OmniVision Technologies, Inc.

Dual Sourcing Likely; Still One of the Bigger Apples of iPhone’s Eye

SUMMARY

First off, no changes to price target and estimates. What our checks suggest and what one can deduce from logic are one and the same: Apple is dual sourcing the image sensor for iPhone. Both OVTI (TSM) and Sony are ramping their CMOS image sensor (CIS) businesses and both seem to be in next gen iPhone. Yes, we think that Apple is dual sourcing the non-VGA sensor while the VGA business belongs to OVTI. We think that this will deliver powerful upside to OVTI given that the market or at least OVTI bears think that it is not in the next generation iPhone. But, sorry bears, OVTI is still in.

KEY POINTS

- Our mosaic of checks suggest that Apple is most likely dual sourcing 8 megapixel (8MP) image sensors. We think that OVTI’s portion is likely to be at least the number of units it supplied for the prior iPhone 4 (~we think at least 60-65kwspm at TSM).
- Sony’s share can be estimated from the 25kwspm being added minus unit growth for its own apps. Prior 25K was/is likely for Sony’s own use, so, a part of next 25K is what Apple will be supplied from. So, max 30% share, if that, assuming Apple insisted on identically sized OVTI and Sony parts.
- Apple is likely asking lens makers and EMS vendors to integrate parts from either vendor, agnostic of where it is from. Our checks with image sensor fabrication tool vendors indicated both OVTI and SNE are increasing capacity. So, obligations from OVTI of $255M from its 10-Q, despite a cooling macro look very respectable in retrospect.
- Importantly, Digitimes also indicated that Tong Hsing’s image sensor revenues will outshine in CY4Q and all of its advanced CIS business comes from OVTI. Assuming OVTI revenues are 35% Apple, 20% RIMM/Nokia, 15% Auto, 5% Medical, and 25% PCs and given low PC growth, its guidance indicates higher CIS for the smartphone fraction.
- After the last quarter, OVTI is likely to have grown wise to estimates from some firms, that, one one hand, continue bear-speak and while on the other fix their estimates sky high. So, we think going forward, less such bear opportunities will arise, macro willing.

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Prices for Non-Covered Stocks as of 9/26/11

Sony (SNE-NYSE, $19.02, Not Rated)
Taiwan Semiconductor (TSM-NYSE, $11.71, Not rated)
Tong Hsing (6271-Taiwan Stock Exch., $77.30, Not rated)
Investment Thesis
OmniVision is a leading provider of CMOS image sensors to the handset, DSC, DVC, notebook, webcam, security and medical markets, and is at the early stages, in our view, of a new product cycle with its backside illumination and wafer-level camera sensors. We believe these innovative products put OmniVision in a strong position to benefit from the upward migration of megapixel resolution and to gain share in the next generation of camera sensors in cameras and a host of other consumer electronics products. Ahead of such growth, we see OmniVision's valuation as attractive with shares trading at low single digit multiple, ex-cash.

Price Target Calculation
Our price target of $35 is based on 10x our FY12 EPS estimate of $2.50 plus net cash per share of over $9 in FY2012. We believe our price target and target multiple are conservative given OmniVision’s exposure to the smartphones/tablets mega-trend, new medical/entertainment/automotive apps, China and India market expansion and its leadership position in the secular shift to BSI sensor architecture.

Key Risks to Price Target
These include weaker than expected demand for the consumer electronic products using OVTI’s sensors (reality in 2H11); share loss to competitors (2H11 could present opportunities to other vendors that can indulge in a price war); higher than expected price pressure, which could impact both revenue and profitability; manufacturing problems, which could reduce yield rates and gross margins (reality in 2H11); a failure to continue innovating and to maintain a technological edge; and unexpected adverse changes to the company's tax rate. However, to some degree, the current stock price more than discounts some of these concerns barring a much more severe macro downturn and the emergence of paradigm shifting technology at a competitor.

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