

Gaming: I-Gaming

GigaMedia Limited | GIGM - \$13.30 - NASDAQ | Buy

Company Update

Stock Data

52 Week Low - High	\$9.02 - \$25.42
Shares Out. (mil)	50.34
Mkt. Cap.(mil)	\$669.6
3-Mo. Avg. Vol.	529,741
12-Mo.Price Target	\$23.00
Tot. Debt (mil)	\$32.00
Debt/Equity	0.15%
Est. 3Yr. EPS Growth	25%

EPS (\$)

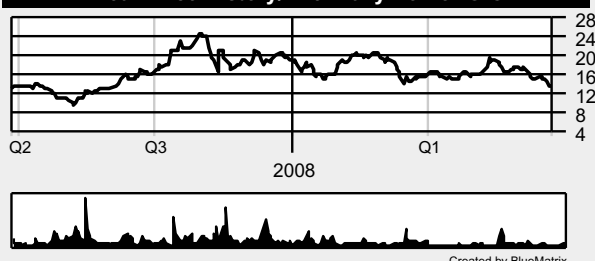
Yr Dec	2007	—2008E—	—2009E—
	Actual	Curr	Curr
1Q	0.14A	0.20A	—
2Q	0.16A	0.19E	—
3Q	0.15A	0.19E	—
4Q	0.16A	0.24E	—
YEAR	0.65A	0.82E	1.04E
P/E	20.5x	16.2x	12.8x

Est's are pro-forma, see model for details

Revenue (\$ millions)

Yr Dec	2007	—2008E—	—2009E—
	Actual	Curr	Curr
1Q	36.1A	54.6A	—
2Q	40.1A	53.6E	—
3Q	43.0A	54.6E	—
4Q	47.7A	65.0E	—
YEAR	166.9A	227.9E	281.4E

1 Year Price History/Ave. Daily Vol for GIGM



Japanese Site Goes Live; BUY on Weakness

- **Japanese site goes live.** Our channel checks suggest that the company's real-money Japanese gaming site went live last night. We continue to view this as a meaningful growth opportunity for the company and we view this event as a positive catalyst for shares.
- **What's the impact?** While its tough to forecast the financial impact from the Japanese site, we believe the opportunity is large considering the population base, discretionary spending levels, and willingness to gamble evidenced by the country's large land-based Pachinko business.
- **What are we looking for.** We are conservatively modeling in \$3M and \$6M in revenue in FY08 and FY09, respectively. However, if the site proves to be successful we believe the financial impact could be much larger (possibly 2-3x) than we are forecasting. We note that mgt has not provided any guidance.
- **Expectations for 2Q.** We believe the recent sell-off in GIGM shares could be attributed to a lack of news flow, worries over the impact of seasonality in 2Q, and a broad sell-off in Asia related equities. We view these issues as non-fundamental and we remain comfortable with our investment thesis and near term and long-term estimates.
- **Sell-off creates attractive buying opportunity.** We continue to believe shares are undervalued at current levels trading for 12.8x our FY09 EPS estimate with expectations for 27% YoY earnings growth. Therefore, we recommend investors take advantage of the recent share price decline and we reiterate our BUY rating and \$23 price target.

VALUATION

Shares of GIGM currently trade for 16.3x and 12.8x our FY08 and FY09 EPS estimates.

While GigaMedia has an attractive business model that generates a significant amount of free cash, the stock trades at a discount relative to other businesses with similar fundamentals due to a higher than normal level of legal and regulatory risk in the real-money I-gaming sector. However, we believe the company's lack of exposure to the U.S. market, improved EU regulatory environment, substantial and increasing casual/online gaming business, and revenue diversification mitigates a good portion of the regulatory risk inherent in the I-gaming sector. Furthermore, we believe the combination of the company's real-money I-gaming operations with its expanding casual/online business provides unique competitive advantages that we believe warrant a premium valuation.

Therefore, we base our price target on a P/E multiple of 25x our FY09 estimate of \$1.04 discounted back 3 qtrs.

RISKS

- The loss of an existing license or the failure to obtain a license in a new jurisdiction could have a negative affect on existing and potential operations.
- New legislation which would require GigaMedia to no longer accept wagers from existing markets would have an adverse financial impact.
- GigaMedia relies on a single licensee, UIM, to generate revenue from using its casino and poker s/w products. The termination of this relationship would have a negative impact on operations.
- GigaMedia generates the majority of its revenue from European markets. The loss of a licensee, increased competition, or restrictive government regulation in any of these markets could have adverse effects on the company's financial performance.
- GigaMedia generates a large portion of its revenue from the Everest Poker branded online poker site. Should the Everest Poker brand or poker in general lose its popularity it would have a negative affect on the company's business operations.

COMPANY DESCRIPTION

GigaMedia Limited, through its subsidiaries, engages in the development and license of entertainment software and provision of application services, and ownership and operation of an online games portal. It also provides broadband Internet access services. The company, through its subsidiary, Cambridge Entertainment Software, develops and licenses software solutions and application services, including online entertainment and social networking in the Internet-based entertainment markets. It also offers FunTown game portal, an Asian casual game portal that provides an online MahJong game site, as well as provides services, such as game clubs for players, tournaments related to FunTown's online casual games, and social networking. In addition, the company provides broadband Internet access services to consumer and corporate customers through various technologies and products, including cable modems, leased-lines, virtual private network, and other value-added services. GigaMedia was founded in 1997 and is headquartered in Taipei, Taiwan.

MENTIONED COMPANIES

GIGM — Income Statement (\$ in 000s, except per share data)

Year End: Dec	2003	2004	2005	2006	Mar Q1:07	Jun Q2:07	Sep Q3:07	Dec Q4:07	2007	Mar Q1:08	Jun Q2:08E	Sep Q3:08E	Dec Q4:08E	2008E	2009E
Revenue:															
Real money gaming	-	11,434	22,511	55,019	26,271	29,221	29,300	34,159	118,951	38,301	38,371	39,647	45,800	162,119	195,117
Casual/Online gaming	-	-	-	18,691	5,471	7,200	10,028	10,074	32,772	12,890	11,994	11,828	16,293	53,014	74,805
ISP	18,829	20,960	21,408	19,621	4,339	3,646	3,705	3,472	15,162	3,435	3,263	3,100	2,945	12,744	11,469
Other	684	450	268	207	5	5	(12)	3	1	4	-	-	-	-	-
Total Revenue	19,513	32,844	44,187	93,538	36,086	40,072	43,021	47,708	166,886	54,629	53,629	54,575	65,038	227,877	281,391
% Change y/y				34.5%	97.7%	90.6%	76.2%	58.7%	78.4%	-41.6%	48.6%	36.2%	51.2%	36.5%	23.5%
% Change q/q	n/a	n/a	n/a	n/a	20.0%	11.0%	7.4%	10.9%	n/a	27.0%	-1.8%	1.8%	19.2%	n/a	n/a
Cost of Services	16,115	16,109	17,383	22,882	7,333	8,265	9,831	10,115	35,544	11,481	11,216	11,157	13,481	47,329	60,034
% of revenue	82.6%	49.0%	39.3%	24.5%	20.3%	20.6%	22.9%	21.2%	21.3%	21.0%	20.9%	20.4%	20.7%	20.8%	21.3%
Gross Profit	3,398	16,735	26,804	70,656	28,753	31,806	33,190	37,592	131,341	43,149	42,413	43,418	51,558	180,548	221,357
% margin	17.4%	51.0%	60.7%	75.5%	79.7%	79.4%	77.1%	78.8%	78.7%	79.0%	79.1%	79.6%	79.3%	79.2%	78.7%
Product development expens	1,211	2,513	3,562	5,738	1,821	1,881	1,442	2,766	7,911	3,367	3,405	3,438	3,740	13,950	14,773
% of revenue	6.2%	7.7%	8.1%	6.1%	5.0%	4.7%	3.4%	5.8%	4.7%	6.2%	6.4%	6.3%	5.8%	6.1%	5.3%
Selling and marketing expens	2,432	6,310	10,777	30,124	13,567	13,829	14,964	19,988	62,349	19,064	19,306	19,783	22,763	80,917	101,301
% of revenue	12.5%	19.2%	24.4%	32.2%	37.6%	34.5%	34.8%	41.9%	37.4%	34.9%	36.0%	36.3%	35.0%	35.5%	36.0%
General and administrative expens	5,162	5,657	7,892	12,421	4,371	5,859	6,630	5,380	22,240	7,723	7,776	7,913	8,325	31,738	36,581
% of revenue	26.5%	17.2%	17.9%	13.3%	12.1%	14.6%	15.4%	11.3%	13.3%	14.1%	14.5%	14.5%	12.8%	13.9%	13.0%
Bad debt expense	128	(220)	207	715	328	138	118	159	743	88	107	164	195	554	844
EBIT	(5,535)	2,475	4,366	21,659	8,665	10,099	10,035	9,299	38,099	12,907	11,818	12,119	16,535	53,389	67,858
% margin	-28.4%	7.5%	9.9%	23.2%	24.0%	25.2%	23.3%	19.5%	22.8%	23.6%	22.0%	22.2%	25.4%	23.4%	24.1%
Non-recurring charge	1,557														
Non-operating income	(2,583)	(1,143)	2,710	10,690	87	510	1,533	353	2,484	501	449	549	649	1,972	4,500
Pretax income	(9,675)	1,332	7,076	32,349	8,753	10,609	11,568	9,653	40,582	13,408	12,267	12,668	17,184	55,362	72,358
% margin	-49.6%	4.1%	16.0%	34.6%	24.3%	26.5%	26.9%	20.2%	24.3%	24.5%	22.9%	23.2%	26.4%	24.3%	25.7%
Tax provision (benefit)	139	(84)	436	1,549	312	336	291	(536)	403	518	491	887	1,547	3,442	5,065
% tax rate	-1.4%	-6.3%	6.2%	4.8%	3.6%	3.2%	2.5%	-5.6%	1.0%	3.9%	4.0%	7.0%	9.0%	6.2%	7.0%
Minority Interest	(15)	163	150	320	(18)	187	1583	-470	1,281	813	400	400	800	2,413	3,000
Net Income from continuing ops	(9,799)	1,253	6,490	30,479	8,459	10,086	9,695	10,659	38,898	12,077	11,376	11,381	14,837	49,507	64,293
Discontinued Ops, net	4,296	(429)	(154)	-	-	-	-	-	-	-	-	-	-	-	-
GAAP Net income	(14,095)	1,682	6,644	30,479	8,459	10,086	9,695	10,659	38,898	12,077	11,376	11,381	14,837	49,507	64,293
% margin	-72.2%	5.1%	15.0%	32.6%	23.4%	25.2%	22.5%	22.3%	23.3%	22.1%	21.2%	20.9%	22.8%	21.7%	22.8%
Gaap EPS - Diluted	(\$0.28)	\$0.03	\$0.12	\$0.50	\$0.14	\$0.17	\$0.16	\$0.18	\$0.65	\$0.20	\$0.19	\$0.19	\$0.24	\$0.82	\$1.04
Pro forma EPS - Diluted*	(\$0.16)	\$0.02	\$0.12	\$0.37	\$0.14	\$0.16	\$0.15	\$0.16	\$0.61	\$0.20	\$0.19	\$0.19	\$0.24	\$0.82	\$1.04
Basic shares outstanding	50,154	50,154	50,312	50,918	51,993	52,774	53,088	53,604	52,865	53,817	54,017	54,217	54,417	54,117	55,000
Diluted shares outstanding	50,154	51,701	55,059	61,471	59,574	59,963	59,927	60,558	60,006	60,445	60,545	60,645	60,745	60,595	62,000
Non-GAAP items:**															
Net Income	(14,095)	1,682	6,644	30,479	8,459	10,086	9,695	10,659	38,898	12,077	11,376	11,381	14,837	49,507	64,293
add back D&A	6,359	6,944	5,703	6,048	1,500	1,500	1,453	1,401	5,854	1,533	1,533	1,533	1,533	6,131	7,000
subtract out non-operating income, net	(2,583)	(1,143)	2,710	10,690	87	510	1,533	353	2,484	501	449	549	649	1,972	4,500
add back taxes	139	(84)	436	1,549	312	336	291	(536)	403	518	491	887	1,547	3,442	5,065
EBITDA	(5,014)	9,685	10,073	27,386	10,184	11,412	9,905	11,171	42,672	13,627	12,950	13,251	17,267	57,107	71,858
% margin	-25.7%	29.5%	22.8%	29.3%	28.2%	28.5%	23.0%	23.4%	25.6%	24.9%	24.1%	24.3%	26.5%	25.1%	25.5%
Operating cash flow	6,439	2,390	11,522	30,237	11,000	17,000	12,200	13,300	53,500	9,000	14,159	14,164	17,620	54,943	76,293
Less capital expenditures	1,913	2,587	2,652	5,700	1,200	2,200	2,700	3,700	9,800	2,800	3,200	3,500	4,000	13,500	15,000
Free cash flow	4,526	(197)	8,870	24,537	9,800	14,800	9,500	9,600	43,700	6,200	10,959	10,664	13,620	41,443	61,293
% margin	23.2%	-0.6%	20.1%	26.2%	27.2%	36.9%	22.1%	20.1%	26.2%	11.3%	20.4%	19.5%	20.9%	18.2%	21.8%

Notes

*Pro forma EPS and EBITDA excludes the following item:

-2003: Plant Property & Equipment Impairment

-2Q06: Excludes \$7 million gain on sale of ADSL business

-4Q06: Excludes gain on sale of marketable security

-2Q07: Excl \$0.5 million gain from Wretch agreement

-3Q07: Excl \$0.9 million related to one-time T2CN gain

-4Q07: excl \$0.5 million tax benefit, \$0.5 million minority interest gain & assumes normalized 3% tax-ra

**Non-GAAP item calculations include quarterly assumptions for operating cash flow and capital expenditures prior to CY

n/a = not applicable or data not available

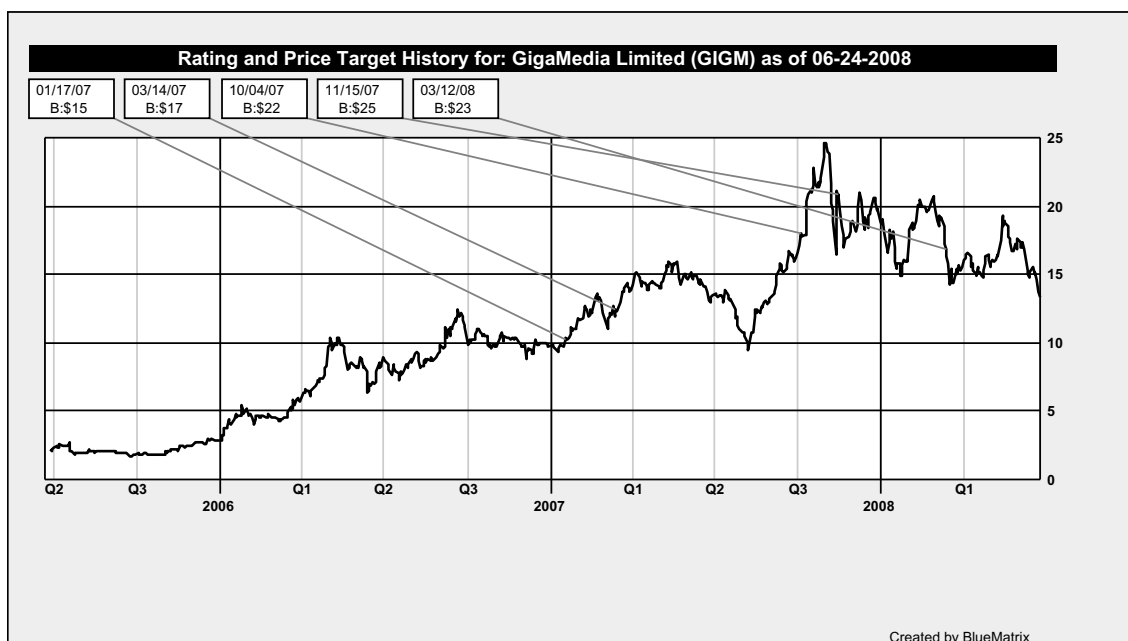
Source: Company reports and Roth Capital Partners estimates.

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Distribution of IB Services Firmwide

Rating	Count	Percent	IB Serv./Past 12 Mos. as of 06/25/08	
			Count	Percent
BUY [B]	131	58.48	16	12.21
HOLD [H]	54	24.11	5	9.26
SELL [S]	2	0.89	0	0
NOT RATED [NR]	37	16.52	13	35.14

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