

TAIWAN

Asustek Computer

30 October 2008

2357 TT **Neutral**

Stock price as of 29 Oct 08	NT\$	45.50
12-month target	NT\$	50.00
Upside/downside	%	+9.9
Valuation	NT\$	47.00-58.70
- ROE-g/COE-g		

GICS sector	technology hardware & equipment		
Market cap	NT\$m	193,195	
30-day avg turnover	NT\$m	1,279.6	
Market cap	US\$m	5,756	
Number shares on issue	m	4,246	

Investment fundamentals

Year end 31 Dec		2007A	2008E	2009E	2010E
Total revenue	bn	227.4	283.9	337.6	398.2
Reported profit	bn	28.2	26.4	24.9	28.1
Profit bonus exp	bn	22.5	26.4	24.9	28.1
Bon exp/rep prof	%	20.4	0.0	0.0	0.0
Adjusted profit	bn	28.2	25.1	24.9	28.1
EPS rep	NT\$	7.03	6.33	5.87	6.62
EPS rep growth	%	51.4	-9.9	-7.3	12.9
EPS bonus exp	NT\$	5.59	6.33	5.87	6.62
EPS bonus growth %		84.0	13.2	-7.3	12.9
PE rep	x	6.5	7.2	7.8	6.9
PE bonus exp	x	8.1	7.2	7.8	6.9
Total DPS	NT\$	1.52	3.33	3.11	2.93
Total div yield	%	3.3	7.3	6.8	6.4
ROA	%	5.3	6.4	5.6	5.9
ROE	%	19.2	14.8	13.5	14.1
EV/EBITDA	x	5.7	4.6	4.6	3.9
Net debt/equity	%	-18.4	-12.7	-12.8	-5.7
Price/book	x	1.2	1.1	1.0	0.9

2357 TT rel Taiex performance, & rec history



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

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Last ground losing support

Event

- We downgrade Asustek to Neutral from Outperform and lower our target price to NT\$50 from NT\$80 as demand from both Eastern and Western Europe is much weaker than we had expected. We also expect notebook (NB) price competition to rise rapidly, which may also hurt Asustek's margin outlook.

Impact

- Macquarie vs consensus.** Our 2009 net profit forecast is 10–15% lower than consensus due to our more conservative motherboard (MB) and NB shipment and margin expectation. Asustek's share price fell sharply on a massive sell-off. We think we were wrong in assuming that Asustek's brand business might decline within an acceptable range and its new low-price products would offset the weakness. We believe the market may still underestimate the rapidly slowing European demand and the impact of falling ASP/margin.
- Falling European demand.** Our recent checks indicate that demand from Europe has shrunk rapidly since October. Demand from pan-Europe and Russia are also falling off a cliff for various reasons including credit tightening, Euro depreciation, low consumer confidence, and a falling economy. We expect Asustek's MB demand to fall by 10% QoQ with ASP erosion in 4Q08 while NB demand may grow at only 10% with faster ASP decline.
- Growth to slow in 2009.** For 2009, we expect MB sales to decline by 10% YoY on both falling demand and ASP. NB sales should grow by only 16% with shipment growth of 25%, offset by the fast ASP decline.
- Margin outlook a concern.** We had previously projected the Asustek's brand business margin to decline, but we now expect this to accelerate as we believe Asustek needs to sacrifice its ASP/margin to maintain market share and growth.
- Eee products are remaining a hotspot.** We remain comfortable with our projection that Asustek's Eee products (Eee PC and Eee-top) will sell well, but we are concerned that the upside may not be able to offset weakness in NB and MB.

Earnings revision

- We cut our FY09 earnings forecast by 21% on demand and margin concerns.

Price catalyst

- 12-month price target: NT\$50.00 based on a ROE-COE methodology.
- Catalyst: Weakening profit momentum and falling margins.

Action and recommendation

- We think we have been late in downgrading our rating seeing the market's recent freefall. However, there are still 17 buys on Bloomberg, which means the market may not be fully aware that pan-European demand is slowing rapidly and ASP/margin is declining. Valuation could be the only reason that we do not rate the stock an Underperform as both PER and P/BV are at historical lows. We expect Asustek's share price to remain within the NT\$40–50 range in the coming quarters. We could revisit the stock when we see evidence of growth recovery.

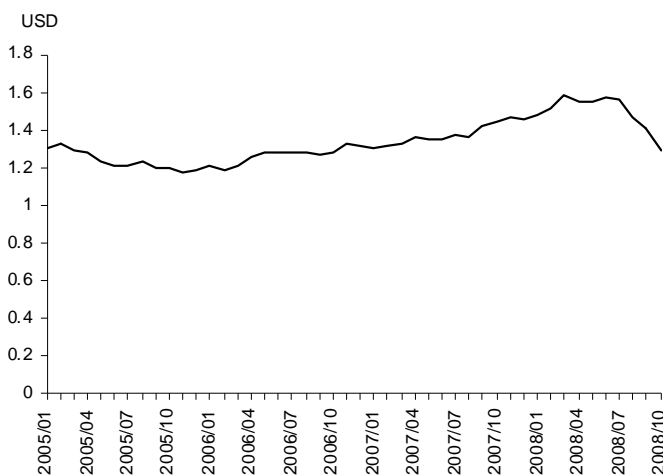
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Last ground losing support

Over the past few quarters, demand from Europe had been strong due to the strong Euro in 1H08 and a stable economy. While the Eurozone economy has fallen rapidly in the past few months, we now see evidence that the financial crisis has affected overall consumer demand for notebooks (NB). Our recent checks suggest that pan-European demand is falling rapidly due to the following.

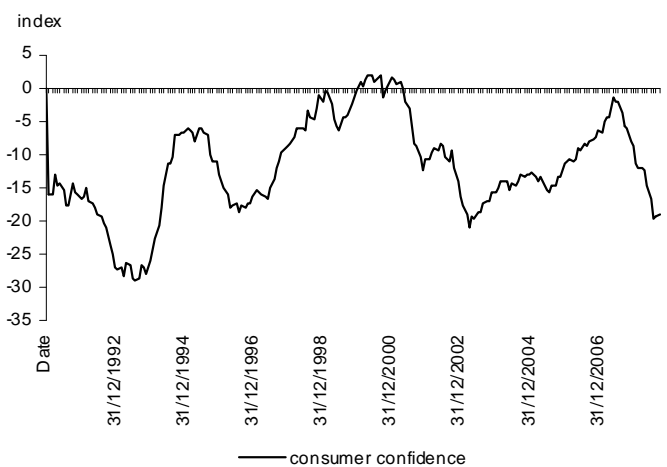
- **Credit tightening.** Demand is weak while channel distributors are also very conservative in building their inventory due to tight credit market.
- **Euro depreciation.** The Euro has depreciated rapidly since 3Q08 due to the weakening economy. The depreciation has lowered purchasing power.
- **Low consumer confidence.** We expect pan-European PC demand to peak in 2Q–3Q08 and then begin to fall in the following quarters. Asustek and Acer (2353 TT, NT\$40.4, Neutral, TP: NT\$46), which have over 40% exposure to Europe, may suffer the most.

Fig 1 Euro dollar has begun to depreciate



Source: TEJ, Macquarie Research, October 2008

Fig 2 Euro consumer confidence index



Source: European commission, Macquarie Research, October 2008

Growth to slow in 2009

We believe slower European demand will affect both NB and MB demand for Asustek. While desktop (DT) demand continues to suffer from both slowing economy and NB replacement, we expect DT shipments to decline further, by 3-4% YoY, in 2009 from -1% in 2008. The slowdown will continue to hurt Asustek's MB shipment, in our view. Worse, we believe Asustek may have to sacrifice its ASP to attract demand. We expect its MB shipments to decline by 6% YoY, ASP to decline by 5% and total MB revenue to drop by 10% YoY in 2009.

Asustek's own-brand NB should continue to grow, though at a slower rate. We expect its NB to grow 25% YoY with ASP erosion and total NB revenue to grow only 16% YoY.

Margin outlook a concern

Due to the slowing economy and anticipated price competition among tier-one brands, we expect Asustek to give up some of its margin in brand NB. In addition, MB has been providing the highest margin in its product portfolio, which means that the slower demand and falling margin will have a higher impact on Asustek's overall margin performance. We expect Asustek's margin to trend down in coming quarters.

Eee products remain strong

We remain confident about our forecast on Asustek's Eee PC. We expect Eee PC to grow from 5.2m units in 2008 to 8.6m units in 2009 as we believe customers may shift some of their demand to low-price products. In addition, Eee-top will be launched next month, which could bring another new earnings contribution to Asustek's brand business. However, we think contribution may not be enough to offset the decline in the brand NB and MB business.

We still like Asustek’s corporate transition over the long term

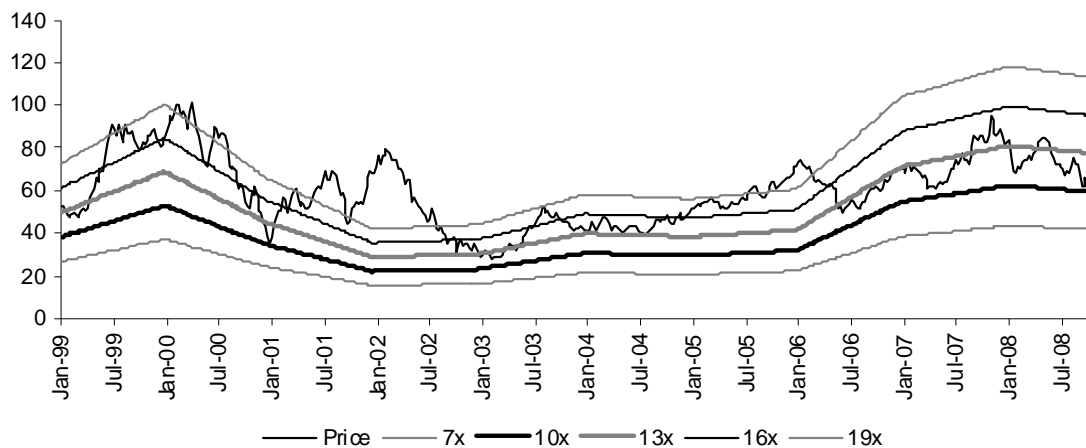
Although the fast global economic decline and demand lead us adopt a more cautious view on Asustek for the coming quarters, we still like the company’s new transformation. Asustek’s corporate culture has become more innovative and flexible. Although Pegatron remains a drag on its P/L and cashflow, the company’s decision to spin it off is an important step, in our view, that will help the company to gradually reduce its exposure to the very capital-intensive ODM business. Asustek should then be able to increase its focus on its branding and marketing.

Why not an Underperform? Cheap valuation but upside could be capped

We like Asustek for the long term. The recent sell-off in the market is a reflection of concerns about a worsening economy in 2009. Due to such a sharp correction in the short term, our rating downgrade on Asustek may seem to be late. However, we note that there are still 17 buy recommendations on the stock on Bloomberg, which means the market may not fully factor in its upcoming fundamental risks.

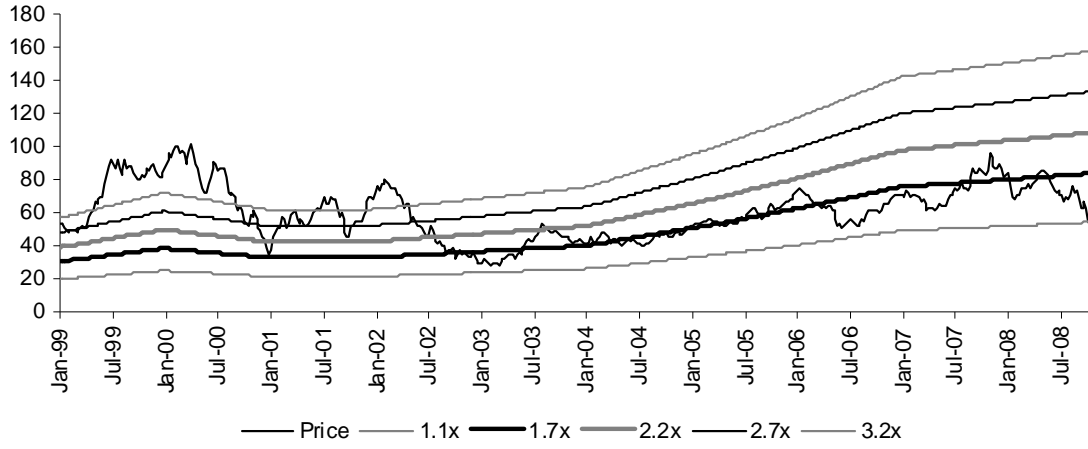
Asustek’s valuation is not expensive after the sharp market correction. The stock is now trading at 7.2x and 7.8x FY08E and FY09E PER respectively. While the company fundamentals are facing grater challenges, such low valuations may only provide downside protection. We expect Asustek shares to trade within NT\$40-50 range in the coming quarters. We could turn more positive when we see more evidence of demand and growth recovery.

Fig 3 Asustek – one-year forward PER at historcal low



Source: Macquarie Research, October 2008

Fig 4 Asustek – P/BV at historical low



Source: Macquarie Research, October 2008

Asustek Computer (2357 TT, Neutral, Target price: NT\$50.00)

Quarterly Results					Profit & Loss						
		2Q/08A	3Q/08E	4Q/08E	1Q/09E		2007A	2008E	2009E	2010E	
Revenue	m	58,062	77,810	85,044	74,791	Revenue	m	227,386	283,883	337,597	398,203
Gross Profit	m	10,371	13,968	13,996	11,521	Gross Profit	m	40,784	49,469	50,877	56,205
Operating Expenses	m	-5,974	-6,797	-7,344	-6,428	Operating Expenses	m	-21,059	-24,583	-28,022	-30,061
Operating Income	m	4,396	7,172	6,653	5,093	Operating Income	m	19,725	24,886	22,855	26,144
Net Non-operating income	m	2,220	1,196	1,513	1,747	Net Non-operating income	m	14,822	7,699	7,533	8,153
Pre-Tax Income	m	6,617	8,368	8,166	6,840	Pre-Tax Income	m	34,548	32,585	30,388	34,297
Tax Expense	m	-973	-1,506	-1,470	-1,231	Tax Expense	m	-6,303	-6,154	-5,470	-6,175
Exceptionals	m	288	0	0	0	Exceptionals	m	41	1,307	0	0
Minority Interests	m	0	0	0	0	Minority Interests	m	0	0	0	0
Reported Earnings	m	5,644	6,861	6,696	5,609	Reported Earnings	m	28,245	26,431	24,918	28,121
Reported Earnings (bonus exp)	m	5,644	6,861	6,696	5,609	Reported Earnings (bonus exp)	m	22,471	26,431	24,918	28,121
Bonus exp / Reported Earnings	%	0.0	0.0	0.0	0.0	Bonus exp / Reported Earnings	%	20.4	0.0	0.0	0.0
Adjusted Earnings	m	5,355	6,861	6,696	5,609	Adjusted Earnings	m	28,204	25,124	24,918	28,121
EBITDA	m	6,345	9,173	8,707	7,184	EBITDA	m	26,151	32,793	31,522	36,725
EPS (rep)	NT\$	1.38	1.62	1.58	1.32	EPS (rep)	NT\$	7.03	6.33	5.87	6.62
EPS pcp growth (rep)	%	-20.9	-10.9	-10.6	-25.1	EPS growth (rep)	%	51.4	-9.9	-7.3	12.9
EPS (rep bonus exp)	NT\$	1.38	1.62	1.58	1.32	EPS (rep bonus exp)	NT\$	5.59	6.33	5.87	6.62
EPS pcp growth (rep bonus exp)	%	-0.6	12.0	12.4	-25.1	EPS growth (rep bonus exp)	%	84.0	13.2	-7.3	12.9
EPS (adj)	NT\$	1.31	1.62	1.58	1.32	EPS (adj)	NT\$	7.02	6.01	5.87	6.62
EPS pcp growth (adj)	%	-24.2	-11.5	-11.2	-12.8	EPS growth (adj)	%	55.5	-14.3	-2.4	12.9
Revenue pcp growth	%	20.0	32.0	17.8	18.8	PE (rep)	x	6.5	7.2	7.8	6.9
Operating Income pcp growth	%	2.9	84.0	-18.9	-23.6	PE (rep bonus adj)	x	8.1	7.2	7.8	6.9
Reported Earnings pcp growth	%	-17.6	-7.7	-7.4	-22.4	PE (adj)	x	6.5	7.6	7.8	6.9
Gross Profit Margin	%	17.9	18.0	16.5	15.4	Total DPS	NT\$	1.52	3.33	3.11	2.93
Operating Income Margin	%	7.6	9.2	7.8	6.8	Total Div Yield	%	3.3	7.3	6.8	6.4
Reported Earnings Margin	%	9.7	8.8	7.9	7.5	Weighted Average Shares	m	4,017	4,173	4,246	4,246
EBITDA Margin	%	10.9	11.8	10.2	9.6	Period End Shares	m	4,100	4,246	4,246	4,246
Profit and Loss Ratios					Cashflow Analysis						
		2007A	2008E	2009E	2010E		2007A	2008E	2009E	2010E	
Revenue Growth	%	-59.4	24.8	18.9	18.0	Reported Earnings	m	28,245	26,431	24,918	28,121
Gross Profit Growth	%	-25.7	21.3	2.8	10.5	Depreciation & Amortisation	m	6,426	7,907	8,667	10,582
Operating Income Growth	%	-3.1	26.2	-8.2	14.4	Chgs in Working Cap	m	-15,373	-22,796	-8,386	-19,009
Reported Earnings Growth	%	47.2	-6.4	-5.7	12.9	Other	m	-5,933	-4,103	-3,875	1,267
EBITDA Growth	%	4.4	25.4	-3.9	16.5	Operating Cashflow	m	13,364	7,439	21,325	20,962
Gross Profit Margin	%	17.9	17.4	15.1	14.1	Acquisitions	m	552	0	0	0
Operating Income Margin	%	8.7	8.8	6.8	6.6	Capex	m	-15,402	-8,000	-8,000	-8,000
Reported Earnings Margin	%	12.4	9.3	7.4	7.1	Asset Sales	m	0	0	0	0
EBITDA Margin	%	11.5	11.6	9.3	9.2	Other	m	942	0	0	0
Payout Ratio	%	21.7	55.3	53.0	44.3	Investing Cashflow	m	-13,908	-8,000	-8,000	-8,000
EV/EBITDA	x	5.7	4.6	4.6	3.9	Dividend (Ordinary)	m	-6,244	-14,122	-13,216	-12,459
EV/EBIT	x	7.4	5.8	6.0	5.2	Equity Raised	m	0	0	0	0
Balance Sheet Ratios						Debt Movements	m	3,238	2,400	2,400	2,400
ROE	%	19.2	14.8	13.5	14.1	Other	m	-3,599	-1,442	-1,442	-3,966
ROA	%	5.3	6.4	5.6	5.9	Financing Cashflow	m	-6,606	-13,165	-12,258	-14,025
ROIC	%	13.8	13.7	10.8	11.6	Net Chg in Cash/Debt	m	-7,149	-13,725	1,067	-1,064
Net Debt/Equity	%	-18.4	-12.7	-12.8	-5.7	Free Cashflow	m	-2,038	-561	13,325	12,962
Interest Cover	x	nmf	nmf	nmf	nmf	FCF per Share	NT\$	-0.51	-0.13	3.14	3.05
Price/Book	x	1.2	1.1	1.0	0.9	P/FCF	x	-89.7	-338.5	14.5	14.9
Book Value per Share	NT\$	39.3	42.0	44.9	48.8	Balance Sheet		2007A	2008E	2009E	2010E
						Cash	m	56,998	50,420	53,754	44,068
						Receivables	m	136,172	111,499	121,377	139,610
						Inventories	m	103,424	133,713	144,136	165,787
						Investments	m	12,199	15,626	20,179	25,342
						Fixed Assets	m	63,177	64,022	64,108	77,596
						Intangibles	m	0	0	0	0
						Other Assets	m	13,773	15,218	16,662	20,634
						Total Assets	m	385,742	390,498	420,217	473,038
						Payables	m	141,565	123,078	134,994	155,870
						Short Term Debt	m	7,166	7,966	8,766	10,966
						Long Term Debt	m	16,389	17,189	17,989	20,189
						Provisions	m	0	0	0	0
						Other Liabilities	m	39,320	43,374	47,427	58,573
						Total Liabilities	m	204,440	191,607	209,176	245,598
						Total S/H Equity	m	181,302	198,891	211,041	227,441
						Total Liab & S/H Funds	m	385,742	390,498	420,217	473,038

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 historical 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/Canada 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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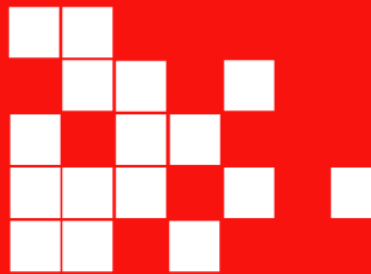
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