



COMPANY UPDATE
Merry Electronics (2439.TW)

Neutral

Trough valuation with upcoming trough growth cycle; keep Neutral

What's changed

Merry reported strong 3Q08 preliminary results with EPS of NT\$1.65 beating GSe/consensus by 22%/26%, but the major upside came from the lower than expected tax rate (due to tax benefits from setting headquarters in Taiwan). Merry's strong cost control sent its EBIT margin to a 4-quarter high at 10.4%, but we noticed that its 3Q08 GM was just roughly flat qoq against the backdrop of a new hands-free model launch and strong NTD depreciation. Management did not provide guidance for 4Q08.

Implications

While Merry delivered solid profitability against a top-line guidance miss in 3Q08, we are still a bit disappointed not to see Merry expanding its GM qoq. As the handset supply chain will face much more pricing pressure going forward due to increasing cost-down requests from OEMs, we believe Merry enjoys less pricing power to defend margins when its main product line, hands-free devices, faces severe competition from the Greater China area and has relatively low entry barriers. We expect Merry to see lackluster top-line growth in the next few quarters, and 2008-2009 could mark the first trough growing cycle since 2001. We see potential near-term share price upside post solid 3Q08 results and recent severe share price correction of 31% in the past month, but we would not be a long-term structural buyer until we see Merry's successful entry into the acoustic component area being more margin-accretive. Maintain Neutral.

Valuation

We are revising our EPS estimates: 2008 up 6%, 2009-2010 down 9%-12%. We lower our DCF-based 12-month target price, based on reduced estimates, to NT\$36 (from NT\$50), implying 7.5X NTM EPS. We believe it will be difficult for Merry to have any strong catalysts drive the shares' re-rating in the near term.

Key risks

Intensified pricing competition; slower global handset shipments.

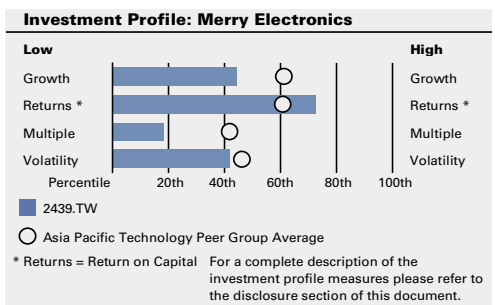
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Coverage View: Neutral

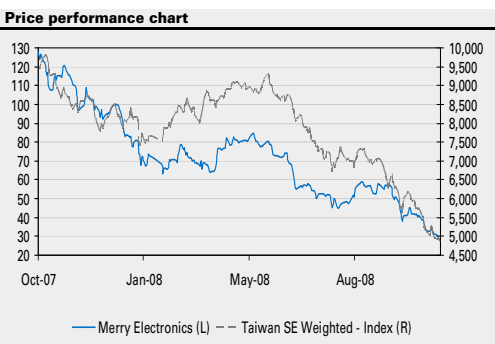
Taiwan:
 Hardware

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Key data	Current
Price (NT\$)	28.20
12 month price target (NT\$)	36.00
Market cap (NT\$ mn / US\$ mn)	4,486.3 / 137.2
Foreign ownership (%)	17.9

	12/07	12/08E	12/09E	12/10E
EPS (NT\$) New	5.65	4.81	4.72	5.12
EPS revision (%)	0.0	6.6	(11.9)	(9.0)
EPS growth (%)	18.3	(14.8)	(1.9)	8.5
EPS (dil) (NT\$) New	5.65	4.81	4.72	5.12
P/E (X)	5.0	5.9	6.0	5.5
P/B (X)	1.0	1.2	1.1	1.0
EV/EBITDA (X)	11.8	3.7	4.0	3.6
Dividend yield (%)	9.6	15.2	12.6	12.7
ROE (%)	20.9	18.2	18.9	19.2



Share price performance (%)	3 month	6 month	12 month
Absolute	(37.3)	(64.5)	(77.4)
Rel. to Taiwan SE Weighted Index	(8.9)	(34.1)	(56.6)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 10/22/2008 close.

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Exhibit 1: Merry's 3Q08 preliminary results beat our forecast by 22% due to lower opex and tax rate

Reported P&L

Merry Electronics (2439.TW) Summary P&L (NT\$m)	3Q2008 GAAP			2Q2008 (QoQ)		3Q2007 (YoY)	
	Actual	GS est.	Diff (%)	Actual	%	Actual	%
Revenues	2,563	2,663	-4%	2,156	19%	2,375	8%
Gross profits	518	540	-4%	437	18%	554	-6%
Operating profits	267	244	9%	185	53%	332	-15%
Non-operating income	(13)	6	-309%	(1)	1560%	(8)	59%
Pretax earnings	253	250	1%	185	46%	323	-17%
Net earnings	262	214	22%	175	59%	262	6%
EPS (NT\$)	1.65	1.35	22%	1.10	59%	1.65	6%
Ratio analysis							
Gross margin (%)	20.2%	20.3%		20.3%		23.3%	
EBIT margin (%)	10.4%	9.2%		8.6%		14.0%	
Tax expense (as % of EBT)	-3.5%	14.5%		5.0%		18.9%	
Net margin (%)	10.2%	8.0%		8.1%		11.0%	
Return analysis							
ROA (% , annualized)	13.8%	9.3%		9.7%		15.0%	
ROE (% , annualized)	27.7%	16.5%		17.2%		25.9%	

Source: Company data, Goldman Sachs Research estimates.

Exhibit 2: We are revising our 2008-2010 EPS forecast post 3Q08 results

Upper table: non-GAAP; bottom table: GAAP

Merry Electronics (2439.TW)

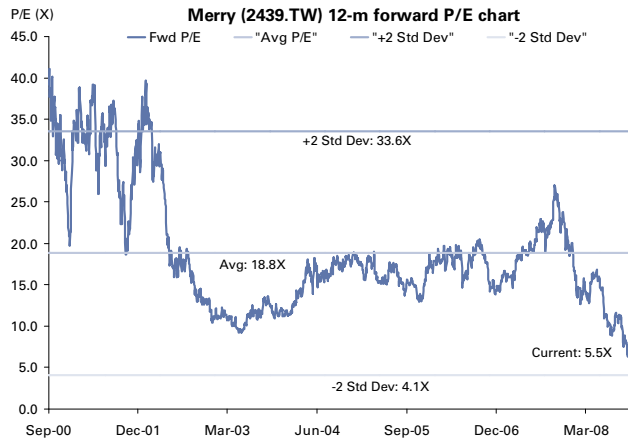
P&L (non-GAAP, NT\$m)	2008E New	2008E Old	Diff.	2009E New	2009E Old	Diff.	2010E New	2010E Old	Diff.
Revenues	9,528	10,050	-5%	9,908	11,453	-13%	11,160	12,591	-11%
Gross profits	1,854	1,962	-5%	1,882	2,191	-14%	2,050	2,322	-12%
Operating profits	919	920	0%	877	1,078	-19%	977	1,179	-17%
Non-operating income	(52)	(33)	NM	28	27	1%	27	25	4%
Pretax earnings	866	888	-2%	905	1,105	-18%	1,004	1,205	-17%
Net earnings	791	768	3%	816	922	-12%	885	966	-8%
EPS (fully diluted, NT\$)	4.98	4.83	3%	5.13	5.80	-12%	5.56	6.08	-8%
Ratio analysis									
Gross margin (%)	19.5%	19.5%		19.0%	19.1%		18.4%	18.4%	
EBIT margin (%)	9.6%	9.2%		8.8%	9.4%		8.8%	9.4%	
Tax expense (as % of EBT)	8.6%	13.5%		9.8%	16.5%		11.8%	19.8%	
Net margin (%)	8.3%	7.6%		8.2%	8.1%		7.9%	7.7%	
Return analysis									
ROA (% , annualized)	10.2%	9.8%		10.0%	11.1%		10.0%	10.6%	
ROE (% , annualized)	18.8%	18.4%		20.6%	23.1%		20.8%	22.3%	

Merry Electronics (2439.TW)

P&L (GAAP, NT\$m)	2008E New	2008E Old	Diff.	2009E New	2009E Old	Diff.	2010E New	2010E Old	Diff.
Revenues	9,528	10,050	-5%	9,908	11,453	-13%	11,160	12,591	-11%
Gross profits	1,854	1,962	-5%	1,882	2,191	-14%	2,050	2,322	-12%
Operating profits	870	869	0%	811	1,004	-19%	906	1,102	-18%
Non-operating income	(52)	(33)	NM	28	27	1%	27	25	4%
Pretax earnings	817	836	-2%	839	1,031	-19%	933	1,127	-17%
Net earnings	766	718	7%	752	853	-12%	815	895	-9%
EPS (fully diluted, NT\$)	4.81	4.52	7%	4.72	5.36	-12%	5.12	5.63	-9%
Ratio analysis									
Gross margin (%)	19.5%	19.5%		19.0%	19.1%		18.4%	18.4%	
EBIT margin (%)	9.1%	8.6%		8.2%	8.8%		8.1%	8.8%	
Tax expense (as % of EBT)	6.3%	14.1%		10.5%	17.3%		12.6%	20.6%	
Net margin (%)	8.0%	7.1%		7.6%	7.5%		7.3%	7.1%	
Return analysis									
ROA (% , annualized)	9.8%	9.1%		9.2%	10.3%		9.2%	9.8%	
ROE (% , annualized)	18.2%	17.2%		18.9%	21.4%		19.2%	20.6%	

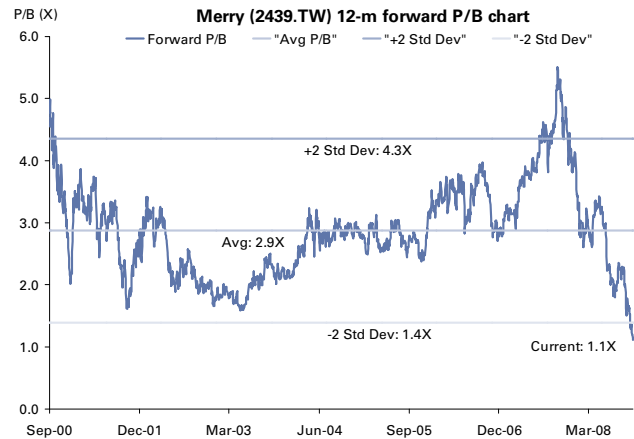
Source: Company data, Goldman Sachs Research estimates.

Exhibit 3: Merry's historical P/E chart



Source: Datastream, company data, Goldman Sachs Research estimates.

Exhibit 4: Merry's historical P/B chart



Source: Datastream, company data, Goldman Sachs Research estimates.

Exhibit 5: Merry's quarterly profit model (consolidated; NT\$ mn)

Non-GAAP basis

Summary P&L (non-GAAP)	4Q2007	1Q2008	2Q2008	3Q2008	4Q2008E	1Q2009E	2Q2009E	3Q2009E	2007	2008E	2009E	2010E
Net sales	2,504	2,181	2,156	2,563	2,629	2,255	2,254	2,587	8,845	9,528	9,908	11,160
Cost of good sold (COGS)	(2,026)	(1,807)	(1,718)	(2,044)	(2,104)	(1,819)	(1,825)	(2,102)	(6,838)	(7,673)	(8,026)	(9,111)
Gross profits	478	373	437	518	525	436	428	484	2,007	1,854	1,882	2,050
Operating expenses	(244)	(215)	(245)	(235)	(241)	(245)	(238)	(259)	(870)	(936)	(1,005)	(1,073)
SG&A	(131)	(133)	(167)	(181)	(184)	(186)	(179)	(195)	(555)	(665)	(759)	(808)
R&D	(114)	(82)	(77)	(54)	(57)	(59)	(59)	(64)	(314)	(271)	(246)	(265)
Operating profits	234	159	193	283	284	191	190	225	1,138	919	877	977
Non-operating income/(loss)	(67)	(44)	(1)	(13)	6	7	8	7	(69)	(52)	28	27
Earnings before tax (EBT)	167	114	192	270	290	198	198	232	1,068	866	905	1,004
Income tax credit/(expense)	(38)	(20)	(11)	9	(31)	(18)	(19)	(24)	(175)	(53)	(89)	(119)
Extraordinary gain/(loss)	-	-	-	-	-	-	-	-	-	-	-	-
Minority Interests	2	0	2	-	-	-	-	-	3	3	-	-
Earnings after tax (EAT)	131	94	184	278	259	180	179	209	896	816	816	885
EPS (NT\$)	0.82	0.59	1.15	1.75	1.63	1.13	1.12	1.31	5.65	4.98	5.13	5.56
EPS (NT\$, fully diluted)	0.82	0.59	1.15	1.75	1.63	1.13	1.12	1.31	5.65	4.98	5.13	5.56
Ratio analysis and assumptions												
As % of sales												
Gross margin	19.1%	17.1%	20.3%	20.2%	20.0%	19.3%	19.0%	18.7%	22.7%	19.5%	19.0%	18.4%
Operating expense ratio	-9.8%	-9.9%	-11.4%	-9.2%	-9.2%	-10.9%	-10.6%	-10.0%	-9.8%	-9.8%	-10.1%	-9.6%
Operating margin	9.3%	7.3%	8.9%	11.0%	10.8%	8.5%	8.5%	8.7%	12.9%	9.6%	8.8%	8.8%
Pre-tax margin	6.7%	5.2%	8.9%	10.5%	11.0%	8.8%	8.8%	9.0%	12.1%	9.1%	9.1%	9.0%
Tax rate (as % of EBT)	22.8%	17.8%	5.6%	-3.3%	10.7%	9.2%	9.8%	10.1%	16.4%	6.2%	9.8%	11.8%
Net margin	5.2%	4.3%	8.5%	10.9%	9.9%	8.0%	7.9%	8.1%	10.1%	8.6%	8.2%	7.9%
Qoq growth (%)												
Sales	5.4%	-12.9%	-1.2%	18.9%	2.6%	-14.2%	-0.1%	14.8%				
Gross profits	-13.7%	-21.9%	17.2%	18.5%	1.3%	-17.0%	-1.8%	13.1%				
Operating profits	-29.6%	-32.1%	21.6%	46.9%	0.4%	-32.8%	-0.3%	18.4%				
Non-operating profits	NM	NM	NM	NM	NM	18.6%	5.5%	-8.3%				
Pre-tax profits	-48.3%	-31.4%	67.7%	40.5%	7.7%	-31.7%	-0.1%	17.4%				
Net profits	-50.0%	-27.8%	94.4%	51.7%	-6.9%	-30.6%	-0.7%	16.9%				
EPS (weighted averaged)	-50.0%	-28.1%	94.4%	51.7%	-6.9%	-30.6%	-0.7%	16.9%				
Yoq growth (%)												
Sales	35.2%	14.0%	4.9%	7.9%	5.0%	3.4%	4.6%	0.9%	50.1%	7.7%	4.0%	12.6%
Gross profits	4.8%	-19.2%	-14.8%	-6.4%	9.9%	16.8%	-2.1%	-6.5%	25.4%	-7.6%	1.5%	8.9%
Operating profits	-1.2%	-41.9%	-35.7%	-14.6%	21.8%	20.5%	-1.2%	-20.4%	23.3%	-19.3%	-4.6%	11.4%
Non-operating profits	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	-4.5%
Pre-tax profits	-22.1%	-58.4%	-36.6%	-16.6%	73.9%	73.1%	3.1%	-13.8%	19.1%	-18.9%	4.4%	11.0%
Net profits	-22.1%	-60.7%	-30.4%	6.3%	98.1%	90.5%	-2.7%	-25.0%	18.9%	-9.0%	0.0%	8.4%
EPS	-22.6%	-60.8%	-30.6%	6.0%	97.5%	90.5%	-2.7%	-25.0%	18.3%	-12.0%	3.1%	8.4%
Dividend policies												
Cash dividends (NT\$ per share)									2.70	4.28	3.55	3.59
Payout ratio (%)									56.9%	76.0%	73.7%	76.0%

Source: Company data, Goldman Sachs Research estimates.

Exhibit 6: Merry's quarterly profit model (consolidated; NT\$m)

GAAP basis

Summary P&L (GAAP)	4Q2007	1Q2008	2Q2008	3Q2008	4Q2008E	1Q2009E	2Q2009E	3Q2009E	2007	2008E	2009E	2010E
Net sales	2,504	2,181	2,156	2,563	2,629	2,255	2,254	2,587	8,845	9,528	9,908	11,160
Cost of good sold (COGS)	(2,026)	(1,807)	(1,718)	(2,044)	(2,104)	(1,819)	(1,825)	(2,102)	(6,838)	(7,673)	(8,026)	(9,111)
Gross profits	478	373	437	518	525	436	428	484	2,007	1,854	1,882	2,050
Operating expenses	(266)	(219)	(252)	(252)	(262)	(259)	(252)	(276)	(1,014)	(985)	(1,071)	(1,143)
SG&A	(138)	(134)	(170)	(187)	(191)	(191)	(184)	(201)	(606)	(682)	(782)	(833)
R&D	(127)	(85)	(82)	(64)	(71)	(68)	(68)	(75)	(408)	(303)	(288)	(311)
Operating profits	212	154	185	267	264	177	176	209	993	870	811	906
Non-operating income/(loss)	(67)	(44)	(1)	(13)	6	7	8	7	(69)	(52)	28	27
Earnings before tax (EBT)	146	110	185	253	270	184	184	216	924	817	839	933
Income tax credit/(expense)	(37)	(20)	(12)	8	(31)	(18)	(19)	(23)	(162)	(54)	(88)	(118)
Extraordinary gain/(loss)	-	-	-	-	-	-	-	-	-	-	-	-
Minority interests	2	0	2	-	-	-	-	-	3	3	-	-
Earnings after tax (EAT)	111	90	175	262	239	166	165	192	765	766	752	815
EPS (NT\$)	0.70	0.57	1.10	1.64	1.50	1.04	1.03	1.21	4.82	4.81	4.72	5.12
EPS (NT\$, fully diluted)	0.70	0.57	1.10	1.64	1.50	1.04	1.03	1.21	4.82	4.81	4.72	5.12
Ratio analysis and assumptions												
As % of sales												
Gross margin	19.1%	17.1%	20.3%	20.2%	20.0%	19.3%	19.0%	18.7%	22.7%	19.5%	19.0%	18.4%
Operating expense ratio	-10.6%	-10.1%	-11.7%	-9.8%	-10.0%	-11.5%	-11.2%	-10.7%	-11.5%	-10.3%	-10.8%	-10.2%
Operating margin	8.5%	7.1%	8.6%	10.4%	10.0%	7.8%	7.8%	8.1%	11.2%	9.1%	8.2%	8.1%
Pre-tax margin	5.8%	5.0%	8.6%	9.9%	10.3%	8.1%	8.1%	8.3%	10.4%	8.6%	8.5%	8.4%
Tax rate (as % of EBT)	25.4%	18.4%	6.2%	-3.3%	11.5%	9.8%	10.4%	10.8%	17.6%	6.6%	10.5%	12.6%
Net margin	4.4%	4.1%	8.1%	10.2%	9.1%	7.3%	7.3%	7.4%	8.6%	8.0%	7.6%	7.3%
QoQ growth (%)												
Sales	5.4%	-12.9%	-1.2%	18.9%	2.6%	-14.2%	-0.1%	14.8%				
Gross profits	-13.7%	-21.9%	17.2%	18.5%	1.3%	-17.0%	-1.8%	13.1%				
Operating profits	-26.6%	-27.5%	20.4%	43.9%	-1.2%	-33.0%	-0.3%	18.5%				
Non-operating profits	NM	NM	NM	NM	NM	18.6%	5.5%	-8.3%				
Pre-tax profits	-48.1%	-24.7%	67.9%	37.2%	6.5%	-31.8%	-0.1%	17.4%				
Net profits	-51.3%	-18.7%	94.7%	49.1%	-8.7%	-30.6%	-0.7%	16.9%				
EPS (weighted averaged)	-51.3%	-18.9%	94.7%	49.1%	-8.7%	-30.6%	-0.7%	16.9%				
YoY growth (%)												
Sales	35.2%	14.0%	4.9%	7.9%	5.0%	3.4%	4.6%	0.9%	50.1%	7.7%	4.0%	12.6%
Gross profits	4.9%	-19.2%	-14.8%	-6.4%	9.9%	16.8%	-2.1%	-6.5%	25.6%	-7.6%	1.5%	8.9%
Operating profits	2.6%	-34.3%	-27.9%	-7.9%	24.1%	14.7%	-5.0%	-21.7%	25.6%	-12.5%	-6.7%	11.7%
Non-operating profits	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	-4.5%
Pre-tax profits	-21.1%	-53.6%	-29.1%	-9.9%	84.8%	67.2%	-0.5%	-14.8%	20.8%	-11.5%	2.7%	11.2%
Net profits	-21.8%	-55.7%	-21.4%	14.9%	115.5%	83.9%	-6.2%	-26.5%	20.9%	0.1%	-1.9%	8.5%
EPS	-22.3%	-55.8%	-21.7%	14.6%	114.8%	83.9%	-6.2%	-26.5%	20.2%	-0.2%	-1.9%	8.5%
Dividend policies												
Cash dividends (NT\$ per share)									2.70	4.28	3.55	3.59
Payout ratio (%)									56.9%	76.0%	73.7%	76.0%

Source: Company data, Goldman Sachs Research estimates.

Reg AC

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Growth is a composite of next year's estimate over current year's estimate, e.g. EPS, EBITDA, Revenue. **Return** is a year one prospective aggregate of various return on capital measures, e.g. CROCI, ROACE, and ROE. **Multiple** is a composite of one-year forward valuation ratios, e.g. P/E, dividend yield, EV/FCF, EV/EBITDA, EV/DACF, Price/Book. **Volatility** is measured as trailing twelve-month volatility adjusted for dividends.

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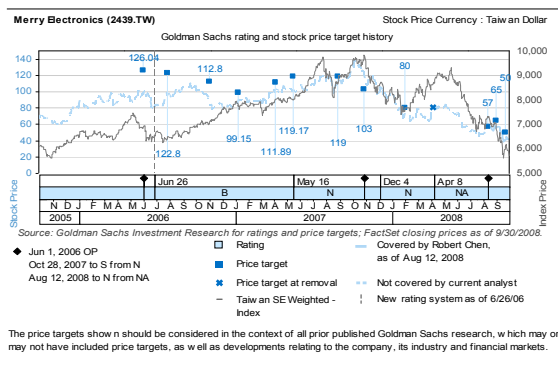
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	Rating Distribution			Investment Banking Relationships		
	Buy	Hold	Sell	Buy	Hold	Sell
Global	26%	57%	17%	52%	47%	37%

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Price target and rating history chart(s)



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