

Dialog Semiconductor

Price EUR30.08

(Too much) cautiousness for Q4 and reiterated confidence for 2017 and 2018

Fair Value EUR37 (+23%)

BUY

Bloomberg	DLG GR
Reuters	DLGS.DE
12-month High / Low (EUR)	47.6 / 24.4
Market Cap (EURm)	2,342
Ev (BG Estimates) (EURm)	1,647
Avg. 6m daily volume (000)	6.80
3y EPS CAGR	10.1%

	1 M	3 M	6 M	31/12/15
Absolute perf.	13.6%	-5.7%	11.8%	-3.7%
Semiconductors	26.9%	23.1%	29.4%	20.2%
DJ Stoxx 600	7.2%	-2.7%	1.4%	-7.2%

YEnd Dec. (USDm)	2015	2016e	2017e	2018e
Sales	1,355	1,153	1,382	1,642
% change		-14.9%	19.8%	18.9%
EBITDA	360	276	373	457
EBIT	317.7	207.0	301.0	385.5
% change		-34.8%	45.4%	28.1%
Net income	238.4	162.0	234.7	309.0
% change		-32.0%	44.8%	31.7%

	2015	2016e	2017e	2018e
Operating margin	23.4	18.0	21.8	23.5
Net margin	17.6	14.0	17.0	18.8
ROE	17.3	21.1	13.0	14.7
ROCE	46.9	38.7	49.8	63.8
Gearing	-54.0	-62.6	-66.7	-70.8

(USD)	2015	2016e	2017e	2018e
EPS	3.02	2.08	3.06	4.03
% change		-31.2%	47.2%	31.7%
P/E	11.0x	16.0x	10.9x	8.3x
FCF yield (%)	9.3%	10.4%	6.8%	9.0%
Dividends (USD)	0.00	0.00	0.00	0.00
Div yield (%)	NM	NM	NM	NM
EV/Sales	1.5x	1.6x	1.2x	0.9x
EV/EBITDA	5.7x	6.6x	4.4x	3.1x
EV/EBIT	6.4x	8.8x	5.5x	3.7x

Following yesterday's guidance update (FY16 growth of -15% vs. high single digit before), we think that management's message and tone was reassuring during the conference call. Overall, we understand that Dialog prefers to adopt an (overly) cautious scenario regarding iPhone production in Q4 2016, creating room for a good surprise. The group believes that Apple will be prudent in its orders given what happened last year. In addition, Dialog confirmed that this adjustment had no impact on the strong momentum expected to be seen in 2017 and 2018. As a result, despite yesterday's adjustment, we continue to see improving momentum ahead and reiterate our Buy recommendation.

ANALYSIS

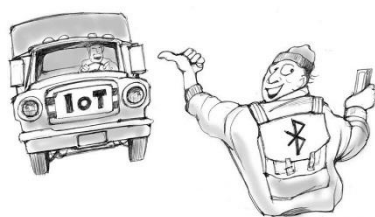
- Regarding the guidance adjustment, the group clarified that this was not a problem of price pressure which is seen to remain flat.** The adjustment was apparently more what we consider as a high level of cautiousness regarding orders from Apple during the December quarter given 1/ a sluggish smartphone market and 2/ a lesson learnt last year by Apple regarding inventory build (which were so strong that inventories needed to be trimmed during Q1 and Q2). We also understand that the mix is unfavourable with a continuous decrease in tablets (in volume terms) which embed PMIC with a higher ASP compared to smartphones.
- A reassuring message regarding 2017 and 2018.** So far, management has been very confident regarding growth over the two next years and, following yesterday's guidance adjustment, the risk was that the group would also announce lower expectations for 2017 and 2018. Without giving any details and without quantifying growth, the group stated that it is very confident regarding a content increase to materialise in 2017 and 2018. This will come from 1/ a more complex PMIC in flagship smartphones from Tier 1 OEMs (i.e. iPhone) and 2/ market share gains thanks to new product design wins (also a mixed signal chip but non-power so different from PMIC).
- Don't forget China!** As we already highlighted in 2015, Chinese OEMs tend to go vertical regarding Application Processor design. As a result, we see this trend as positive for Dialog since they will be in a similar situation as Apple as they will need a high level of expertise regarding Power management. This was commented on today as a potential source of growth. In addition, we understand that the relationship between Dialog and the Chinese OEMs continues to strengthen. This market can also be a part of the group's confidence that management shared with investors regarding 2017/2018 growth.
- Following yesterday's guidance adjustment, we have updated our model and trim our estimates.** We have applied a decrease of 14.8% to FY16 sales and an underlying gross margin of 46.1% (vs. 46.6% a year ago). We have also frozen the level of opex for the next two quarters, we still anticipate an acceleration in R&D investments but we believe it will be offset by more cautious SG&A expenses given the sluggish environment. In addition, we have fine-tuned our 2017 and 2018 estimates. Overall, our adjustments lead to an impact of -4% on EPS over the next three-year sequence. These adjustments are partly offset by an update to the FX rate (the group reports in USD and the share price is in EUR) with EUR/USD now at 1.10 vs. 1.11 before. As a result, the update has no impact on our FV.

VALUATION

- Although yesterday's guidance adjustment impacted negatively our short term expectations, we continue to believe that Dialog remains attractive. The share trades at low valuation ratios (2016e P/E ratios of 16.0x to be compared to fabless peers trading at 23x) and the new guidance now offers room for a good surprise during Q4 (i.e. at the Q3 publication, the group could communicate Q4 guidance). Looking beyond 2016, we see a rebound in momentum in both sales and margins (given the pressure on margin observed today), that should also provide a tailwind to for the share price. As a result, with attractive valuation metrics and short-term and mid-term catalyst ahead, we reiterate our Buy recommendation.

NEXT CATALYSTS

- 3rd November 2016: Q3 2016 results



Detailed P&L

[USDm]	1Q16	2Q16	3Q16e	4Q16e	FY16e	FY17e	FY18e
Total Group	241	246	305	361	1153	1382	1642
<i>Q/Q growth</i>	-39.2%	1.8%	24.0%	18.6%	-14.9%	19.8%	18.9%
<i>Y/Y growth</i>	-22.4%	-22.4%	-7.8%	-9.0%	-14.9%	19.8%	18.9%
Cost of goods sold	-134	-132	-166	-197	-629	-752	-893
Gross margin	44.6%	46.3%	45.6%	45.5%	45.5%	45.6%	45.6%
SG&A	-36	-31	-36	-28	-131	-144	-154
R&D	-58	-60	-56	-57	-231	-253	-294
Other operating income	16	9	9	4	39	55	51
Adj. EBIT	30	33	59	84	207	301	385
<i>adj. operating margin</i>	12.4%	13.5%	19.5%	23.4%	18.0%	21.8%	23.5%
EBIT	151	23	47	80	301	235	302
<i>operating margin</i>	62.6%	9.3%	15.4%	22.1%	26.1%	17.0%	18.4%
Net financial result	-2	1	1	1	1	3	3
Income tax	-4	-9	-11	-19	-42	-53	-62
<i>tax rate</i>	-2.7%	-34.0%	-23.0%	-23.0%	-14.1%	-22.5%	-20.5%
Adj. Net income (loss)	22	27	47	67	162	235	309
Net income (loss)	143	17	37	63	259	183	242
Dil. Adj. EPS (in USD)	0.28	0.34	0.60	0.85	2.08	3.06	4.03

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	1250	1467	1754	1153	1382	1642	-7%
<i>% change</i>	-7.8%	17.4%	19.6%	-14.9%	19.8%	18.9%	
Adj. EBIT	243	314	384	207	301	385	-6%
<i>Adj. operating margin</i>	19.5%	21.4%	21.9%	18.0%	21.8%	23.5%	
Dil. Adj. EPS (in USD)	2.38	3.12	3.96	2.08	3.06	4.03	-4%

Source: Bryan Garnier & Co. ests.

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Analyst :
Dorian Terral
33(0) 1.56.68.75.92
dterral@bryangarnier.com

Sector Team :
Richard-Maxime Beaudoux
Thomas Coudry
Gregory Ramirez

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London	Paris	New York	Munich	New Delhi
Beaufort House	26 Avenue des Champs Elysées	750 Lexington Avenue	Widenmayerstrasse 29	The Imperial Hotel Janpath
15 St. Botolph Street	75008 Paris	New York, NY 10022	80538 Munich	New Delhi 110 001
London EC3A 7BB	Tel: +33 (0) 1 56 68 75 00	Tel: +1 (0) 212 337 7000	Germany	Tel +91 11 4132 6062
Tel: +44 (0) 207 332 2500	Fax: +33 (0) 1 56 68 75 01	Fax: +1 (0) 212 337 7002	+49 89 2422 62 11	+91 98 1111 5119
Fax: +44 (0) 207 332 2559	Regulated by the	FINRA and SIPC member		Fax +91 11 2621 9062
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Financial Conduct Authority (FCA)	Autorité de Contrôle prudentiel et de			rue de Grenus 7
	resolution (ACPR)			CP 2113
				Genève 1, CH 1211
				Tel +4122 731 3263
				Fax+4122731 3243
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