

TAIWAN

HTC

7 October 2008

2498 TT **Outperform**

Stock price as of 03 Oct 08	NT\$	444.50
12-month target	NT\$	588.00
Upside/downside	%	+32.3
Valuation	NT\$	720.00
- DCF (WACC 9.0%)		

GICS sector	technology hardware & equipment	
Market cap	NT\$m	335,772
30-day avg turnover	NT\$m	4,976.2
Market cap	US\$m	10,441
Number shares on issue	m	755.4

Investment fundamentals

Year end 31 Dec		2007A	2008E	2009E	2010E
Total revenue	bn	118.6	152.0	186.0	220.4
Reported profit	bn	28.9	28.6	31.7	35.2
Profit bonus exp	bn	22.7	28.6	31.7	35.2
Bon exp/rep prof	%	21.7	0.0	0.0	0.0
Adjusted profit	bn	28.9	28.6	31.7	35.2
EPS rep	NT\$	39.45	38.09	41.93	46.54
EPS rep growth	%	13.0	-3.4	10.1	11.0
EPS bonus exp	NT\$	30.88	38.09	41.93	46.54
EPS bonus growth %		10.5	23.4	10.1	11.0
PE rep	x	11.3	11.7	10.6	9.6
PE bonus exp	x	14.4	11.7	10.6	9.6
Total DPS	NT\$	26.56	30.22	33.00	37.00
Total div yield	%	6.0	6.8	7.4	8.3
ROA	%	39.7	32.8	32.9	31.0
ROE	%	58.7	47.1	45.5	44.3
EV/EBITDA	x	8.7	8.9	7.7	7.0
Net debt/equity	%	-98.2	-80.6	-82.7	-85.0
Price/book	x	5.9	5.2	4.5	4.0

2498 TT rel Taiex performance, & rec history



Source: Datastream, Macquarie Research, October 2008 (all figures in NT\$ unless noted)

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3Q08 results just meet guidance

Event

- HTC reported September sales and preliminary 3Q08 results. 3Q08 results met the company's guidance but trailed our estimates by 7%.
- HTC has been consistently beating its guidance over the past year and a half. Just meeting guidance means to us that the macro headwinds are getting stronger, and we have aggressively cut our 2009 forecasts to reflect this. However, even after the cut HTC's valuation still looks attractive to us. We maintain our Outperform rating.

Impact

- 3Q08 met guidance and trailed our estimates:** HTC reported preliminary 3Q08 pretax income of NT\$7.1bn (down 2% YoY) on sales of NT\$37.9bn (up 30% YoY). The 3Q08 pretax margin dropped 0.4ppt to 20.7%. On its 2Q08 earnings conference, HTC guided to 3Q08 sales growth of 30% YoY and to an operating margin/pretax margin drop of 0.5ppt sequentially (due to higher ODM sales). Compared with our forecasts, HTC's 3Q08 sales and pretax profits trailed by 6% and 7%, respectively.
- Likely to outperform again in 4Q08:** With newly launched products receiving positive client feedbacks, HTC reiterated that 2008 sales are likely to hit the higher end of official guidance (20–30% YoY growth), which implies 4Q08 sales will see 25%-plus QoQ growth. Even factoring in a 1–1.5ppt gross margin decline (still due to higher ODM sales), this performance still dwarfs most of HTC's tech hardware peers.
- Cash is the king amid market turmoil.** HTC is in a net cash position. The company also has a good track record in working capital management. Its cash-conversion cycle (days) has been improving since its IPO (see Figure 1). Starting from 2007, its CCC days have even turned negative, which means that it can quickly turn the inventory into sales and collect money from clients before paying bills to its component vendors.

Earnings revision

- IDC has just cut its 2008–2012 smartphone forecasts by mid-to-high single digits (See Figure 2) in its September industry report to reflect the weaker environment.
- We benchmark its forecasts and trim our HTC sales forecasts by a similar degree. We also have adopted more conservative margin assumptions. All in all, we have revised down our 2008/2009 EPS estimates by 8%/20% respectively (See Figure 3).

Price catalyst

- 12-month price target: NT\$588.00 based on a PER methodology.
- Catalyst: Strong 4Q08 growth outlook, plus attractive valuation

Action and recommendation

- We revise down our HTC target price to NT\$588 (14x 2009E EPS) from NT\$700. HTC is currently trading at less than 10x 2009E EPS. Considering its 45%-plus ROE, 7%-plus cash yield, net cash (net cash/market cap = 18%) and strong industry position, the current valuation looks very attractive. We reaffirm our Outperform rating.

Please refer to the important disclosures and analyst certification on inside back cover of this document, or on our website www.macquarie.com.au/research/disclosures.

Fig 1 HTC's cash-conversion cycle has been improving since its IPO in 2002

	2002	2003	2004	2005	2006	2007	2008E	2009E	2010E
Inventory turnover	10.1	9.1	9.0	12.1	14.4	13.1	15.7	16.6	16.4
AR turnover	5.7	4.3	5.2	6.3	6.1	6.1	6.7	6.5	6.4
AP turnover	6.2	4.1	4.4	5.0	4.6	3.8	4.3	4.4	4.2
Inventory days	36.1	40.0	40.7	30.1	25.3	27.8	23.3	22.0	22.3
AR days	63.9	84.5	70.1	58.4	59.9	60.3	54.4	56.3	57.2
AP days	59.1	89.0	82.6	72.5	79.0	97.3	85.0	83.2	86.6
CCC	40.9	35.4	28.3	16.0	6.2	-9.2	-7.3	-4.9	-7.2

Source: Macquarie Research, October 2008

Fig 2 IDC's recent downward revision on global smartphone shipment forecasts

(k units)	2005	2006	2007	2008E	2009E	2010E	2011E	2012E
Sep. 2008 forecast	56,282	81,807	124,305	157,128	198,258	247,259	292,807	338,798
Jun. 2008 forecast	56,282	81,807	124,278	164,731	213,984	269,301	316,764	363,263
Change (%)	-	-	0	-4.6	-7.3	-8.2	-7.6	-6.7

Source: IDC, September 2008

Fig 3 Earnings revision

P/L Revision (NT\$ mn)	2007 Actual	2008E		2009E		Change (%)	
		Old	New	Old	New	2008F	2009F
Net sales	118,580	160,510	152,010	207,828	186,028	-5.3	-10.5
Gross profits	45,700	56,156	51,534	74,768	61,262	-8.2	-18.1
Operating expenses	14,676	22,471	20,825	30,447	26,416	-7.3	-13.2
Operating profit	31,023	33,685	30,708	44,321	34,846	-8.8	-21.4
Pretax profits	32,151	34,370	31,739	44,793	35,993	-7.7	-19.6
Net profit	28,939	30,933	28,565	39,418	31,674	-7.7	-19.6
EPS	39.4	41.3	38.1	52.2	41.9	-7.7	-19.6
Key ratio (%)							
Sale growth	13.1	35.4	28.2	29.5	22.4		
Gross margin	38.5	35.0	33.9	36.0	32.9		
Net margin	24.4	19.3	18.8	19.0	17.0		

Source: Macquarie Research, October 2008

Fig 4 Valuation comparison table

Company	Price (lc) Ticker	MACQ Rating	Mkt cap (US\$ m)	EPS (lc)			PER (x)			EPS growth (%)			
				2007	2008E	2009E	2007	2008E	2009E	2007	2008E	2009E	
Global peers													
Nokia	NOK US	17.75	UP	67,465	2.5	1.8	2.7	7.0	10.1	6.6	90.2	-30.4	51.7
Motorola	MOT US	6.72	NR	15,223	0.0	0.1	0.4	na	97.4	18.0	na	na	440.6
LG Elec.	066570 KS	102500	OP	11,688	7,412	9,851	12,812	13.8	10.4	8.0	474.7	32.9	30.1
RIM	RIM CN	66.03	NR	34,405	2.2	3.6	4.9	29.5	18.2	13.4	73.5	61.7	36.3
Apple	AAPL US	97.07	NR	85,992	4.0	5.2	5.9	24.0	18.6	16.4	71.2	28.9	13.4
Palm	PALM US	5.88	NR	639	0.6	-0.5	0.0	10.7	na	653.3	-83.5	na	na
Average					-	-	-	17.0	31.0	119.3	125.2	23.3	114.4
Local peers													
FIH	2038 HK	3.64	OP	3,309	0.8	0.4	0.7	4.5	8.4	5.6	0.4	-46.2	50.7
HTC	2498 TT	414	OP	9,658	39.5	38.1	41.9	10.5	10.9	9.9	13.0	-3.4	10.1
CCI	8078 TT	35.00	UP	663	6.8	2.8	3.0	5.2	12.5	11.6	-26.4	-58.6	7.3
Arima Com	8101 TT	10.45	NR	120	-1.7	-0.2	0.6	na	na	17.7	na	na	na
IAC	3367 TT	34.10	NR	540	7.0	5.5	5.0	4.8	6.2	6.8	56.4	-21.3	-9.6
Average					-	-	-	6.2	9.5	10.3	10.9	-32.4	14.6

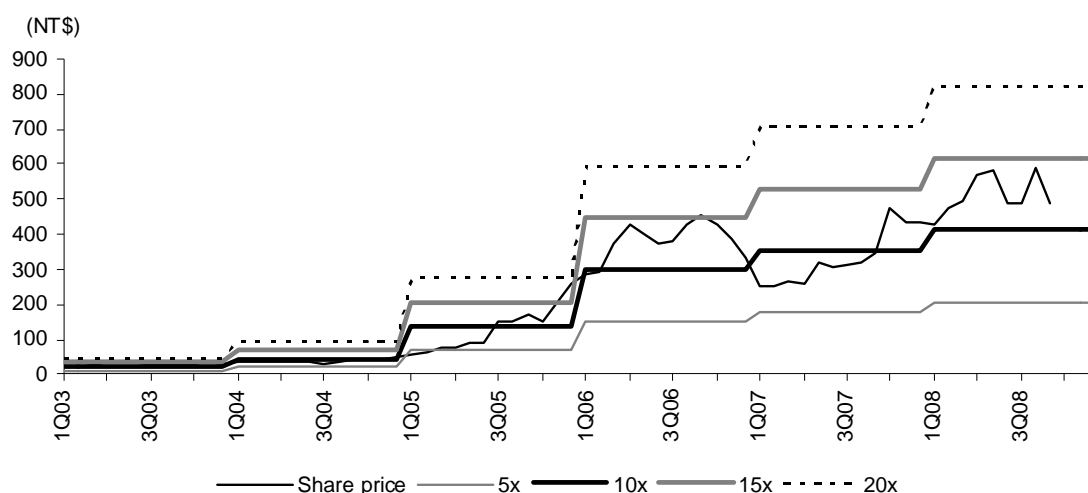
Source: Bloomberg, Macquarie Research, October 2008

Fig 5 Valuation comparison table

Company	Ticker	ROE(%)			BVPS (lc)			PBR (x)			EV/EBITDA (x)		
		2007	2008E	2009E	2007	2008E	2009E	2007	2008E	2009E	2007	2008E	2009E
Global peers													
Nokia	NOK US	53.9	35.3	35.6	5.6	5.1	5.6	3.2	3.5	3.2	5.5	4.3	4.5
Motorola	MOT US	-0.3	1.2	5.3	6.8	6.6	6.6	1.0	1.0	1.0	9.2	11.0	5.4
LG Elec.	066570 KS	17.9	19.8	21.0	45,989	57,188	69,369	2.2	1.8	1.5	15.2	6.5	5.7
RIM	RIM CN	28.2	39.7	36.2	5.2	10.4	14.9	12.6	6.3	4.4	18.9	11.3	9.9
Apple	AAPL US	28.5	27.8	23.3	16.7	23.1	29.2	5.8	4.2	3.3	16.3	9.4	7.1
Palm	PALM US	5.5	-20.8	22.8	10.2	1.5	1.0	0.6	4.0	6.0	1.2	na	na
Average		22.3	17.2	24.0	-	-	-	4.2	3.5	3.2	11.1	8.5	6.5
Local peers													
FIH	2038 HK	25.5	11.1	14.7	3.7	4.1	4.7	1.0	0.9	0.8	3.4	4.5	3.2
HTC	2498 TT	58.7	47.1	45.5	75.6	86.3	98.2	5.5	4.8	4.2	8.7	8.9	7.7
CCI	8078 TT	32.0	14.1	15.4	21.0	18.9	20.2	1.7	1.9	1.7	6.9	23.0	15.8
Arima Com	8101 TT	-13.5	na	na	11.6	na	na	0.9	na	na	6.3	na	na
IAC	3367 TT	26.3	23.2	na	28.3	26.6	na	1.2	1.3	na	2.7	3.1	2.9
Average		25.8	23.9	25.2	-	-	-	2.0	2.2	2.2	5.6	9.9	7.4

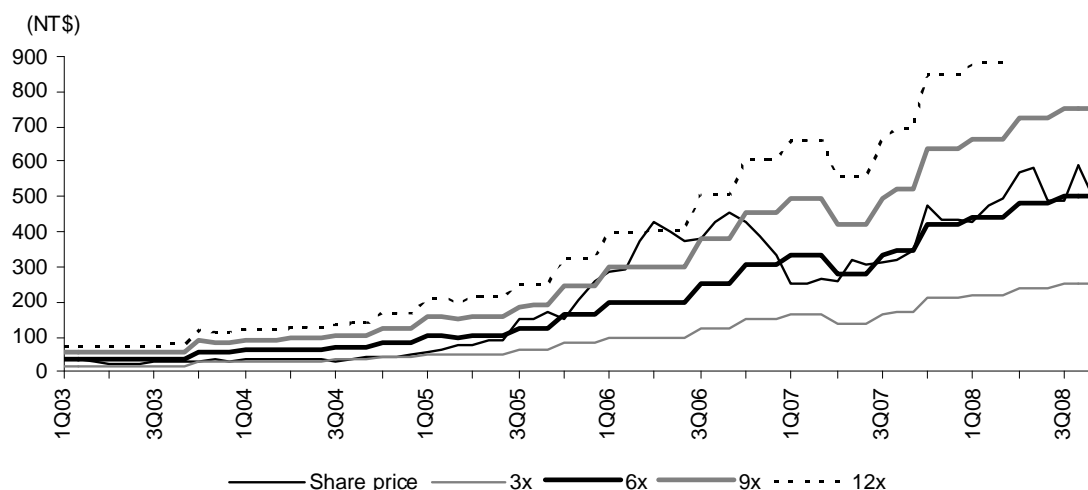
Source: Bloomberg, Macquarie Research, October 2008

Fig 6 PER band - annual



Source: Bloomberg, Macquarie Research, October 2008

Fig 7 P/BV band



Source: Bloomberg, Macquarie Research, October 2008

HTC (2498 TT, Outperform, Target price: NT\$588.00)

Quarterly Results					Profit & Loss						
		2Q/08A	3Q/08E	4Q/08E	1Q/09E		2007A	2008E	2009E	2010E	
Revenue	m	34,620	37,859	46,828	42,061	Revenue	m	118,580	152,010	186,028	220,350
Gross Profit	m	11,960	12,758	15,159	13,514	Gross Profit	m	45,700	51,534	61,262	70,466
Operating Expenses	m	-5,050	-5,250	-6,326	-5,804	Operating Expenses	m	-14,676	-20,825	-26,416	-31,951
Operating Income	m	6,910	7,508	8,834	7,709	Operating Income	m	31,023	30,708	34,846	38,515
Net Non-operating income	m	390	338	104	287	Net Non-operating income	m	1,128	1,031	1,147	1,438
Pre-Tax Income	m	7,300	7,846	8,938	7,996	Pre-Tax Income	m	32,151	31,739	35,993	39,953
Tax Expense	m	-680	-775	-1,009	-960	Tax Expense	m	-3,212	-3,174	-4,319	-4,794
Exceptionals	m	0	0	0	0	Exceptionals	m	0	0	0	0
Minority Interests	m	0	0	0	0	Minority Interests	m	0	0	0	0
Reported Earnings	m	6,620	7,071	7,929	7,037	Reported Earnings	m	28,939	28,565	31,674	35,158
Reported Earnings (bonus exp)	m	6,620	7,071	7,929	7,037	Reported Earnings (bonus exp)	m	22,655	28,565	31,674	35,158
Bonus exp / Reported Earnings	%	0.0	0.0	0.0	0.0	Bonus exp / Reported Earnings	%	21.7	0.0	0.0	0.0
Adjusted Earnings	m	6,620	7,071	7,929	7,037	Adjusted Earnings	m	28,939	28,565	31,674	35,158
EBITDA	m	7,141	7,739	9,160	8,055	EBITDA	m	31,579	31,727	36,332	40,386
EPS (rep)	NT\$	8.83	9.43	10.57	9.32	EPS (rep)	NT\$	39.45	38.09	41.93	46.54
EPS pcg growth (rep)	%	8.4	-6.9	-22.4	0.6	EPS growth (rep)	%	13.0	-3.4	10.1	11.0
EPS (rep bonus exp)	NT\$	8.83	9.43	10.57	9.32	EPS (rep bonus exp)	NT\$	30.88	38.09	41.93	46.54
EPS pcg growth (rep bonus exp)	%	38.4	18.9	-0.8	0.6	EPS growth (rep bonus exp)	%	10.5	23.4	10.1	11.0
EPS (adj)	NT\$	8.83	9.43	10.57	9.32	EPS (adj)	NT\$	39.45	38.09	41.93	46.54
EPS pcg growth (adj)	%	8.4	-6.9	-22.4	0.6	EPS growth (adj)	%	13.0	-3.4	10.1	11.0
Revenue pcg growth	%	28.9	30.1	20.0	28.6	PE (rep)	x	11.3	11.7	10.6	9.6
Operating Income pcg growth	%	-1.7	1.0	-15.4	3.4	PE (rep bonus adj)	x	14.4	11.7	10.6	9.6
Reported Earnings pcg growth	%	10.8	-4.9	-20.6	1.3	PE (adj)	x	11.3	11.7	10.6	9.6
Gross Profit Margin	%	34.5	33.7	32.4	32.1	Total DPS	NT\$	26.56	30.22	33.00	37.00
Operating Income Margin	%	20.0	19.8	18.9	18.3	Total Div Yield	%	6.0	6.8	7.4	8.3
Reported Earnings Margin	%	19.1	18.7	16.9	16.7	Weighted Average Shares	m	733.6	749.9	755.4	755.4
EBITDA Margin	%	20.6	20.4	19.6	19.2	Period End Shares	m	742.0	755.4	755.4	755.4
Profit and Loss Ratios		2007A	2008E	2009E	2010E	Cashflow Analysis		2007A	2008E	2009E	2010E
Revenue Growth	%	13.1	28.2	22.4	18.4	Reported Earnings	m	28,939	28,565	31,674	35,158
Gross Profit Growth	%	34.3	12.8	18.9	15.0	Depreciation & Amortisation	m	-556	-1,018	-1,486	-1,871
Operating Income Growth	%	16.8	-1.0	13.5	10.5	Chgs in Working Cap	m	10,257	-9,633	1,177	1,205
Reported Earnings Growth	%	14.6	-1.3	10.9	11.0	Other	m	1,008	1,937	2,852	3,592
EBITDA Growth	%	16.2	0.5	14.5	11.2	Operating Cashflow	m	39,648	19,850	34,217	38,084
Gross Profit Margin	%	38.5	33.9	32.9	32.0	Acquisitions	m	-1,971	-105	-85	-85
Operating Income Margin	%	26.2	20.2	18.7	17.5	Capex	m	-1,331	-2,949	-2,495	-2,515
Reported Earnings Margin	%	24.4	18.8	17.0	16.0	Asset Sales	m	0	0	0	0
EBITDA Margin	%	26.6	20.9	19.5	18.3	Other	m	-238	97	-115	-125
Payout Ratio	%	67.3	79.3	78.7	79.5	Investing Cashflow	m	-3,540	-2,957	-2,695	-2,725
EV/EBITDA	x	8.7	8.9	7.7	7.0	Dividend (Ordinary)	m	-11,685	-19,487	-22,662	-24,928
EV/EBIT	x	8.9	9.2	8.1	7.3	Equity Raised	m	-3,750	-0	0	0
Balance Sheet Ratios						Debt Movements	m	-0	20	2	-10
ROE	%	58.7	47.1	45.5	44.3	Other	m	-0	0	-0	-0
ROA	%	39.7	32.8	32.9	31.0	Financing Cashflow	m	-15,435	-19,467	-22,660	-24,938
ROIC	%	341.6	2,745.9	242.0	264.4	Net Chg in Cash/Debt	m	20,672	-2,574	8,862	10,421
Net Debt/Equity	%	-98.2	-80.6	-82.7	-85.0	Free Cashflow	m	38,316	16,901	31,722	35,569
Interest Cover	x	nmf	nmf	nmf	nmf	FCF per Share	NT\$	52.23	22.54	41.99	47.09
Price/Book	x	5.9	5.2	4.5	4.0	P/FCF	x	8.5	19.7	10.6	9.4
Book Value per Share	NT\$	75.6	86.3	98.2	111.7	Balance Sheet		2007A	2008E	2009E	2010E
						Cash	m	55,069	52,496	61,357	71,778
						Receivables	m	19,484	25,821	31,599	37,429
						Inventories	m	6,119	6,698	8,318	9,992
						Investments	m	2,899	3,104	3,309	3,544
						Fixed Assets	m	3,716	5,741	6,856	7,615
						Intangibles	m	0	0	0	0
						Other Assets	m	3,157	2,999	3,337	3,077
						Total Assets	m	90,445	96,859	114,776	133,436
						Payables	m	22,020	24,775	32,131	39,011
						Short Term Debt	m	0	11	12	11
						Long Term Debt	m	0	1	1	1
						Provisions	m	0	0	0	0
						Other Liabilities	m	12,349	6,918	8,466	10,016
						Total Liabilities	m	34,369	31,705	40,610	49,040
						Total S/H Equity	m	56,076	65,154	74,166	84,396
						Total Liab & S/H Funds	m	90,445	96,859	114,776	133,436

All figures in NT\$ unless noted.
Source: Macquarie Research, October 2008

Important disclosures:

Recommendation definitions	Volatility index definition*	Financial definitions
<p>Macquarie - Australia/New Zealand Outperform – return >5% in excess of benchmark return (>2.5% in excess for listed property trusts) Neutral – return within 5% of benchmark return (within 2.5% for listed property trusts) Underperform – return >5% below benchmark return (>2.5% below for listed property trusts)</p> <p>Macquarie – Asia/Europe Outperform – expected return >+10% Neutral – expected return from -10% to +10% Underperform – expected return <-10%</p> <p>Macquarie First South - South Africa Outperform – expected return >+10% Neutral – expected return from -10% to +10% Underperform – expected return <-10%</p> <p>Macquarie - Canada Outperform – return >5% in excess of benchmark return Neutral within 5% of benchmark return Underperform – return >5% below benchmark return</p> <p>Macquarie - USA Outperform (Buy) – return >5% in excess of benchmark return Neutral (Hold) – return within 5% of benchmark return Underperform (Sell) – return >5% below benchmark return</p> <p>Recommendations – 12 months</p> <p>Note: Quant recommendations may differ from Fundamental Analyst recommendations</p>	<p>This is calculated from the volatility of historic price movements.</p> <p>Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.</p> <p>High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.</p> <p>Medium – stock should be expected to move up or down at least 30–40% in a year.</p> <p>Low–medium – stock should be expected to move up or down at least 25–30% in a year.</p> <p>Low – stock should be expected to move up or down at least 15–25% in a year.</p> <p>* Applicable to Australian/NZ stocks only</p>	<p>All "Adjusted" data items have had the following adjustments made: Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests</p> <p>EPS = adjusted net profit / epowa* ROA = adjusted ebit / average total assets ROA Banks/Insurance = adjusted net profit / average total assets ROE = adjusted net profit / average shareholders funds Gross cashflow = adjusted net profit + depreciation *equivalent fully paid ordinary weighted average number of shares</p> <p>All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).</p>

Recommendation proportions – For quarter ending 30 September 2008

	AU/NZ	Asia	RSA	USA	CA	EUR
Outperform	43.17%	61.57%	63.08%	53.60%	71.54%	43.00%
Neutral	41.37%	16.43%	30.77%	37.60%	24.61%	48.00%
Underperform	15.47%	22.00%	6.15%	8.80%	3.85%	9.00%

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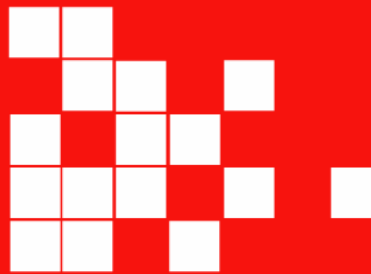
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