Flashnote

HSBC
Global Research

Telecoms, Media & Technology
Electrical Equipment
Equity – Taiwan

Largan Precision (3008)

Neutral (V)

Target price (TWD)	300
Share price (TWD)	297
Potential total return (%)	4

Performance	1M	3M	12M
Absolute (%)	-19.7	-19.4	-21.9
Relative^ (%)	-2.8	11.3	52.2

Index^	TAIWAN WEIGHTED INDEX
RIC	3008.TW
Bloomberg	3008 TT
Market cap (USDm)	1,186
Market cap (TWDm)	38,650
Enterprise value (TWDm)	33733
Free float (%)	77

Note: (V) = volatile (please see disclosure appendix)

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Remain N(V): Don't expect typical Christmas season

- **3Q08 results in line with our estimates if excluding one-time disposal gain and FX impact**
- **However, we don't expect the typical Christmas season on rising uncertainty in November-December**
- **Neutral (V) and TWD300 target price unchanged**

Don't expect Christmas selling season this year, based on the rising order uncertainty for the next two months. This corresponds to our estimate of 3% qoq global shipment growth for 4Q, much lower than the historical average of 15-20%.

3Q08 results in line. 3Q net income was in line with our estimate (5% higher), if one excludes the one-time disposal gain and foreign exchange gains on the stronger US dollar. Gross margin of 54.6% slightly exceeded our 53% largely due to the stronger US currency, yield enhancement and improving product mix (more 3MP products). Even so, we expect margin pressure (down to 49%) in 2009 under negative global handset shipment growth.

Migration to 3MP is a definite trend. We believe the handset models that are "stuck-in-the-middle" will suffer the most in the slowing global economy. Handset vendors have to provide either cheap entry-level phones for new subscribers or enhance phone specifications to stimulate replacement demand. As 2 mega-pixel (MP) is already the mainstream for this year, we believe migration to 3MP is a must for mid- to high-end phones. Therefore, we estimate 3MP+ products will account for 25% of 2009 overall shipments, up from only 10% this year.

Neutral (V) and TWD300 target price unchanged. Largan is the most expensive handset stock currently and is trading at a premium to other handset players (12x 2009e EPS vs. other handset players at 8-10x). In addition, we forecast 3% yoy earnings decline in 2009. Our channel checks indicate that handset vendors will implement VGA lenses using wafer-level camera module technology in 2H09 on a large scale, which is negative for Largan.

Largan Precision – forecasts (2007-10)

(TWD m)	2007a	2008e	2009e	2010e
Revenue	5,882	8,008	8,336	9,368
Net profit	2,570	2,918	2,819	2,972
EPS (TWD)	20.44	23.21	22.42	23.64
PE (x)	14.5	12.8	13.2	12.6
PB (x)	3.7	3.2	2.8	2.5

Source: Company data, HSBC estimates

3Q08 results (post-bonus expense)

Largan Precision – 3Q08 results

	Actual TWD m	Actual % qoq	Actual % yoy	HSBC	Diff %	Comments
Revenues	2,159	14.6%	54.2%	2,152	0.3%	
Gross profit	1,179	16.9%	53.6%	1,141	3.4%	
Gross margin (%)	54.6%			53.0%		Higher gross margin due to 1) stronger USD, 2) higher yield rates on 3MP products, 3) improving product mix (more 3MP)
Operating profit	925	14.7%	38.4%	886	4.4%	
Operating margin (%)	42.8%			41.2%		
Pre-tax profit	1,134	38.1%	62.7%	885	28.1%	For non-operating income, interest income and gains from disposal of investment accounted for around TWD50m; unrealized and realized FX gains about TWD150m
Net profit	1,133	56.9%	72.7%	779	45.4%	
EPS (TWD)	8.70	51.5%	66.8%	5.99	45.4%	

Source: Company data, HSBC estimates

Largan Precision – 3Q08 and 4Q08e preview

(TWD m)	3Q08 Previous	3Q08 Actual	3Q08 Consensus	4Q08e Previous	4Q08e New	4Q08e Consensus
Revenue	2,152	2,159	2,138	2,259	2,259	2,334
Diff		0.3%	1.0%		0.0%	-5.1%
Gross margin	53.0%	54.6%		53.7%	53.7%	
Op margin	41.2%	42.8%	42.9%	41.9%	41.9%	44.2%
EPS	5.99	8.71	6.76	6.40	6.40	7.41
Diff		45.4%	28.8%		0.0%	-12.3%

Source: Company data, HSBC estimates, Reuters consensus

Valuation and risks

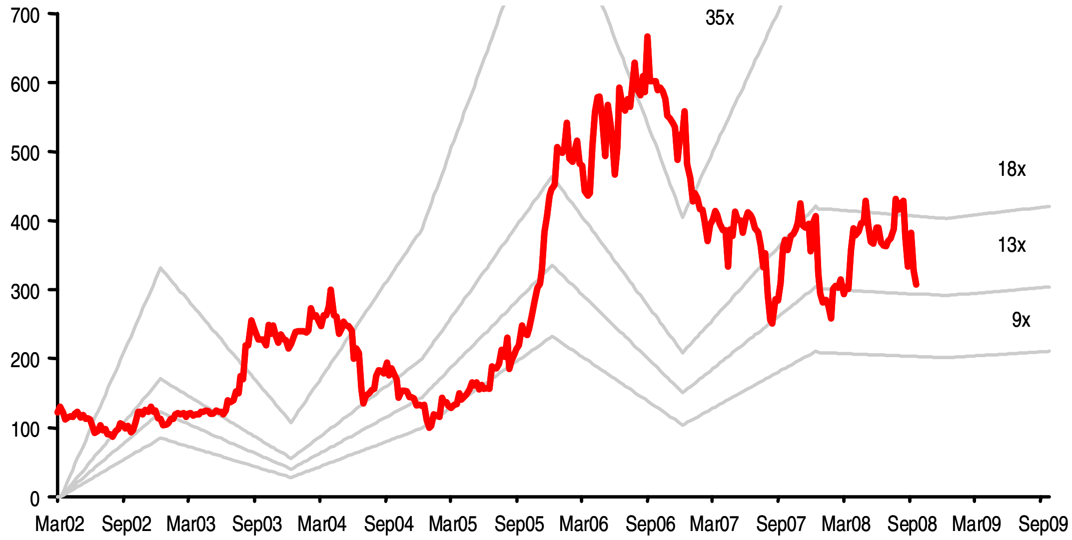
Our DCF-based target price is TWD300, based on a WACC of 11.8% and terminal growth of 3.5%. This translates to 13x 2009e EPS, compared to its historical PE range of 9-35x.

Under our research model, for stocks with a volatility indicator, the Neutral band is 10 percentage points above and below the hurdle rate for Taiwan stocks of 10%. For Largan, this translates into a Neutral band of 0-20% around the current share price. Our target price implies a total return (including dividend yield) of 4.11%; thus, we remain Neutral (V) on Largan.

Upside risks include: 1) faster-than-expected migration on 5MP lenses, 2) higher-than-expected order volume for 3MP products, and 3) stronger than expected gross margin expansion on high utilization rate and better mix.

Downside risks include: 1) faster-than-expected penetration of wafer-level camera module would impact Largan's sales and margins, and 2) worse-than-expected global handset shipments for the next year.

Largan forward PE band



Source: TEJ, HSBC estimates

Financials & valuation

Financial statements

Year to	12/2007a	12/2008e	12/2009e	12/2010e
Profit & loss summary (TWDm)				
Revenue	5,882	8,008	8,336	9,368
EBITDA	3,468	3,952	3,793	4,044
Depreciation & amortisation	-551	-577	-619	-660
Operating profit/EBIT	2,917	3,376	3,174	3,384
Net interest	54	0	0	0
PBT	3,066	3,146	3,203	3,377
HSBC PBT	3,066	3,146	3,203	3,377
Taxation	-432	-228	-384	-405
Net profit	2,634	2,918	2,819	2,972
HSBC net profit	2,634	2,918	2,819	2,972
Cash flow summary (TWDm)				
Cash flow from operations	3,619	2,772	3,300	3,632
Capex	-720	-881	-917	-1,031
Cash flow from investment	-717	-881	-917	-1,031
Dividends	-1,383	-1,156	-1,313	-1,268
Change in net debt	-1,310	-520	-1,070	-967
FCF equity	2,703	2,121	2,354	2,608
Balance sheet summary (TWDm)				
Intangible fixed assets	0	0	0	0
Tangible fixed assets	4,163	4,467	4,765	5,136
Current assets	6,715	8,146	9,445	10,907
Cash & others	4,216	4,736	5,806	6,773
Total assets	11,172	12,907	14,504	16,337
Operating liabilities	1,027	1,216	1,307	1,437
Gross debt	24	24	24	24
Net debt	-4,192	-4,711	-5,782	-6,748
Shareholders funds	10,121	11,667	13,172	14,876
Invested capital	5,635	6,662	7,097	7,834

Ratio, growth and per share analysis

Year to	12/2007a	12/2008e	12/2009e	12/2010e
Y-o-y % change				
Revenue	-19.9	36.1	4.1	12.4
EBITDA	-25.0	13.9	-4.0	6.6
Operating profit	-29.1	15.7	-6.0	6.6
PBT	-26.4	2.6	1.8	5.4
HSBC EPS	-34.7	10.8	-3.4	5.4
Ratios (%)				
Revenue/IC (x)	1.0	1.3	1.2	1.3
ROIC	43.2	50.9	40.6	39.9
ROE	27.3	26.8	22.7	21.2
ROA	24.5	24.2	20.6	19.3
EBITDA margin	59.0	49.4	45.5	43.2
Operating profit margin	49.6	42.2	38.1	36.1
EBITDA/net interest (x)				
Net debt/equity	-41.4	-40.4	-43.9	-45.4
Net debt/EBITDA (x)	-1.2	-1.2	-1.5	-1.7
CF from operations/net debt				
Per share data (TWD)				
EPS reported (fully diluted)	20.95	23.21	22.42	23.64
HSBC EPS (fully diluted)	20.95	23.21	22.42	23.64
DPS	11.00	9.20	10.44	10.09
NAV	80.50	92.80	104.78	118.33

Key forecast drivers

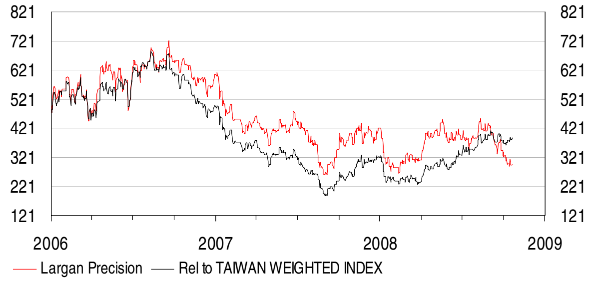
Year to	12/2007a	12/2008e	12/2009e	12/2010e
Global handset shipments	1,137	1,228	1,282	1,360
Parent sales (TWDm)	4,160	7,076	8,336	8,485
China operation sales (TWDm)	1,723	932	0	0

Valuation data

Year to	12/2007a	12/2008e	12/2009e	12/2010e
EV/sales	5.8	4.2	3.9	3.4
EV/EBITDA	9.9	8.5	8.6	7.8
EV/IC	6.1	5.1	4.6	4.0
PE*	14.2	12.8	13.2	12.6
P/NAV	3.7	3.2	2.8	2.5
FCF yield (%)	7.0	5.5	6.1	6.8
Dividend yield (%)	3.7	3.1	3.5	3.4

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 20 Oct 2008

Disclosure appendix

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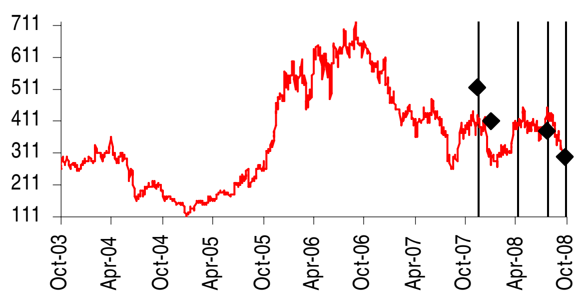
Underweight (Sell)	17%	(23% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Largan Precision (3008.TW) Share Price performance TWD Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Overweight (V)	05 December 2007
Overweight (V)	Neutral (V)	22 April 2008
Neutral (V)	Underweight (V)	12 August 2008
Underweight (V)	Neutral (V)	14 October 2008
Target Price	**Value**	**Date**
Price 1	519.61	05 December 2007
Price 2	411.76	22 January 2008
Price 3	380.00	12 August 2008
Price 4	300.00	14 October 2008

Source: HSBC

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