

Company Focus

 SMALL &
 MID CAP

13 January 2009 | 10 pages

D-Link (2332.TW)

 Target price change
 Estimate change

Buy: Government Projects to Resume After Near-term Shortfall

- Lowering target to NT\$30 from NT\$34** — We are lowering D-Link's target price to NT\$30, equating to 1.0-1.1x book, to reflect weaker sales and earnings outlooks due to project delays in emerging markets and concerns over potential losses in 1H09. But we expect infrastructure projects, less focus on the US and Europe retail segments, and lowered OPEX should help D-Link's operating margin recover gradually by 2H09E.
- What's new** — D-Link reported 08 consolidated brand revenue of NT\$33.02bn, -1% yoy due to 4Q's 14% qoq sales drop as orders were affected by contract delays. In addition, low-end router prices also fell below US\$50. To counter weaker demand, the company is aggressively cutting expenses and has frozen employee headcount.
- 09E drivers** — 1) While some projects were delayed due to year-end financing concerns, a more robust financing climate should lead to restart of some infrastructure projects. We expect sales to see sequential recovery by 3Q09; 2) Popularity of netbook and smartphones will help increase penetration of wireless routers outdoors and in restaurants, along with its products tailored for 3.5G/HSDPA connectivity; 3) Consolidation in the space should help brand-name makers capture market share.
- Lowering estimates** — We are lowering our EPS forecasts for 09-10E by 48% and 42% to NT\$1.35 and NT\$1.84, respectively, to reflect more severe pricing pressures and demand declines.

Buy/Medium Risk	1M
Price (13 Jan 09)	NT\$21.65
Target price	NT\$30.00
	<i>from NT\$34.00</i>
Expected share price return	38.6%
Expected dividend yield	4.2%
Expected total return	42.8%
Market Cap	NT\$12,237M
	US\$368M

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



Figure 1. D-Link — Statistical Abstract

Year to	Net profit	EPS	EPS	P/E	PB	ROE	EV/EBITDA	Bloomberg	% diff
31-Dec	NT\$m	NT\$	YoY	(x)	(x)	(%)	(x)	NT\$	
2006A	2,521	3.69	53%	5.9	1.0	19%	7.1		
2007E	3,339	4.91	33%	4.4	0.9	21%	9.0		
2008E*	1,255	2.21	-55%	9.8	0.8	8%	8.9	2.67	-17%
2009E*	755	1.35	-39%	16.0	0.8	5%	12.4	2.36	-42%
2010E*	1,035	1.84	36%	11.8	0.8	7%	9.9	2.74	-33%

Source: Company Reports and Citi Investment Research estimates *Bonus Adjusted Earnings from 2008E

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

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¹Citigroup Global Markets Taiwan Securities Co. Limited

Fiscal year end 31-Dec	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	5.9	4.4	9.8	16.0	11.8
EV/EBITDA adjusted (x)	2.8	1.7	1.6	1.9	0.9
P/BV (x)	1.0	0.9	0.8	0.8	0.8
Dividend yield (%)	10.3	11.5	4.3	4.1	4.7
Per Share Data (NT\$)					
EPS adjusted	3.69	4.91	2.21	1.35	1.84
EPS reported	3.69	4.91	2.21	1.35	1.84
BVPS	21.68	24.40	27.53	27.78	28.54
DPS	2.23	2.50	0.92	0.89	1.02
Profit & Loss (NT\$M)					
Net sales	29,822	33,230	33,020	28,744	31,483
Operating expenses	-27,523	-30,926	-31,536	-28,042	-30,477
EBIT	2,299	2,304	1,484	702	1,006
Net interest expense	160	170	0	0	0
Non-operating/exceptionals	563	1,098	60	192	225
Pre-tax profit	3,022	3,572	1,545	894	1,231
Tax	-465	-233	-289	-140	-196
Extraord./Min.Int./Pref.div.	-36	0	0	0	0
Reported net income	2,521	3,339	1,255	755	1,035
Adjusted earnings	2,521	3,339	1,255	755	1,035
Adjusted EBITDA	2,928	3,036	2,338	1,670	2,088
Growth Rates (%)					
Sales	14.5	11.4	-0.6	-13.0	9.5
EBIT adjusted	64.1	0.2	-35.6	-52.7	43.3
EBITDA adjusted	44.1	3.7	-23.0	-28.6	25.0
EPS adjusted	52.7	33.2	-55.0	-38.7	35.7
Cash Flow (NT\$M)					
Operating cash flow	3,329	5,546	2,658	2,949	2,023
Depreciation/amortization	629	732	854	968	1,082
Net working capital	302	1,475	549	1,226	-93
Investing cash flow	130	-655	-700	-700	-700
Capital expenditure	-644	-655	-700	-700	-700
Acquisitions/disposals	801	0	0	0	0
Financing cash flow	-350	-3,143	-2,682	-460	-445
Borrowings	-111	-1,629	0	0	0
Dividends paid	-717	-1,320	-2,682	-461	-446
Change in cash	3,109	1,747	-725	1,788	879
Balance Sheet (NT\$M)					
Total assets	27,200	28,168	26,300	25,612	26,911
Cash & cash equivalent	3,905	5,652	4,927	6,714	7,592
Accounts receivable	8,081	8,104	8,455	7,286	7,901
Net fixed assets	3,535	3,459	3,305	3,037	2,655
Total liabilities	12,533	11,481	11,041	10,060	10,769
Accounts payable	6,481	6,839	6,423	5,963	6,339
Total Debt	1,929	300	300	300	300
Shareholders' funds	14,667	16,686	15,259	15,552	16,142
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	9.8	9.1	7.1	5.8	6.6
ROE adjusted	18.8	21.3	7.9	4.9	6.5
ROIC adjusted	19.0	23.2	15.3	8.4	14.0
Net debt to equity	-13.5	-32.1	-30.3	-41.2	-45.2
Total debt to capital	11.6	1.8	1.9	1.9	1.8

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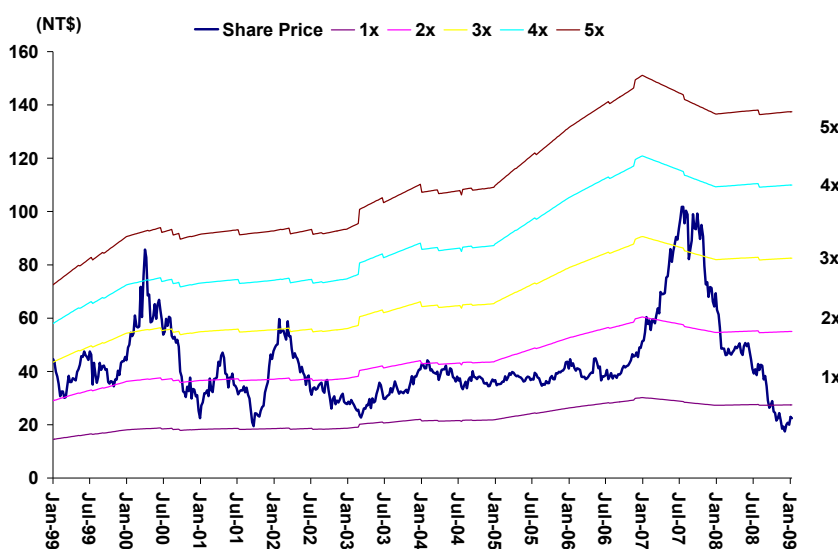


Navigating Through Challenging 09E

Demand for D-Link's networking products in 4Q08 declined sharply, as many projects are being delayed on financing concerns. But as we look into 09E, we believe the company is positioned for recovery in 2H09E as government infrastructure spending could lead to higher demand for networking systems.

Although D-Link may see losses in 1H09, we believe much of the bad news has been priced in. The company is now trading below book, and the current valuation is already 20% below the 01 trough level.

Figure 2. D-Link — PB Band, 1999-2009



Source: Citi Investment Research

In the past, D-Link's networking solutions were mainly viewed as second-tier brands in the retail market. While its product lines are still limited to enterprise usage, we expect its strong presence in emerging markets to help the company enjoy sector recovery.

Opportunities in Infrastructure and Mobile

Infrastructure project restarts

D-Link missed its guidance by a wide margin in 4Q08, as many of its earlier booked projects were delayed or the original terms were extended as financing tightened in 2H08. In addition, the rapid change in the exchange rate also made it extremely difficult for customers to maintain margins, which affected channel inventories. As some of its projects were delayed due to year-end financing concerns, a more robust financing climate in 09E should lead to restart of some infrastructure projects. We expect sales to sequentially recover by 3Q09, once inventory is digested and driven by demand from emerging markets.

Mobile and 3.5G segments to see growth

The growing popularity of netbooks and smartphones should help increase the penetration of wireless routers outdoors and in restaurants, as more people with smartphones (e.g. iPhones) demand connectivity. While this segment will compete with unlimited 3.5G/HSDPA connectivity solutions, it will also introduce new applications such as 3.5G routers (e.g. DIR-451), in which D-Link has developed a product line with much higher selling prices than traditional wireless routers. In addition, given D-Link's experience, 3.5G connectivity solutions may also be an area where D-Link can consider investing to provide growth to its core business, given its cash and technology position. Note that the company has already developed data-card products that are used by mobile operators.

Figure 3. D-Link — Quarterly Earnings Adjustment

	1Q08A	2Q08A	3Q08A	4Q08E	2008E	1Q09E	2Q09E	3Q09E	4Q09E	2009E
Old										
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
Revision										
Sales in NT\$m	8,493	8,507	8,629	7,391	33,020	6,690	6,582	7,614	7,858	28,744
Gross profits	2,864	2,852	2,820	2,213	10,749	2,084	2,048	2,385	2,399	8,917
Gross margin	34%	34%	33%	30%	33%	31%	31%	31%	31%	31%
Op profits	480	353	539	112	1,484	95	80	275	252	702
Op margin	6%	4%	6%	2%	4%	1%	1%	4%	3%	2%
Net profits	371	339	458	87	1,255	69	83	340	263	755
Net margin%	4%	4%	5%	1%	4%	1%	1%	4%	3%	3%
Earnings per share (NT\$)	0.65	0.60	0.81	0.15	2.21	0.12	0.15	0.61	0.47	1.35
Revision in %										
Sales in NT\$m	0%	0%	0%	-5%	-1%	-6%	-9%	-7%	-8%	-8%
Gross profits	0%	0%	0%	-12%	-3%	-10%	-13%	-12%	-13%	-12%
Gross margin	0%	0%	0%	-8%	-2%	-4%	-4%	-4%	-5%	-4%
Op profits	0%	0%	0%	-70%	-15%	-72%	-78%	-33%	-36%	-54%
Op margin	0%	0%	0%	-69%	-14%	-71%	-76%	-28%	-30%	-50%
Net profits	0%	0%	0%	-77%	-19%	-75%	-74%	-25%	-34%	-48%
Net margin%	0%	0%	0%	-76%	-18%	-74%	-71%	-19%	-28%	-44%
Earnings per share (NT\$)	0%	0%	0%	-77%	-19%	-75%	-74%	-25%	-34%	-48%

Source: Company Reports and Citi Investment Research estimates

Figure 4. D-Link — Earnings Revision

Year to	Net Profit (NT\$ mn)			Diluted EPS		
	Old	New	% Chg	Old	New	% Chg
2008E	1,546	1,255	-18.8%	2.72	2.21	-18.8%
2009E	1,448	755	-47.9%	2.60	1.35	-47.9%
2010E	1,779	1,035	-41.8%	3.16	1.84	-41.8%

Source: Citi Investment Research estimates

Figure 5. D-Link — Quarterly Income Statement (2006-2010E, NT\$ in Millions)

BRAND ONLY NT\$ in mn	FYE '06	2007				FYE '07	2008E				FYE '08	2009E				FYE '09	2010E				FYE '10
		1Q	2Q	3Q	4Q		1QA	2QA	3QA	4Q		1Q	2Q	3Q	4Q		1Q	2Q	3Q	4Q	
NET REVENUES	29,822	7,512	7,833	8,999	8,886	33,230	8,493	8,507	8,629	7,391	33,020	6,690	6,582	7,614	7,858	28,744	7,248	7,125	8,356	8,754	31,483
Total cost of good sold	(19,768)	(4,889)	(5,117)	(5,851)	(5,989)	(21,846)	(5,629)	(5,655)	(5,809)	(5,178)	(22,271)	(4,606)	(4,533)	(5,229)	(5,459)	(19,827)	(4,959)	(4,862)	(5,686)	(6,011)	(21,518)
GROSS PROFIT	10,054	2,623	2,716	3,148	2,897	11,384	2,864	2,852	2,820	2,213	10,749	2,084	2,048	2,385	2,399	8,917	2,289	2,263	2,670	2,743	9,965
R&D	(411)	(121)	(182)	(209)	(236)	(748)	(171)	(199)	(178)	(177)	(725)	(162)	(169)	(173)	(185)	(689)	(175)	(180)	(190)	(202)	(746)
SG&A	(7,344)	(1,908)	(1,936)	(2,253)	(2,236)	(8,332)	(2,176)	(2,266)	(2,050)	(1,914)	(8,406)	(1,819)	(1,790)	(1,899)	(1,933)	(7,442)	(1,873)	(1,918)	(2,105)	(2,175)	(8,072)
Operating expenses	(7,755)	(2,029)	(2,118)	(2,462)	(2,472)	(9,081)	(2,384)	(2,499)	(2,281)	(2,101)	(9,265)	(1,989)	(1,969)	(2,110)	(2,147)	(8,215)	(2,071)	(2,117)	(2,348)	(2,422)	(8,959)
OPERATING INCOME	2,299	594	598	686	425	2,303	480	353	539	112	1,484	95	80	275	252	702	217	146	322	321	1,006
Int&other inc/(exp)	723	621	78	274	296	1,269	(49)	38	83	(12)	60	(13)	19	127	59	192	(11)	23	143	70	225
PRETAX INCOME	3,022	1,215	676	960	721	3,572	431	391	622	101	1,545	82	99	403	311	894	206	168	465	391	1,231
Taxes or tax credit	(465)	(48)	105	(156)	(134)	(233)	(60)	(52)	(164)	(13)	(289)	(13)	(15)	(63)	(48)	(140)	(33)	(27)	(74)	(62)	(196)
NET INCOME	2,521	1,158	771	801	610	3,339	371	339	458	87	1,255	69	83	340	263	755	173	142	391	329	1,035
Earnings per share	3.69	1.70	1.13	1.18	0.90	4.91	0.65	0.60	0.81	0.15	2.21	0.12	0.15	0.61	0.47	1.35	0.31	0.25	0.69	0.58	1.84
Fully diluted shares (mn)	684	680	680	680	680	680	568	568	568	568	568	557	557	557	557	557	563	563	563	563	563
Operating Ratios																					
Gross margins	34%	35%	35%	35%	33%	34%	34%	34%	33%	30%	33%	31%	31%	31%	31%	31%	32%	32%	32%	31%	32%
Operating margin	7.7%	7.9%	7.6%	7.6%	4.8%	6.9%	5.7%	4.1%	6.2%	1.5%	4.5%	1.4%	1.2%	3.6%	3.2%	2.4%	3.0%	2.0%	3.9%	3.7%	3.2%
Interest inc/(exp)	2%	8%	1%	3%	3%	4%	-1%	0%	1%	0%	0%	0%	0%	2%	1%	1%	0%	0%	2%	1%	1%
Pre-tax margin	10%	16%	9%	11%	8%	11%	5%	5%	7%	1%	5%	1%	1%	5%	4%	3%	3%	2%	6%	4%	4%
Net margin	8%	15%	10%	9%	7%	10%	4%	4%	5%	1%	4%	1%	1%	4%	3%	3%	2%	2%	5%	4%	3%
Year-to-Year %																					
Net revenues	15%	9%	15%	13%	9%	11%	13%	9%	-4%	-17%	-1%	-21%	-23%	-12%	6%	-13%	8%	8%	10%	11%	10%
Gross profit	24%	14%	27%	22%	-5%	13%	9%	5%	-10%	-24%	-6%	-27%	-28%	-15%	8%	-17%	10%	10%	12%	14%	12%
Operating income	64%	39%	79%	18%	-55%	0%	-19%	-41%	-21%	-74%	-36%	-80%	-77%	-49%	124%	-53%	128%	83%	17%	27%	43%
Net income	54%	97%	93%	12%	-26%	32%	-68%	-56%	-43%	-86%	-62%	-81%	-75%	-26%	201%	-40%	151%	70%	15%	25%	37%
Qtr-to-Qtr %																					
Net revenues		-8%	4%	15%	-1%		-4%	0%	1%	-14%		-9%	-2%	16%	3%		-8%	-2%	17%	5%	
Gross profit		-14%	4%	16%	-8%		-1%	0%	-1%	-22%		-6%	-2%	16%	1%		-5%	-1%	18%	3%	
Operating income		-38%	1%	15%	-38%		13%	-26%	53%	-79%		-15%	-16%	246%	-9%		-14%	-33%	121%	0%	
Net income		41%	-33%	4%	-24%		-39%	-9%	35%	-81%		-21%	21%	308%	-23%		-34%	-18%	176%	-16%	

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, with a target price of NT\$30. 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. Although the company may face sharp declines in earnings due to a fall in demand, it has maintained a lower operating expenses to sales ratio than its peers by keeping a small sales team. We expect D-Link's operating margin to improve in the next 2-3 quarters by aggressively cutting its expenses. In addition, its government contracts may also resume in 1H09 to help offset the impact of weaker consumer demand for networking equipments.

Valuation

Our target price of NT\$30 is based on 1.0-1.1x book, near the trough reached in the previous down cycles. We are switching to a PB-based valuation methodology from a PE-based metric (12-13x 09E EPs) due to further uncertainty to earnings in 09E. The company may start to report near-term losses. In the past 9 years, the stock has traded at 1.06-4.63x, with a mean of 1.97x; we expect the stock to revert to its historical trough valuation when visibility improves. Investors may also start to give the stock higher valuations when they begin to recognise D-Link's growing brand presence in 802.11N solution and its opportunities in the mobile (3.5G/HSDPA) 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

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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



Chart current as of 10 January 2009

	Date	Rating	Target Price	Closing Price
1	14-Jun-06	1L	*46.67	35.16
2	21-Jul-06	1L	*46.67	36.17
3	6-Aug-06	1L	*45.63	35.48
4	16-Jan-07	1L	*66.17	57.27
5	13-Feb-07	1L	*68.45	54.99

	Date	Rating	Target Price	Closing Price
6	3-Apr-07	1L	*77.58	66.28
7	5-Jun-07	1L	*100.40	87.39
8	2-Aug-07	1L	*100.40	92.05
9	31-Oct-07	*3L	*81.46	84.37
10	29-Jan-08	3L	*39.22	46.14

	Date	Rating	Target Price	Closing Price
11	20-Mar-08	Coverage suspended		
12	4-Sep-08	*1M	*46.50	34.10
13	15-Oct-08	1M	*39.80	25.90
14	28-Oct-08	1M	*34.00	19.60

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 31 Dec 2008

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