9th March 2016

TMT

Dialog Semiconductor

Price EUR31.93

We believe the tough times are over

Fair Value EUR40 vs. EUR38 (+25%) **BUY vs. NEUTRAL**

Bloomberg	DLG GR
Reuters	DLGS.DE
12-month High / Low (EUR)	53.3 / 24.4
Market Cap (EURm)	2,486
Ev (BG Estimates) (EURm)	1,738
Avg. 6m daily volume (000)	15.10
3y EPS CAGR	10.0%

	1 M	3 M	6 M	31/12/15
Absolute perf.	25.9%	-5.1%	-28.6%	2.3%
Semiconductors	10.6%	-8.2%	-1.7%	-5.2%
DJ Stoxx 600	7.4%	-7.7%	-6.0%	-7.7%

YEnd Dec. (USDm)	2015	2016e	2017e	2018e
Sales	1,355	1,381	1,619	1,733
% change		*1.9%*	*17.2%*	*7.1%*
EBITDA	360	381	441	472
EBIT	317.7	313.4	368.9	400.2
% change		*-1.4%*	*17.7%*	*8.5%*
Net income	238.4	231.3	284.5	308.7
% change		*-3.0%*	*23.0%*	*8.5%*

	2015	2016e	2017e	2018e
Operating margin	23.4	22.7	22.8	23.1
Net margin	17.6	16.7	17.6	17.8
ROE	17.3	15.7	16.9	15.6
ROCE	46.9	49.9	59.8	64.0
Gearing	-54.0	-61.5	-67.2	-71.9

(USD)	2015	2016e	2017e	2018e
EPS	3.02	3.01	3.71	4.02
% change	-	*-0.2%*	*23.0%*	*8.5%*
P/E	10.6x	10.6x	8.6x	7.9x
FCF yield (%)	9.8%	7.9%	9.7%	10.7%
Dividends (USD)	0.00	0.00	0.00	0.00
Div yield (%)	NM	NM	NM	NM
EV/Sales	1.4x	1.3x	0.9x	0.7x
EV/EBITDA	5.4x	4.6x	3.4x	2.6x
EV/EBIT	6.1x	5.5x	4.1x	3.1x

Following the conference held yesterday by Dialog about Q4-15 results, we upgrade our recommendation to Buy from Neutral and increase our FV to EUR40 from EUR38. While we agree that 2016 will be a transition year, we believe all the tough times are over and we expect a rerating to gradually occur as 1/ the share trades at a strong discount vs. peers (P/E 2016e at 10.6x vs. 19.3x), 2/ the momentum will improve throughout the year with positive newsflow (new iPhone family) and recurring seq. growth, 3/ the group clarified its M&A target profile and said it is now looking for a smaller acquisition than Atmel with lower risks from an investor perspective and 4/ the group is making an important step towards investors with the proposition to put in place a framework for a share buy-back program.

ANALYSIS

- **2016 is a transition year.** In the Mobile Business segment, the ASP is seen to remain at the current level. The group said yesterday that it increased content just enough to offset price erosion, but we must expect no particular increase this year while the ASP for the group (excl. Connectivity and Power conv.) stood at 3.13 in 2015. Unsurprisingly, the most dynamic part of the group should be the connectivity division thanks to 1/ BT LE strong traction in fitness bands, BT tags and beacons leading sales to be up by more than +100% and helping to close the gap with the 25% market share target (BG ests. BT FY16 sales USD55m vs. FY15 at USD25m) and 2/ DECT momentum in the non-phone part (mainly wireless speakers and professional headsets). Also, the Power Conversion division is expected to achieve 20%/25% growth thanks to design wins in the rapid charging where the group estimates its market share to be at about 70%/80%. Finally, we expect Mobile Systems division sales for 2016 to be broadly the same as 2015 (down -1% at USD1105m). Overall, Dialog should achieve a strong performance during the second part of the year (as usually seen in the past) and we believe that Q1 will be the lowest quarter.
- **2017 should be brighter thanks to the Mobile Systems division.** We believe that the group is working on a new PMIC architecture to improve performance and which is delivering higher content per chip for Dialog. However, the positive impacts should be expected for 2017 on the ASP side. 2017 should also benefit from higher volume (end of the disappointing iPhone 6S cycle).
- **On the cost side, the group is doing a great job keeping things under control.** Despite the current slow momentum in the smartphone market, the group posted Q4-15 underlying operating margin of 26.3%, which was well above market expectations. During yesterday's conference call, the management highlighted that the group should maintain its gross margin level of about 46% through 2016 and the 25% of sales envelope in OPEX. The group is clearly taking benefit of its fabless model here. As a result, we slightly increase our expectations in term of operating margin and we adopt a scenario with FY16/FY17 underlying operating margin of 22.7%/22.8% vs. 21.7%/22.6% previously.
- **The tax rate LT view remains the same.** Last year, the group shared its LT view of a tax rate of about 20% thanks to realignment of sales and IP and benefit from more friendly UK tax conditions. In Q4-15, the tax rate sharply raised due to a one-time effect of the Atmel acquisition but we had confirmation that the LT view remains 20%. Overall, taking into account the change cited above, our FY16/17 EPS are marginally lowered by -0.5%.
- **The group is still looking for an acquisition, but the CEO says it is looking at smaller acquisitions rather than companies the size of Atmel.** The management is still looking to expand the customer base and technology portfolio through acquisitions, but we understood from yesterday's conference call that there is no hurry to find a target. In addition, the CEO commented on Bloomberg that the group is now looking for smaller acquisitions rather than companies the size of Atmel. This is reassuring in our view, since it means that the group should not go through a new acquisition implying an important dilution for historical investors.

VALUATION

- **We update our FV to EUR40 from EUR38.** It is derived from a DCF (@ EUR39) and updated peer multiples valuation (@ EUR40). Remember that we adopted a valuation method with an increased beta of 1.6 and a 15% discount vs. peers in September 2015 following the announcement of

Atmel. We maintain these adjustments reflecting investors' loss of references on the stock so far.

- **We now believe it is time to look back to the case.** Dialog's share trade at a FY16e P/E ratio of 10.6x, i.e. a significant discount compared to Fabless peers (average FY16e P/E at 19.3x). In our view, a rerating should gradually occur given 1/ a positive newsflow in the NT with the highly expected announcement of the new iPhone SE in late march, 2/ an improving momentum through the year at historically highest operating margin, 3/ an important step towards investors by adopting a more friendly shareholder policy with the setup of a framework for a share buy-back program and 4/ the M&A concern now over with recent clarification about target size and timing of inorganic growth opportunities. We believe it is now time to capture the 25% upside highlighted by our FV. As a result, we upgrade to Buy vs. Neutral.

NEXT CATALYSTS

- May 4th 2016, Q1-16 results.

Our new P&L

[USDm]	FY15	1Q16e	2Q16e	3Q16e	4Q16e	FY16e	FY17e
Total Group	**1355**	**242**	**252**	**348**	**539**	**1381**	**1619**
Q/Q growth	*17.2%*	*-39.0%*	*4.0%*	*38.0%*	*55.1%*	*1.9%*	*17.2%*
Y/Y growth	*17.2%*	*-22.1%*	*-20.4%*	*5.3%*	*35.8%*	*1.9%*	*17.2%*
Cost of goods sold	-731	-131	-136	-187	-290	-745	-873
Gross margin	**46.1%**	**45.9%**	**46.0%**	**46.2%**	**46.2%**	**46.1%**	**46.1%**
SG&A	-143	-27	-25	-35	-46	-133	-146
R&D	-223	-45	-47	-63	-92	-246	-282
Other operating income	59	9	9	11	26	55	50
Adj. EBIT	**318**	**48**	**53**	**75**	**137**	**313**	**369**
adj. operating margin	*23.4%*	*20.0%*	*21.1%*	*21.5%*	*25.3%*	*22.7%*	*22.8%*
EBIT	260	40	45	63	111	259	320
operating margin	*19.2%*	*16.5%*	*17.8%*	*18.2%*	*20.6%*	*18.8%*	*19.8%*
Net financial result	-5	-1	-1	0	-1	-3	-2
Income tax	-78	-11	-13	-18	-24	-65	-72
tax rate	*-30.4%*	*-28.5%*	*-28.5%*	*-28.5%*	*-21.6%*	*-25.5%*	*-22.5%*
Adj. Net income (loss)	**238**	**37**	**40**	**56**	**112**	**231**	**285**
Net income (loss)	177	28	32	45	86	191	247
Diluted adjusted EPS	**3.02**	**0.48**	**0.52**	**0.73**	**1.45**	**3.01**	**3.71**

Source: Bryan, Garnier & Co ests.

New vs Old

[USDm]	2016e			2017e		
	Old	**New**	**Δ%**	**Old**	**New**	**Δ%**
SALES	**1468**	**1381**	**-5.9%**	**1693**	**1619**	**-4.4%**
EBITDA	**387**	**381**	**-1.5%**	**455**	**441**	**-3.1%**
	26%	28%		27%	27%	
EBIT	**272**	**259**	**-4.6%**	**336**	**320**	**-4.6%**
	18.5%	18.8%		19.8%	19.8%	
EPS	**3.0**	**3.0**	**0.7%**	**3.8**	**3.7**	**-1.7%**

Source: Bryan, Garnier & Co ests.

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BUY ratings 63.4% NEUTRAL ratings 29.1% SELL ratings 7.5%

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