

Semiconductor Sector

Sector valuation revisit after recent rally; Potential rerating opportunities ahead

**OUTPERFORM
(Maintain)**

- **China's stock markets (both A/H shares) have soared recently on government stimulus policies.** Per Reuters, Chinese stocks recorded their biggest single-day gains since 2008, with highest turnover (domestic A-share) on 30 Sep. As of 2 Oct 2024, **HSI and CSI 300** have surged 32.2% and 18.5% YTD, respectively, **currently ranking as top performing indices globally.**
- **Semiconductor and communication sectors soared with broad market advancement.** Semiconductor sector index was up 15.5% on 30 Sep 2024, ranking first among all subsectors in terms of single-day performance. From 23 Sep to 30 Sep, the average increases in share price of our selected semiconductor A-share group and optical/telecom group were 37% and 32% (mainland market is closed for National Day holidays). Since 23 Sep, the average increase in share price of our selected H-share peers was 38%. **However, most of these stocks are still trading at discounts to their historical highs largely due to slower-than-expected recovery in demand (non-AI).** The average discounts of current share prices vs. historical highs were 51% for the semiconductor A-share groups and 24% for optical/telecom group. During 23 Sep and 2 Oct, the average increase in share prices of our selected H-share was 51%.
- **As the market went up significantly in a short period of time, investors who are already on the train asking if the rally can continue or a pullback is coming? Investors who missed the train asking if it is still good to get on board or the valuation of A/H stocks are elevated.** We did a valuation check for these stocks. **We found that most of the semiconductor peers are still trading below their 5-year historical avg. fwd. P/E multiples, with an average -0.5 SD below historical avg.**
- **Possible re-rating opportunities for the semi sector. In the near term, we believe that the market momentum is likely to stay, especially for Hong Kong equities.**
 - **For semiconductor sector, we are optimistic that HK-listed companies will have upside opportunities driven by improvements of the market sentiment and funds inflows.** SMIC (981 HK, NR), Hua Hong (1347 HK, BUY) and ZTE (763 HK, BUY) may be more favored by funds considering their larger market capitalization and better liquidity. In addition, with the short-term surge in share price, some funds may lock profit and rotate back to telecom sector. Furthermore, we believe the willingness of investors to participate in HK IPOs is improving as the market sentiment recovers.
 - **During the National Day holidays, we believe investors on A-share market will digest more information from all aspects.** If the consumer data is optimistic during the holidays and beat expectations, it may further strengthen market confidence. For A-share semiconductors, we continue to recommend Innolight (300308 CH, BUY) and Naura (002371 CH, BUY) as the top choices. At the same time, we are positive that industry leaders such as Willsemi (603501 CH, BUY) and Maxscend (300782 CH, BUY) will be favored by investors given their low valuation and higher exposure to the consumer market.
 - **In the longer term, China's central bank lowered interest rates and the PBoC will help firms buy back their own shares by refinancing bank loans used for that purpose.** This will bring liquidity to the market and hopefully stabilize the market. **With a potential positive outlook for the economy and revenue growth, there could be re-rating opportunities for the semi sector** as investors may revise up estimates and feel more comfortable with expanded multiples. We will follow up with the progress.

China Semiconductors Sector

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China stocks soared on stimulus; HSI and CSI300 have been top performing indices YTD

China's stock markets (both A/H shares) have soared recently on government stimulus policies. Per Reuters, Chinese stocks have obtained their biggest single-day gains since 2008, with highest turnover (domestic A-share) on 30 Sep. SSE/SZSE Composite Index advanced 8.1%/10.7% and closed at 3,336.5/10,529.8. Hang Seng index was up 2.4% and closed at 21,133.7. ChiNext board surged 15.36%, while STAR 50 index jumped 17.88%.

As of 2 Oct 2024, HSI and CSI 300 have surged 32.2% and 18.5% YTD, respectively, currently ranking as top performing indices globally. Below is a table of major regional/country indices.

Figure 1: Hang Seng index and CSI 300 are the top performing indices YTD

Index	Value (as of 1 Oct.)	Change		Adv/Dcl	P/E			Div. yield LTM (%)
		1M%	YTD%		Current	FY24E	FY25E	
Americas								
DOW JONES	42156.97	1%	12%	11/19	21.5	21.2	18.9	1.8
S&P 500	5708.75	1%	20%	164/340	24.5	23.7	20.8	1.3
NASDAQ	17910.36	1%	19%	793/2360	34.4	33.8	26.7	0.8
S&P/TSX Comp	24033.99	3%	13%	127/93	16.6	16.5	16.6	2.9
S&P/BMV IPC	52477.30	2%	-21%	9/25	14.6	12.1	10.6	3.6
IBOVESPA	132495.16	1%	-12%	45/37	10.1	8.9	7.5	6.5
EMEA								
Euro Stoxx 50	4954.15	0%	10%	14/36	14.0	14.3	13.3	3.2
FTSE 100	8276.65	0%	12%	46/50	12.1	12.4	11.8	3.8
CAC 40	7574.07	-1%	1%	13/27	13.9	14.2	13.1	3.3
DAX	19213.14	1%	15%	11/29	14.0	14.4	12.7	2.9
IBEX 35	11673.50	2%	16%	10/22	11.1	11.2	11.0	4.1
FTSE MIB	33771.08	-2%	12%	13/26	8.5	9.6	9.3	4.9
OMX STKH30	2611.34	1%	7%	5/25	13.8	17.8	16.6	3.5
SWISS MKT	12086.66	-2%	8%	3/16	19.8	18.9	17.3	3.0
Asia/Pacific								
NIKKEI	37808.76	0%	11%	35/187	22.8	21.0	18.8	1.8
HANG SENG	22443.73	25%	32%	77/5	11.5	10.7	10.0	3.6
CSI 300	4017.35	23%	18%	298/0	16.1	14.7	13.0	2.5
S&P/ASX 200	8198.19	3%	9%	61/133	19.0	19.0	18.1	3.6
Global								
BBG World L/M	1969.52	2%	16%	464/653	20.7	19.5	17.5	1.9

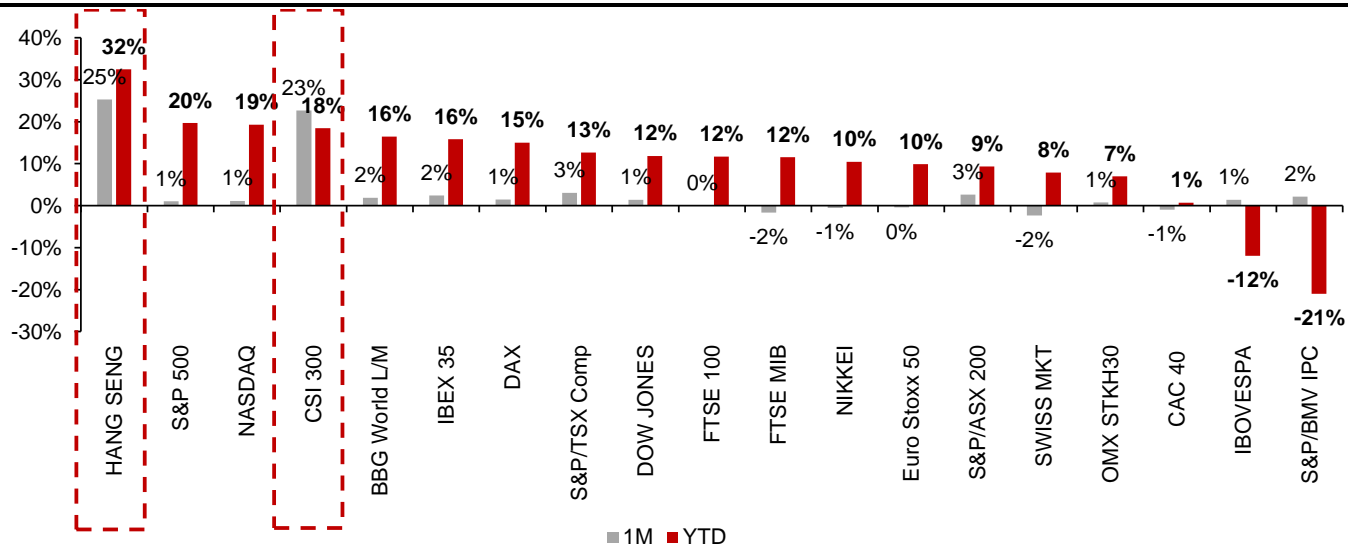
Source: Bloomberg and CMBIGM

Note: Adv/Dcl. represents no. of constituents which advanced and declined.

Asia/Pacific and global indices are as of market close on 2 Oct 2024, except for CSI 300 which is as of market close on 30 Sep 2024.

Hang Seng index and CSI 300 advanced mostly within the recent month, with 25.3% and 22.7% of increase. While domestic A-share market was closed for National Day holidays, Hong Kong stock market opened on 2 Oct. As of the market close on 2 Oct, HSI advanced further with single-day gain of 6.2%.

Figure 2: Changes of major indices: 1 month vs. YTD; HSI and CSI300 are top performing indices



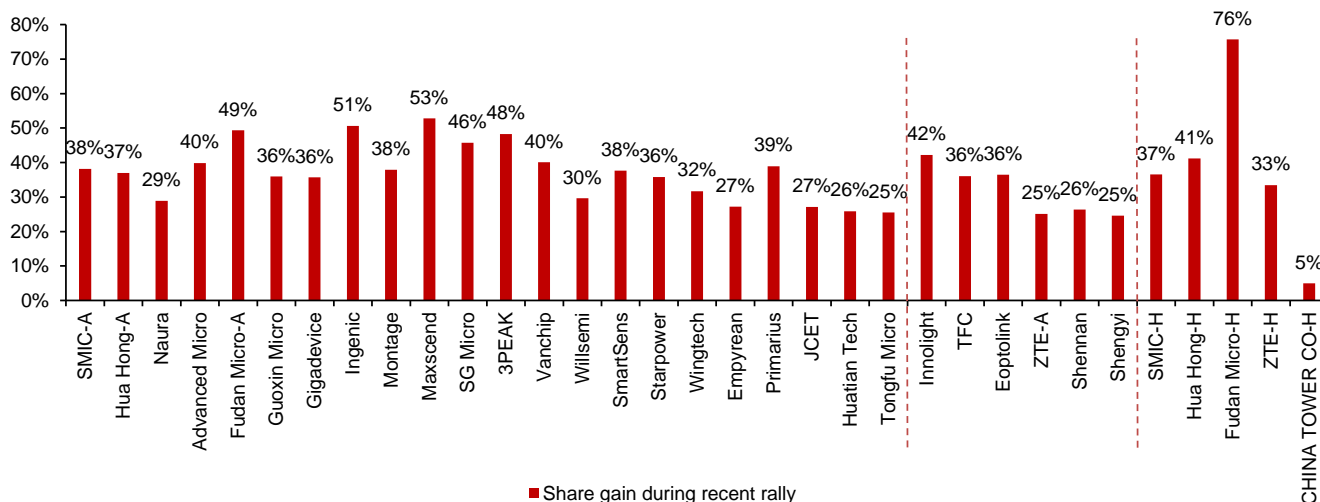
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Valuation revisit for China semiconductor/communication sector: peers were trading at deep discounts pre-rally and are still trading at an avg. of -0.5 SD below 5-year P/E multiple currently

Semiconductor and communication sectors soared with broad market advancement. Semiconductor sector index was up 15.5% on 30 Sep 2024, ranking first among all subsectors in terms of single-day performance. From 23 Sep to 30 Sep, the avg. increases in share price of selected semiconductor A-share group and optical/telecom group were 37% and 32% (mainland market is closed for National Day holidays). Since 23 Sep, the avg. increase in share price of selected H-share peers was 38%.

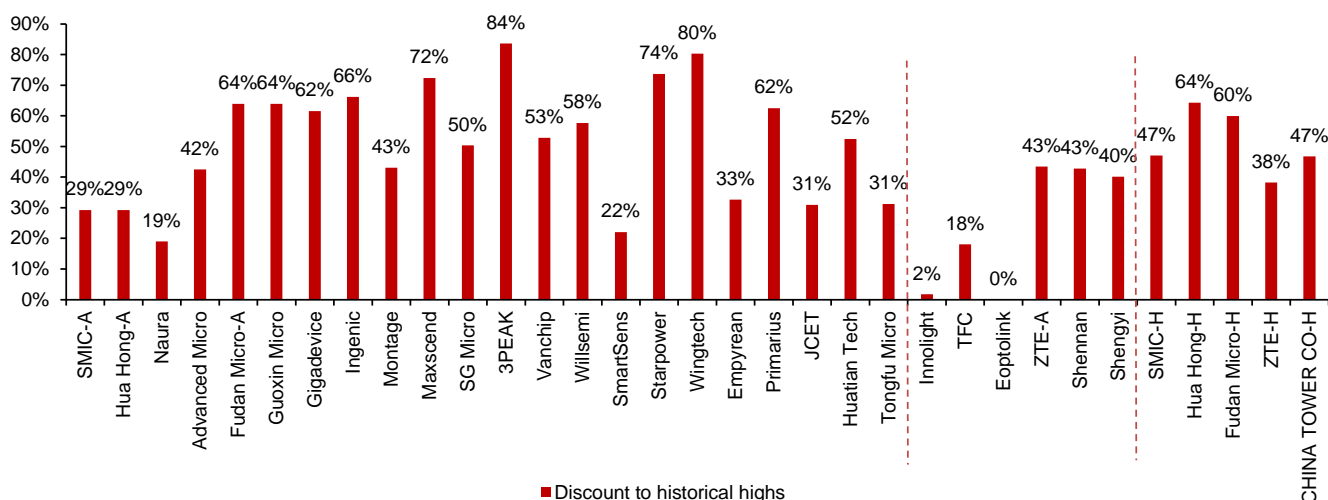
Figure 3: The shares of selected group of industry leaders gained during recent rally (23-30 Sep.)



Source: Bloomberg and CMBIGM

However, most of these stocks are still trading at discounts to their historical highs largely due to slower-than-expected recovery in demand (non-AI). The avg. discounts of current share prices vs. historical highs were 51% for the semiconductor A-share groups and 24% for optical/telecom group. During 23 Sep and 2 Oct, the avg. increase in share prices of our selected H-shares was 51%.

Figure 4: However, current prices are still at a discount to their historical highs



Source: Bloomberg and CMBIGM

As the market went up significantly in a short period of time, investors who are already on the train asking if the rally can continue or a pullback is coming? Investors who missed the train asking if it is still good to get on board or the valuation of A/H stocks are elevated.

We did a valuation check for these stocks. We found that most of the semiconductor peers are still trading below their 5-year historical avg. fwd. P/E multiples, with an average -0.5 SD below avg., excluding EDA peers.

Figure 5: China semiconductor/communication (optical/telecom) sector valuation revisit

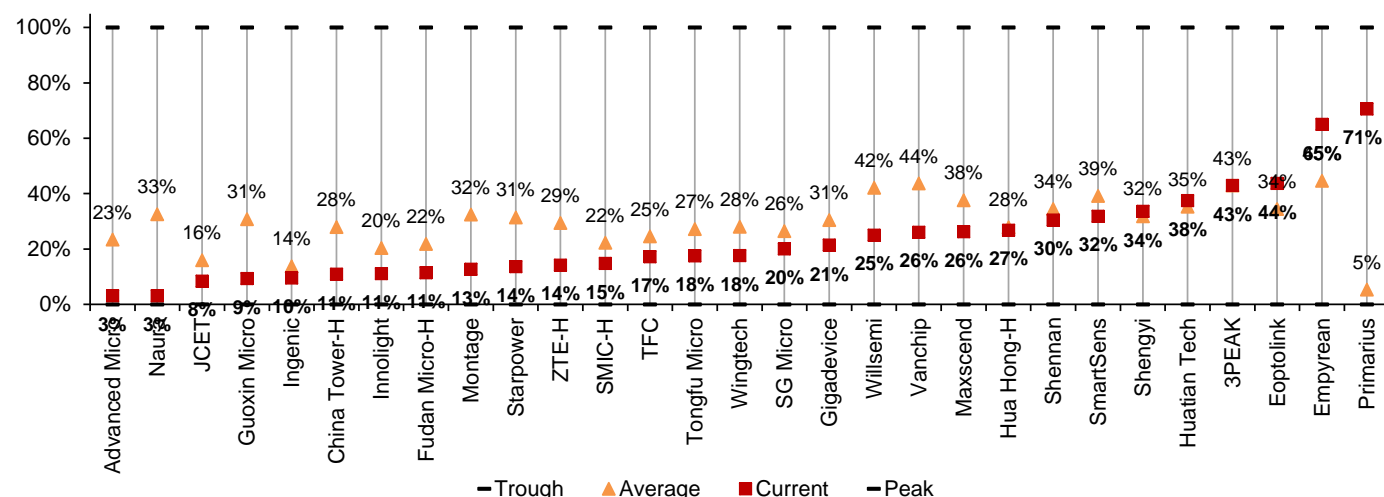
Company	Ticker	Price (LC)	5-year P/E valuation (x)			
			Current	Trough	Peak	# SD +/- avg.
Foundries						
SMIC-H	981 HK	22.20	27.2	9.1	119.8	-0.3
Hua Hong-H	1347 HK	22.70	26.5	7.3	72.0	0.1
Foundries peers average						-0.1
Equipment						
Naura	002371 CH	365.98	27.1	21.1	209.6	-1.2
Advanced Micro	688012 CH	164.00	43.2	31.1	414.6	-0.9
Equipment peers average						-1.1
Logic/Memory						
Fudan Micro-H	1385 HK	16.34	16.6	8.1	62.6	-0.4
Guoxin Micro	002049 CH	62.37	20.2	12.0	99.4	-1.0
Gigadevice	603986 CH	88.37	38.5	15.9	121.7	-0.5
Ingenic	300223 CH	64.92	40.4	21.3	221.1	-0.2
Montage	688008 CH	66.88	36.5	26.4	106.4	-1.0
Logic/Memory peers average						-0.6
Analog						
Maxscend	300782 CH	92.89	38.5	20.0	90.7	-0.4
SG Micro	300661 CH	95.00	68.8	33.8	208.1	-0.3
3PEAK	688536 CH	100.96	47.7	31.9	68.6	0.0
Vanchip	688153 CH	36.32	36.5	19.0	86.2	-0.7
Analog peers average						-0.4
Optoelectronics						
Willsemi	603501 CH	107.20	31.2	16.3	75.6	-0.8
SmartSens	688213 CH	57.71	41.0	20.3	85.3	-0.3
Optoelectronics peers average						-0.6
Power						
Starpower	603290 CH	91.25	21.2	13.9	67.2	-0.7
Wingtech	600745 CH	32.73	19.1	9.7	63.2	-0.5
Power peers average						-0.6
EDA						
Empyrean	301269 CH	93.01	208.5	116.7	257.8	1.0
Primarius	688206 CH	17.80	1,915.0	100.4	2,670.0	5.6
EDA peers average						3.3
OSAT						
JCET	600584 CH	35.33	24.0	11.1	163.7	-0.4
Huatian Tech	002185 CH	9.34	35.2	13.8	70.9	0.1
Tongfu Micro	002156 CH	22.89	29.5	13.4	105.1	-0.5

OSAT peers average						-0.3
Optical/Telecom						
Innolight	300308 CH	154.86	22.4	14.9	82.0	-0.6
TFC	300394 CH	100.50	27.1	15.7	82.0	-0.5
Eoptolink	300502 CH	129.97	32.8	11.1	60.7	0.4
ZTE-H	763 HK	21.75	14.2	9.5	42.8	-0.7
China Tower-H	788 HK	1.06	13.3	10.0	40.0	-0.7
Optical peers average						-0.4
Group average						-0.2
Group average, excluding EDA peers						-0.5

Source: Company data, Bloomberg consensus

We also ranked the group of peers by their current trading levels (P/E) vs. their 5-year historical average/trough/peak positions, from smallest to largest. 23 of the companies are trading below historical average P/E, representing 79% of the sample.

Figure 6: Group of peers by their current trading levels (P/E) vs. their 5-year historical average/trough/peak positions, from smallest to largest



Source: Company data, Bloomberg consensus

Possible re-rating opportunities for the semi sector

In the near term, we believe that the market momentum is likely to stay, especially for Hong Kong equities.

For semiconductor sector, we are optimistic that HK-listed companies will have upside opportunities driven by improvements of the market sentiment and funds inflows.

- **SMIC (981 HK, NR), Hua Hong (1347 HK, BUY) and ZTE (763 HK, BUY) may be more favored by funds** considering their larger market capitalization and better liquidity.
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