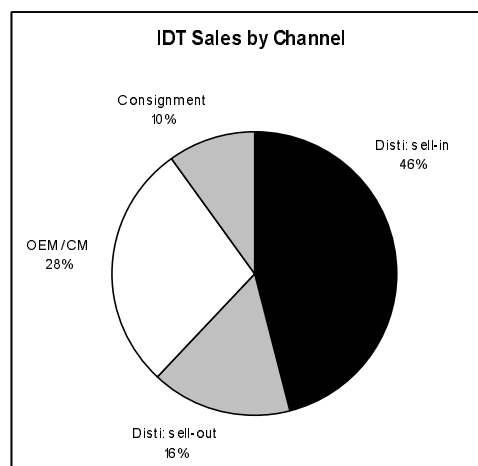


IDT: First Negative Preannouncement for CY1Q
Blames PC and Server Weakness, But Probably NOT a Leading Indicator

Summary: IDTI preannounced expected weakness for the March-ending quarter after the close yesterday due to PC channel inventory reductions, as well as server memory interface weakness due to customer financial issues. While this is noteworthy as the first negative preannouncement from the chip sector for CY1Q, the magnitude of IDT’s expected revenue decline and a disproportionate share of business via distribution mitigates a broad indictment of the PC and server markets at this time, in my opinion.

IDT Shortfall: IDTI lowered guidance for its March-ended quarter after the close yesterday. Revenue is expected at \$106-108M, down from original guidance at \$114-126M, and for non-GAAP EPS of a loss of (\$0.03), down from a range of break-even to \$0.04. Reductions in PC-related channel inventory, as well lower server memory interface products due to certain customer financial difficulties accounted for the weakness. The company announced a salary freeze, suspension of 401K matching contributions, and mandatory vacations and factory shut-downs to compensate for the shortfall. The good news is that the book-to-bill ratio last quarter was greater than 1:1 and management expects flat to slight revenue growth this quarter. March-ended FY4Q earnings are scheduled for April 30.

Market	Rev	CY4Q	CY1Q	
			Guidance	Update
Computer	42%	-25%	-25%	
PC-audio codec and clocks				shortfall
Servers-memory interface		-1-3%	-10-13%	shortfall
Servers-PCI Express		-10-13%	+15%	
Consumer	16%	-10%	-50%	
gaming		down		
displays		up		
Communications	42%	-20%	-20%	
wireless		down	(China 3G strength)	
wireline		down		
enterprise		down		
SRAMs (5%)				
Total (\$ mil)	167.1	-17%	-32-25%	-37-35%



First Negative Preannouncement: Of the over 110 companies in the Tokeneke Universe, this is the first negative preannouncement for CY1Q09. Of the 10 preannouncements and mid-quarter updates prior to IDTI, eight slightly raised expectations to less pronounced sequential declines (ALTR, DIOD, LSCC, MSPD, SMSC, TSM, TXN, XLNX) and two reiterated original expectations or narrowed the range (ACTL, MCHP).

Not So Fast: At first blush, this appears to indicate incremental weakness in the PC and server markets—which is especially surprising after reports of incremental improvements from companies in the US and Taiwan centered around Chinese 3G infrastructure builds and white-box handsets, as well as notebook PCs and netbooks. However, I argue that this portended weakness is not necessarily this case for two reasons: First, the net magnitude of IDT’s two-quarter revenue decline is consistent with other PC-related chip companies; and second, there may be a timing issue related to the significant portion of the company’s distribution channel shipments.

The table at the right identifies a number of chip companies with at least some PC and server exposure, their reported actual sequential revenue decline for CY4Q, the mid-point of most recent guidance for the expected revenue change for CY1Q, and then calculates the multiplicative sum of the two quarters. As you can see, IDT’s revised estimates are close to the average cumulative expectation.

Company	Revenue Change		
	CY4Q	CY1Q	Total
IDT	-16.7%	-36.0%	-46.7%
AATI	-26.8%	-22.0%	-42.9%
AMD	-35.0%	-10.0%	-41.5%
ATHR	-28.8%	-15.0%	-39.5%
CY	-25.6%	-26.5%	-45.3%
FCS	-25.1%	-27.5%	-45.7%
Intel	-19.5%	-15.0%	-31.6%
ISIL	-40.0%	-16.0%	-49.6%
Nvidia	-46.4%	0.0%	-46.4%
OllM	-40.0%	-16.5%	-49.9%
PSEM	-30.1%	-20.0%	-44.1%
SMSC	-13.3%	-41.5%	-49.3%
VLTR	-28.4%	-20.0%	-42.7%
		Average:	-44.2%

Approximately 62% of IDT's revenue is shipped via distribution, and this intermediate inventory location may well be a significant contributor to 'reductions in PC-related channel inventories.' Also, we don't know if the server weakness is demand-related: the wording seems to indicate customer-specific financial issues at companies that make memory boards for servers that require IDT's interface products.

Finally, there is a very clear silver lining in the preliminary CY2Q guidance calling for flat to slightly increasing sales based on a book-to-bill ratio over 1:1 last quarter. This booking data is consistent with incrementally improving business conditions reported in the February and March timeframes.

Outlook Unchanged—Despite the Red Flag: Notwithstanding IDTI's negative preannouncement, business conditions across the semiconductor industry continue to unfold consistent with my expectations: a bottom appears to have been reached and near-term incremental improvements have surfaced, although this plateau has occurred at a fairly depressed level and the timing and profile of the ultimate macroeconomic recovery remains elusive.

I continue to believe we remain in an equity market environment that will be characterized by rallies followed by retreats, although my macro outlook turned slightly bullish from moderately bearish following the Fed's move in early-March to inject \$1 trillion into treasuries and mortgages. We could very well experience a near-term correction after the peak from last week's rally.

I continue to expect positive fundamental news this month from the chip sector: February monthly industry sales will be reported in the next couple of days and is very likely to improve on a sequential monthly basis for the first time in several months, and clearly denote a revenue bottom; and IQ earnings announcements during April are shaping-up to be better than originally expected.

However, this good news will be tempered by the fact that IQ will still contract by around 10% sequentially, and my expectation for generally uninspiring flat-to-slightly-up 2Q guidance will continue to render the recovery as elusive.

Stock Recommendations: Please see the most recently published reports for additional information.

MU: Buy recommendation with a 12-month target price of \$12—for the unusually risk-tolerant investor.

TXN: Accumulate as it approaches support around \$14, and lighten-up as it approaches my \$19 target price.

INTC: I'm not interested until it approaches its recent support level just over \$12.

NSM: Also not interested until it approaches a recent support level around \$9.50.

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