5th May 2016

TMT

Dialog Semiconductor

Price EUR27.28

Recovery is delayed, but is still on the cards

Fair Value EUR35 vs. EUR39 (+28%) **BUY**

Bloomberg	DLG GR
Reuters	DLGS.DE
12-month High / Low (EUR)	53.3 / 24.4
Market Cap (EUR)	2,124
Ev (BG Estimates) (EUR)	1,365
Avg. 6m daily volume (000)	11.80
3y EPS CAGR	9.4%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-23.9%	0.4%	-25.4%	-12.6%
Semiconductors	-9.0%	-2.1%	-10.7%	-9.4%
DJ Stoxx 600	-0.8%	0.9%	-12.7%	-9.3%

YEnd Dec. (USDm)	2015	2016e	2017e	2018e
Sales	1,355	1,250	1,467	1,754
% change		*-7.8%*	*17.4%*	*19.6%*
EBITDA	360	316	386	456
EBIT	317.7	248.0	313.9	384.1
% change		*-21.9%*	*26.6%*	*22.4%*
Net income	238.4	182.8	242.0	303.8
% change		*-23.3%*	*32.4%*	*25.6%*

	2015	2016e	2017e	2018e
Operating margin	23.4	19.8	21.4	21.9
Net margin	17.6	14.6	16.5	17.3
ROE	17.3	20.9	14.0	15.7
ROCE	46.9	39.8	51.4	62.9
Gearing	-54.0	-62.1	-66.6	-71.0

(USD)	2015	2016e	2017e	2018e
EPS	3.02	2.34	3.15	3.96
% change	-	*-22.4%*	*34.5%*	*25.6%*
P/E	9.0x	11.6x	8.7x	6.9x
FCF yield (%)	11.4%	12.4%	9.0%	11.9%
Dividends (USD)	0.00	0.00	0.00	0.00
Div yield (%)	NM	NM	NM	NM
EV/Sales	1.2x	1.1x	0.8x	0.5x
EV/EBITDA	4.4x	4.3x	3.1x	2.1x
EV/EBIT	4.9x	5.5x	3.8x	2.4x

Dialog is currently going through a soft patch. A still-lackluster smartphone market (especially in the Apple supply chain) is muting 2016 growth. However, we remain convinced that group's momentum will improve and we expect to see it from H2 with a expected sequential increase of sales of more than 50% (even pointing to a small yoy increase of 4% for H2). Market share gains and new products will then help from 2017, while higher volume and favorable mix should help to drive margin improvement from FY16 levels. We update our model and lower our FV from EUR39 to EUR35. However, given current valuation levels (2016e P/E ratio of 11.6x vs. peers at c. 18x) and our anticipation of an improving momentum, we maintain our Buy recommendation.

ANALYSIS

- **The group expects to sees mobile shipment decline yoy over FY16.** Given 1/ the updated FY16 guidance of a high-single-digit decline in sales, 2/ the confirmation of company's expectation for broadly flat ASP over FY16 and 3/ on the other hand, the confirmation of a strong momentum in the Connectivity (9% of group sales) and Power Conversion business (6% of group sales), we understand that management expects a strong decline in iPhone shipments over 2016 (note that Dialog's sales remain heavily iPhone skewed). The previous guidance left little chance for an iPhone shipments increase in FY16, but this new guidance provides confirmation. We believe that Apple smartphone shipments are expected to decline by more than -20%.
- **Growth scheduled to be back on 2017 and 2018.** With a strong R&D pipeline, management is confident about the company's ability to generate growth in 2017 and higher growth in 2018. We understand that catalysts should be 1/ an major step in content increase (in our view, 2017 generation of smartphones will use similar PMIC to the current most advanced iPad Pro, i.e. a system PMIC and an auxiliary system PMIC to avoid thermal and stability problems, 2/ increasing share in major smartphones with more chips (we believe the group is striving to provide more chips to Apple), 3/ a continuous positive momentum in Connectivity and Power Conversion, 4/ market share gain and design-wins thanks to a stronger collaboration with new Chinese players such as HiSilicon or Spreadtrum and a continuous collaboration with MediaTek, 5/ marginally, the development of the new lines of products such as PMIC for ARM based notebooks, TVs, STBs, Media sticks and Wireless routers or the audio product line.
- **Operating margin should be impacted: FY16 operating expenses should increase vs. FY15 even though the increase should be limited**. Given the current expected opportunity for 2017, the group does not plan to cut R&D expenses significantly. They are said to be necessary to sustain mid-term growth, which is coherent and reassuring in our view. Regarding other businesses, Bluetooth is said to have a positive impact on margins and Connectivity should be profitable in 2016, while Power Conversion should be breakeven by FY16. As a result, our model now includes a 5% increase in FY16 operating expenses compared to FY15 and, given a slightly lower gross margin expectations vs. FY15 (45.7% vs. 46.1% respectively), points to underlying operating result of 19.8% (vs. 21% before revision).
- **Our model update points to a 12% EPS cut.** In addition to the adjustment described previously, we also lowered our top-line expectation for FY17 to USD1,467m from USD1,567m while we keep our FY18 top-line estimate. As for FY16, we fine tune the opex and lower FY17/FY18 underlying operating margin from 23%/23% to 21%/22%. As a result, our EPS sequence for the next three years is cut by 12%.

VALUATION

- **Dialog is currently through a soft patch, but we remain convinced that group's momentum will improve.** A still-lackluster smartphone market - especially in the Apple supply chain - is muting 2016 growth. However, we continue to believe that the momentum should improve and it will start from H2 with expected sequential increase of sales of more than 50% and even points to a small yoy increase of 4%. Market share gain and new product will then help to take over from 2017, while the mix should help to drive margin improvement from FY16 levels. We remain convinced that Dialog's share will benefit from these catalysts as of H2.

- Based on our estimates, the share is trading on 2016e EV/EBIT of 5.5x and 2016e P/E of 11.6x. Over 2016/18e our estimates show average annual EPS growth of 9.5%, pointing to 2016e PEG of 1.4x. Given these valuation levels and our anticipation of an improving momentum, we keep our Buy recommendation.

NEXT CATALYSTS

- July 28th 2016, Q2 results.

Detailed P&L

[USDm]	1Q16	2Q16e	3Q16e	4Q16e	FY16e	FY17e	FY18e
Total Group	**241**	**249**	**304**	**455**	**1250**	**1467**	**1754**
Q/Q growth	*-39.2%*	*3.2%*	*22.0%*	*49.7%*	*-7.8%*	*17.4%*	*19.6%*
Y/Y growth	*-22.4%*	*-21.3%*	*-8.0%*	*14.6%*	*-7.8%*	*17.4%*	*19.6%*
Cost of goods sold	-134	-136	-164	-245	-679	-791	-945
Gross margin	**44.6%**	**45.5%**	**46.2%**	**46.1%**	**45.7%**	**46.1%**	**46.1%**
SG&A	-36	-36	-36	-37	-145	-153	-165
R&D	-58	-51	-53	-57	-219	-268	-314
Other operating income	16	10	9	5	41	59	54
Adj. EBIT	**30**	**36**	**61**	**121**	**248**	**314**	**384**
adj. operating margin	*12.4%*	*14.4%*	*20.1%*	*26.6%*	*19.8%*	*21.4%*	*21.9%*
EBIT	151	26	52	116	346	257	331
operating margin	*62.6%*	*10.6%*	*17.1%*	*25.6%*	*27.7%*	*17.5%*	*18.9%*
Net financial result	-2	-1	0	0	-3	-2	-2
Income tax	-4	-7	-15	-61	-88	-57	-68
tax rate	*-2.7%*	*-28.5%*	*-28.5%*	*-52.9%*	*-25.5%*	*-22.5%*	*-20.5%*
Adj. Net income (loss)	**22**	**28**	**46**	**60**	**183**	**242**	**304**
Net income (loss)	143	18	37	55	256	198	262
Dil. Adj. EPS (in USD)	**0.28**	**0.36**	**0.59**	**0.77**	**2.34**	**3.15**	**3.96**

Source: Bryan Garnier & Co. ests.

P&L changes highlights

[USDm]	Old			New			Old vs. New
	FY16e	FY17e	FY18e	FY16e	FY17e	FY18e	avg. Δ%
Net revenue	**1381**	**1619**	**1754**	**1250**	**1467**	**1754**	**-6%**
% change	*1.9%*	*17.2%*	*8.3%*	*-7.8%*	*17.4%*	*19.6%*	
Adj. EBIT	291	366	405	248	314	384	-11%
Adj. operating margin	*21.1%*	*22.6%*	*23.1%*	*19.8%*	*21.4%*	*21.9%*	
Dil. Adj. EPS (in USD)	**2.80**	**3.67**	**4.07**	**2.34**	**3.15**	**3.96**	**-11%**

Source: Bryan Garnier & Co. ests.

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