

A defensive play for value investors; Buy



Resilient share price; offers best value among ODMs

Compal's share price has demonstrated resilience over the past one month (**flattish; outperformed market by ~13%**), supported by its share buyback and expected in line 3Q results. Among the NB ODM space, we prefer Compal and retain our Buy rating as we believe it offers the best value from a balance sheet and cash flow standpoint. We view the stock as a defensive play and expect it to attract the attention of L-T value-focused investors.

Quality balance sheet; with strong cash on hand

Among Taiwan's top four NB ODMs, Compal stands out in terms of its balance sheet and cash position: quick ratio (>1.0), D/E ratio (~1.5), cash conversion days (<15 days), and net cash/mkt cap (~45%). Compal also leads its peers in terms of Free Cash Flow (FCF) and cash yield (~10%).

We expect in line 3Q results; recovery from low base

We expect Compal to report in line or slightly better 3Q results (in the week of 27 October), helped by its 27% QoQ sales growth and sustained OP margins. We also expect that recent poor sentiment will gradually dissipate, given its moderate growth for 4Q08E (NB shipments +10%) and share gains from Toshiba and Acer orders in 2009.

Downside scenario also suggests that valuation is at trough

Compal is currently trading at 6.8x 2008E P/E and 1.1x P/BV. Even under our **downside scenario analysis** (only 6-10% YoY sales growth for 2009E, further deterioration in OP margin by 10-20bp and no improvement in VIBO/TPO investments), Compal is trading at 6.6-7.0x 2009E P/E – its historical trough valuation since 2001.

Estimates (Dec)

| (NT\$) | 2006A | 2007A | 2008E | 2009E | 2010E |
|-----------------------------|-------|--------|--------|--------|--------|
| Net Income (mn) Taiwan GAAP | 8,752 | 13,683 | 13,089 | 14,520 | 15,968 |
| EPS (Pre Bonus) | 2.22 | 3.47 | 3.86 | 4.29 | 4.71 |
| EPS (Post Bonus) | 1.93 | 2.96 | 3.32 | 3.69 | 4.05 |
| EPS Change (YoY) | 3.1% | 53.7% | 12.3% | 10.9% | 10.0% |
| Dividend / Share | 1.70 | 2.40 | 2.33 | 2.76 | 3.04 |
| Free Cash Flow / Share | 3.65 | 2.93 | 1.77 | 3.54 | 2.63 |

* Taiwan GAAP changed from Pre Bonus to Post Bonus earnings from 2008.

Valuation (Dec)

| | 2006A | 2007A | 2008E | 2009E | 2010E |
|-----------------------|--------|--------|--------|--------|--------|
| P/E (Post Bonus) | 11.71x | 7.62x | 6.79x | 6.12x | 5.56x |
| Dividend Yield | 7.54% | 10.64% | 10.31% | 12.26% | 13.48% |
| Free Cash Flow Yield* | 16.16% | 12.98% | 7.85% | 15.70% | 11.67% |

* For full definitions of *iQmethod*SM measures, see page 9.

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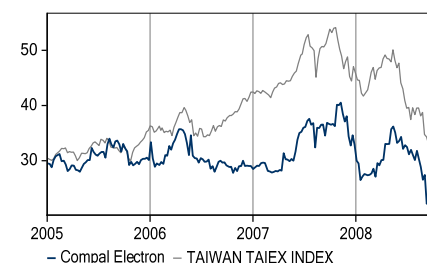
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Stock Data

| | |
|-----------------------------|---------------------|
| Price | NT\$22.55 |
| Price Objective | NT\$34.30 |
| Date Established | 20-Aug-2008 |
| Investment Opinion | C-1-7 |
| Volatility Risk | HIGH |
| 52-Week Range | NT\$20.65-NT\$42.99 |
| Mrkt Val / Shares Out (mn) | US\$2,730 / 3,940.0 |
| Average Daily Volume | 13,764,110 |
| ML Symbol / Exchange | CMLPF / TWO |
| Bloomberg / Reuters | 2324 TT / 2324.TW |
| ROE (2008E) | 16.3% |
| Net Dbt to Eqty (Dec-2007A) | -27.7% |
| Est. 5-Yr EPS / DPS Growth | 10.0% / 10.0% |
| Free Float | 70.0% |



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20 October 2008

iQprofileSM Compal Electronics

| Key Income Statement Data (Dec) | 2006A | 2007A | 2008E | 2009E | 2010E |
|--|---------|---------|---------|---------|---------|
| (NT\$ Millions) | | | | | |
| Sales | 303,071 | 427,460 | 405,171 | 473,494 | 521,453 |
| Gross Profit | 14,433 | 20,630 | 19,774 | 22,057 | 23,669 |
| Sell General & Admin Expense | (5,197) | (6,269) | (8,980) | (9,137) | (9,595) |
| Operating Profit | 9,236 | 14,361 | 10,794 | 12,919 | 14,074 |
| Net Interest & Other Income | 1,156 | 2,184 | 5,019 | 5,007 | 5,640 |
| Associates | NA | NA | NA | NA | NA |
| Pretax Income | 10,392 | 16,545 | 15,813 | 17,926 | 19,714 |
| Tax (expense) / Benefit | (1,640) | (2,862) | (2,724) | (3,406) | (3,746) |
| Net Income (Adjusted) | 8,752 | 13,683 | 13,089 | 14,520 | 15,968 |
| Average Fully Diluted Shares Outstanding | 3,940 | 3,940 | 3,940 | 3,940 | 3,940 |

Key Cash Flow Statement Data

| | | | | | |
|---|----------|----------|----------|----------|----------|
| Net Income (Reported) | 8,752 | 13,683 | 13,089 | 14,520 | 15,968 |
| Depreciation & Amortization | 360 | 551 | 528 | 617 | 680 |
| Change in Working Capital | 5,755 | (5,296) | (2,551) | 3,028 | (1,407) |
| Deferred Taxation Charge | NA | NA | NA | NA | NA |
| Other Adjustments, Net | (287) | 2,827 | (3,775) | (3,847) | (4,460) |
| Cash Flow from Operations | 14,580 | 11,765 | 7,291 | 14,319 | 10,782 |
| Capital Expenditure | (218) | (232) | (320) | (374) | (412) |
| (Acquisition) / Disposal of Investments | (1,456) | (2,689) | (500) | (500) | (500) |
| Other Cash Inflow / (Outflow) | 562 | 111 | 0 | 0 | 0 |
| Cash Flow from Investing | (1,112) | (2,810) | (820) | (874) | (912) |
| Shares Issue / (Repurchase) | 0 | 0 | 0 | 0 | 0 |
| Cost of Dividends Paid | (5,552) | (6,674) | (9,100) | (9,301) | (11,710) |
| Cash Flow from Financing | (5,552) | (6,674) | (9,100) | (9,301) | (11,710) |
| Free Cash Flow | 14,362 | 11,533 | 6,971 | 13,945 | 10,370 |
| Net Debt | (34,072) | (21,699) | (24,279) | (22,140) | (22,864) |
| Change in Net Debt | (7,916) | (2,281) | 2,629 | (4,144) | 1,840 |

Key Balance Sheet Data

| | | | | | |
|-------------------------------|---------|---------|---------|---------|---------|
| Property, Plant & Equipment | 2,402 | 2,158 | 2,478 | 2,852 | 3,263 |
| Other Non-Current Assets | 44,403 | 45,666 | 49,907 | 54,359 | 59,394 |
| Trade Receivables | 62,065 | 64,836 | 61,053 | 71,348 | 77,147 |
| Cash & Equivalents | 34,072 | 31,443 | 34,023 | 31,884 | 32,608 |
| Other Current Assets | 11,638 | 13,587 | 10,686 | 12,514 | 12,433 |
| Total Assets | 154,580 | 157,690 | 158,146 | 172,957 | 184,845 |
| Long-Term Debt | 0 | 9,744 | 9,744 | 9,744 | 9,744 |
| Other Non-Current Liabilities | 216 | 511 | 511 | 511 | 511 |
| Short-Term Debt | 0 | 0 | 0 | 0 | 0 |
| Other Current Liabilities | 83,131 | 69,185 | 65,794 | 75,500 | 83,458 |
| Total Liabilities | 83,347 | 79,440 | 76,049 | 85,755 | 93,713 |
| Total Equity | 71,233 | 78,249 | 82,045 | 87,060 | 91,103 |
| Total Equity & Liabilities | 154,580 | 157,689 | 158,093 | 172,815 | 184,816 |

iQmethodSM - Bus Performance*

| | | | | | |
|----------------------------|-------|-------|-------|-------|-------|
| Return On Capital Employed | 10.8% | 15.8% | 10.6% | 11.8% | 12.3% |
| Return On Equity | 12.9% | 18.3% | 16.3% | 17.2% | 17.9% |
| Operating Margin | 3.0% | 3.4% | 2.7% | 2.7% | 2.7% |
| EBITDA Margin | 3.2% | 3.5% | 2.8% | 2.9% | 2.8% |

iQmethodSM - Quality of Earnings*

| | | | | | |
|--------------------------|--------|--------|--------|--------|--------|
| Cash Realization Ratio | 1.7x | 0.9x | 0.6x | 1.0x | 0.7x |
| Asset Replacement Ratio | 0.6x | 0.4x | 0.6x | 0.6x | 0.6x |
| Tax Rate (Reported) | 15.8% | 17.3% | 17.2% | 19.0% | 19.0% |
| Net Debt-to-Equity Ratio | -47.8% | -27.7% | -29.6% | -25.4% | -25.1% |
| Interest Cover | 46.2x | NM | NA | NA | NA |

Key Metrics

| | | | | | |
|---------------------------|--------|-------|-------|-------|-------|
| Stock comp. adjusted ROIC | 8.7% | 14.9% | 9.4% | 10.6% | 11.0% |
| Stock comp. adjusted ROE | 11.2% | 15.6% | 14.7% | 15.5% | 16.1% |
| Stock comp. adjusted EPS | 1.93 | 2.96 | 3.32 | 3.69 | 4.05 |
| Stock comp. adjusted P/E | 11.71x | 7.62x | 6.79x | 6.12x | 5.56x |

* For full definitions of iQmethodSM measures, see page 9.

Company Description

Compal is the second largest manufacturer of notebook PCs in the world with about 15-20% share in 2006. NB PCs account for 85% of revenue and the balance comes from handsets, monitors, and flat TVs. Top customers include Dell, HP, Toshiba, and Acer. Compal has three key affiliates-Compal Communication (for handsets), Toppoly (for LCD panels), and VIBO (Telecom operator).

Investment Thesis

We expect Compal to show solid growth in 2008-09, given its leverage to the solid growth in the notebook PC industry. Among notebook ODMs, Compal has a good track record of margin retention. In addition, we see higher contributions from its long-term investments starting from 2008, given the potential breakeven of Toppoly (s/m-size LCD panels). Compal's commitment to increase dividend payout (70 pct) makes its share price more attractive to investors, in our view.

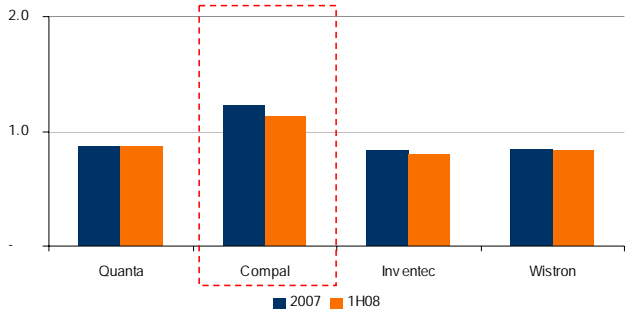
Stock Data

Price to Book Value 1.1x

Compal: Standout B/S and cash

With the expectation that revenue and earnings growth concerns will mount for NB ODMs in 2009, we recommend investors to seek safety from quality names with solid balance sheet/strong cash flow. Among Taiwan's top four NB ODMs, Compal stands out in terms of its balance sheet and cash position: quick ratio (>1.0), D/E ratio (~1.5), cash conversion days (CCC; <15 days), and net cash/mkt cap (~45%). Compal also leads its peers in terms of FCF and cash yield (~10%).

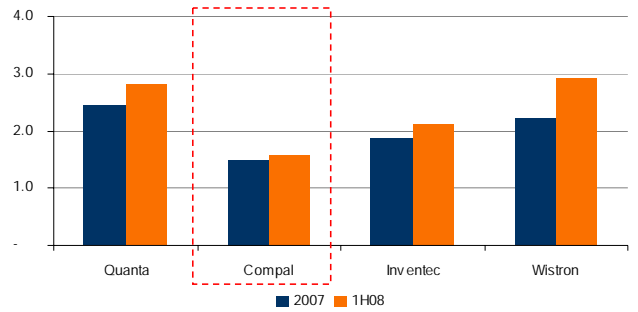
Figure 1: Quick Ratio



Source: TEJ, Merrill Lynch

* Quick Ratio = (Current Asset - Inventory/ Pre-paid/Others) / Current Liability

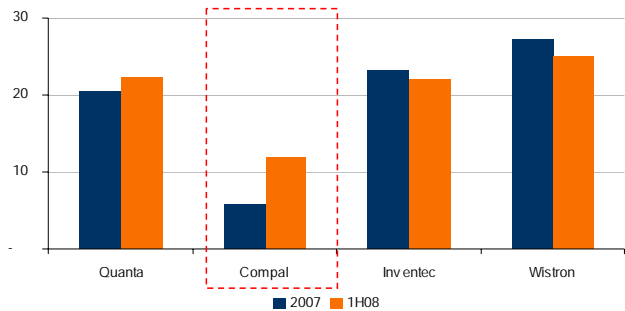
Figure 2: D/E Ratio



Source: TEJ, Merrill Lynch

* D/E Ratio = Total Liability / Total Equity

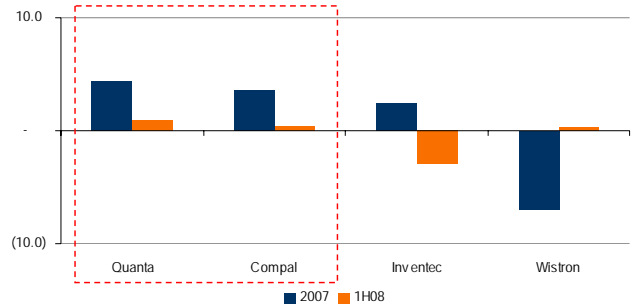
Figure 3: Cash Conversion Cycle (CCC) Days



Source: TEJ, Merrill Lynch

* CCC Days = A/R Days + Inventory Days - A/P Days

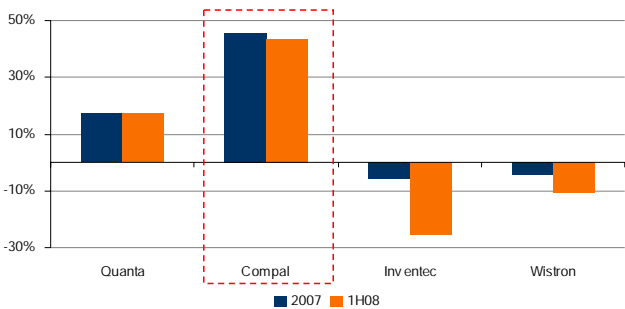
Figure 4: Free Cash Flow (FCF)/ share



Source: TEJ, Merrill Lynch

* Free Cash Flow/ Share = (Operating CF - Capex) / Out. shares

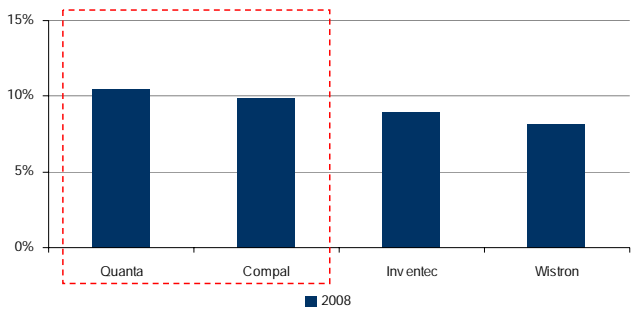
Figure 5: Net Cash/ Mkt Cap



Source: TEJ, Merrill Lynch

* Net Cash = Cash + Marketable security - S-T Debt - L-T Debt

Figure 6: Cash Yield



Source: TEJ, Merrill Lynch

* Cash yield = 2008 Cash dividend/ share price

Sentiment should recover from low base

Compal's revenues have declined 4% YTD (lowest among Taiwan ODM peers) due to: (1) its share loss at Toshiba and (2) weaker corporate NB model shipments to Dell due to the IT spending slowdown in the US and Europe. We estimate that Compal will ship only 27mn NB units (+20% YoY) for 2008, lower than the company's reduced guidance of 28-29mn units.

However, we expect that the recent poor sentiment will gradually recover from the low base, given in line or slightly better 3Q results (will report in the week of 27 October) and a moderate pick up in 4Q08E (NB units up ~10% QoQ). We forecast Compal's NB shipments to grow 20% YoY to 32-33mn units for 2009. Stronger order flow from Toshiba and Netbook project wins from Acer (10" Aspire One) should largely offset weakness at Dell (corporate NB models).

Table 1: Notebook Supply Chain Matrix for 2008

| | WW share | Units (mn) | Quanta | | Compal | | Wistron | | Inventec | | Pegatron | | Others | |
|--------------|-------------|--------------|------------|-------------|------------|-------------|------------|-------------|------------|-------------|-----------|-------------|------------|-------------|
| | | | Share | Units | Share | Units | Share | Units | Share | Units | Share | Units | Share | Units |
| HP | 20% | 29.5 | 37% | 10.9 | 24% | 7.1 | 19% | 5.6 | 20% | 5.9 | | | 0% | 0.0 |
| Dell | 14% | 20.7 | 27% | 5.6 | 35% | 7.2 | 33% | 6.8 | | 0.0 | 5% | 1.0 | 0% | 0.0 |
| Acer | 14% | 20.7 | 30% | 6.2 | 27% | 5.6 | 35% | 7.2 | 8% | 1.7 | | | 0% | 0.0 |
| Toshiba | 9% | 13.3 | 22% | 2.9 | 15% | 2.0 | | | 50% | 6.6 | 3% | 0.4 | 10% | 1.3 |
| Lenovo | 7% | 10.8 | 6% | 0.6 | 33% | 3.6 | 17% | 1.8 | | | 5% | 0.5 | 39% | 4.2 |
| Fujitsu | 4% | 5.9 | 6% | 0.4 | 10% | 0.6 | 6% | 0.4 | 8% | 0.5 | | | 70% | 4.1 |
| Apple | 5% | 6.9 | 100% | 6.9 | | - | | - | | - | | | 0% | 0.0 |
| Asustek | 8% | 11.1 | 0% | 0 | | | | | | | 95% | 10.5 | 5% | 0.6 |
| Sony | 4% | 5.6 | 10% | 0.6 | | | | | | | | | 90% | 5.0 |
| Others | 16% | 23.2 | 14% | 3.2 | 4% | 1.0 | 1% | 0.2 | 1% | 0.3 | 4% | 0.9 | 75% | 17.5 |
| Total | 100% | 147.5 | 25% | 37.3 | 18% | 27.0 | 15% | 22.1 | 10% | 15.0 | 9% | 13.4 | 22% | 32.7 |

Source: IDC, company's data, Merrill Lynch estimates

What's the worst case?

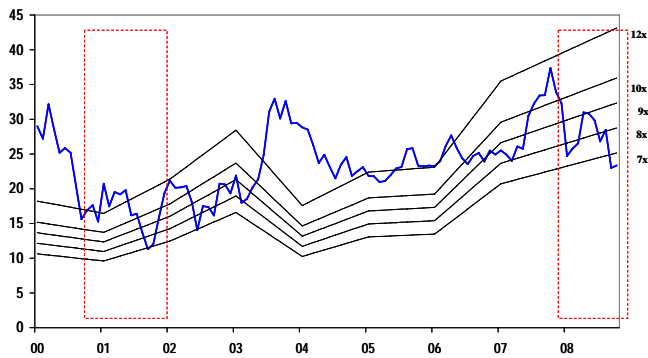
Our **Downside Scenario Analysis** suggests: (1) only 6-10% YoY sales growth for 2009 (due to global demand slowdown and larger ASP drop on mix shift to low end), (2) further deterioration in OP margin by 10-20bp YoY and (3) no non-op improvement in VIBO/TPO investments. Under this worst case scenario, Compal is currently trading at 6.6-7.0x 2009E P/E – its historical trough valuation since 2001 (Chart 7).

Table 2: Compal: Downside scenario analysis (NT\$m)

| | 2008E | | 2009E Scenario | |
|-----------------------|----------------|--------------------|----------------|----------------|
| | Base | Current Assumption | Downside 1 | Downside 2 |
| NB revenue | 367,615 | 425,128 | 397,024 | 380,481 |
| (1) unit growth (mn) | 27.4 | +23% | +20% | +15% |
| (2) ASP (USD) | 419 | -6% | -10% | -10% |
| Total Revenue | 405,171 | 473,494 | 445,390 | 428,847 |
| YoY % | | 17% | 10% | 6% |
| Gross margin | 4.9% | 4.7% | 4.7% | 4.6% |
| OP margin | 2.7% | 2.7% | 2.6% | 2.5% |
| Non-op incomes | 5,019 | 5,007 | 4,827 | 4,627 |
| (1) TPO | (363) | (70) | (150) | (250) |
| (2) VIBO | (1,466) | (1,300) | (1,400) | (1,500) |
| (3) Others | 6,848 | 6,377 | 6,377 | 6,377 |
| Net earnings | 13,089 | 14,520 | 13,454 | 12,585 |
| YoY % | | 11% | 3% | -4% |
| EPS (NT\$) | 3.32 | 3.69 | 3.41 | 3.19 |
| P/E (X) | 6.8x | 6.1x | 6.6x | 7.0x |

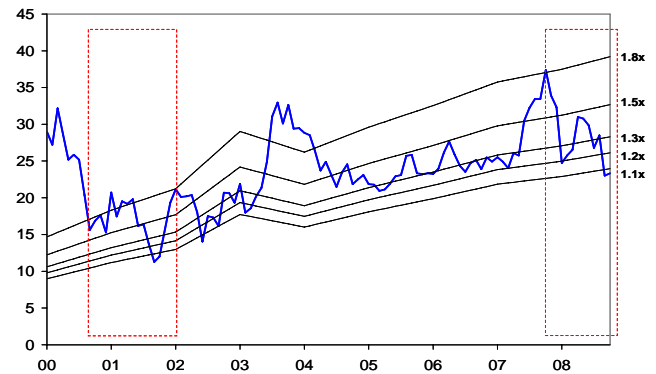
Source: Merrill Lynch estimates

Figure 7: Compal: P/E bands



Source: Merrill Lynch estimates, TEJ

Figure 8: Compal: P/B Bands



Source: Merrill Lynch estimates, TEJ

Share price demonstrates relative resilience

We retain our Buy rating on Compal. Its share price has demonstrated resilience over the past one month (flatish; outperformed TAIEX and Tech index by ~13%). Compal's share price should have good support in the near term, given our expectation of in line or slightly better 3Q08 results and its continued share buyback program (from 24 September 2008 to 23 November 2008; 3.81% of outstanding shares).

With Taiwan's top four NB ODMs currently trading at similar valuations (6-7x 2008E P/E), we believe Compal offers the best value from a B/S and cash flow standpoint. We view Compal as a defensive play with solid cash/dividend support and expect it to attract the attention of long-term value-focused investors.

Table 3: Share price performance table

| | 1m | 2m | 6m | YTD |
|------------|------|------|------|------|
| Compal | -1% | -18% | -20% | -30% |
| Quanta | -18% | -25% | -17% | -16% |
| Inventec | -9% | -21% | -18% | -17% |
| Wistron | -16% | -24% | -35% | -38% |
| Hon Hai | -21% | -33% | -42% | -47% |
| Tech Index | -13% | -29% | -40% | -42% |
| TAIEX | -14% | -29% | -45% | -42% |

Source: TEJ

Table 4: Valuation comparison table

| | ML Symbol | ML Rating | Price (NT\$) 17-Oct-08 | Mkt Cap (US\$m) | EPS (Local) | | EPG | | PER(x) | | PBR(x) 1H08 | Net Cash / Mkt Cap | CCC (days) | QFII % Now | QFII % 31-Dec-07 | Price YTD | |
|-----------|-----------|-----------|------------------------|-----------------|-------------|------|------|------|--------|------|-------------|--------------------|------------|------------|------------------|-----------|------|
| | | | | | 08E | 09E | 08E | 09E | 08E | 09E | | | | | | | |
| Brand | Acer | ASIYF | C-1-7 Buy | 47.0 | 3,751 | 5.6 | 6.8 | 11% | 22% | 8.4 | 6.9 | 1.7 | 8% | 48.1 | 44% | 47% | -19% |
| | Asustek | AKCPF | C-1-7 Buy | 50.9 | 6,972 | 6.5 | 7.4 | -9% | 14% | 7.8 | 6.9 | 1.2 | 19% | 46.4 | 35% | 38% | -39% |
| | HTC | HTCCF | C-2-7 Neutral | 426.0 | 10,375 | 40.9 | 49.6 | 7% | 21% | 10.4 | 8.6 | 6.6 | 23% | -11.3 | 52% | 44% | -1% |
| NB ODM | Compal | CMPLF | C-1-7 Buy | 22.6 | 2,866 | 3.3 | 3.7 | -4% | 11% | 6.8 | 6.1 | 1.1 | 45% | 11.9 | 56% | 62% | -30% |
| | Quanta | QUCPF | C-3-7 Underpe | 34.4 | 4,050 | 5.0 | 4.5 | -1% | -10% | 6.9 | 7.6 | 1.4 | 17% | 22.4 | 23% | 20% | -16% |
| | Wistron | WICOF | C-2-7 Neutral | 33.2 | 1,621 | 4.8 | 5.5 | 10% | 15% | 6.9 | 6.0 | 1.5 | -12% | 25.0 | 50% | 68% | -38% |
| | Inventec | IVCJF | C-2-7 Neutral | 13.7 | 1,128 | 2.1 | 2.4 | -4% | 14% | 6.4 | 5.6 | 1.0 | -27% | 21.9 | 12% | 10% | -17% |
| Component | FTC | FXTCF | C-1-8 Buy | 80.1 | 2,189 | 9.1 | 12.5 | -14% | 37% | 8.8 | 6.4 | 1.9 | -10% | 49.5 | 25% | 40% | -65% |
| | Catcher | CHERF | C-1-8 Buy | 82.0 | 1,584 | 8.0 | 9.3 | -34% | 17% | 10.3 | 8.8 | 2.0 | 0% | 167.5 | 23% | 37% | -50% |
| | SZS | SZUSF | C-1-7 Buy | 118.5 | 474 | 9.8 | 12.4 | 0% | 27% | 12.1 | 9.5 | 3.1 | 13% | 95.0 | 15% | 23% | -32% |
| | Chicony | CCNYF | C-1-7 Buy | 44.3 | 796 | 5.2 | 6.1 | 8% | 17% | 8.5 | 7.3 | 2.9 | -20% | 67.1 | 22% | 22% | -15% |
| | Simple | SPLOF | C-1-7 Buy | 91.6 | 615 | 10.6 | 12.6 | 7% | 19% | 8.6 | 7.3 | 2.2 | 25% | 43.3 | 15% | 25% | -34% |

Source: Merrill Lynch estimates, BBG

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Table 5: Compal: quarterly incomes statement (parent)

| NT\$mnn | 1Q08A | 2Q08A | 3Q08E | 4Q08E | 1Q09E | 2Q09E | 3Q09E | 4Q09E | 2007A | 2008E | 2009E | 2010E |
|----------------------|----------|----------|----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Sales | 101,641 | 86,418 | 102,608 | 114,504 | 105,066 | 111,544 | 124,190 | 132,694 | 427,460 | 405,171 | 473,494 | 521,453 |
| Cost of Sales | (96,833) | (81,853) | (97,645) | (109,065) | (100,089) | (106,309) | (118,439) | (126,600) | (406,830) | (385,397) | (451,437) | (497,785) |
| Gross Profit | 4,808 | 4,565 | 4,963 | 5,439 | 4,976 | 5,235 | 5,752 | 6,093 | 20,630 | 19,774 | 22,057 | 23,669 |
| Operating Expense | (2,078) | (2,241) | (2,257) | (2,405) | (2,080) | (2,164) | (2,372) | (2,521) | (6,269) | (8,980) | (9,137) | (9,595) |
| Oper.Exp.Promotion | (462) | (512) | (513) | (515) | (504) | (513) | (559) | (597) | (2,230) | (2,003) | (2,173) | (2,242) |
| OperatingExp.-ADM | (586) | (691) | (616) | (630) | (525) | (535) | (571) | (597) | (1,139) | (2,523) | (2,229) | (2,399) |
| Operat.Expense-R&D | (1,029) | (1,037) | (1,129) | (1,260) | (1,051) | (1,115) | (1,242) | (1,327) | (2,900) | (4,454) | (4,735) | (4,954) |
| Operating Profit | 2,730 | 2,324 | 2,705 | 3,035 | 2,896 | 3,071 | 3,380 | 3,572 | 14,361 | 10,794 | 12,919 | 14,074 |
| Non-operating Income | 1,229 | 1,402 | 1,136 | 1,251 | 894 | 1,228 | 1,353 | 1,532 | 2,183 | 5,019 | 5,007 | 5,640 |
| Net Interest Income | 194 | 194 | 200 | 200 | 240 | 240 | 240 | 240 | 826 | 788 | 960 | 1,080 |
| Investment Income | 1,025 | 963 | 836 | 951 | 604 | 938 | 1,063 | 1,242 | 1,155 | 3,775 | 3,847 | 4,460 |
| Disposal Gain | - | - | - | - | - | - | - | - | 101 | - | - | - |
| Exchange Gain | (63) | 187 | - | - | - | - | - | - | (28) | 124 | - | - |
| Others | 73 | 59 | 100 | 100 | 50 | 50 | 50 | 50 | 129 | 332 | 200 | 100 |
| Pre-tax Profit | 3,959 | 3,726 | 3,842 | 4,286 | 3,790 | 4,299 | 4,733 | 5,105 | 16,544 | 15,813 | 17,926 | 19,714 |
| Tax Expense | (750) | (511) | (691) | (771) | (720) | (817) | (899) | (970) | (2,861) | (2,724) | (3,406) | (3,746) |
| Net Profit | 3,209 | 3,215 | 3,150 | 3,514 | 3,070 | 3,482 | 3,834 | 4,135 | 13,683 | 13,089 | 14,520 | 15,968 |
| EPS (NT\$) | 0.81 | 0.82 | 0.80 | 0.89 | 0.78 | 0.88 | 0.97 | 1.05 | 3.47 | 3.32 | 3.69 | 4.05 |
| % | | | | | | | | | | | | |
| Gross Margin | 4.7% | 5.3% | 4.8% | 4.8% | 4.7% | 4.7% | 4.6% | 4.6% | 4.8% | 4.9% | 4.7% | 4.5% |
| Operating Expense | -2.0% | -2.6% | -2.2% | -2.1% | -2.0% | -1.9% | -1.9% | -1.9% | -1.5% | -2.2% | -1.9% | -1.8% |
| Operating Margin | 2.7% | 2.7% | 2.6% | 2.7% | 2.8% | 2.8% | 2.7% | 2.7% | 3.4% | 2.7% | 2.7% | 2.7% |
| Pre-tax Margin | 3.9% | 4.3% | 3.7% | 3.7% | 3.6% | 3.9% | 3.8% | 3.8% | 3.9% | 3.9% | 3.8% | 3.8% |
| Net Margin | 3.2% | 3.7% | 3.1% | 3.1% | 2.9% | 3.1% | 3.1% | 3.1% | 3.2% | 3.2% | 3.1% | 3.1% |
| Tax Rate | 19% | 14% | 18% | 18% | 19% | 19% | 19% | 19% | 17% | 17% | 19% | 19% |
| Sequential Growth | | | | | | | | | | | | |
| Sales | -13% | -15% | 19% | 12% | -8% | 6% | 11% | 7% | 41% | -5% | 17% | 10% |
| Cost of Sales | -12% | -15% | 19% | 12% | -8% | 6% | 11% | 7% | 41% | -5% | 17% | 10% |
| Gross Profit | -16% | -5% | 9% | 10% | -9% | 5% | 10% | 6% | 43% | -4% | 12% | 7% |
| Operating Expense | 20% | 8% | 1% | 7% | -13% | 4% | 10% | 6% | 21% | 43% | 2% | 5% |
| Operating Profit | -32% | -15% | 16% | 12% | -5% | 6% | 10% | 6% | 55% | -25% | 20% | 9% |
| Non-operating Income | 17% | 14% | -19% | 10% | -29% | 37% | 10% | 13% | 89% | 130% | 0% | 13% |
| Pre-Tax Profit | -22% | -6% | 3% | 12% | -12% | 13% | 10% | 8% | 59% | -4% | 13% | 10% |
| Tax Expense | -17% | -32% | 35% | 12% | -7% | 13% | 10% | 8% | 74% | -5% | 25% | 10% |
| Net Profit | -23% | 0% | -2% | 12% | -13% | 13% | 10% | 8% | 56% | -4% | 11% | 10% |
| Key Assumptions | | | | | | | | | | | | |
| Notebook (mn) | 6.2 | 6.2 | 7.1 | 8.0 | 7.3 | 8.0 | 9.0 | 9.6 | 22.6 | 27.4 | 33.8 | 40.0 |
| LCD Monitor (mn) | 0.5 | 0.7 | 0.6 | 0.7 | 0.7 | 0.8 | 0.8 | 0.9 | 2.8 | 2.5 | 3.2 | 3.4 |
| LCD TV (000) | 205 | 376 | 550 | 650 | 500 | 550 | 600 | 700 | 180 | 1,781 | 2,350 | 2,703 |

Source: Merrill Lynch estimates, Compal

Price objective basis & risk

Compal Electron (CMPLF)

Our PO of NT\$34.3 equates to a P/E of 10x 08/09E bonus-adjusted EPS, which is at the mid-end of Compal's historical P/E band since 2005. This P/E is slightly lower than the valuations for other leading NB PC ODMs (ie, Quanta's 10.5x), due to the volatility in non-core business, in our view. Its valuation is also lower than the valuations for component suppliers and brand companies likely due to a high degree of concentration on certain customers and more intense competition. Risks to our price objective: (1) slowdown in NB PC demand, (2) higher-than-expected competition in pricing leading to larger margin decline and (3) retention of key customers.

Analyst Certification

I, Tina Chang, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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APR - Technology Hardware Coverage Cluster

| Investment rating | Company | ML ticker | Bloomberg symbol | Analyst |
|-------------------|------------------|-----------|------------------|------------------------|
| BUY | Acer, Inc | ASIYF | 2353 TT | Tony Tseng, CFA |
| | Asustek | AKCPF | 2357 TT | Tony Tseng, CFA |
| | BYD | BYDDF | 1211 HK | Daniel Kim, CFA |
| | Catcher Tech | CHERF | 2474 TT | Tony Tseng, CFA |
| | Cheil Industries | CLFUF | 001300 KS | Simon Dong-je Woo, CFA |
| | Chicony Elect | CCNYF | 2385 TT | Tina Chang, CFA |
| | Compal Electron | CMPLF | 2324 TT | Tina Chang, CFA |
| | Coretronic | CCOCF | 5371 TT | Jeffrey Su |

20 October 2008

APR - Technology Hardware Coverage Cluster

| Investment rating | Company | ML ticker | Bloomberg symbol | Analyst |
|---------------------|------------------------|-----------|------------------|------------------------|
| | Delta Elect | DLTEF | 2308 TT | Jeffrey Su |
| | Foxconn Tech | FXTCF | 2354 TT | Tony Tseng, CFA |
| | InnoLux | INXDF | 3481 TT | Jeffrey Su |
| | Ju Teng Intl | JUTGF | 3336 HK | Ronnie Ho |
| | Kingboard | KBDCF | 148 HK | Ronnie Ho |
| | Largan Precision | LGANF | 3008 TT | Laura Chen |
| | LG Electronics | LGAEF | 066570 KS | Daniel Kim, CFA |
| | Samsung Techwin | SGTWF | 012450 KS | Simon Dong-je Woo, CFA |
| | Shin Zu Shing | SZUSF | 3376 TT | Tina Chang, CFA |
| | Simplo Tech | SPLOF | 6121 TT | Tina Chang, CFA |
| | SSCP CO LTD | SSCPF | 071660 KS | Daniel Kim, CFA |
| | TPV | TPVTF | 903 HK | Daniel Kim, CFA |
| | Venture Corp. | VEMLF | VMS SP | Ronnie Ho |
| NEUTRAL | | | | |
| | AU Optronics | AUO | AUO US | Jeffrey Su |
| | AU Optronics | AUOPF | 2409 TT | Jeffrey Su |
| | Foxconn Intl Hld | FXCNF | 2038 HK | Tony Tseng, CFA |
| | Hon Hai Prec. | HNHAF | 2317 TT | Tony Tseng, CFA |
| | HTC Corp. | HTCCF | 2498 TT | Tony Tseng, CFA |
| | Inventec | IVCJF | 2356 TT | Tina Chang, CFA |
| | Inventec Applian | IVAPF | 3367 TT | Tina Chang, CFA |
| | Lenovo Group | LNVGF | 992 HK | Daniel Kim, CFA |
| | Lenovo Group | LNVGY | LNVGY US | Daniel Kim, CFA |
| | Oisda Corp | BNOCF | 2352 TT | Jeffrey Su |
| | Radiant | ROPTF | 6176 TT | Jeffrey Su |
| | Sillitech | SLKCF | 3311 TT | Laura Chen |
| | Wistron | WICOF | 3231 TT | Tony Tseng, CFA |
| | Yageo Corp | YGEQF | 2327 TT | Ronnie Ho |
| UNDERPERFORM | | | | |
| | Alpha Networks I | AHNWF | 3380 TT | Laura Chen |
| | Chi Mei Opto | CMEOF | 3009 TT | Jeffrey Su |
| | Compal Comm | CPCMF | 8078 TT | Laura Chen |
| | Epistar Corp | EPIPF | 2448 TT | Jeffrey Su |
| | Everlight Elec | EVLEF | 2393 TT | Jeffrey Su |
| | Gemtek Technolog | GTKTF | 4906 TT | Laura Chen |
| | LG Display Co., Ltd. | LPHLF | 034220 KS | Daniel Kim, CFA |
| | LG Display Co., Ltd.-A | LPL | LPL US | Daniel Kim, CFA |
| | Lite-On Tech | LOTZF | 2301 TT | Jeffrey Su |
| | Merry Electron | MMECF | 2439 TT | Laura Chen |
| | Mitac Intl | MTCXF | 2315 TT | Tina Chang, CFA |
| | Quanta Computer | QUCCPF | 2382 TT | Tony Tseng, CFA |
| | Samsung Elec M | SSEMF | 009150 KS | Daniel Kim, CFA |
| | Samsung SDI | SSDIF | 006400 KS | Daniel Kim, CFA |
| | Seoul Semicon | SLSOF | 046890 KS | Simon Dong-je Woo, CFA |
| | Unisteel Tech | UNSGF | USTL SP | Ronnie Ho |
| | Wellypower | XTTWF | 3080 TT | Jeffrey Su |
| | ZTE Corp - H | ZTCOF | 763 HK | Ronnie Ho |

iQmethodSM Measures Definitions

| Business Performance | Numerator | Denominator |
|-----------------------------|--|---|
| Return On Capital Employed | $\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$ | Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill |
| Return On Equity | Net Income | Shareholders' Equity |
| Operating Margin | Operating Profit | Sales |
| Earnings Growth | Expected 5-Year CAGR From Latest Actual | N/A |
| Free Cash Flow | Cash Flow From Operations – Total Capex | N/A |
| Quality of Earnings | | |
| Cash Realization Ratio | Cash Flow From Operations | Net Income |
| Asset Replacement Ratio | Capex | Depreciation |
| Tax Rate | Tax Charge | Pre-Tax Income |
| Net Debt-To-Equity Ratio | Net Debt = Total Debt, Less Cash & Equivalents | Total Equity |
| Interest Cover | EBIT | Interest Expense |
| Valuation Toolkit | | |
| Price / Earnings Ratio | Current Share Price | Diluted Earnings Per Share (Basis As Specified) |
| Price / Book Value | Current Share Price | Shareholders' Equity / Current Basic Shares |
| Dividend Yield | Annualised Declared Cash Dividend | Current Share Price |
| Free Cash Flow Yield | Cash Flow From Operations – Total Capex | Market Cap. = Current Share Price * Current Basic Shares |
| Enterprise Value / Sales | $\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$ | |
| EV / EBITDA | Enterprise Value | Basic EBIT + Depreciation + Amortization |

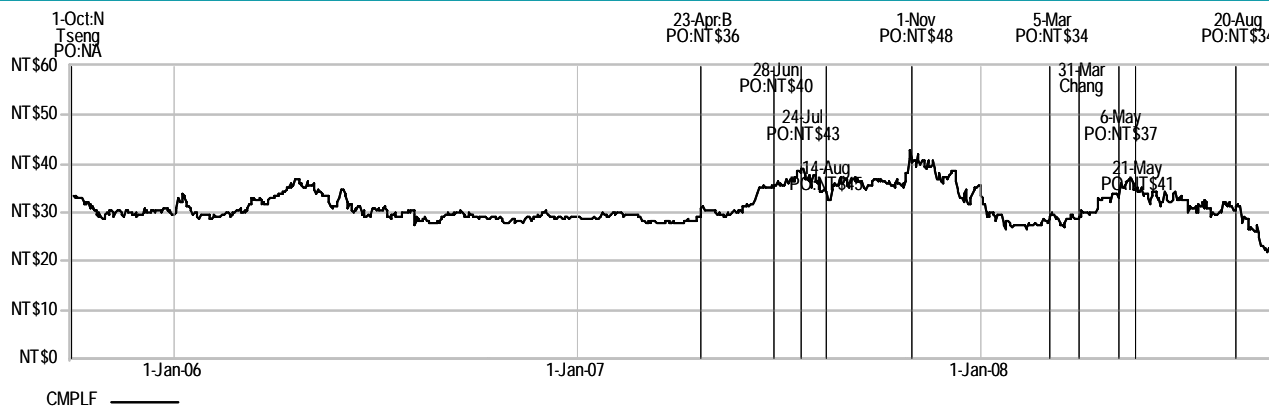
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CMPLF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of September 30, 2008 or such later date as indicated.

Investment Rating Distribution: Electronics Group (as of 01 Oct 2008)

| Coverage Universe | Count | Percent | Inv. Banking Relationships* | Count | Percent |
|-------------------|-------|---------|-----------------------------|-------|---------|
| Buy | 42 | 40.00% | Buy | 8 | 20.51% |
| Neutral | 32 | 30.48% | Neutral | 3 | 11.11% |
| Sell | 31 | 29.52% | Sell | 2 | 7.41% |

Investment Rating Distribution: Global Group (as of 01 Oct 2008)

| Coverage Universe | Count | Percent | Inv. Banking Relationships* | Count | Percent |
|-------------------|-------|---------|-----------------------------|-------|---------|
| Buy | 1647 | 45.31% | Buy | 429 | 28.83% |
| Neutral | 858 | 23.60% | Neutral | 240 | 31.41% |
| Sell | 1130 | 31.09% | Sell | 227 | 22.02% |

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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| Investment rating | Total return expectation (within 12-month period of date of initial rating) | Ratings dispersion guidelines for coverage cluster* |
|-------------------|---|---|
| Buy | ≥ 10% | ≤ 70% |
| Neutral | ≥ 0% | ≤ 30% |
| Underperform | N/A | ≥ 20% |

* Ratings dispersions may vary from time to time where Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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