Macquarie Research
Equities

TAIWAN

Acer

30 October 2008

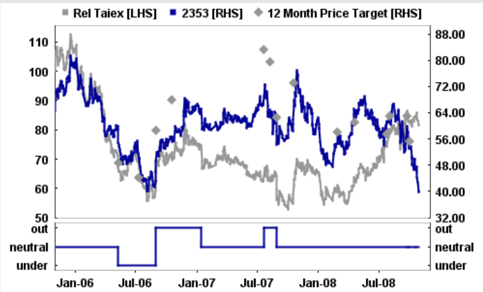
2353 TT		Neutral
Stock price as of 29 Oct 08	NT$	40.40
12-month target	NT$	45.00
Upside/downside	%	+11.4
Valuation	NT$	42.00-51.00
- Sum of Parts		

GICS sector	technology hardware & equipment	
Market cap	NT$m	106,766
30-day avg turnover	NT$m	1,166.5
Market cap	US$m	3,181
Number shares on issue	m	2,643

Investment fundamentals

Year end 31 Dec		2007A	2008E	2009E	2010E
Total revenue	bn	462.1	589.0	647.5	686.7
Reported profit	bn	13.0	13.1	12.5	13.6
Profit bonus exp	bn	10.7	13.1	13.1	13.6
Bon exp/rep prof	%	17.6	0.0	0.0	0.0
Adjusted profit	bn	9.3	10.6	11.5	12.6
EPS rep	NT$	5.33	4.92	4.73	5.13
EPS rep growth	%	10.1	-7.7	-4.0	8.6
EPS bonus exp	NT$	4.39	4.92	4.73	5.13
EPS bonus growth	%	21.7	12.1	-4.0	8.6
PE rep	x	7.6	8.2	8.5	7.9
PE bonus exp	x	9.2	8.2	8.5	7.9
Total DPS	NT$	3.18	2.97	2.84	3.08
Total div yield	%	7.9	7.4	7.0	7.6
ROA	%	4.7	5.1	4.9	5.0
ROE	%	12.4	13.0	12.9	13.1
EV/EBITDA	x	7.1	6.4	6.1	5.6
Net debt/equity	%	-24.4	-15.7	-14.7	-18.6
Price/book	x	1.3	1.2	1.2	1.1

2353 TT rel Taiex performance, & rec history



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

Analyst

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Many concerns

Event

- We lower our TP from NT$55.3 to NT$45 and maintain our Neutral rating. We have been more negative than the street since 1H08 as we believe Acer may face various challenges from 2H08 onward. We expect Acer to suffer not only from a weakening fundamental outlook, but also from we believe unrealistic expectations by the street.

Impact

- **Macquarie vs consensus** – Our 2009E sales growth of 9% is well below the street's 18–20% expectation and our margin forecasts are also lower than consensus due to anticipated, severe price wars.
- **Street's high expectation** – Consensus is looking at 18–20% sales growth in 2009, which we believe is very difficult to achieve. We expect NB ASP to fall by as much as 15% in 2009, and think Acer needs to generate much stronger shipment growth to meet such high expectations. In addition, global NB demand should come in lower next year and Acer's newly acquired brands are also losing share. All will likely make Acer difficult to meet such high growth numbers.
- **US margin to fall very quickly** – We believe Acer's US margins will face greater challenges given price competition. US demand is dropping very quickly while its competition is surging. Apple, Lenovo and Dell are all entering the mainstream consumer market in the US. We believe everyone is fighting for a shrinking pie. Acer has 30% sales exposure to the US, which may suffer falling margins. We think component cost savings will not be able to offset such price competition.
- **Falling European demand** – Our recent checks indicate that European demand has shrunk rapidly from October. We see Pan-Europe and Russia falling off a cliff due to various reasons such as credit tightening, Euro depreciation, low consumer confidence, and a falling economy.
- **Requiring efficient working capital management** – Acer's net cash to equity has dropped from 2006's 49% to 1H08's 10% due to its aggressive acquisitions. Acer's operating cashflow is weaker than previous years given inventory requirements from a surge of revenue. We worry that it may quickly need to raise debt to fund its business or turn to a more conservative strategy.

Earnings revision

- We cut our 2009 OP profit by 8% due to more conservative sales and margins.

Price catalyst

- 12-month price target: NT$45.00 based on a Sum of Parts methodology.
- Catalyst: Slower sales and conservative margin outlook.

Action and recommendation

- Acer's valuation is not that demanding, in our opinion, after the market's recent massive selling. However, as we believe Acer is facing various challenges and high street expectations, the stock is unlikely to outperform. Our TP is based on sum-of-parts with 9x its 2009E core earnings. We believe 9x is reasonable and in line with global peers, considering its growing risks.

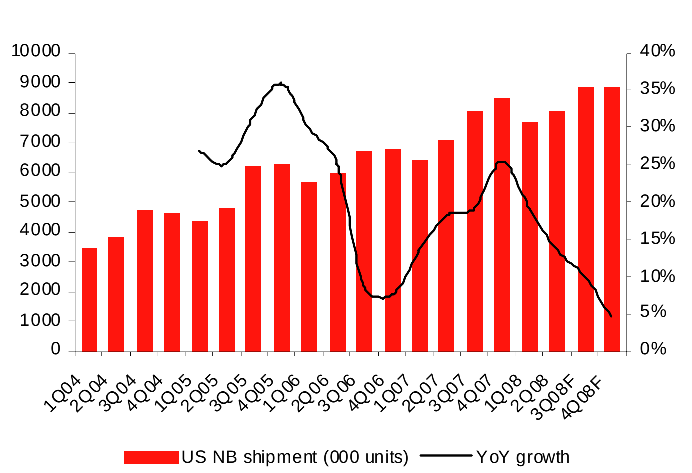
Various concerns

While the majority of analysts remain bullish on Acer, we hold our more conservative view and believe headwinds for Acer' are just underway. We have been highlighting Acer's concerns since 1H08 and these concerns have not been removed, but seem to be worsening. Below are our concerns.

US margins will be under great pressure

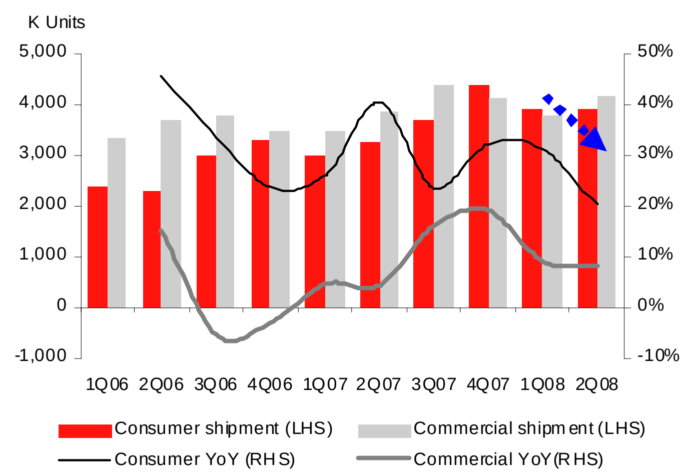
US NB demand is falling rapidly due to both a falling economy and mature market. While the demand pie is shrinking, we see its competition rising very rapidly. Both Dell and Lenovo are facing growth challenges due to their exposure to the commercial segment. Both giants are now jumping into the mainstream consumer market in the US.

Fig 1 US NB demand is shrinking



Source: Macquarie Research, October 2008

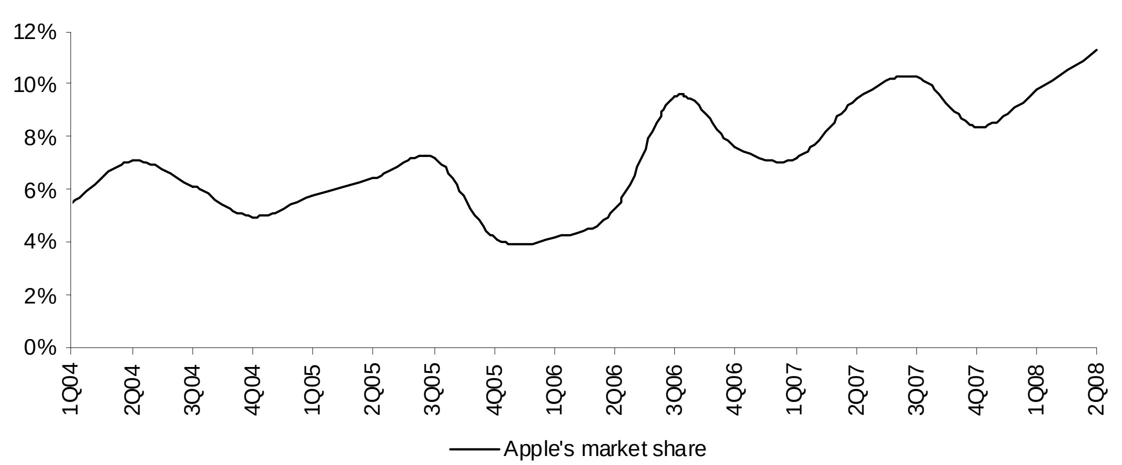
Fig 2 US consumer NBs are also falling



Source: Macquarie Research, October 2008

In addition, Apple's NB market share in the US also surged to 11–12% (No 3 in the region). In our view, Apple is now moving into the mainstream consumer market by offering more affordable prices. We see everyone now fighting for a shrinking pie, so we believe margins in the US are about to drop. Acer has about 30% sales exposure to the US, which we believe will be at risk. In fact, Acer's OPM is the lowest among the tier one, so the company will be very sensitive to any price wars.

Fig 3 Apple market share in the US is very high now



Source: IDC, Macquarie Research, October 2008

Falling pan European demand

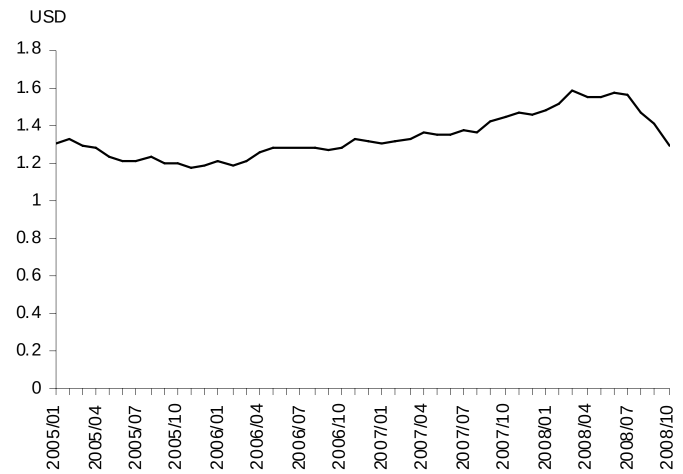
European demand has been strong over the past few quarters due to the strong Euro in 1H08 and a stable economy. While the Euro zone economy has fallen rapidly in the past few months, we now see evidence that the financial crisis has affected consumers' overall demand for NBs. Our recent checks suggest that Pan-European demand has fallen rapidly recently due to following reasons:

1) Credit tightening – demand is weak while channel distributors are also very conservatively building their inventory due to tight credit market.

2) Euro depreciation – The Euro dollar has depreciated rapidly since 3Q08 (see Fig 4) due to the weakening economy. The depreciation has lowered consumers' purchasing power.

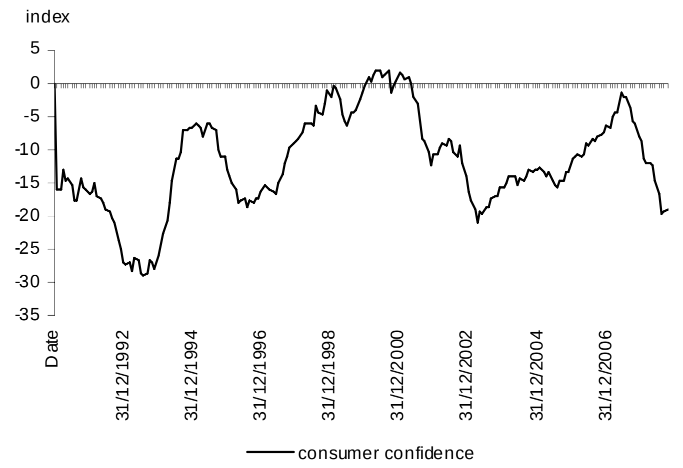
3) Low consumer confidence – We expect pan European PC demand to peak in the 2Q-3Q08 period and begin to fall in the following quarters. Acer has over 40% exposure to Europe and may suffer the most.

Fig 4 Euro dollar has begun to depreciate



Source: TEJ, Macquarie Research, October 2008

Fig 5 Euro consumer confidence index

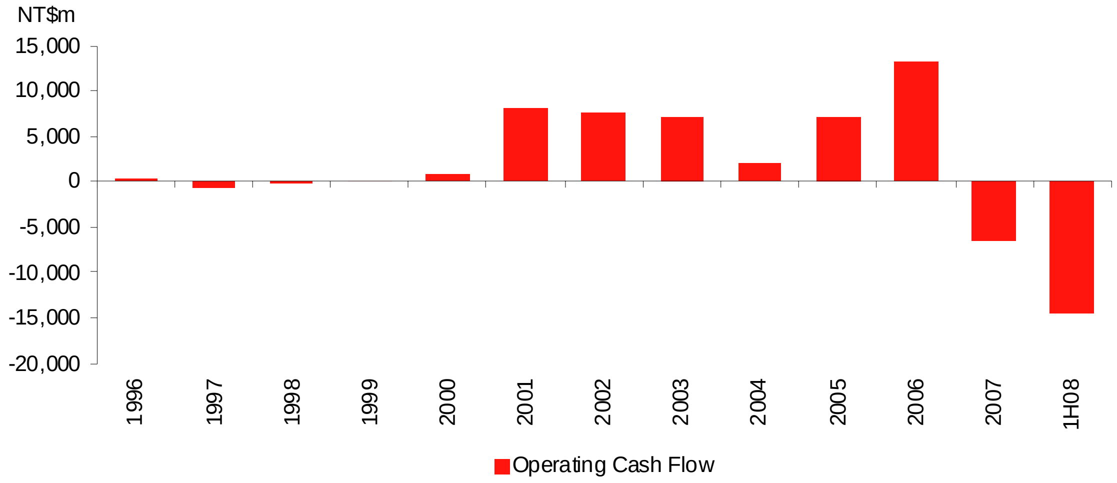


Source: European commission, Macquarie Research, October 2008

Working capital requirement

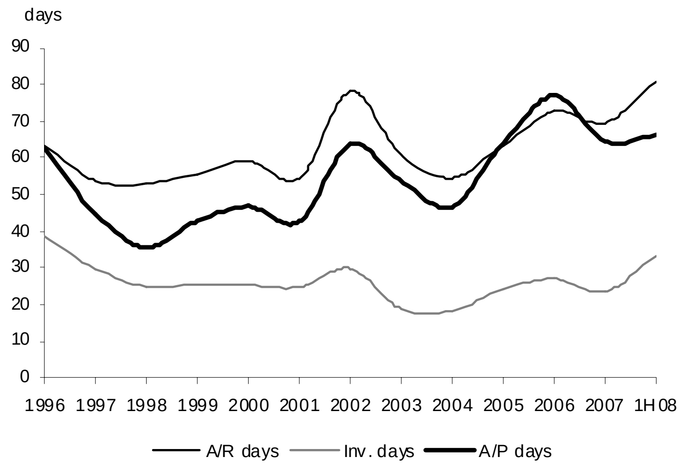
Acer's net cash position has been weakening since 2006 due to its aggressive acquisitions over the past two years. Net cash to equity has dropped from 49% in 2006 to 1H08's 10%. While we are heading into a more challenging year, we are concerned that Acer's inventory management will become even more difficult and that its cash requirement for WC may likely surge. In addition, A/R quality may also deteriorate as its distributors may delay their payment due to their tight B/S. In which case, Acer's current low cash position may soon need a new capital injection to fund its WC needs. Of course, if global demand comes in weaker as we have anticipated, Ace's WC burden will also reduce significantly.

Fig 6 Acer's operating cashflow



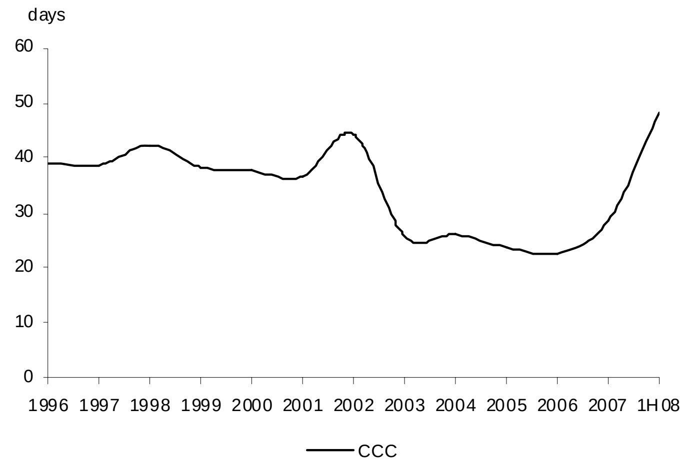
Source: TEJ, Macquarie Research, October 2008

Fig 7 Acer - AR vs AP vs Inventory days



Source: TEJ, Macquarie Research, October 2008

Fig 8 Acer's cash conversion cycle is worsening



Source: TEJ, Macquarie Research, October 2008

Different from other PC ODM/EMSs, we believe Acer's inventory and A/R are more difficult to control than A/P during this down cycle. Acer's A/P can be managed as it can put pressure on its suppliers due to its pricing power. However, Acer's cash requirement will come mostly from its inventory and A/R. We provide a quick sensitivity analysis on Acer where we focus on its inventory and A/R days and how an increase in WC would affect its current net cash position.

Acer was considered a cash-rich firm in the past. After its recent aggressive acquisitions, the firm is now no longer that cash rich. In fact, its high working capital nature is eating at much of its cashflow. In our base case, assuming Acer's A/R worsens by 20% and inventory increases by 20%, Acer may require an additional NT$38.6bn, which is significantly higher than its existing cash on hand (NT$20–25bn) and its net debt to equity may rise to as high as 31%. We believe Acer will continue to squeeze its suppliers (ODM/EMS partners) and try to manage its inventory. We believe the latter part will be more difficult during a weakening economy. Hence, the WC risk is higher.

Fig 9 Acer WC requirement and net debt (cash) sensitivity analysis

Inventory vs AR	5%	10%	15%	20%	25%	30%
5%	9,651	16,375	23,099	29,823	36,548	43,272
10%	12,577	19,301	26,025	32,750	39,474	46,198
15%	15,503	22,227	28,952	35,676	42,400	49,124
20%	18,429	25,154	31,878	38,602	45,326	52,051
25%	21,356	28,080	34,804	41,529	48,253	54,977
30%	24,282	31,006	37,731	44,455	51,179	57,903
Net debt/equity	**5%**	**10%**	**15%**	**20%**	**25%**	**30%**
5%	0%	7%	15%	22%	29%	36%
10%	3%	11%	18%	25%	32%	40%
15%	6%	14%	21%	28%	35%	43%
20%	10%	17%	24%	31%	39%	46%
25%	13%	20%	27%	34%	42%	49%
30%	16%	23%	30%	38%	45%	52%

Source: Macquarie Research, October, 2008

Note: Grey shading represents base-case assumptions and red text indicates the worst-case scenario

Street's high expectations

At this moment, consensus is still projecting 18–20% sales growth in 2009. We find it difficult to achieve. We expect NB ASP to fall by as much as 15% in 2009 due to the poor economy. Acer needs to generate much stronger shipment growth to compensate for ASP losses and to meet such high revenue expectations. In addition, global NB demand should come in lower next year, which we expect to grow only 14%. Finally, Acer's new acquired brands are losing market share. All will likely make Acer difficult to meet such high growth numbers.

The street is also expecting Acer's OPM to expand from 2008's 2.2% to 2.5%. Given growing competition and fast falling ASPs in the NB industry, we find it hard to believe Acer is able to manage margin expansion even with help from some component cost declines. We expect Acer's OPM to be flat or down in 2009.

Aspire One is the only bright spot

Same as Asustek, we are positive on netbook's volume growth. We project Acer's Aspire One will grow from 4m in 2008 to 8m units in 2009. However, the netbook contribution will not be enough to offset the challenges in conventional NB industry, in our view.

Valuation – still not exciting

Despite its recent, sharp share price fall, we find it difficult to turn positive on Acer. Our key concerns remain its worsening fundamental outlook and street's high expectations. We would wait for more earnings downgrades to come.

Our TP of NT$45 is based on sum-of-parts, where we assign 9x PER to its 2009E core earnings. The 9x PER is similar to where DELL and HPQ are trading at the moment. While the sector is facing multiple challenges, we suggest investors stay way from Acer for now until we are clear about NB demand, the price competition situation, and more reasonable earnings expectations by the street.

Fig 10 Acer sum-of-part valuation

	2009
Acer net income ex-disposal gains after tax	11,529
EPS ex-disposal gain	4.36
Target PER multiple (09)	9
Core business value	39.26
plus net cash per share	5.15
Target price ex-investment income	44.41
Investment value	0.59
Target price	45

Source: Macquarie Research, October 2008

Acer (2353 TT, Neutral, Target price: NT$45.00)

Quarterly Results		2Q/08A	3Q/08E	4Q/08E	1Q/09E
Revenue	**m**	**124,811**	**159,131**	**177,648**	**151,585**
Gross Profit	**m**	**13,500**	**16,058**	**17,919**	**15,003**
Operating Expenses	m	-10,787	-12,514	-13,958	-11,989
Operating Income	**m**	**2,713**	**3,545**	**3,961**	**3,014**
Net Non-operating income	m	1,205	825	825	525
Pre-Tax Income	**m**	**3,918**	**4,370**	**4,786**	**3,539**
Tax Expense	m	-994	-874	-957	-708
Exceptionals	m	755	600	600	300
Minority Interests	m	0	0	0	0
Reported Earnings	**m**	**2,924**	**3,496**	**3,829**	**2,831**
Reported Earnings (bonus exp)	m	2,924	3,496	3,829	2,831
Bonus exp / Reported Earnings	%	0.0	0.0	0.0	0.0
Adjusted Earnings	**m**	**2,232**	**2,959**	**3,292**	**2,594**
EBITDA	**m**	**3,004**	**3,841**	**4,264**	**3,318**
EPS (rep)	NT$	1.09	1.32	1.45	1.07
EPS pcp growth (rep)	%	36.4	10.7	47.6	0.7
EPS (rep bonus exp)	NT$	1.09	1.32	1.45	1.07
EPS pcp growth (rep bonus exp)	%	65.5	34.4	79.1	0.7
EPS (adj)	NT$	0.83	1.12	1.25	0.98
EPS pcp growth (adj)	%	21.2	-19.0	6.5	23.8
Revenue pcp growth	%	33.5	30.5	20.8	19.0
Operating Income pcp growth	%	38.3	26.3	14.2	10.1
Reported Earnings pcp growth	%	47.6	19.8	59.8	-0.7
Gross Profit Margin	%	10.8	10.1	10.1	9.9
Operating Income Margin	%	2.2	2.2	2.2	2.0
Reported Earnings Margin	%	2.3	2.2	2.2	1.9
EBITDA Margin	%	2.4	2.4	2.4	2.2

Profit and Loss Ratios		2007A	2008E	2009E	2010E
Revenue Growth	%	25.2	27.5	9.9	6.0
Gross Profit Growth	%	21.9	28.5	5.5	5.7
Operating Income Growth	%	30.4	27.2	4.3	9.9
Reported Earnings Growth	%	14.1	1.1	-4.7	8.6
EBITDA Growth	%	27.2	24.8	4.4	9.5
Gross Profit Margin	%	10.3	10.3	9.9	9.9
Operating Income Margin	%	2.2	2.2	2.1	2.2
Reported Earnings Margin	%	2.8	2.2	1.9	2.0
EBITDA Margin	%	2.5	2.4	2.3	2.4
Payout Ratio	%	83.0	74.5	64.9	64.5
EV/EBITDA	x	7.1	6.4	6.1	5.6
EV/EBIT	x	7.9	7.0	6.7	6.1
Balance Sheet Ratios					
ROE	%	12.4	13.0	12.9	13.1
ROA	%	4.7	5.1	4.9	5.0
ROIC	%	34.0	17.7	14.8	15.0
Net Debt/Equity	%	-24.4	-15.7	-14.7	-18.6
Interest Cover	x	nmf	nmf	nmf	nmf
Price/Book	x	1.3	1.2	1.2	1.1
Book Value per Share	NT$	31.5	32.6	34.9	37.8

Profit & Loss		2007A	2008E	2009E	2010E
Revenue	**m**	**462,066**	**588,966**	**647,521**	**686,668**
Gross Profit	**m**	**47,419**	**60,942**	**64,264**	**67,914**
Operating Expenses	m	-37,234	-47,986	-50,752	-53,060
Operating Income	**m**	**10,185**	**12,956**	**13,512**	**14,854**
Net Non-operating income	m	4,924	3,420	2,100	2,100
Pre-Tax Income	**m**	**15,109**	**16,377**	**15,612**	**16,954**
Tax Expense	m	-2,666	-3,276	-3,122	-3,391
Exceptionals	m	4,167	2,743	1,200	1,200
Minority Interests	m	515	0	0	0
Reported Earnings	**m**	**12,958**	**13,101**	**12,489**	**13,563**
Reported Earnings (bonus exp)	m	10,677	13,101	12,489	13,563
Bonus exp / Reported Earnings	%	17.6	0.0	0.0	0.0
Adjusted Earnings	**m**	**9,342**	**10,610**	**11,541**	**12,615**
EBITDA	**m**	**11,328**	**14,136**	**14,751**	**16,154**
EPS (rep)	NT$	5.33	4.92	4.73	5.13
EPS growth (rep)	%	10.1	-7.7	-4.0	8.6
EPS (rep bonus exp)	NT$	4.39	4.92	4.73	5.13
EPS growth (rep bonus exp)	%	21.7	12.1	-4.0	8.6
EPS (adj)	NT$	3.83	3.99	4.37	4.77
EPS growth (adj)	%	40.3	4.1	9.4	9.3
PE (rep)	x	7.6	8.2	8.5	7.9
PE (rep bonus adj)	x	9.2	8.2	8.5	7.9
PE (adj)	x	10.5	10.1	9.3	8.5
Total DPS	NT$	3.18	2.97	2.84	3.08
Total Div Yield	%	7.9	7.4	7.0	7.6
Weighted Average Shares	m	2,432	2,663	2,643	2,643
Period End Shares	m	2,442	2,643	2,643	2,643

Cashflow Analysis		2007A	2008E	2009E	2010E
Reported Earnings	**m**	**12,958**	**13,101**	**12,489**	**13,563**
Depreciation & Amortisation	m	1,142	1,179	1,239	1,300
Chgs in Working Cap	m	-25,231	-22,580	-8,561	-5,184
Other	m	5,152	-420	1,616	1,616
Operating Cashflow	**m**	**-5,978**	**-8,720**	**6,784**	**11,296**
Acquisitions	m	-217	0	0	0
Capex	m	-535	-700	-800	-800
Asset Sales	m	8,734	2,808	1,200	1,200
Other	m	12,333	0	0	0
Investing Cashflow	**m**	**20,315**	**2,108**	**400**	**400**
Dividend (Ordinary)	m	-9,395	-7,775	-7,861	-7,494
Equity Raised	m	0	2,372	0	0
Debt Movements	m	14,354	210	240	240
Other	m	-26,432	1,233	-416	-343
Financing Cashflow	**m**	**-21,473**	**-3,959**	**-8,037**	**-7,597**
Net Chg in Cash/Debt	**m**	**-6,157**	**-10,572**	**-853**	**4,099**
Free Cashflow	m	-6,513	-9,420	5,984	10,496
FCF per Share	NT$	-2.68	-3.54	2.26	3.97
P/FCF	x	-15.1	-11.4	17.8	10.2

Balance Sheet		2007A	2008E	2009E	2010E
Cash	m	41,053	24,421	24,526	29,726
Receivables	m	102,406	121,191	134,485	142,616
Inventories	m	33,816	53,169	58,526	62,064
Investments	m	11,203	11,433	11,681	11,929
Fixed Assets	m	8,636	8,439	8,286	8,072
Intangibles	m	0	0	0	0
Other Assets	m	46,170	46,150	47,954	49,684
Total Assets	**m**	**243,283**	**264,802**	**285,458**	**304,091**
Payables	m	80,843	96,466	106,557	113,042
Short Term Debt	m	5,372	1,722	1,802	1,882
Long Term Debt	m	16,791	9,033	9,113	9,193
Provisions	m	0	0	0	0
Other Liabilities	m	62,868	70,771	75,109	79,446
Total Liabilities	**m**	**165,874**	**177,993**	**192,581**	**203,563**
Total S/H Equity	**m**	**77,409**	**86,810**	**92,877**	**100,528**
Total Liab & S/H Funds	**m**	**243,283**	**264,802**	**285,458**	**304,091**

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

Important disclosures:

Recommendation definitions

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)

Macquarie – Asia/Europe
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie First South - South Africa
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie – **Canada**
Outperform – return >5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return >5% below benchmark return

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

Recommendations – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Volatility index definition*

This is calculated from the volatility of historic price movements.

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.

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.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low–medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.
* Applicable to Australian/NZ stocks only

Financial definitions

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

EPS = adjusted net profit / efpowa*
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

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

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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