

## Company Focus

29 October 2008 | 9 pages

# D-Link (2332.TW)

## Buy: Better Op Margins in 3Q08; More Conservative 09 Forecast

- Re-iterate Buy** — D-Link reported better-than-expected 3Q operating margin by controlling its expenses, and we expect the share price to rebound once sentiment recovers. We are lowering our target price to NT\$34, on 13x 2009E earnings to reflect our more conservative 2009E earnings forecasts.
- Results and outlook** — D-Link reported 3Q08 revenue of NT\$8.6bn, up 1.4% qoq. Gross margin was 32.7%, and operating margin improved to 6.2% (from 4.1% in 2Q) as the company cut back on advertising expenses, and EPS was NT\$0.81. The company expects 4Q revenue to decline by a high-single digit QoQ, with operating margin of 5-5.5%.
- Our view vs. consensus** — While consensus is looking for a sharp decline in 2009E and is worried about weaker margins, we think the company's exposure to emerging market telco projects and growing presence in US/Europe SMEs will help D-Link cope with the slowdown. We expect D-Link's unit shipments to be flat in 2009, while sales and earnings are likely to decline by 5-7% yoy in 2009E, driven mainly by blended ASP declines. In addition, margins should also be higher for the company's SME solutions due to fewer customer rebates.
- Revising estimates** — We are lowering our 2009/10 EPS estimates by 15% and 9%, respectively, to reflect a weaker sales outlook and lower gross margins.

<b>Buy/Medium Risk</b>	<b>1M</b>
Price (28 Oct 08)	NT\$19.60
Target price	NT\$34.00
	<i>from NT\$39.80</i>
Expected share price return	73.5%
Expected dividend yield	7.8%
<b>Expected total return</b>	<b>81.2%</b>
Market Cap	NT\$11,078M
	US\$331M

### Price Performance (RIC: 2332.TW, BB: 2332 TT)



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Dec	(NT\$M)	(NT\$)	(%)	(x)	(x)	(%)	(%)
2006A	2,521	3.69	52.7	5.3	0.9	18.8	5.5
2007A	3,339	4.91	33.2	4.0	0.8	21.3	11.4
2008E	1,546	2.72	-44.5	7.2	0.7	9.6	12.8
2009E	1,448	2.60	-4.6	7.5	0.7	9.1	7.8
2010E	1,779	3.16	21.6	6.2	0.7	10.7	9.5

Source: Powered by dataCentral

 Timothy Lam<sup>1</sup>

See Appendix A-1 for Analyst Certification and important disclosures.

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<sup>1</sup>Citigroup Global Markets Inc - Taipei Branch

Fiscal year end 31-Dec	2006	2007	2008E	2009E	2010E
<b>Valuation Ratios</b>					
P/E adjusted (x)	5.3	4.0	7.2	7.5	6.2
EV/EBITDA adjusted (x)	2.4	1.3	0.9	0.6	0.0
P/BV (x)	0.9	0.8	0.7	0.7	0.7
Dividend yield (%)	5.5	11.4	12.8	7.8	9.5
<b>Per Share Data (NT\$)</b>					
EPS adjusted	3.69	4.91	2.72	2.60	3.16
EPS reported	3.69	4.91	2.72	2.60	3.16
BVPS	21.68	24.40	28.06	28.94	30.02
DPS	1.08	2.23	2.50	1.52	1.87
<b>Profit &amp; Loss (NT\$M)</b>					
Net sales	29,822	33,230	33,414	31,126	34,471
Operating expenses	-27,523	-30,926	-31,661	-29,616	-32,602
<b>EBIT</b>	<b>2,299</b>	<b>2,304</b>	<b>1,753</b>	<b>1,510</b>	<b>1,869</b>
Net interest expense	160	170	0	0	0
Non-operating/exceptionals	563	1,098	128	212	246
<b>Pre-tax profit</b>	<b>3,022</b>	<b>3,572</b>	<b>1,881</b>	<b>1,722</b>	<b>2,115</b>
Tax	-465	-233	-334	-274	-336
Extraord./Min.Int./Pref.div.	-36	0	0	0	0
<b>Reported net income</b>	<b>2,521</b>	<b>3,339</b>	<b>1,546</b>	<b>1,448</b>	<b>1,779</b>
Adjusted earnings	2,521	3,339	1,546	1,448	1,779
Adjusted EBITDA	2,928	3,036	2,607	2,478	2,951
<b>Growth Rates (%)</b>					
Sales	14.5	11.4	0.6	-6.8	10.7
EBIT adjusted	64.1	0.2	-23.9	-13.8	23.8
EBITDA adjusted	44.1	3.7	-14.1	-4.9	19.1
EPS adjusted	52.7	33.2	-44.5	-4.6	21.6
<b>Cash Flow (NT\$M)</b>					
<b>Operating cash flow</b>	<b>3,329</b>	<b>5,546</b>	<b>3,000</b>	<b>3,459</b>	<b>2,756</b>
Depreciation/amortization	629	732	854	968	1,082
Net working capital	302	1,475	600	1,043	-105
<b>Investing cash flow</b>	<b>130</b>	<b>-655</b>	<b>-700</b>	<b>-700</b>	<b>-700</b>
Capital expenditure	-644	-655	-700	-700	-700
Acquisitions/disposals	801	0	0	0	0
<b>Financing cash flow</b>	<b>-350</b>	<b>-3,143</b>	<b>-2,682</b>	<b>-795</b>	<b>-1,000</b>
Borrowings	-111	-1,629	0	0	0
Dividends paid	-717	-1,320	-2,682	-796	-1,001
<b>Change in cash</b>	<b>3,109</b>	<b>1,747</b>	<b>-382</b>	<b>1,964</b>	<b>1,056</b>
<b>Balance Sheet (NT\$M)</b>					
<b>Total assets</b>	<b>27,200</b>	<b>28,168</b>	<b>26,652</b>	<b>26,969</b>	<b>28,530</b>
Cash & cash equivalent	3,905	5,652	5,258	7,291	8,281
Accounts receivable	8,081	8,104	7,741	7,139	7,827
Net fixed assets	3,535	3,459	3,305	3,037	2,655
<b>Total liabilities</b>	<b>12,533</b>	<b>11,481</b>	<b>11,113</b>	<b>10,708</b>	<b>11,557</b>
Accounts payable	6,481	6,839	6,448	6,321	6,763
Total Debt	1,929	300	300	300	300
<b>Shareholders' funds</b>	<b>14,667</b>	<b>16,686</b>	<b>15,550</b>	<b>16,203</b>	<b>16,981</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	9.8	9.1	7.8	8.0	8.6
ROE adjusted	18.8	21.3	9.6	9.1	10.7
ROIC adjusted	19.0	23.2	18.3	18.4	25.8
Net debt to equity	-13.5	-32.1	-31.9	-43.1	-47.0
Total debt to capital	11.6	1.8	1.9	1.8	1.7

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**Figure 1. D-Link – Quarterly Earnings Adjustment**

	1Q08A	2Q08A	3Q08A	4Q08E	2008E	1Q09E	2Q09E	3Q09E	4Q09E	2009E
<b>Old</b>										
Sales in NT\$m	8,493	8,507	8,631	8,386	34,017	7,878	8,056	9,164	9,563	34,661
Gross profits	2,864	2,852	2,855	2,739	11,310	2,685	2,731	3,164	3,237	11,817
Gross margin	34%	34%	33%	33%	33%	34%	34%	35%	34%	34%
Op profits	480	353	403	409	1,645	385	409	513	557	1,865
Op margin	6%	4%	5%	5%	5%	5%	5%	6%	6%	5%
Net profits	371	339	413	400	1,522	312	360	502	531	1,705
Net margin%	4%	4%	5%	5%	4%	4%	4%	5%	6%	5%
Earnings per share (NT\$)	0.65	0.60	0.73	0.70	2.68	0.56	0.65	0.90	0.95	3.06
<b>Revision</b>										
Sales in NT\$m	8,493	8,507	8,629	7,784	33,414	7,081	7,232	8,229	8,584	31,126
Gross profits	2,864	2,852	2,820	2,521	11,057	2,303	2,346	2,696	2,762	10,107
Gross margin	34%	34%	33%	32%	33%	33%	32%	33%	32%	32%
Op profits	480	353	539	381	1,753	345	359	412	395	1,510
Op margin	6%	4%	6%	5%	5%	5%	5%	5%	5%	5%
Net profits	371	339	458	379	1,546	279	318	453	398	1,448
Net margin%	4%	4%	5%	5%	5%	4%	4%	6%	5%	5%
Earnings per share (NT\$)	0.65	0.60	0.81	0.67	2.72	0.50	0.57	0.81	0.71	2.60
<b>Revision in %</b>										
Sales in NT\$m	0%	0%	0%	-7%	-2%	-10%	-10%	-10%	-10%	-10%
Gross profits	0%	0%	-1%	-8%	-2%	-14%	-14%	-15%	-15%	-14%
Gross margin	0%	0%	-1%	-1%	0%	-5%	-4%	-5%	-5%	-5%
Op profits	0%	0%	34%	-7%	7%	-10%	-12%	-20%	-29%	-19%
Op margin	0%	0%	34%	0%	8%	0%	-2%	-11%	-21%	-10%
Net profits	0%	0%	11%	-5%	2%	-11%	-12%	-10%	-25%	-15%
Net margin%	0%	0%	11%	2%	3%	-1%	-2%	1%	-16%	-5%
Earnings per share (NT\$)	0%	0%	11%	-5%	2%	-11%	-12%	-10%	-25%	-15%

Source: Company Reports and Citi Investment Research estimates

**Figure 2. D-Link – Earnings Revision**

Year to	Net Profit (NT\$ mn)			Diluted EPS		
	Old	New	% Chg	Old	New	% Chg
2008E	1,522	1,546	1.6%	2.68	2.72	1.6%
2009E	1,705	1,448	-15.1%	3.06	2.60	-15.1%
2010E	1,954	1,779	-9.0%	3.47	3.16	-9.0%

Source: Citi Investment Research estimates

Figure 3. D-Link – Quarterly Income Statement (2006-2010E, NT\$ in Millions)

BRAND ONLY NT\$ in mn	2007					2008E					2009E					2010E					
	FYE '06	1Q	2Q	3Q	4Q	FYE '07	1QA	2QA	3Q	4Q	FYE '08	1Q	2Q	3Q	4Q	FYE '09	1Q	2Q	3Q	4Q	FYE '10
NET REVENUES	<b>29,822</b>	7,512	7,833	8,999	8,886	<b>33,230</b>	8,493	8,507	8,629	7,784	<b>33,414</b>	7,081	7,232	8,229	8,584	<b>31,126</b>	7,919	7,806	9,156	9,590	<b>34,471</b>
Total cost of good sold	<b>(19,768)</b>	(4,889)	(5,117)	(5,851)	(5,989)	<b>(21,846)</b>	(5,629)	(5,655)	(5,809)	(5,264)	<b>(22,357)</b>	(4,778)	(4,886)	(5,533)	(5,822)	<b>(21,019)</b>	(5,284)	(5,195)	(6,066)	(6,413)	<b>(22,959)</b>
GROSS PROFIT	<b>10,054</b>	2,623	2,716	3,148	2,897	<b>11,384</b>	2,864	2,852	2,820	2,521	<b>11,057</b>	2,303	2,346	2,696	2,762	<b>10,107</b>	2,635	2,611	3,090	3,177	<b>11,512</b>
R&D	<b>(411)</b>	(121)	(182)	(209)	(236)	<b>(748)</b>	(171)	(199)	(178)	(159)	<b>(707)</b>	(143)	(152)	(170)	(172)	<b>(636)</b>	(159)	(161)	(189)	(188)	<b>(697)</b>
SG&A	<b>(7,344)</b>	(1,908)	(1,936)	(2,253)	(2,236)	<b>(8,332)</b>	(2,176)	(2,266)	(2,050)	(1,942)	<b>(8,434)</b>	(1,778)	(1,791)	(2,053)	(2,141)	<b>(7,763)</b>	(2,008)	(1,972)	(2,307)	(2,416)	<b>(8,704)</b>
Employee bonus impact							(37)	(34)	(53)	(39)	<b>(163)</b>	(38)	(43)	(62)	(54)	<b>(197)</b>	(47)	(51)	(76)	(68)	<b>(243)</b>
Operating expenses	<b>(7,755)</b>	(2,029)	(2,118)	(2,462)	(2,472)	<b>(9,081)</b>	(2,384)	(2,499)	(2,281)	(2,140)	<b>(9,304)</b>	(1,959)	(1,987)	(2,284)	(2,367)	<b>(8,597)</b>	(2,215)	(2,185)	(2,571)	(2,673)	<b>(9,644)</b>
OPERATING INCOME	<b>2,299</b>	594	598	686	425	<b>2,303</b>	480	353	539	381	<b>1,753</b>	345	359	412	395	<b>1,510</b>	420	426	518	504	<b>1,869</b>
Int&other inc/(exp)	<b>723</b>	621	78	274	296	<b>1,269</b>	(49)	38	83	56	<b>128</b>	(13)	19	127	79	<b>212</b>	(11)	23	143	92	<b>246</b>
PRETAX INCOME	<b>3,022</b>	1,215	676	960	721	<b>3,572</b>	431	391	622	437	<b>1,881</b>	331	378	539	473	<b>1,722</b>	409	449	661	596	<b>2,115</b>
Taxes or tax credit	<b>(465)</b>	(48)	105	(156)	(134)	<b>(233)</b>	(60)	(52)	(164)	(58)	<b>(334)</b>	(53)	(60)	(86)	(75)	<b>(274)</b>	(65)	(71)	(105)	(94)	<b>(336)</b>
Minority interest	<b>(36)</b>	(9)	(10)	(4)	23	<b>(0)</b>	-	-	-	-	<b>-</b>	-	-	-	-	<b>-</b>	-	-	-	-	<b>-</b>
NET INCOME	<b>2,521</b>	1,158	771	801	610	<b>3,339</b>	371	339	458	379	<b>1,546</b>	279	318	453	398	<b>1,448</b>	344	378	556	501	<b>1,779</b>
Earnings per share	<b>3.69</b>	1.70	1.13	1.18	0.90	<b>4.91</b>	0.65	0.60	0.81	0.67	<b>2.72</b>	0.50	0.57	0.81	0.71	<b>2.60</b>	0.61	0.67	0.99	0.89	<b>3.16</b>
Fully diluted shares (mn)	<b>684</b>	680	680	680	680	<b>680</b>	568	568	568	568	<b>568</b>	557	557	557	557	<b>557</b>	563	563	563	563	<b>563</b>
<b>Operating Ratios</b>																					
Gross margins	<b>34%</b>	35%	35%	35%	33%	<b>34%</b>	34%	34%	33%	32%	<b>33%</b>	33%	32%	33%	32%	<b>32%</b>	33%	33%	34%	33%	<b>33%</b>
R&D	<b>-1%</b>	-2%	-2%	-2%	-3%	<b>-2%</b>	-2%	-2%	-2%	-2%	<b>-2%</b>	-2%	-2%	-2%	-2%	<b>-2%</b>	-2%	-2%	-2%	-2%	<b>-2%</b>
SG&A	<b>-25%</b>	-25%	-25%	-25%	-25%	<b>-25%</b>	-26%	-27%	-24%	-25%	<b>-25%</b>	-25%	-25%	-25%	-25%	<b>-25%</b>	-25%	-25%	-25%	-25%	<b>-25%</b>
Operating margin	<b>7.7%</b>	7.9%	7.6%	7.6%	4.8%	<b>6.9%</b>	5.7%	4.1%	6.2%	4.9%	<b>5.2%</b>	4.9%	5.0%	5.0%	4.6%	<b>4.9%</b>	5.3%	5.5%	5.7%	5.3%	<b>5.4%</b>
Interest inc/(exp)	<b>2%</b>	8%	1%	3%	3%	<b>4%</b>	-1%	0%	1%	1%	<b>0%</b>	0%	0%	2%	1%	<b>1%</b>	0%	0%	2%	1%	<b>1%</b>
Pre-tax margin	<b>10%</b>	16%	9%	11%	8%	<b>11%</b>	5%	5%	7%	6%	<b>6%</b>	5%	5%	7%	6%	<b>6%</b>	5%	6%	7%	6%	<b>6%</b>
Tax rate	<b>-15%</b>	-4%	16%	-16%	-19%	<b>-7%</b>	-14%	-13%	-26%	-13%	<b>-18%</b>	-16%	-16%	-16%	-16%	<b>-16%</b>	-16%	-16%	-16%	-16%	<b>-16%</b>
Net margin	<b>8%</b>	15%	10%	9%	7%	<b>10%</b>	4%	4%	5%	5%	<b>5%</b>	4%	4%	6%	5%	<b>5%</b>	4%	5%	6%	5%	<b>5%</b>
<b>Year-to-Year %</b>																					
Net revenues	<b>15%</b>	9%	15%	13%	9%	<b>11%</b>	13%	9%	-4%	-12%	<b>1%</b>	-17%	-15%	-5%	10%	<b>-7%</b>	12%	8%	11%	12%	<b>11%</b>
Gross profit	<b>24%</b>	14%	27%	22%	-5%	<b>13%</b>	9%	5%	-10%	-13%	<b>-3%</b>	-20%	-18%	-4%	10%	<b>-9%</b>	14%	11%	15%	15%	<b>14%</b>
Operating income	<b>64%</b>	39%	79%	18%	-55%	<b>0%</b>	-19%	-41%	-21%	-10%	<b>-24%</b>	-28%	2%	-24%	4%	<b>-14%</b>	22%	19%	26%	28%	<b>24%</b>
Net income	<b>54%</b>	97%	93%	12%	-26%	<b>32%</b>	-68%	-56%	-43%	-38%	<b>-54%</b>	-25%	-6%	-1%	5%	<b>-6%</b>	23%	19%	23%	26%	<b>23%</b>
<b>Qtr-to-Qtr %</b>																					
Net revenues		-8%	4%	15%	-1%		-4%	0%	1%	-10%		-9%	2%	14%	4%		-8%	-1%	17%	5%	
Gross profit		-14%	4%	16%	-8%		-1%	0%	-1%	-11%		-9%	2%	15%	2%		-5%	-1%	18%	3%	
Operating income		-38%	1%	15%	-38%		13%	-26%	53%	-29%		-9%	4%	15%	-4%		6%	1%	22%	-3%	
Net income		41%	-33%	4%	-24%		-39%	-9%	35%	-17%		-26%	14%	43%	-12%		-14%	10%	47%	-10%	

Source: Company Reports and Citi Investment Research estimates

## D-Link

### Company description

D-Link, founded in 1986, has grown into a global supplier of networking products. It is a global leader in the design, manufacture and marketing of advanced networking, broadband, digital, voice and data communications solutions. The company's products are available in more than 100 countries. D-Link is headquartered in Taipei and has more than 90 global offices.

### Investment strategy

We rate D-Link Buy/Medium Risk, and lower our target price to NT\$34 (from NT\$39.80 due to weaker 2009E earnings outlook). With an established distribution network, it has gradually extended its footprint and brand presence to both developed and developing countries. This should soften the risks from economic slowdown in any one region. The company has also maintained lower operating expenses to sales ratio than its peers by keeping a small sales team. D-Link's strong operating leverage has helped it supply a wide range of products to the networking sector and given it more room for product pricing adjustments.

### Valuation

Our target price of NT\$34 is based on 12-13x (no change in multiple) 09E EPS. The stock's trading range over the past five years has been 5-24x forward earnings, with the average at 11.3x. We assign a slightly higher-than-average multiple to D-Link as prospects for higher growth and profitability have improved, based on our analysis. Investors could give the stock higher valuations when they begin to recognise D-Link's growing brand presence in the 802.11N solution. Our target multiple is at a discount to that of Cisco, the industry leader, as D-Link has limited exposure to the high-end enterprise market segment.

### Risks

We rate D-Link Medium Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. Downside risks to our target price include worse-than-expected declines in sales; higher than expected operating expenses, especially related to D-Link's SME expansion; and currency risks associated with its global operation.

# Appendix A-1

## Analyst Certification

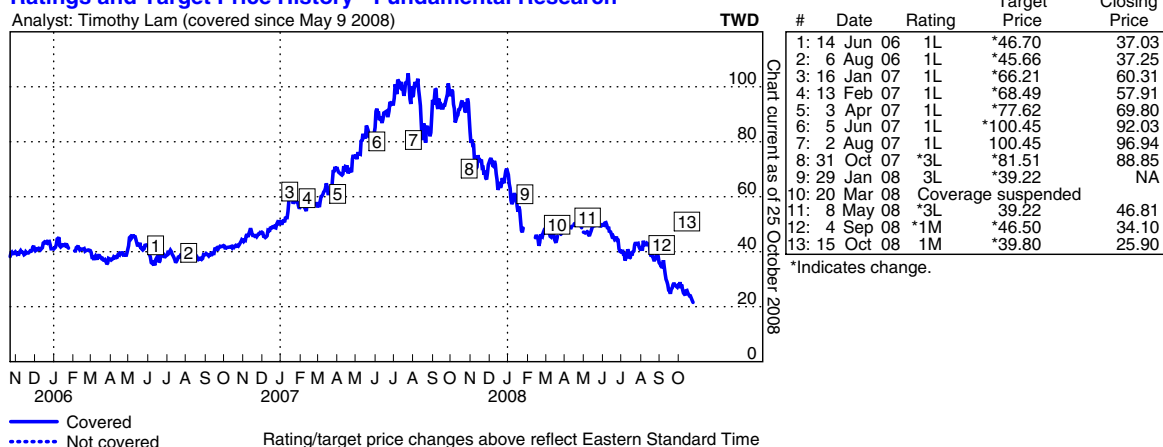
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## IMPORTANT DISCLOSURES

### D-Link (2332.TW)

#### Ratings and Target Price History - Fundamental Research

Analyst: Timothy Lam (covered since May 9 2008)



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