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Ams AG facing challenges amid near-term chip sector weakness

By Liu Hanlei

Cautious views and weaker sales outlook have been echoed by executives across the semiconductor industry, which acts as a signal of the broader tech sector. Leading semiconductor firms such as Texas Instruments Inc, STMicroelectronics NV and Taiwan Semiconductor Manufacturing Co, have warned about slowing electronics demand in the upcoming quarters and the slowing investment across the sector. This is not helped by the uncertainty caused by the escalating trade conflict between the US and China. The US have implemented 10% taxes on USD 200bn worth of Chinese imports and are set to rise to 25% by January 1, 2019 which could further affect products manufactured with semiconductors. This uncertainty and pessimism in the near term has affected the chip supply chain and related companies' share prices have taken a hit. The market capitalization of about 400 companies in the semiconductor industry specializing in electronic components have dropped about 22% since its peak in June 2018. The RMI-CRI 1-year aggregate Probability of Default (PD) for these globally listed semiconductor firms rose to 9.3bps over the past year with a higher increase in the month of September to October 2018 relative to the other periods (see Figure 1).

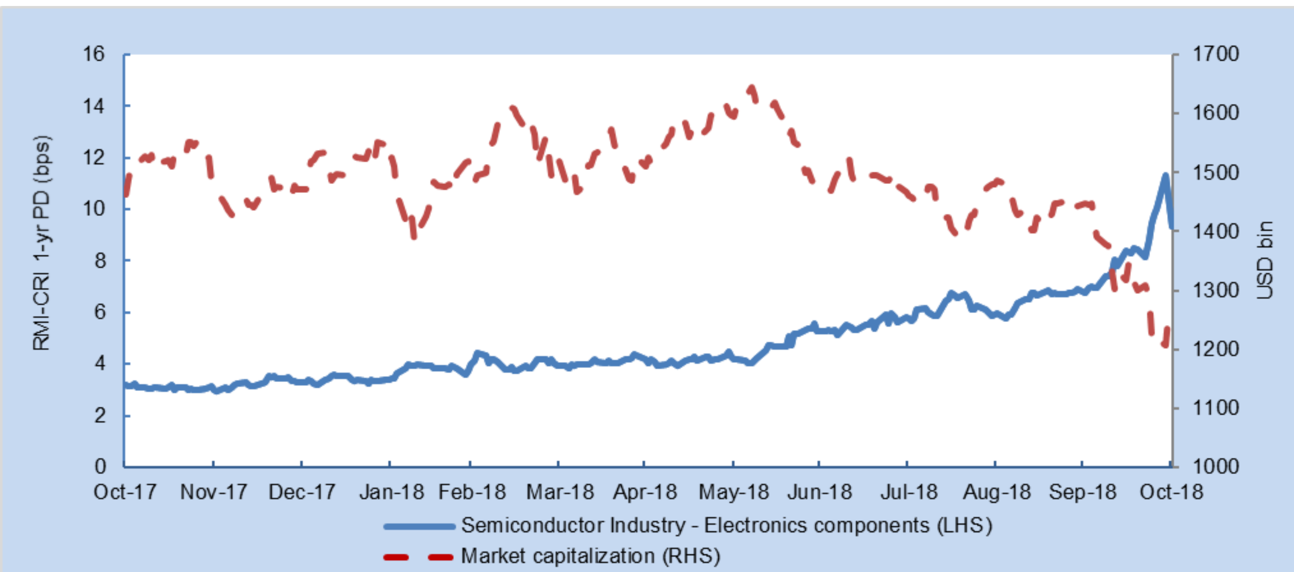

Figure 1: RMI-CRI 1-year Aggregate PD for Semiconductor industry – electronics components producers and its market capitalization. *Source: RMI-CRI, Bloomberg*

In the semiconductor industry, there are many sub sectors and the specific analog integrated circuit sub sector belongs to one of them. These circuits convert analog signals such as sound, light and heat into digital signals for the computer to process. Ams AG and 3 other companies belong to this sector according to Bloomberg Industry Classification. Ams specializes in developing sensor solutions that is being used in the communications, automotive and industrial business. One of Ams' products is the optical sensor which help to adjust the brightness and colours on smartphone screens.

In Ams' recent earnings release, Ams reported its third quarter earnings which saw its sales jumped by 57% to USD 479.6mn YoY but its guidance for fourth quarter operating margin missed estimates. Market consensus had expected fourth quarter adjusted operating margin (which excludes acquisition cost) to be 27%, similar to Q4 2017. However, its recent guidance for its operating margin is between 16-20%, attributed to the increased in competition in various product mix. As a result of the missed estimates, the market cap of Ams dropped by 32%. The RMI-CRI 1-year PD of Ams rose to a high of 160bps as a result, signifying a weaker credit profile (see Figure 2 below). Ams' RMI-CRI Distance-To-Default (DTD) measures are also lower than its peers. A low DTD is usually associated with a high PD, and changes in DTD are a significant determinant of RMI-CRI 1-year PDs.

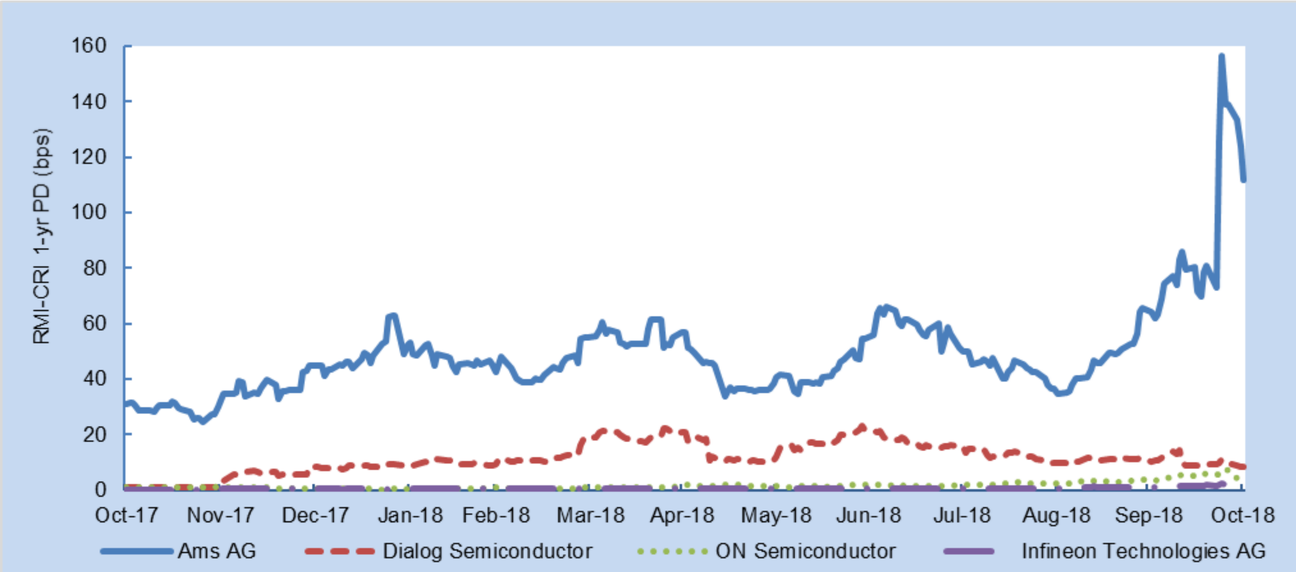

Figure 2: RMI-CRI 1-year PD for Ams AG and its peers. *Source: RMI-CRI*

Among its peers, Ams faces the weakest operating margin and the highest leverage ratios (see Table 1 below) as of Q3 2018. Operating margin after accounting for acquisition cost is relatively weaker and it has the highest net debt to EBITDA and net debt/equity. A negative net debt/equity position for Infineon and Dialog means that these companies are in a net cash position. Comparing to the median of the semiconductor industry, Ams' leverage ratios stand out. One reason for Ams' high leverage is its acquisition of companies over the past few years in order to expand its product base and obtain new technologies. Despite the expanded product base, Ams is still dependent on Apple as it is estimated that approximately 40% of Ams' revenue comes from Apple. In its recent earnings release, Apple also reported to forecast a slower holiday sales season which further exacerbate the need to reduce Ams' dependency on Apple. AMS has been working on selling its sensors to Android customers but competition has been stiff. This is evidenced by the recent agreement worth USD 600mn that its German rival Dialog Semiconductor manage to secure with Google.

	Operating margin (%)	Net debt/EBITDA (X)	Net debt/equity (%)
Ams AG	7.15	4.42	114.21
On Semiconductor	12.28	1.37	71.49
Infineon Technologies	13.92	-0.36	-10.96
Dialog Semiconductor	13.82	-2.12	-33.70
Median of semiconductor industry	6.34	-0.63	-9.82

Table 1: Financial ratios for Ams AG, its peers and the median of the semiconductor industry as of Q3 2018. *Source: Bloomberg*

The semiconductor industry is expecting the global semiconductor market revenue to grow from 15.8% in 2018 to 4.4% and 4.3% over the next two years. Ams' relatively weaker profitability and higher leverage will make it tougher to survive and compete with its peers. It has tried to diversify its product mix and announced new deals by starting to produce 3D face recognition sensors for two Android customers, including China's Xiaomi and Huawei. Despite securing new deals on new products, it remains to be seen if Ams can weather the slowing industry amid its relatively weaker credit profile.

Credit News

Default risk rise in USD 355bn China builder bond market

Nov 5. Investors are bracing for more debt defaults among China's real estate developers as funding costs escalate and refinancing pressure intensifies. As shown by the ICE BofAML indexes, the borrowing costs in dollar terms for China's high-yield issuers, most of whom are property developers, almost doubled this year to 11.2%, reaching near 4-years high. The sector also faces a record USD 18bn of bond maturities in both onshore and offshore markets in the first quarter of 2019, exacerbating the situation. According to Bloomberg-compiled data, the figure might double if investors demand early repayments. China's property developers have been facing a funding crunch due to government's clampdown on shadow financing. It is noted that at least four property related firms have defaulted on notes this year. (Bloomberg)

Trade war squeezes corporate earnings in Japan and China

Nov 5. Many Japanese companies and Chinese businesses are going through a tough time because of US-China trade war. The combined net profit of Japanese companies rose just 0.5% for the July- September quarter after climbing by double digits for seven straight quarters. The slower growth is mainly attributed to slower shipment to China, lower new orders and decline in capital- spending in China. In China, a wide range of companies are suffering from a sharp slowdown in growth - from manufacturers and marine shipping companies directly hit by the trade tensions, to airlines that faced higher costs due to a weaker yuan, as well as automakers and supermarket chains slammed by sluggish consumer spending. Meanwhile, there are companies doing fairly well, such as Chinese state-owned enterprises in the resources sector and Japanese technology companies. (Nikkei Asian Review)

India central bank to help shadow banks refinance debt as default worries loom

Nov 2. The Reserve Bank of India said that banks could now provide partial credit enhancement to refinance bonds issued by non-banking finance companies (NBFCs) and housing finance companies with tenors of not less than three years. Panic over potential debt defaults in the shadow banking sector have caused a liquidity crunch, as shown by the yields of NBFCs' corporate bonds which have risen by more than 80bps since September. Analysts say that the new measures may drive mutual funds and insurance companies who are more risk-averse, to rely on the credit enhancement and buy such bonds. (Reuters)

Cities threatened by climate risk still getting AAA bond ratings

Nov 2. Cities threatened by climate risk are yet to receive downgrades as credit rating agencies believe that the cities are taking steps to protect themselves. However, some investors and policy experts dispute the idea that municipalities have done enough to protect themselves to warrant the high ratings. It is noted that while big storms can do measurable damage to a city's tax base and therefore its ability to pay back bonds, it is more difficult to measure the effects of other problems such as sea-level rise and flooding. While credit rating agencies such as S&P, Moody's and Fitch have pledged to account for such risks in their analyses last year, most cities with high level of exposure to the effects of climate change still received perfect ratings over the past year. (Bloomberg)

Banks shrug off regulators' leveraged loan warnings

Nov 2. New issuances of US leveraged loans have exceeded levels last seen in the lead up to the last financial crisis and regulators including the Federal Reserve and the Bank of England are warning about the breakneck pace of leveraged lending. Loosening standards in the leverage loan market comes at a time when borrowing costs are low and non-financial debt levels are rising. Bankers say regulators should not merely criticize the market but provide clear guidance to lenders about exceeding leverage loan issuance limits and its potential penalties. Market participants will be taking cues from the upcoming Shared National Credit review in December which is expected to assess trends and practices within the risk management units amongst various financial institutions. (Reuters)

With Mexico Airport bonds at 80 cents, adviser warns of default (Bloomberg)

Loan funds see biggest outflows since 2015 (Reuters)

At least three English universities on the 'verge of bankruptcy' (Yahoo)

Regulatory Updates

EBA publishes 2018 EU-wide stress test results

Nov 2. The European Banking Authority (EBA) published the results of the 2018 EU-wide stress test, involving 48 banks from 15 countries and covering broadly 70% of total EU banking sector assets. It was revealed that the adverse scenario had an impact of -395 bps on banks' CET1 fully loaded capital ratio, leading to a 10.1% CET1 capital ratio at the end of 2020. Mario Quagliariello, the Director of Economy Analysis and Statistics at the EBA said that the outcome showed that the banks' efforts to build up their capital base in recent years have contributed positively to their resilience in withstanding the severe shocks and material capital impacts of the 2018 exercise. (EBA)

ECB reports results on the September 2018 survey on credit terms and conditions in euro-denominated markets

Oct 29. Respondents to the ECB bank lending survey reported tighter credit terms and conditions offered to counterparties for both securities financing and over-the-counter derivative transactions. The tightening was in line with the expectations reported in June and was explained mainly by the deterioration in the liquidity conditions and functioning of the general collateral market, as well as the lack of intermediaries' balance sheet capacity. Banks and dealers have also increased the level of resources and attention devoted to the management of concentrated credit exposures. Also, liquidity and general trading conditions for the underlying collateral improved slightly, following several quarters of deterioration. (ECB)

China to sell debt in Hong Kong to support Renminbi (FT)

China to tighten rules on five financial giants (WSJ)

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