

11 November 2008 | 9 pages

Ralink Technology (3534.TW)

 Target price change
 Estimate change

Sell: Weaker Sales Signal Pricing Squeeze; Lower Target Price

- Reiterate Sell (3H)** — We reiterate our negative view on Ralink and lower our target price to NT\$78, on 10-11x 09E earnings. Given rising uncertainty and more order cutbacks, we fear the competitive pricing environment will continue to worsen and affect Ralink into 1H09E.
- What's new** — Ralink's October revenue of NT\$389mn was weaker than expected, and we now expect 4Q08 to fall by 5-10% qoq (vs. guidance of 0 to -5%) on weaker sales in the retail segment and order cutbacks by its PC/NB customers. In addition, we now expect its APSoc router IC may not fully ramp until 1H09. Faced with these last-minute pullbacks, we are increasingly concerned that networking IC suppliers will face an unexpected inventory build.
- Management changes** — Ralink announced today that 1) its general manager has resigned due to personal reasons, to be replaced by the company's Chairman; 2) the company is forming an investment holding company, with capital of NT\$500 million, or 12% of Ralink's cash balance at the end of 3Q (NT\$4.15bn). While forming subsidiaries to invest in new technologies may benefit Ralink in the long run, we are puzzled by the timing of the events and believe better corporate transparency is warranted in the uncertain times that lie ahead.
- Lower estimates** — We are lowering our 2008/2009E EPS estimates further by 3% and 10% to NT\$7.95 and NT\$7.47, respectively, to reflect weaker sales and earnings outlook.

Sell/High Risk	3H
Price (11 Nov 08)	NT\$84.70
Target price	NT\$78.00
	from NT\$100.00
Expected share price return	-7.9%
Expected dividend yield	3.5%
Expected total return	-4.4%
Market Cap	NT\$10,213M
	US\$311M

Price Performance (RIC: 3534.TW, BB: 3534 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	688	7.52	62.3	11.3	4.4	48.0	0.0
2007A	1,164	11.98	59.2	7.1	2.7	45.9	3.2
2008E	915	7.95	-33.6	10.7	2.7	25.7	5.3
2009E	906	7.47	-6.1	11.3	2.4	22.1	3.5
2010E	1,120	9.12	22.2	9.3	2.1	24.1	5.4

Source: Powered by dataCentral

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

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Fiscal year end 31-Dec	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	11.3	7.1	10.7	11.3	9.3
EV/EBITDA adjusted (x)	13.4	7.1	7.0	6.2	4.5
P/BV (x)	4.4	2.7	2.7	2.4	2.1
Dividend yield (%)	0.0	3.2	5.3	3.5	5.4
Per Share Data (NT\$)					
EPS adjusted	7.52	11.98	7.95	7.47	9.12
EPS reported	7.52	11.98	7.95	7.47	9.12
BVPS	19.43	31.36	31.75	35.65	39.98
DPS	0.00	2.68	4.50	3.00	4.54
Profit & Loss (NT\$M)					
Net sales	2,773	3,845	4,732	5,169	6,020
Operating expenses	-2,141	-2,763	-3,825	-4,273	-4,883
EBIT	631	1,082	907	897	1,136
Net interest expense	17	28	0	0	0
Non-operating/exceptionals	28	58	38	63	63
Pre-tax profit	676	1,168	945	960	1,199
Tax	12	-4	-30	-54	-79
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	688	1,164	915	906	1,120
Adjusted earnings	688	1,164	915	906	1,120
Adjusted EBITDA	685	1,184	1,038	1,065	1,346
Growth Rates (%)					
Sales	52.0	38.7	23.1	9.2	16.5
EBIT adjusted	62.1	71.4	-16.2	-1.1	26.7
EBITDA adjusted	63.0	72.7	-12.4	2.7	26.3
EPS adjusted	62.3	59.2	-33.6	-6.1	22.2
Cash Flow (NT\$M)					
Operating cash flow	407	1,019	1,366	1,044	1,203
Depreciation/amortization	54	102	131	168	209
Net working capital	-303	-185	320	-30	-127
Investing cash flow	-96	-273	-131	-213	-249
Capital expenditure	-17	-51	-4	-20	-20
Acquisitions/disposals	-67	-224	10	-143	-179
Financing cash flow	22	327	-368	-371	-560
Borrowings	0	0	0	0	0
Dividends paid	0	-222	-445	-362	-557
Change in cash	333	1,072	867	459	393
Balance Sheet (NT\$M)					
Total assets	2,395	4,153	5,088	5,772	6,500
Cash & cash equivalent	956	2,029	2,896	3,359	3,752
Accounts receivable	604	1,097	1,037	1,133	1,319
Net fixed assets	24	65	53	48	38
Total liabilities	608	874	1,259	1,405	1,573
Accounts payable	451	428	764	864	996
Total Debt	0	0	0	0	0
Shareholders' funds	1,787	3,278	3,829	4,367	4,927
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	24.7	30.8	21.9	20.6	22.4
ROE adjusted	48.0	45.9	25.7	22.1	24.1
ROIC adjusted	157.3	159.0	140.3	178.7	194.8
Net debt to equity	-53.5	-61.9	-75.6	-76.9	-76.1
Total debt to capital	0.0	0.0	0.0	0.0	0.0

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Figure 1. Ralink – Quarterly Earnings Adjustment

	1Q08A	2Q08A	3Q08A	4Q08E	1Q09E	2Q09E	3Q09E	4Q09E
Old forecast								
Net sales in NT\$ mn	1,063.3	1,218.2	1,279.6	1,243.1	1,173.2	1,282.7	1,461.7	1,528.6
Gross profits in NT\$ mn	497.9	502.3	481.8	490.4	458.2	494.5	569.4	601.6
Gross margin (%)	47%	41%	38%	39%	39%	39%	39%	39%
Op profits	300.1	226.5	196.4	218.2	192.9	220.2	281.6	306.2
Op margin (%)	28%	19%	15%	18%	16%	17%	19%	20%
Net profits	224.7	223.7	259.4	239.7	196.9	222.7	280.6	303.9
Net margin (%)	21%	18%	20%	19%	17%	17%	19%	20%
Dividend adj EPS in NT\$	1.95	1.94	2.26	2.08	1.62	1.84	2.31	2.51
Full year EPS in NT\$				8.24				8.28
Bloomberg EPS in NT\$								
New forecast								
Net sales in NT\$ mn	1,063.3	1,218.2	1,279.6	1,171.0	1,112.4	1,217.5	1,387.6	1,451.9
Gross profits in NT\$ mn	497.9	502.3	481.8	462.0	434.4	469.4	540.5	571.4
Gross margin (%)	47%	41%	38%	39%	39%	39%	39%	39%
Op profits	300.1	226.5	196.4	183.5	172.1	196.7	252.4	275.6
Op margin (%)	28%	19%	15%	16%	15%	16%	18%	19%
Net profits	224.7	223.7	259.4	207.0	177.3	200.5	253.1	275.0
Net margin (%)	21%	18%	20%	18%	16%	16%	18%	19%
Dividend adj EPS in NT\$	1.95	1.94	2.26	1.80	1.46	1.65	2.09	2.27
Full year EPS in NT\$				7.95				7.47
Bloomberg EPS in NT\$								
Revision (%)								
Net sales in NT\$ mn	0%	0%	0%	-6%	-5%	-5%	-5%	-5%
Gross profits	0%	0%	0%	-6%	-5%	-5%	-5%	-5%
Op profits	0%	0%	0%	-16%	-11%	-11%	-10%	-10%
Net EPS	0%	0%	0%	-14%	-10%	-10%	-10%	-9%
Yearly EPS				-3.5%				-9.8%

Source: Company Reports and Citi Investment Research estimates

Figure 2. Ralink – Earnings Revision

Year to	Net Profit (NT\$ Mils.)		Diluted EPS (NT\$)		
	Old	New	Old	New	% Chg
31-Dec					
2008E	948	915	8.24	7.95	-3.5%
2009E	1004	906	8.28	7.47	-9.8%
2010E	1239	1120	10.09	9.12	-9.6%

Source: Citi Investment Research estimates

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

11/11/2008	2007A					2008E					2009E				2010E						
(NT\$ mn)	FYE '06	1QA	2QA	3QA	4QA	FYE '07	1QA	2QA	3Q	4Q	FYE '08	1Q	2Q	3Q	4Q	FYE '09	1Q	2Q	3Q	4Q	FYE '10
NET REVENUES	2,773	749	937	1,027	1,132	3,845	1,063	1,218	1,280	1,171	4,732	1,112	1,218	1,388	1,452	5,169	1,386	1,418	1,572	1,644	6,020
Total cost of good sold	(1,648)	(448)	(523)	(546)	(606)	(2,123)	(565)	(716)	(798)	(709)	(2,788)	(678)	(748)	(847)	(881)	(3,154)	(840)	(860)	(946)	(989)	(3,635)
GROSS PROFIT	1,124	301	414	481	526	1,722	498	502	482	462	1,944	434	469	541	571	2,016	545	558	627	655	2,385
Operating expenses	(493)	(143)	(153)	(158)	(187)	(640)	(198)	(276)	(285)	(278)	(1,037)	(262)	(273)	(288)	(296)	(1,119)	(289)	(304)	(324)	(332)	(1,249)
OPERATING INCOME	631	158	261	323	340	1,082	300	227	196	184	907	172	197	252	276	897	257	254	302	323	1,136
Int&other inc/(exp)	45	27	15	(0)	44	86	(82)	18	66	36	38	16	16	16	16	63	16	16	16	16	63
PRETAX INCOME	676	185	276	323	384	1,168	218	245	263	219	945	188	212	268	291	960	272	270	318	339	1,199
Taxes or tax credit	12	10	(7)	(3)	(4)	(4)	7	(21)	(3)	(12)	(30)	(11)	(12)	(15)	(16)	(54)	(18)	(18)	(21)	(22)	(79)
NET INCOME	688	195	269	319	380	1,164	225	224	259	207	915	177	201	253	275	906	254	252	297	317	1,120
PRETAX EPS IN NT\$	7.40	1.90	2.84	3.32	3.95	12.02	1.89	2.13	2.28	1.91	8.21	1.55	1.75	2.21	2.40	7.91	2.22	2.20	2.59	2.76	9.77
NET EPS IN NT\$	7.52	2.01	2.77	3.29	3.91	11.98	1.95	1.94	2.26	1.80	7.95	1.46	1.65	2.09	2.27	7.47	2.07	2.05	2.42	2.58	9.12
Fully diluted shares (mn)	91	97	97	97	97	97	115	115	115	115	115	121	121	121	121	121	123	123	123	123	123
Operating Ratios																					
Gross margins	41%	40%	44%	47%	46%	45%	47%	41%	38%	39%	41%	39%	39%	39%	39%	39%	39%	39%	40%	40%	40%
Operating margin	23%	21%	28%	31%	30%	28%	28%	19%	15%	16%	19%	15%	16%	18%	19%	17%	19%	18%	19%	20%	19%
Interest inc/(exp)	2%	4%	2%	0%	4%	2%	-8%	1%	5%	3%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%
Pre-tax margin	24%	25%	29%	31%	34%	30%	20%	20%	21%	19%	20%	17%	17%	19%	20%	19%	20%	19%	20%	21%	20%
Net margin	25%	26%	29%	31%	34%	30%	21%	18%	20%	18%	19%	16%	16%	18%	19%	18%	18%	18%	19%	19%	19%
Year-to-Year %																					
Net revenues	52%	N/A	N/A	N/A	-59%	39%	42%	30%	25%	3%	23%	5%	0%	8%	24%	9%	25%	16%	13%	13%	16%
Gross profit	60%	N/A	N/A	N/A	-53%	53%	65%	21%	0%	-12%	13%	-13%	-7%	12%	24%	4%	26%	19%	16%	15%	18%
Operating income	62%	N/A	N/A	N/A	-46%	71%	90%	-13%	-39%	-46%	-16%	-43%	-13%	28%	50%	-1%	49%	29%	20%	17%	27%
Pretax income	69%	N/A	N/A	N/A	-43%	73%	18%	-11%	-19%	-43%	-19%	-14%	-13%	2%	33%	2%	45%	27%	19%	16%	25%
Net income	65%	N/A	N/A	N/A	-45%	69%	15%	-17%	-19%	-46%	-21%	-21%	-10%	-2%	33%	-1%	44%	26%	17%	15%	24%
Qtr-to-Qtr %																					
Net revenues			25%	10%	10%		-6%	15%	5%	-8%		-5%	9%	14%	5%		-5%	2%	11%	5%	
Gross profit			38%	16%	9%		-5%	1%	-4%	-4%		-6%	8%	15%	6%		-5%	2%	12%	5%	
Operating income			65%	23%	5%		-12%	-25%	-13%	-7%		-6%	14%	28%	9%		-7%	-1%	19%	7%	
Net income			38%	19%	19%		-41%	0%	16%	-20%		-14%	13%	26%	9%		-7%	-1%	18%	7%	

Source: Company Reports and Citi Investment Research estimates

Ralink Technology

Company description

Ralink was founded in 2001 and has evolved to become one of the key supplier of wireless networking IC products. Ralink is a wireless networking IC vendor focusing on 802.11x chipset solutions for client-based and access-point (AP) communication equipments. The company has been gaining momentum in the 802.11n market, and its new single-chip offering will help it maintain a cost advantage in 2H08.

Investment strategy

We have a Sell/High Risk rating on Ralink and a target price of NT\$78. Since the company's listing on the TSE Main Board in April 2008, the stock's trading has been highly volatile due to a limited float and uncertainty on its margin outlook. While margins may remain under pressure, we are cautious as we are concerned that Ralink's growth in market shares, due to its close relationships with strategic partners, may be offset by tougher pricing competition in the market.

Valuation

Our target price for Ralink of NT\$78 is based on a 2009E P/E multiple of 10-11x, lowered from 12-13x to reflect no earnings growth in 2009E. Since its listing in April 2008, the stock has traded between 10x to 34x forward earnings. Given our lowered outlook for Ralink's sales growth in 2009E, we no longer expect the company to trade at the same valuation multiple as companies that can sustain growth in the next year and expect the stock to maintain at trough valuation. We expect Ralink's ramp-up of its router chipsets and low-profile 802.11n client solutions will help it make additional design-ins in the notebook segment, while facing tougher ASP declines in the coming quarters.

Risks

We have a High Risk rating on the Ralink stock based on our quantitative risk rating system which tracks 260-day share price volatility. Upside risks to our target price are if company can introduce new products ahead of schedule, improve gross margin significantly, or rapidly gain market shares from its competitors.

Appendix A-1

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IMPORTANT DISCLOSURES

Ralink Technology (3534.TW)

Ratings and Target Price History

Fundamental Research

Analyst: Timothy Lam

Covered since March 19 2008

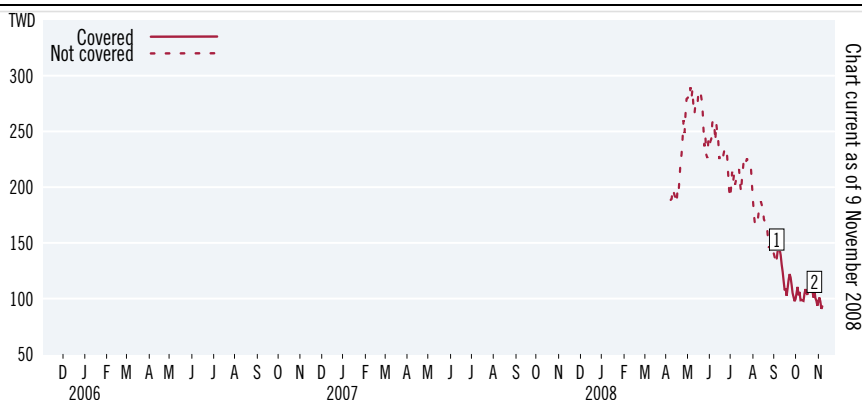


Chart current as of 9 November 2008

Date	Rating	Target Price	Closing Price
[1] 4-Sep-08	*1H	*181.00	136.00

Date	Rating	Target Price	Closing Price
[2] 28-Oct-08	*3H	*100.00	108.00

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 9 Nov 2008

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