

Dialog Semiconductor

Price EUR25.63

Momentum recovery delayed, not cancelled but current valuation appears to be a non-sense

Fair Value EUR35 (+37%)

BUY

Bloomberg	DLG GR
Reuters	DLGS.DE
12-month High / Low (EUR)	53.3 / 24.4
Market Cap (EURm)	1,996
Ev (BG Estimates) (EURm)	1,330
Avg. 6m daily volume (000)	11.10
3y EPS CAGR	9.4%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-24.4%	0.4%	-33.9%	-17.9%
Semiconductors	-9.0%	7.2%	-12.8%	-11.1%
DJ Stoxx 600	-0.5%	6.6%	-10.6%	-8.9%

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%

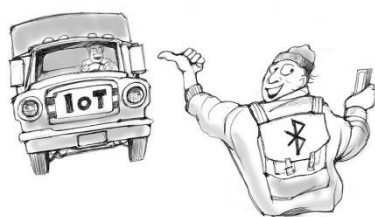
	2015	2016e	2017e	2018e
Operating margin	23.4	19.8	21.4	21.9
Net margin	17.6	14.6	16.5	17.3
ROE	17.3	20.9	14.0	15.7
ROCE	46.9	39.8	51.4	62.9
Gearing	-54.0	-62.1	-66.6	-71.0

(USD)	2015	2016e	2017e	2018e
EPS	3.02	2.34	3.15	3.96
% change		-22.4%	34.5%	25.6%
P/E	9.7x	12.5x	9.3x	7.4x
FCF yield (%)	10.7%	11.6%	8.4%	11.1%
Dividends (USD)	0.00	0.00	0.00	0.00
Div yield (%)	NM	NM	NM	NM
EV/Sales	1.3x	1.2x	0.9x	0.6x
EV/EBITDA	4.8x	4.8x	3.5x	2.4x
EV/EBIT	5.4x	6.1x	4.2x	2.8x

Dialog is a hot topic among investors, some focus on recent disappointments, other prefer to see a buy opportunity given the current particularly low share price. We clearly take position in the second camp. Adopting a bear case scenario with Sales down 8% in 2016e and down 5% in 2017e/2018e (vs. respectively +17% and +20% in our central scenario) would point to a valuation of EUR30 at the lowest. In addition, current valuation metrics highlight a significant discount relative to peers: DLG shares trade on 2016e P/E and EV/EBIT ratios of 12.5x and 6.1x, to be compared to 19.2x and 13.4x respectively for fabless peers. We reiterate our Buy recommendation.

ANALYSIS

- Apple is not set to disappear from smartphone market, this is a soft pocket.** That is a fact, current iPhone momentum is particularly weak compared to what we have been used to. As a result, some investors are afraid that Apple is going to disappear as Nokia did before, but we wouldn't bet on this. The group created and rules this market, almost as Nokia did with mobile market, however we see no comparison with the Finnish group and current Apple situation: Nokia failed to compete with a new (but powerful) entrant while the current weakness is mostly due to a weak market environment and also a long success story that accustomed us to high expectations and created high comps. We remind that 2008/2015 iPhone volume CAGR is c. 68%. In addition, Apple succeeded in creating a strong ecosystem as no one did before and boasts from a massive installed base of more than 500m iPhone. As a result, while we use in our Dialog model a decline of 21% in iOS devices in H2-16 vs. H1-15 (in line with Nikkei bear scenario) and agree to say that NT momentum is weak at Apple due to high comps, we hardly believe in a LT massive failure of Apple.
- Momentum recovery is delayed, not cancelled.** NT is expected to be soft, and speculations about the new iPhone 7 do not help. This new iPhone features are said to be close to the current model with limited innovation while new iPhone family usually introduces a new design and new features. However, with the large installed base, the continuous recruitment of new users into Apple ecosystem and the fact that a large majority of iPhone sales are driven by current user replacement, we expect to see a strong boost in 2017. This thought is also strengthened by current rumours about a strong technological improvement in this model, also driving higher ASP for Dialog (as already commented by DLG's management).
- Diversification to come.** As a result, we believe that an entirely new iPhone will come next year and trigger a stronger momentum no later than 2017. In the meantime, Dialog should benefit from its diversification and Bluetooth (BG. ests 2016e Connectivity sales USD145m, up 24% yoy) is only a part of it. We also believe the group will take advantage of the quick charge (allowing to charge a smartphone in less than one hour) technology that is being adopted by most of the OEMs. This will help Power Conversion division' momentum where we expect sales to jump from USD84.6m in 2015 to USD99.9m in 2016 (up 18%). In addition, we remind that the level of investment in R&D remains high with 17%-18% of sales being reinvested in 2016. In our view, this means that the group sees opportunity in the market and does not want to miss it. In our view, the group targets share gain at Apple (adding Dialog chips in the next iPhone) and sees room for growth in China (through MediaTek partnership but also on a stand-alone basis). Finally, the group should benefit from 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.
- Amid a weak environment, we see room for growth in H2.** The second half of the year is the period of inventory building for most OEMs as they prepare for Christmas period. It is even more important for Apple and its supply chain since the group generally unveils a new version of its iPhone in September. As a result, the year is always back-end loaded at Dialog and 2016 should not break the rule. While we see a weaker momentum yoy compared to iPhone 6 cycle (H2-14 was up 26% yoy) however given the low FY15 comparable, we continue to see some upside potential in 2016 of c. 4%. This include a Mobile Systems division sales flat yoy. On a sequential basis, we expect Q3-16e sales to be up 22% and Q4-16e to be up 50%. Overall, this leads to a FY16 sales down 8% with a current operating margin a penny below the 20% level (BG ests. 2016e Current Op. margin at 19.8%).



VALUATION

- **A strong discount vs. peers in EV/EBIT terms that appears to be unjustified.** At current share price, we see an opportunity to buy as we can't justify by any coherent valuation method a share price of EUR25. Plugging a bear case scenario into our model (FY16e sales -8%, FY17e/FY18e -5% vs. FY16/FY17/FY18e sales growth of -8%/+17%/+20% respectively in our central scenario) points to a share price of EUR30. We also remind that current valuation metrics highlight a strong discount relative to peers: Dialog currently trades on 2016e P/E and EV/EBIT ratios of 12.5x and 6.1x respectively, to be compared to 19.2x and 13.4x for fabless peers.
- **Given the currently low valuation levels, a potential upside of 37% vs. our FV of EUR35, a gradually improving momentum on the medium-term and anticipations of LT growth, we reiterate our Buy recommendation.**

NEXT CATALYSTS

- Q2 results on July 28th 2016.

Detailed P&L

[USDm]	1Q16	2Q16e	3Q16e	4Q16e	FY16e	FY17e	FY18e
Total Group	241	249	304	455	1250	1467	1754
<i>Q/Q growth</i>	-39.2%	3.2%	22.0%	49.7%	-7.8%	17.4%	19.6%
<i>Y/Y growth</i>	-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
<i>adj. operating margin</i>	12.4%	14.4%	20.1%	26.6%	19.8%	21.4%	21.9%
EBIT	151	26	52	116	346	257	331
<i>operating margin</i>	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
<i>tax rate</i>	-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.

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