

Analyst: Sam Ho

Main Board Listing- Research

華潤上華科技有限公司

CSMC Technologies Corporation - [Stock Code: 0597]
Global Coordinator, Bookrunner and Sponsor : Citigroup

Joint Lead Managers : Citigroup

DBS

UBS

Sector : Semiconductor

Business: Manufacture and sale of ICs

Total share offer: <u>621,000,000</u> shares (27.22% of the enlarged share capital) Placement: 558,900,000 shares (90%) IPO: 62,100,000 shares (10%) Greenshoe: 93,150,000 shares	<u>Business of CSMC</u> The Company owns and operates an open semiconductor foundry in China. It provides manufacturing services mainly for CMOS logic, mixed signal, high voltage and non-volatile memory ICs. It also offers assistance to its customers by arranging upstream IC design services as well as downstream testing and packaging services. Its principal customers are the rapidly-growing fabless design houses in China. The Company currently targets the market for ICs manufactured with 1.5 microns to 0.4 micron process technologies on 6-inch wafers, and plans to produce ICs with 0.35-micron process technology by the end of 2004. Its wafer fabrication facility is located in Wuxi, Jiangsu province, which currently produces 6-inch wafers using 0.4 micron and larger process technologies. This 6-inch fab has a capacity of 26,667 wafers per month by the end of 2003, with a capacity utilization rate of 95%.
Price: HK\$0.73-HK\$1.10 per share Market cap: HK\$1,792 mln-HK\$2,701 mln Staffing: 920 Prospective 2004 P/E: 23.5x-35.3x 2004E proforma price-to-book: 1.25x-1.60x Adjusted NAV per share: HK\$0.47-HK\$0.56	
IPO commences: 15 th June 2004 IPO ends: 18 th June 2004 Share registrar: Computershare Hong Kong Investor Services Receiving bank: Standard Chartered Bank Listing date: 25 th June 2004	

Major Shareholders after Listing

(Assuming the over-allotment option is not exercised and the subscription rights attached to the warrants are not exercised)

*China Resources Logic (stock code: 1193)	24.88%
CSMC Cayman	22.10%
*Crown Crystal Investments	6.63%
Chartered Semiconductor Manufacturing Ltd, a Singapore-listed company	5.39%
*3i Group, a London-listed company	2.98%
*3i Asia Pacific, an English limited partnership	0.99%
*International Finance Corporation	3.18%
*DBS	2.65%
*Templeton	1.33%
*Pacific Venture Management	1.06%
*Investor AB, a Stockholm-listed company	0.80%
*Fortune Holdings	0.53%
*Sumitomo Corporation, a Tokyo-listed company	0.27%
	72.79%

*- these shareholders were granted a total of 17.4 million warrants to further subscribe for 174 million ordinary shares of the Company

Use of Proceeds

Net proceeds from the offer are estimated to be US\$52.10 million- US\$81.58 million

(Assuming the over-allotment option is not exercised)

	US\$ million
To acquire, refurbish and install reconditioned equipment in Fab 1	76
To partly fund the construction of Fab 2 shell, including the installation of utilities, clean rooms and contingencies, which was estimated at US\$82 million	Balance

Financial Highlights

	Year ended 31 st December		
	2003 US\$'000	2002 US\$'000	2001 US\$'000
Turnover - 5-inch wafer	-	962	5,895
- 6-inch wafer	40,629	39,965	23,842
Mask making	<u>1,448</u>	<u>50</u>	<u>211</u>
	<u>42,077</u>	<u>40,977</u>	<u>29,948</u>
Operating profit	5,275	11,879	4,880
Net profit	<u>4,015</u>	<u>10,364</u>	<u>3,970</u>
Dividend	13,000	-	4,880
EPS- basic	<u>US\$0.04</u>	<u>US\$0.11</u>	<u>US\$0.04</u>

Operating data

	Year ended 31 st December		
	2003 US\$million	2002 US\$million	2001 US\$million
Depreciation and amortization	9.12	2.29	0.38
Capex	34.02	21.15	8.20
Wafer sales	Units	Units	Units
6-inch (12-layer equivalent)	214,990	182,199	104,356
5-inch (7-layer equivalent)	nil	12,774	82,220
Average selling price	US\$	US\$	US\$
6-inch (12-layer equivalent)	196	224	239
5-inch (7-layer equivalent)	Nil	77	75

Strengths/ Opportunities

- ✓ According to *IC Insights*, worldwide semiconductor sales are expected to reach US\$211 billion in 2004, representing a 27% increase over 2003's sales of US\$166 billion, while China accounted for a 14% of the market share. It further estimated that sales of semiconductor in China will reach US\$80 billion by the end of 2010 as China would increase its share of total global semiconductor consumption to 30%
- ✓ The Company has low capex as well as fixed overheads due to its strategy to use reconditioned semiconductor equipment and focus on the mainstream IC market segment in China.
- ✓ The Company enjoys solid support and assistance from a wide range of international investors, including China Resources Logic, Chartered Semiconductor, 3i Group and IFC.

Weaknesses/ Threats

- × Competition in the China semiconductor industry is intense, and big players TSMC and UMC had already announced plans to build fabs in China.
- × Semiconductor industry is highly cyclical in nature. The intervals between revenue growth and decline for the global market ranged from 1-2 years over the last decade.
- × Lower R&D resources due to smaller economies of scale versus global and local leaders.
- × The Company recorded a sharp drop in net profit in 2003 as profit margins were negatively affected by the drop in average selling price and utilization rate amid the SARS outbreak, as well as an increase in the depreciation cost per unit (due to larger capex). In fact, gross-profit margin declined from 38% for 2002 to 22.8% for 2003.
- × A change in tax incentive might adversely impact its earnings. In fact, the Company received a tax rebate of US\$1.1 million in 2003, while its net profit was only US\$4 million.
- × The Company estimates that it will need a total of US\$398 million to build and ramp up a new 6-inch and 8-inch wafer fabrication facilities in the next 2 years. The proceeds from the IPO could only meet a fraction of the funding needs. The Company needs to pursue other means, such as internal resources or bank borrowings, to fill the gap. As at 31/12/2003, the Company was free from long-term bank loans.
- × With shares priced at 2004E P/E of 23.5x-35.3x, valuation of CSMC is quite demanding, when compared with other locally-listed semiconductor plays SMIC (*stock code: 0981*)'s 2004E P/E of 28.8x and Solomon Systech (*stock code: 2878*)'s 2004E P/E of 12.3x. Moreover, regional player TSMC was only trading at 2004E P/E of 9.4x.

Recommendation: Unexciting