than other Korean semiconductor parts makers do.

Technology update

Cost issues have delayed an introduction of through-silicon via (TSV) technology, which many had expected to generate high value for package subset makers. TSMC's integrated fan-out (InFO) technology is garnering attention, but offers only limited value, will likely take a long time to be introduced, and has limited applications. We believe concerns about the TSV delay are overblown.

Meanwhile, system in packages (SIP) are slowly replacing high-density interconnect (HDI) substrates. SIPs allow for thinner devices, though the technology shift will likely proceed slowly Simmtech makes only SIPs.

Low valuation

Simmtech is trading at just 4.3x 2016 P/E, deeply discounted to the industry average of 12.5x. When the firm starts growing profits faster than its rivals, investors will take notice. We believe mobile device- and PC makers will start building DDR4 inventories in 1Q16, and that will be a good time to accumulate the shares

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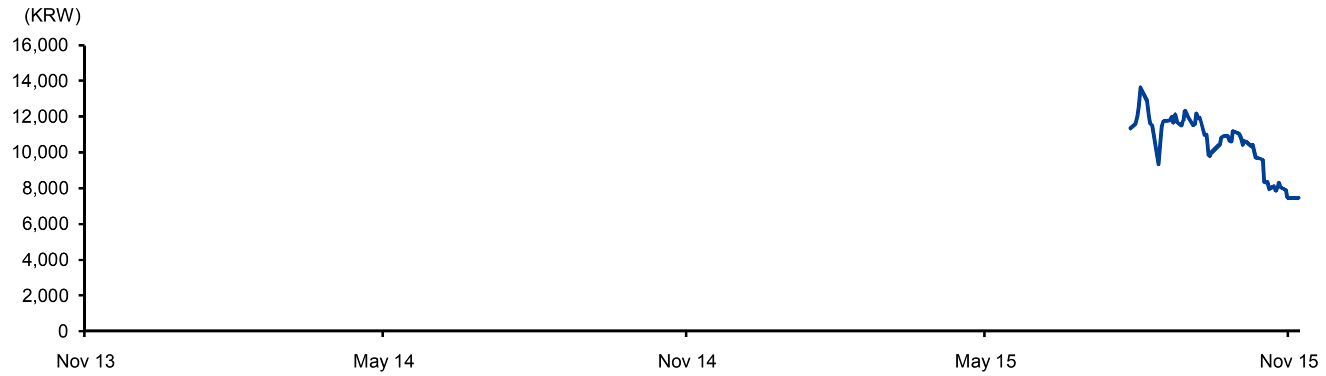
Target price changes in past two years



Rating changes in past two years

Date	2015/11/11
Recommendation	Not Rated
Target price (KRW)	n/a

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Company

BUY★★★	Expected to increase in value by 30% or more within 12 months and is highly attractive within sector
BUY	Expected to increase in value by 10% or more within 12 months
HOLD	Expected to increase/decrease in value by less than 10% within 12 months
SELL	Expected to decrease in value by 10% or more within 12 months
SELL★★★	Expected to decrease in value by 30% or more within 12 months

Industry

OVERWEIGHT	Expected to outperform market by 5% or more within 12 months
NEUTRAL	Expected to outperform/underperform market by less than 5% within 12 months
UNDERWEIGHT	Expected to underperform market by 5% or more within 12 months

Percentage of ratings in 12 months prior to Sep 30, 2015

BUY (71.8%) | HOLD (28.2%) | SELL (0%)

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