



Revised 2013 forecast; maintain Overweight and revised target price to US\$1.85 (31.2% upside)

Long-term outlook remains promising; short-term slowdown in multimedia IC segment; 2013 growth driver will be the security and surveillance segment

Following our latest Q4-2012 earnings report, we have now revised our outlook of Vimicro's growth potential, particularly in the security and surveillance segment. We were slightly aggressive on the short-term growth prospect by underestimating the time between signing of the sales contract and recognition of revenues in addition to typical seasonality. We have thus revised our sales forecast for the security and surveillance segment to US\$4.6 million for Q1-2013 (down from US\$6.9 million in the original estimate from our Q3-2012 report dated November 8, 2012) and US\$32.8 million for FY2013 (up from US\$31.1 million in the original estimate). We have accounted for the additional time that Vimicro needs to grow its security and surveillance revenues, and our expectation that the income contribution from the Zhongtianxin partnership with Shanxi Guoxin Investment (Group) Corporation and Vimicro Fuzhou (from sales made to the Fuzhou local government of Fujian province) will not appear until Q3 or Q4-2013. In terms of growth, Vimicro's security and surveillance sales grew by 47% in 2012, and we forecast the growth rate to be 85% for the full-year in 2013. We believe that 2013 will be an important year for sales in Vimicro's security and surveillance division, comprising 40% or more of total sales. The security and surveillance division may even have the potential of achieving segment breakeven by the end of the year on a quarterly basis.

The slowdown in the personal computer (PC) and notebook market continues to impact Vimicro's multimedia IC segment. From our conversation with Vimicro's management, we learned that much of the slowdown in Q1-2013 sales can be attributed to one of Vimicro's major multimedia IC customers delaying orders due to its own supply chain and inventory management issues. Vimicro's management expects to resume supplying the customer later this year. We believe that the PC and notebook market is in a transition stage and expect its conditions to improve by the second half of 2013. Our revised top-line sales forecasts for the multimedia IC segment are US\$7.9 million for Q1-2013 (down from US\$12.3 million) and US\$49.2 million for FY2013 (down from US\$54.9 million). Exhibit 1 on the next page shows our revised sales forecast for Vimicro.

May 9, 2013

OVERWEIGHT

Target price US\$1.85
Upside 31.2%

Company data

Price (US\$)	1.41
Market cap. (US\$m)	41.1
Shares (ADS) OS (mn)	29.1
52-week range (\$)	0.69 – 1.86
Dividend yield (%)	-
EV/sales 2013E	0.15x
P/TBV 2013E	0.51x
Sector	Information Technology
Industry	Semiconductor / Security

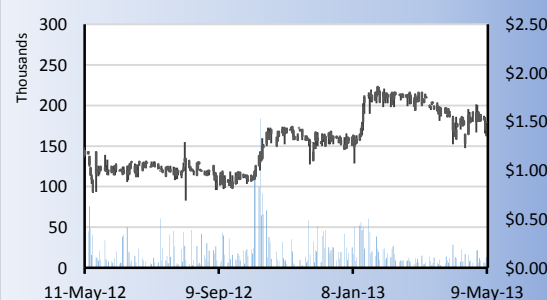
Note: Market data as of May 9, 2013

Financials

FYE Dec; US\$m	2012A	2013E	2014E
Sales	71.2	82.1	93.3
Gross margin	36.6%	37.2%	38.4%
Net margin	N.M.	0.2%	3.0%
Net income (adj.)	1.2	3.1	3.0
ROE (adj.)	1.6%	3.9%	3.6%
D/E	10.0%	40.3%	36.7%
R&D as % of sales	11.1%	10.0%	9.3%

Source: BlackOre Research, company filings

Share price history



All figures in the report are in US\$ unless otherwise stated

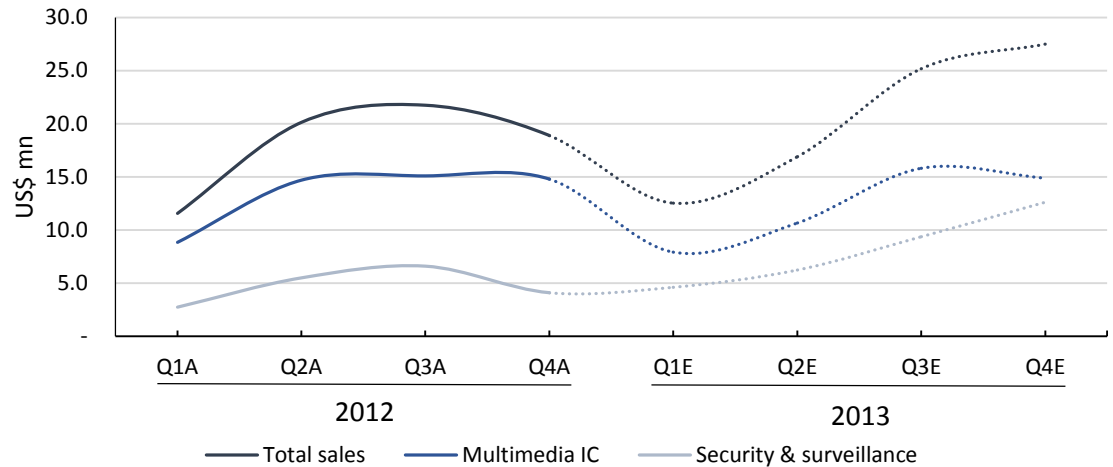
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Exhibit 1 – Vimicro 2013 sales forecast by segments



Source: Company filings and BlackOre Research estimates

Operating expenses remain stable; expect slight increase in R&D expenses

Our revised operating expenses have remained close to our original forecast with the exception of R&D expenses, which we have revised to US\$8.2 million from US\$6.4 million for 2013. We expect the increase in R&D expenses would relate to Vimicro’s continuous effort in developing its security and surveillance segment. R&D expenses are expected to continue to increase in 2014 with the expected completion of the new Tianjin security and surveillance R&D facility. In addition, we have forecasted US\$0.3 million in other non-operating income (net) for 2013 in relation to real estate assets owned by Vimicro Tianjin.

Expect modest full-year GAAP profitability, despite net losses for the first two quarters of 2013

As discussed above, we have revised our top-line forecasts, which directly impacted the forecasted bottom-line performance for Vimicro. We expect a net loss attributable to Vimicro (after accounting for non-controlling interest) of US\$1.8 million for Q1-2013. We believe that 2013 will be a milestone year for Vimicro as we expect to see the security and surveillance division to turn a profit on a quarterly basis in Q4-2013. For FY2013, we expect a total net profit of US\$0.2 million, of which US\$3.3 million is attributable to Vimicro (US\$3.1 million if we do not include other non-operating income).

Valuation

We maintain our Overweight rating and revised target price down slightly to US\$1.85 from US\$1.90. The revised target price implies a 31.2% upside to the current market price. Our target price revision reflects the delay in sales recognition for the security and surveillance segment and slowdown in multimedia IC. Our Overweight rating reflects our long-term positive view on the company. The weighting and multiples that we have used for each valuation method is shown in Exhibit 2. Vimicro’s relative valuation against its peers is shown in Exhibit 3.

Exhibit 2 – Valuation summary

				Implied value/ADS	Premium/(discount) to current price*	Weight
		Terminal factor				
DCF valuation						
DCF - terminal multiple (EBITDA)		3.5x		\$2.01	42.6%	30.0%
DCF - terminal growth		1.0%		\$2.43	72.3%	30.0%
	Multimedia IC	Security & surveillance	Overall			
Peer trading multiple						
EV/sales (FY2013E)	1.00x	2.00x	1.53x	\$3.94	179.4%	10.0%
EV/EBITDA (FY2013E)	5.0x	8.5x	6.4x	\$0.80	(43.3%)	-
P/E (FY2013E)**	9.0x	27.0x	16.2x	\$1.59	12.8%	10.0%
P/TBV (2012A)	2.00x	3.60x	2.64x	\$6.46	358.2%	-
Historical implied multiples***	High	Low	Target			
EV/sales (1-year forward)	4.40x	0.14x	0.50x	\$2.19	55.3%	5.0%
EV/sales (2-year forward)	4.67x	0.39x	1.00x	\$2.37	68.1%	5.0%
P/TBV (1-year forward)	4.38x	0.79x	1.00x	\$1.97	39.7%	5.0%
P/TBV (2-year forward)	4.40x	0.14x	0.50x	\$2.10	48.9%	5.0%
Weighted average value per ADS				\$2.32	64.5%	
Discount				20.0%		
Final target price per ADS				\$1.85	31.2%	

Source: Thomson ONE & BlackOre Research estimates; market value as of May 9, 2013

Note: * Current Vimicro share price of US\$1.41 as of May 9, 2013

** Based on adjusted net income. Adjusted for one-time items (asset impairment, FX gain/loss, gain/loss from disposals, other, and net income/loss from discontinued operations)

*** Historical implied multiples are forward multiples derived from historical market prices and actual sales, EBITDA, or tangible BV figures reported in company's filings.

Exhibit 3 – Multiples

	Ticker	Mkt Cap (US\$ mn)	EV/Sales**		EV/EBITDA**		P/E (Dil.)		P/TBV
			LTM	FY2013E	LTM	FY2013E	LTM	FY2013E	Latest
Multimedia semiconductor									
Hewlett-Packard (H3C Technologies)	HPQ	41,174	0.50x	0.51x	4.0x	4.1x	NM	6.1x	NM
Ricoh Co. Ltd.*	7752	8,099	0.80x	-	9.6x	-	24.8x	-	0.90x
Marvell Technology Group Ltd.	MRVL	5,418	1.10x	1.12x	7.9x	6.9x	20.0x	13.9x	2.40x
Realtek Semiconductor Corp.*	2379	1,481	1.30x	-	11.0x	-	19.6x	-	2.40x
Silicon Motion Technology Corp.	SIMO	383	0.80x	0.82x	4.1x	4.9x	9.8x	8.5x	1.70x
Ali Corp.*	3041	329	1.20x	-	5.7x	-	12.5x	-	1.90x
PixArt Imaging Inc.	3227	292	1.30x	-	9.3x	-	29.2x	-	1.60x
Sonix Technology Company Ltd.*	5471	241	1.40x	-	7.2x	-	13.6x	-	2.20x
Sunplus Technology Co. Ltd.*	2401	186	0.40x	-	88.0x	-	NM	-	0.60x
QuickLogic Corporation	QUIK	102	6.00x	3.51x	NM	-	NM	NM	4.20x
Multimedia IC average			1.48x	1.49x	16.3x	5.3x	18.5x	9.5x	1.99x
Multimedia IC median			1.15x	0.97x	7.9x	4.9x	19.6x	8.5x	1.90x
Vimicro International Corp.	VIMC	41	0.17x	0.15x	N.M.	3.1x	N.M.	13.1x	0.53x
Security surveillance									
Texas Instruments Inc.*	TXN	41,050	3.40x	3.47x	11.0x	10.7x	22.9x	18.8x	10.40x
Sony Corporation*	6758	17,758	0.30x	0.27x	3.4x	3.5x	43.4x	27.6x	1.70x
Hangzhou Hikvision Digital Technology Co., Ltd.*	002415	11,494	8.70x	-	27.9x	-	31.4x	-	8.10x
STMicroelectronics NV*	STM	8,196	0.80x	0.84x	15.8x	7.5x	NM	47.9x	1.40x
NXP Semiconductors NV*	NXPI	7,309	2.30x	2.14x	9.5x	7.3x	NM	10.0x	NM
Zhejiang Dahua Technology Co., Ltd.	002214	6,949	11.00x	-	-	-	54.9x	-	19.00x
Samsung Techwin Co., Ltd.	A012450	3,289	1.40x	-	15.3x	-	27.4x	-	2.60x
Avigilon Corporation	AVO	536	4.30x	3.17x	33.3x	22.5x	55.9x	34.1x	7.10x
Shenzhen Infinova Limited	002528	519	2.10x	-	-	-	NM	-	1.70x
Av Tech Corporation	8072	319	1.80x	-	6.1x	-	12.9x	-	2.00x
Zhejiang Dali Technology Co. Ltd.	002236	273	6.70x	-	34.9x	-	50.0x	-	3.90x
Shenzhen Division Video Communications Co., Ltd.	300167	269	6.80x	-	77.4x	-	101.0x	-	1.90x
Beijing Jiaxun Feihong Electrical Co., Ltd.	300213	211	2.50x	-	42.1x	-	53.8x	-	2.40x
Napco Security Technologies, Inc.	NSSC	85	1.40x	-	19.2x	-	48.6x	-	3.20x
Vicon Industries Inc.	VII	14	0.10x	-	NM	-	NM	-	0.70x
ANV Security Group, Inc.	ANVS	4	10.70x	-	NM	-	NM	-	2.80x
Security surveillance average			4.02x	1.98x	24.7x	10.3x	45.7x	27.7x	4.59x
Security surveillance median			2.40x	2.14x	17.5x	7.5x	48.6x	27.6x	2.60x

Source: Thomson ONE & BlackOre Research estimates

Note: * Competitors identified by Vimicro in 20F filings

** Enterprise value (EV) calculated based on market capitalization + net debt + non-controlling interest. Cash used to calculate net debt includes cash and cash equivalents, investment in securities, but excludes restricted cash for comparability purpose.

FINANCIAL SUMMARY

Income Statement									
	Dec-31	Dec-31	Dec-31	Mar-31	Jun-30	Sep-30	Dec-31	Dec-31	Dec-31
	2010A	2011A	2012A	Q1E	Q2E	Q3E	Q4E	2013E	2014E
Sales									
Multimedia IC	68.6	46.9	53.4	7.9	10.7	15.8	14.9	49.2	48.9
Security and surveillance	7.8	12.1	17.8	4.6	6.2	9.4	12.6	32.8	44.3
Total sales	76.5	59.0	71.2	12.5	16.9	25.2	27.5	82.1	93.3
COGS									
Multimedia IC	(44.9)	(29.7)	(30.6)	(4.7)	(6.3)	(9.3)	(8.9)	(29.2)	(28.6)
Security and surveillance	(6.2)	(13.2)	(14.6)	(3.1)	(4.2)	(6.4)	(8.6)	(22.3)	(28.8)
Total COGS	(51.1)	(38.5)	(45.1)	(7.8)	(10.5)	(15.7)	(17.5)	(51.5)	(57.4)
Gross profit									
Multimedia IC	23.7	17.1	22.8	3.2	4.4	6.5	5.9	20.0	20.3
Security and surveillance	1.6	(1.1)	3.2	1.5	2.0	3.0	4.0	10.5	14.8
Total gross profit	25.3	20.5	26.0	4.7	6.4	9.5	10.0	30.6	35.8
Gross margin (%)	33.1%	34.8%	36.6%	37.7%	37.7%	37.7%	36.3%	37.2%	38.4%
Operating expenses									
Stock-based compensation	(4.1)	(2.4)	(2.1)	(0.4)	(0.4)	(0.4)	(0.4)	(1.6)	(1.5)
Research & Development	(17.7)	(18.2)	(7.9)	(3.1)	(2.3)	(1.6)	(1.1)	(8.2)	(8.7)
Sales and marketing	(6.0)	(12.0)	(9.0)	(2.0)	(2.1)	(2.1)	(2.1)	(8.2)	(8.3)
G&A	(7.5)	(9.9)	(11.3)	(3.2)	(2.7)	(2.8)	(3.0)	(11.6)	(11.8)
EBIT	(10.0)	(22.0)	(4.3)	(3.9)	(1.1)	2.6	3.4	1.0	5.5
EBIT margin (%)	(13.1%)	(37.3%)	(6.0%)	(31.2%)	(6.5%)	10.2%	12.5%	1.2%	5.9%
Interest income/(expenses)	1.1	0.7	0.2	(0.1)	(0.2)	(0.4)	(0.5)	(1.2)	(2.0)
EBT before unusual and infrequent items	(8.9)	(21.3)	(4.0)	(4.0)	(1.3)	2.1	2.9	(0.2)	1.0
Other non-operating & unusual items									
Asset impairment	-	(6.6)	(1.4)	-	-	-	-	-	-
FX gain/(loss)	0.6	1.7	(0.0)	-	-	-	-	-	-
Gain (loss) on disposal of marketable securities	0.4	1.5	-	-	-	-	-	-	-
Gain on disposal of equity interest	-	-	1.5	-	-	-	-	-	-
Others, net	0.5	0.5	0.2	-	-	-	0.3	0.3	-
EBT after non-operating and unusual items	(7.5)	(24.3)	(3.9)	(4.0)	(1.3)	2.1	3.2	0.1	3.5
Income tax (expense)/benefits	(0.8)	0.9	(0.2)	0.6	0.2	(0.3)	(0.5)	(0.0)	(0.9)
Net income (loss) before unconsolidated affiliate	(8.2)	(23.4)	(4.1)	(3.4)	(1.1)	1.8	2.7	0.1	2.6
Equity in profit of an unconsolidated affiliate	-	-	(0.1)	(0.1)	(0.1)	0.2	0.1	0.1	0.2
Net income (loss) from continuing operations	(8.2)	(23.4)	(4.1)	(3.5)	(1.2)	2.0	2.8	0.2	2.8
Net income (loss) from cont. operations									
Attributable to non-controlling interest	-	(10.1)	(5.5)	(1.6)	(1.1)	(0.5)	0.2	(3.1)	(0.2)
Attributable to Vimicro Intl. Corp.	-	(13.3)	1.4	(1.8)	(0.1)	2.5	2.6	3.3	3.0
Income (loss) from discont. operations, net of tax	(16.9)	(16.7)	(3.1)	-	-	-	-	-	-
Net income (loss)	(25.1)	(40.1)	(7.3)	(3.5)	(1.2)	2.0	2.8	0.2	2.8
Net margin (%)	(32.8%)	(68.0%)	(10.2%)	(27.7%)	(7.0%)	8.0%	10.2%	0.2%	3.0%
Net income (loss)									
Attributable to non-controlling interest	(6.5)	(11.9)	(6.6)	(1.6)	(1.1)	(0.5)	0.2	(3.1)	(0.2)
Attributable to Vimicro Intl. Corp.	(18.6)	(28.2)	(0.6)	(1.8)	(0.1)	2.5	2.6	3.3	3.0
Adjusted net income (incl. non-controlling interest)*	(9.5)	(20.9)	(4.3)	(3.5)	(1.2)	2.0	2.6	(0.1)	2.8
Adjusted figures attributable to Vimicro									
Adjusted net income*	(3.0)	(10.8)	1.2	(1.8)	(0.1)	2.5	2.5	3.1	3.0
Adj. basic earnings per ADS	(\$0.08)	(\$0.30)	\$0.04	(\$0.06)	(\$0.00)	\$0.09	\$0.09	\$0.11	\$0.10
Adj. diluted earnings per ADS	(\$0.08)	(\$0.30)	\$0.04	(\$0.06)	(\$0.00)	\$0.08	\$0.08	\$0.10	\$0.09
Supplementary data									
EBITDA	(6.3)	(17.5)	(2.2)	(3.2)	(0.3)	3.3	4.2	4.0	15.8
WASO - basic**	147.8	145.1	123.3	119.9	118.3	117.4	117.0	117.0	116.8
WASO - diluted**	147.8	145.1	127.6	127.6	127.6	127.6	127.6	127.6	127.6

Note: * Adjusted for one-time items (asset impairment, FX gain/loss, gain/loss from disposals, other, and net income/loss from discontinued operations).

** WASO: weighted average of common shares outstanding. The ADS ratio is 1 ADS to 4 common shares.

Balance sheet				
	Dec-31	Dec-31	Dec-31	Dec-31
	2011A	2012A	2013E	2014E
Current assets				
Cash and cash equivalents	49.2	55.5	37.9	50.4
Securities and restricted cash	3.5	2.6	4.1	5.8
A/R and notes receivable	17.9	24.6	35.8	17.7
Amounts due from related party	4.8	4.2	-	-
Inventories	18.7	11.4	17.5	16.1
Other current assets	4.4	5.2	6.5	6.2
Total current assets	98.6	103.5	101.7	96.2
PP&E	14.3	20.5	46.9	50.6
Land use rights	21.5	14.8	14.5	14.2
Other assets	2.9	5.8	5.8	5.8
Total assets	137.3	144.5	168.9	166.7
Current liabilities				
Accounts payable	9.3	7.3	12.3	11.1
Notes payable	1.0	-	-	-
Amounts due to related party	1.0	2.2	-	-
Taxes payable	1.2	2.3	1.0	1.0
ST bank loans	-	-	-	8.9
Other current liabilities	16.2	27.4	18.8	13.7
Total current liabilities	28.6	39.2	32.0	34.6
Deferred tax liabilities	0.0	0.0	0.0	0.0
Product warranty	0.3	0.5	0.7	2.3
Other long-term liabilities	-	4.8	9.5	7.6
LT bank loans	-	4.8	29.6	20.7
Total liabilities	29.0	49.3	71.8	65.3
Shareholders' equity				
Common equity	168.0	161.3	163.0	164.5
Retained earnings (deficits)	(82.6)	(83.2)	(83.1)	(80.3)
Non-controlling interest	22.9	17.2	17.2	17.2
Total shareholders' equity	108.3	95.2	97.0	101.4
Total liabilities and SE	137.3	144.5	168.9	166.7

Cash flow statement				
	Dec-31	Dec-31	Dec-31	Dec-31
	2011A	2012A	2013E	2014E
Operating activities				
Net income (loss)	(40.1)	(7.3)	0.2	2.8
Non-cash items				
Depreciation	4.5	2.1	3.0	10.3
Stock-based compensation	2.4	2.1	1.6	1.5
Other non-cash items	5.8	4.0	-	-
Total non-cash items	12.7	8.2	4.6	11.8
Working capital				
Restricted cash	1.4	1.4	(1.5)	(1.7)
A/R and notes receivable	(0.7)	(8.0)	(11.2)	18.0
Amount due from related party	0.6	(1.1)	4.2	-
Inventories	(3.8)	3.5	(6.1)	1.4
A/P	1.9	(0.0)	5.0	(1.2)
Amount due to related party	(3.9)	1.2	(2.2)	-
Notes payable	1.0	(0.7)	-	-
Taxes payable	0.2	1.0	(1.3)	-
Other working capital items	3.9	8.8	(9.7)	(3.2)
Net change in working capital	0.7	6.1	(22.9)	13.4
Total operating cash flows	(26.8)	7.1	(18.1)	28.0
Investing activities				
Sale (purchase) of securities	14.0	-	-	-
Purchase of PP&E	(11.7)	(8.5)	(29.5)	(14.0)
Disposal of VMF Shanghai	-	10.4	-	-
Investment in an equity investee	-	(4.3)	-	-
All other investing activities	4.8	0.0	0.3	0.3
Total investing cash flows	7.0	(2.4)	(29.1)	(13.7)
Financing activities				
Repurchase of shares	(2.7)	(7.4)	-	-
Proceeds from bank loans	-	4.8	24.8	-
Proceeds from interest-free Gov. loan	-	4.8	4.7	-
All other financing activities	0.7	(0.5)	0.1	(1.8)
Total financing cash flows	(1.9)	1.7	29.6	(1.8)
FX effect on cash	1.4	(0.1)	-	-
Net increase (decrease) in cash	(20.3)	6.3	(17.7)	12.5
Cash at the start of year	69.5	49.2	55.5	37.9
Cash at the end of year	49.2	55.5	37.9	50.4

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