

Company Flash

21 October 2008 | 10 pages

Chi Mei Opto (3009.TW)

Downgrade to Sell: Rising Company Specific Risks

 Change in opinion
 Rating change
 Target price change
 Estimate change

- Downgrade to Sell** — Despite CMO already breaking below its prior trailing trough P/BV, we have decided to downgrade the name to Sell (3L) from Buy (1L) and cut our target price to NT\$15 from NT\$45.5 as we believe this company will bring larger downside risks to investors by carrying a higher gearing ratio, weaker FCF yield, and larger book value contraction.
- Near-term losses widen** — As TV and monitor panels demand being affected by global financial crisis, we expect CMO 4Q08 sales decline of 10-15% QoQ (flattish in shipment but with blended ASP decline of 10-15% QoQ), resulting in op margin to -4 to -7% level. However, due to higher debt level, we should see another 200-300 basis points lower in net margin.
- Company specific concerns** — 1) CMO has much higher net debt to equity ratio of 50-55% vs. AUO/LGD's 10% level, suggesting larger refinancing risks; 2) By spending higher capex without better ROE/ROA, CMO reported gross FCF margin of -18% vs. AUO/LGD's -5% in the past five years and likely the gap to remain for the next three years; 3) We estimate larger book value contraction for CMO than AUO for the next 2-3 quarters.
- Slashing estimates** — By factoring in larger-than-expected panel price contraction and demand fall for next 2-3 quarters, we are cutting our 2008E EPS by 21% to NT\$3.8 and 2009E EPS to -NT\$0.39 from NT\$3.9. We now forecast CMO sales to decline 10% YoY in 2009 from 12% YoY growth earlier.

Sell/Low Risk	3L
<i>from Buy/Low Risk</i>	
Price (20 Oct 08)	NT\$16.90
Target price	NT\$15.00
<i>from NT\$45.50</i>	
Expected share price return	-11.2%
Expected dividend yield	8.9%
Expected total return	-2.4%
Market Cap	NT\$123,478M
	US\$3,786M

Price Performance (RIC: 3009.TW, BB: 3009 TT)


 Andrew Lu¹
Figure 1. CMO – Statistical Abstract

Year to 31-Dec	Net profit (NT\$ Mils.)	EPS (NT\$)	EPS Growth (%)	P/E (x)	ROIC (%)	ROE (%)	P/B (x)	I/B/E/S (NT\$)	% diff
2006	3,045	0.43	-67%	38.0	1%	2%	0.7		
2007	35,717	5.01	1066%	3.3	9%	19%	0.6		
2008E	27,731	3.80	-24%	4.3	6%	13%	0.5	3.12	22%
2009E	(2,834)	(0.39)	-110%	-41.8	-1%	-1%	0.6	(1.99)	80%
2010E	7,223	1.00	-355%	16.4	2%	4%	0.6	2.99	-67%

Source: Company Reports and Citi Investment Research estimates

See Appendix A-1 for Analyst Certification and important disclosures.

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¹Citigroup Global Markets Inc - Taipei Branch

Fiscal year end 31-Dec	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	39.3	3.4	4.5	nm	17.0
EV/EBITDA adjusted (x)	5.0	2.7	2.8	3.8	3.3
P/BV (x)	0.7	0.6	0.5	0.6	0.6
Dividend yield (%)	0.6	0.6	8.9	8.9	8.9
Per Share Data (NT\$)					
EPS adjusted	0.43	5.01	3.80	-0.39	1.00
EPS reported	0.43	5.01	3.80	-0.39	1.00
BVPS	24.35	29.21	30.78	29.16	28.63
DPS	0.10	0.10	1.50	1.50	1.50
Profit & Loss (NT\$M)					
Net sales	187,052	302,473	347,963	311,904	344,775
Operating expenses	-178,939	-258,237	-313,100	-308,296	-330,572
EBIT	8,113	44,236	34,863	3,608	14,202
Net interest expense	-2,987	-5,388	-5,643	-6,000	-6,000
Non-operating/exceptionals	-1,580	-774	26	-550	-550
Pre-tax profit	3,546	38,075	29,247	-2,942	7,652
Tax	-3	-1,903	-1,515	108	-429
Extraord./Min.Int./Pref.div.	-498	-454	0	0	0
Reported net income	3,045	35,717	27,731	-2,834	7,223
Adjusted earnings	3,045	35,717	27,731	-2,834	7,223
Adjusted EBITDA	41,392	91,505	100,695	76,415	92,879
Growth Rates (%)					
Sales	22.4	61.7	15.0	-10.4	10.5
EBIT adjusted	-21.0	445.2	-21.2	-89.7	293.6
EBITDA adjusted	27.2	121.1	10.0	-24.1	21.5
EPS adjusted	-67.3	nm	-24.3	-110.3	354.7
Cash Flow (NT\$M)					
Operating cash flow	62,348	81,195	89,707	73,069	85,495
Depreciation/amortization	33,279	47,269	65,832	72,807	78,677
Net working capital	24,689	-2,293	-3,857	3,096	-405
Investing cash flow	-140,217	-116,838	-100,100	-70,100	-90,100
Capital expenditure	-127,365	-124,911	-100,000	-70,000	-90,000
Acquisitions/disposals	-8,852	5,077	0	0	0
Financing cash flow	107,544	16,225	17,087	-10,865	-10,875
Borrowings	71,285	19,194	26,420	0	0
Dividends paid	0	0	0	0	0
Change in cash	29,675	-19,418	6,693	-7,896	-15,480
Balance Sheet (NT\$M)					
Total assets	412,420	502,435	558,146	539,751	545,432
Cash & cash equivalent	50,366	30,948	37,641	29,746	14,266
Accounts receivable	27,979	58,366	61,966	55,545	61,398
Net fixed assets	267,311	345,115	379,383	376,676	388,099
Total liabilities	224,137	279,300	318,239	313,542	322,875
Accounts payable	37,830	70,679	79,811	78,910	84,783
Total Debt	154,386	173,580	200,000	200,000	200,000
Shareholders' funds	188,283	223,135	239,907	226,209	222,557
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	22.1	30.3	28.9	24.5	26.9
ROE adjusted	2.0	18.8	12.8	-1.3	3.4
ROIC adjusted	3.4	13.4	9.0	1.0	3.5
Net debt to equity	55.2	63.9	67.7	75.3	83.5
Total debt to capital	45.1	43.8	45.5	46.9	47.3

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Figure 2. CMO – Quarterly Earnings Adjustment

	1Q08	2Q08	3Q08E	4Q08E	1Q09E	2Q09E	3Q09E	4Q09E
Original forecast								
Revenue in NT\$m	92,085	95,489	81,829	85,401	88,650	92,190	100,720	106,707
Gross profit	23,019	21,228	9,717	10,653	10,165	12,000	17,468	21,389
Gross margin(%)	25%	22%	12%	12%	11%	13%	17%	20%
Op profit	17,751	15,255	4,398	5,102	4,402	6,008	10,921	14,453
Op margin (%)	19%	16%	5%	6%	5%	7%	11%	14%
Net profit	15,204	13,808	2,723	3,479	2,869	4,614	8,808	12,093
Net margin (%)	17%	14%	3%	4%	3%	5%	9%	11%
Net EPS (NT\$)	2.08	1.89	0.37	0.48	0.39	0.63	1.21	1.66
Annual EPS (NT\$)				4.82				3.90
New forecast								
Revenue	93,312	96,875	83,673	74,103	64,592	70,910	83,670	92,733
Gross profit	23,270	21,533	10,014	1,837	-292	2,387	8,234	13,553
Gross margin(%)	25%	22%	12%	2%	0%	3%	10%	15%
Op profit	17,853	15,415	4,575	-2,980	-4,491	-2,222	2,796	7,525
Op margin (%)	19%	16%	5%	-4%	-7%	-3%	3%	8%
Net profit	15,422	13,820	2,748	-4,259	-5,772	-3,405	972	5,371
Net margin (%)	17%	14%	3%	-6%	-9%	-5%	1%	6%
Net EPS (NT\$)	2.11	1.89	0.38	-0.58	-0.80	-0.47	0.13	0.74
Annual EPS (NT\$)				3.80				-0.39
Bloomberg EPS			0.20	-0.31	(0.79)	(0.69)	0.12	0.74
% Revision								
Sales	1%	1%	2%	-13%	-27%	-23%	-17%	-13%
Gross profit	1%	1%	3%	-83%	nm	-80%	-53%	-37%
Op profit	1%	1%	4%	nm	nm	nm	-74%	-48%
Net profit	1%	0%	1%	nm	nm	nm	-89%	-56%
Annual EPS				-21%				nm

Source: Company Reports and Citi Investment Research estimates

Figure 3. CMO Quarterly Income Statement

	2007					2008E					2009E					2010E					FYE '10
	FYE '06	1Q	2Q	3Q	4Q	FYE '07	1QA	2QA	3Q	4Q	FYE '08	1Q	2Q	3Q	4Q	FYE '09	1Q	2Q	3Q	4Q	
NET REVENUES	187,052	47,095	61,099	88,209	106,070	302,473	93,312	96,875	83,673	74,103	347,963	64,592	70,910	83,670	92,733	311,904	85,779	88,470	86,958	83,568	344,775
Depreciation	-33,113	-9,800	-11,145	-12,300	-13,863	-47,108	-15,156	-16,384	-16,762	-17,430	-65,732	-17,086	-18,177	-18,540	-18,904	-72,707	-18,466	-19,644	-20,037	-20,430	-78,577
Other cost of good sold	-132,303	-33,269	-40,696	-54,548	-63,453	-191,966	-54,886	-58,958	-56,897	-54,836	-225,578	-47,798	-50,346	-56,896	-60,276	-215,315	-54,041	-57,506	-60,001	-59,333	-230,880
GROSS PROFIT	21,636	4,026	9,258	21,361	28,754	63,399	23,270	21,533	10,014	1,837	56,654	-292	2,387	8,234	13,553	23,882	13,273	11,320	6,920	3,805	35,318
R&D	-5,232	-1,521	-2,200	-2,200	-2,350	-8,271	-1,907	-2,035	-2,092	-1,853	-7,887	-1,615	-1,773	-2,092	-2,318	-7,798	-2,144	-2,212	-2,174	-2,089	-8,619
SG&A	-8,291	-1,900	-2,630	-2,678	-3,684	-10,892	-3,511	-4,082	-3,347	-2,964	-13,904	-2,584	-2,836	-3,347	-3,709	-12,476	-3,431	-3,096	-3,044	-2,925	-12,496
Operating expenses	-13,523	-3,421	-4,830	-4,878	-6,034	-19,163	-5,418	-6,118	-5,439	-4,817	-21,791	-4,198	-4,609	-5,439	-6,028	-20,274	-5,576	-5,308	-5,217	-5,014	-21,115
OPERATING INCOME	8,113	606	4,428	16,483	22,720	44,236	17,853	15,415	4,575	-2,980	34,863	-4,491	-2,222	2,796	7,525	3,608	7,697	6,012	1,702	-1,209	14,202
Int&other inc/(exp)	-4,567	-1,708	-1,108	-2,175	-909	-5,900	-1,544	-871	-1,651	-1,551	-5,616	-1,650	-1,400	-1,750	-1,750	-6,550	-1,650	-1,400	-1,750	-1,750	-6,550
PRETAX INCOME	3,546	-1,103	3,320	14,308	21,811	38,336	16,309	14,545	2,924	-4,531	29,247	-6,141	-3,622	1,046	5,775	-2,942	6,047	4,612	-48	-2,959	7,652
NET INCOME BEF PRE DIV	3,543	-1,104	3,316	13,724	20,236	36,171	15,422	13,820	2,748	-4,259	27,731	-5,772	-3,405	972	5,371	-2,834	5,684	4,335	-44	-2,752	7,223
NET EPS IN NT\$	0.43	-0.17	0.45	1.91	2.82	5.01	2.11	1.89	0.38	-0.58	3.80	-0.80	-0.47	0.13	0.74	-0.39	0.78	0.60	-0.01	-0.38	1.00
Operating Ratios																					
Gross margins	12%	9%	15%	24%	27%	21%	25%	22%	12%	2%	16%	0%	3%	10%	15%	8%	15%	13%	8%	5%	10%
Operating margin	4%	1%	7%	19%	21%	15%	19%	16%	5%	-4%	10%	-7%	-3%	3%	8%	1%	9%	7%	2%	-1%	4%
Pre-tax margin	2%	-2%	5%	16%	21%	13%	17%	15%	3%	-6%	8%	-10%	-5%	1%	6%	-1%	7%	5%	0%	-4%	2%
Net margin	2%	-2%	5%	16%	19%	12%	17%	14%	3%	-6%	8%	-9%	-5%	1%	6%	-1%	7%	5%	0%	-3%	2%
Year-to-Year %																					
Net revenues	22%	0%	68%	83%	92%	62%	98%	59%	-5%	-30%	15%	-31%	-27%	0%	25%	-10%	33%	25%	4%	-10%	11%
Gross profit	9%	-60%	171%	872%	379%	193%	478%	133%	-53%	-94%	-11%	N/A	-89%	-18%	638%	-58%	N/A	374%	-16%	-72%	48%
Operating income	-21%	-92%	875%	N/A	1657%	445%	2848%	248%	-72%	N/A	-21%	N/A	N/A	-39%	N/A	-90%	N/A	N/A	-39%	N/A	294%
Pretax income	-55%	N/A	N/A	N/A	4892%	981%	N/A	338%	-80%	N/A	-24%	N/A	N/A	-64%	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Net income	-56%	N/A	N/A	N/A	4543%	921%	N/A	317%	-80%	N/A	-23%	N/A	N/A	-65%	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Qtr-to-Qtr %																					
Net revenues		-15%	30%	44%	20%		-12%	4%	-14%	-11%		-13%	10%	18%	11%		-7%	3%	-2%	-4%	
Gross profit		-33%	130%	131%	35%		-19%	-7%	-53%	-82%		N/A	N/A	245%	65%		-2%	-15%	-39%	-45%	
Operating income		-53%	631%	272%	38%		-21%	-14%	-70%	N/A		N/A	N/A	N/A	169%		2%	-22%	-72%	N/A	
Net income		N/A	N/A	314%	47%		-24%	-10%	-80%	N/A		N/A	N/A	N/A	452%		6%	-24%	N/A	N/A	

Source: Company Reports and Citi Investment Research estimates

Chi Mei Opto

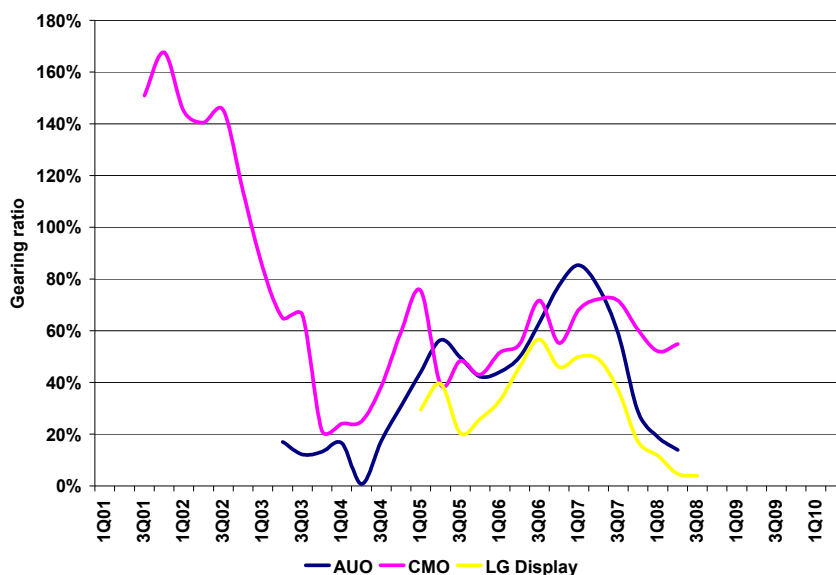
Company description

Established in December 1997 and listed in late August 2002, Chi Mei Optoelectronics (CMO) is the second-largest TFT LCD panel manufacturer in Taiwan, and is a subsidiary of the Chi Mei Group.

Investment strategy

Despite CMO already breaking below its prior trailing trough P/BV, we rate CMO Sell (3) with a target price of NT\$15 as we believe it brings greater downside risks to investors by carrying higher gearing ratio, weaker FCF yield, and larger book value contraction. Company specific concerns: 1) CMO has much higher net debt to equity ratio of 50-55% vs. AUO/LGD's 10% level, suggesting larger refinancing risks; 2) By spending higher capex without better ROE/ROA, CMO reported gross FCF margin of -18% vs. AUO/LGD's -5% in the past five years and likely to remain for the next three years; 3) We estimate larger book value contraction for CMO than AUO for the next 2-3 quarters.

Gearing ratio comparison



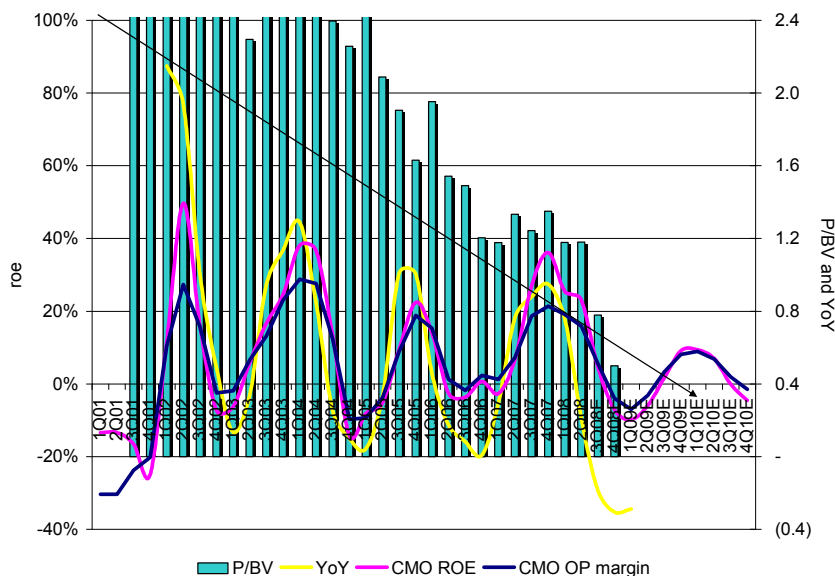
Source: Company Reports and CIR Estimates

Valuation

Our NT\$15 target price or nearly 0.5x 2008-2010E book factors in 2-3 quarters of losses. We use P/B as our primary valuation method due to the earnings volatility in the sector. Over the past five years, CMO traded at 1.5x average trailing book with an average ROE of 10%. Given we expect CMO's ROE to

contract to 4-5% for the next 5 years, we expect long-term average P/BV to come down to 0.5-0.7x from 1.5x by assuming a similar P/BV to ROE ratio. However, if CMO can improve its free cash flow position and do better capital management to improve its long-term ROE back to 10-12% level, we are not ruling out a likely re-rating. But, till now, we do not see this.

CMO – P/BV, YoY sales, ROE, and Op margin comparison



Source: Company Reports and CIR Estimates

Risks

We rate CMO shares Low Risk based on our quantitative risk-rating system, which tracks historical 260-day share price volatility. Upside risks that could prevent the shares from reaching our target price are) Stronger-than-expected panel price recovery; 2) a dramatic cut in capex to improve its FCF and to lower its net debt to equity ratio; and 3) Share gains from competitors like LGD and AUO.

Appendix A-1

Analyst Certification

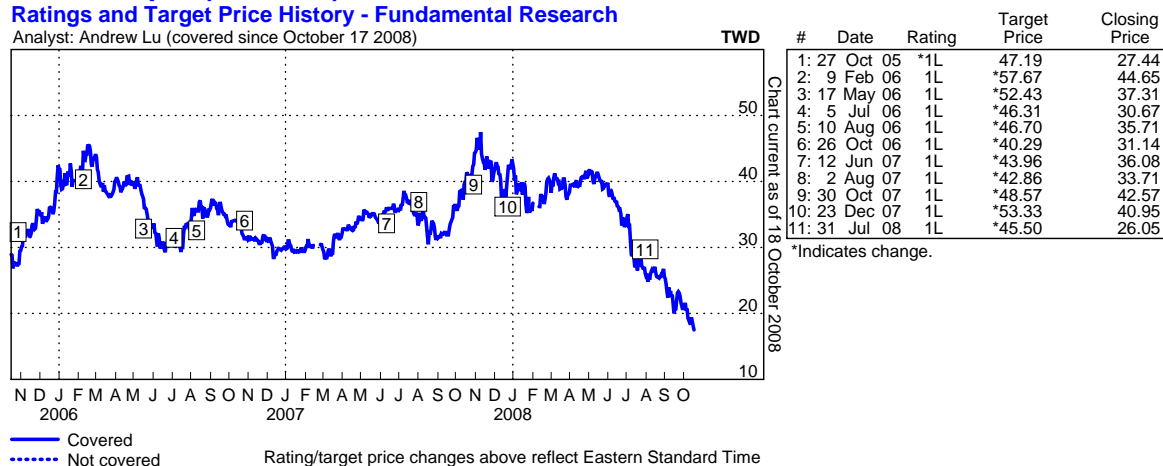
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Chi Mei Opto (3009.TW)

Ratings and Target Price History - Fundamental Research

Analyst: Andrew Lu (covered since October 17 2008)



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Data current as of 30 September 2008

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