

TAIWAN

Formosa Taffeta

24 November 2008

1434 TT Underperform

Stock price as of 21 Nov 08	NT\$	16.95
12-month target	NT\$	15.00
Upside/downside	%	-11.5
Valuation	NT\$	16.71
- DCF (WACC 8.2%)		

GICS sector	consumer durables & apparel		
Market cap	NT\$m	28,555	
30-day avg turnover	NT\$m	40.8	
Market cap	US\$m	855	
Number shares on issue	m	1,685	

Investment fundamentals

Year end 31 Dec		2007A	2008E	2009E	2010E
Total revenue	m	29,252	28,646	24,018	24,342
EBIT	m	770	704	370	558
EBIT Growth	%	-10.7	-8.6	-47.4	50.8
Reported profit	m	7,374	3,649	2,520	2,229
Adjusted profit	m	7,374	3,649	2,520	2,229
EPS rep	NT\$	4.38	2.17	1.50	1.32
EPS rep growth	%	116.6	-50.5	-30.9	-11.6
EPS bonus growth	%	116.6	-50.5	-30.9	-11.6
PE rep	x	3.9	7.8	11.3	12.8
PE bonus exp	x	3.9	7.8	11.3	12.8
Total DPS	NT\$	3.20	1.62	1.20	1.12
Total div yield	%	18.9	9.6	7.1	6.6
ROA	%	1.1	1.1	0.7	1.0
ROE	%	13.4	7.2	6.3	5.6
EV/EBITDA	x	7.0	7.6	9.4	9.8
Net debt/equity	%	11.0	22.9	22.3	23.3
Price/book	x	0.5	0.7	0.7	0.7

1434 TT rel Taiex performance, & rec history



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

Analyst

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Weighed down by investments

Event

- We reduce our target price for Formosa Taffeta to NT\$15 from NT\$20, primarily due to lower market values and target prices for its listed investments. We've also reduced our EBIT outlook, as we see a more-challenging outlook for the textile and tyre segments into which it sells. We maintain our Underperform rating.

Impact

- Projection for further decline in FPCC.** We look for continued weakness in the share price of 3.8%-held Formosa Petrochemical (FPCC, 6505 TT, NT\$69, Underperform, TP: NT\$56) to reduce further Formosa Taffeta's share price. The market value of the holding has fallen to NT\$24.6bn from NT\$34.5bn at the end of FY07, and we look for it to decline to NT\$19.9bn.
- Tech investments a drag.** Reduced market values for Formosa Taffeta's stakes in IC packager Formosa Advanced Technology (FATC, 8131 TT, NT\$15.9, Not rated) and DRAM maker Nanya Technology (2408 TT, NT\$3.96, Not rated) contributed to the reduction in our target price.
- Outlook for declining earnings through FY10E.** Declining earnings for FPCC this year and in FY09E in our view will result in reduced cash dividends from FPCC, contributing to a declining trend in Formosa Taffeta's earnings through FY10E.
- Weak outlook for textiles and tyres a negative.** Contracting global demand conditions in our view will place downward pressure on Formosa Taffeta's fabric and tyre cord segments, contributing to what we expect will be a 47% YoY decline in EBIT next year.
- Macquarie vs consensus.** We do not believe useful consensus estimates exist for this stock.

Earnings revision

- After incorporating recent results and a more challenging outlook for its investments and core business, we increase our FY08E EPS by 6% but reduce our FY09E EPS by 21% and our FY10E EPS by 39%.

Price catalyst

- 12-month price target: NT\$15.00 based on a sum-of-parts methodology.
- Catalyst: Further decline in share price of its subsidiary FPCC.

Action and recommendation

- We retain our Underperform rating for Formosa Taffeta. We believe a decline in the share price of FPCC will place further downward pressure on its share price. We also look for declining conditions ahead for its fabric and nylon tyre cord operations.

Please refer to the important disclosures and analyst certification on inside back cover of this document, or on our website www.macquarie.com.au/research/disclosures.

Analysis

We reduce our share target price for Formosa Taffeta to NT\$15 from NT\$20 after factoring in a lower target price for 4%-held FPCC, reduced market values for FATC and Nanya Technology and a reduced EBIT outlook following on a downgrade to our global GDP outlook. We believe a further decline in the share price of FPCC over the next 12 months will contribute to further weakness in the share price of Formosa Taffeta, and we maintain our Underperform rating.

FPCC is facing a period of significant challenges to its refining and intermediate petrochemical operations, in our view. Its naphtha cracking operations in Mailiao are currently operating at about 50% utilisation due to weak demand, a rate which now looks set to continue through the end of this year. For further details, see our 11 November note **Formosa Petrochemical: Pressure building**.

Figure 1 provides our target price calculation. We've reduced our valuation for Formosa Taffeta's FPCC stake to NT\$9.5/share from NT\$10.3/share, reflecting a reduction in our FPCC share price target to NT\$56 from NT\$61. Our FATC stake valuation declined to NT\$2.5/share from NT\$4.9/share following a decline in its share price, while our valuation of the Nanya Tech stake declined to NT\$0.6/share from NT\$1.3/share for the same reason. Following on reductions to our Formosa Taffeta EBIT projections, we have reduced our valuation of its core business to NT\$6.8/share from NT\$8.5/share.

Fig 1 Formosa Taffeta target price calculation (NT\$/share)

	Stake (%)	Valuation (NT\$/share)	Valuation (NT\$/share)	Share price (NT\$)	Target price (NT\$)	Comments
NPV of core business FCF		6.78				Based on DCF
Long-term investments		15.36				
Formosa Petrochemical (6505 TT, UP)	3.8		9.47	69.0	56	20% discount to target price
FCFC (1326 TT, UP)	0.2		0.19	46.1	39	20% discount to target price
Nan Ya Technology (2408 TT, NR)	6.2		0.55	3.96	NA	20% discount to market value
Formosa Advanced Tech (8131 TT, NR)	65.7		2.46	15.9	NA	10% discount to market value
China plants	100.0		1.42			1x FY08E BV
Vietnam plants	100.0		0.95			1x FY08E BV
Other investments			0.32			20% discount to FY07E BV
Adjusted asset value		22.14				
Net debt		-5.43				FY08E BV
Per share equity value		16.71				
At 10% downcycle discount		15.04				
Target (NT\$)		15.00				

Source: Macquarie Research, November 2008

Figure 2 provides a view of Formosa Taffeta's parts prior to our holding company and downcycle discounts, and using the market value for FPCC rather than our target price. The result of this approach is NT\$22.6/share. Major sources of variance between this approach and our target price calculation are that we look for the share price of FPCC to decline significantly, and we also maintain a 20% holding company discount for this stake.

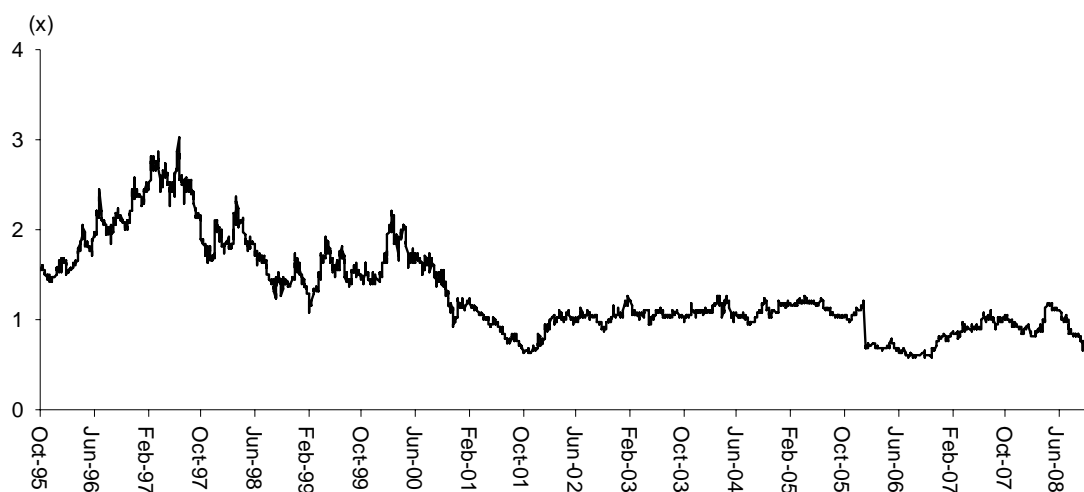
Fig 2 Formosa Taffeta's NAV without discounts (NT\$/share)

	Stake (%)	Valuation (NT\$/share)	Valuation (NT\$/share)	Share price (NT\$)	Comments
NPV of core business FCF		6.78			Based on DCF
Long-term investments		21.25			
Formosa Petrochemical (6505 TT)	3.8		14.58	69.0	Market value
FCFC (1326 TT, UP)	0.2		0.29	46.1	Market value
Nanya Technology (2408 TT)	6.2		0.69	3.96	Market value
Formosa Advanced Tech (8131 TT)	65.7		2.73	15.9	Market value
China plants	100.0		1.42		FY08E BV
Vietnam plants	100.0		0.95		FY08E BV
Other investments			0.59		FY08E BV
Sub-total		28.03			
Net debt		-5.43			FY08E BV
Total:		22.60			

Source: Macquarie Research, November 2008

Formosa Taffeta's 0.7x FY09E P/BV multiple is a slight premium to its 0.6x trough level reached in 2001 and 2006, as indicated in Figure 3. Formosa Taffeta's BV is a moving target however, as it is revised to reflect the market value of its stake in FPCC and Nanya Tech. This contributed to a 23% decline in its shareholders equity to NT\$46.9bn in 3Q08 from NT\$60.8bn at the end of 2007.

Fig 3 Formosa Taffeta's P/BV trend



Source: TEJ, Macquarie Research, November 2008

Earnings changes

After reviewing recent results, and taking into account recent changes to our regional oil and petrochemical price assumptions as well as a lower global GDP outlook, we've increased our FY09E EPS for Formosa Taffeta by 6% but reduced our FY09E EPS by 21% and our FY10E by 39%.

For EBIT, costs for this year have been trending below our previous projections, and we've reduced these more than we've reduced estimated sales. However, for FY09E we believe the severe contraction in global consumption will negatively affect Formosa Taffeta's fabric and nylon tyre cord operations, as we look for softer demand conditions for clothing and tyres. For tyres, this consists of both passenger vehicles as well as industrial vehicles.

We've reduced our investment income outlook for Formosa Taffeta. For FY08E and FY09E, the changes come from a variety of sources, including more cautious projection for Formosa Taffeta's Vietnam operations, which are geared to fabrics. We've also incorporated a reduced investment income outlook from FATC, given what we believe is a weaker outlook for its IC packaging and testing operations. For FY10E, the major change is a substantial reduction in our projected dividend from FPCC. This follows on our recent reduction to our FPCC FY09E earnings outlook.

Fig 4 Changes to our Formosa Taffeta earnings outlook

	FY08E previous (NT\$m)	FY08E new (NT\$m)	Change (%)	FY09E previous (NT\$m)	FY09E new (NT\$m)	Change (%)	FY10E previous (NT\$m)	FY10E new (NT\$m)	Change (%)
Sales	29,913	28,646	-4	29,900	24,018	-20	28,863	24,342	-16
COGS	-27,360	-26,023	-5	-27,007	-21,847	-19	-25,670	-21,934	-15
Gross profit	2,553	2,623	3	2,893	2,171	-25	3,193	2,408	-25
Gross margin (%)	8.5	9.2	7	9.7	9.0	-7	11.1	9.9	-11
SG&A	-2,034	-1,919	-6	-2,123	-1,801	-15	-2,107	-1,850	-12
EBIT	519	704	36	770	370	-52	1,086	558	-49
EBIT margin (%)	1.7	2.5	42	2.6	1.5	-40	3.8	2.3	-39
Net interest	-288	-208	-28	-390	-269	-31	-431	-294	-32
Investment income	3,279	3,169	-3	2,966	2,489	-16	3,193	2,040	-36
FPCC	2,355	2,355	0	1,774	1,733	-2	1,705	1,059	-38
Other invest. income	924	814	-12	1,192	756	-37	1,488	981	-34
Other non-op items	300	400	33	80	100	25	101	100	-1
Pre-tax profit	3,810	4,065	7	3,426	2,690	-21	3,949	2,404	-39
Taxes	-374	-416	11	-254	-170	-33	-323	-175	-46
Net profit	3,436	3,649	6	3,172	2,520	-21	3,626	2,229	-39
EPS (NT\$)	2.04	2.17	6	1.88	1.50	-21	2.15	1.32	-39

Source: Macquarie Research, November 2008

Formosa Taffeta (1434 TT, Underperform, Target price: NT\$15.00)

Quarterly Results		3Q/08A	4Q/08E	1Q/09E	2Q/09E	Profit & Loss		2007A	2008E	2009E	2010E
Revenue	m	7,677	6,740	5,524	6,004	Revenue	m	29,252	28,646	24,018	24,342
Gross Profit	m	676	564	499	543	Gross Profit	m	2,895	2,623	2,171	2,408
Operating Expenses	m	-497	-477	-432	-450	Operating Expenses	m	-2,125	-1,919	-1,801	-1,850
Operating Income	m	179	87	67	92	Operating Income	m	770	704	370	558
Net Non-operating income	m	451	-7	58	108	Net Non-operating income	m	6,845	3,361	2,320	1,846
Pre-Tax Income	m	630	80	125	200	Pre-Tax Income	m	7,615	4,065	2,690	2,404
Tax Expense	m	-78	-10	-30	-40	Tax Expense	m	-241	-416	-170	-175
Exceptionals	m	0	0	0	0	Exceptionals	m	0	0	0	0
Minority Interests	m	0	0	0	0	Minority Interests	m	0	0	0	0
Reported Earnings	m	552	70	95	160	Reported Earnings	m	7,374	3,649	2,520	2,229
Reported Earnings (bonus exp)	m	552	70	95	160	Reported Earnings (bonus exp)	m	7,374	3,649	2,520	2,229
Bonus exp / Reported Earnings	%					Bonus exp / Reported Earnings	%				
Adjusted Earnings	m	552	70	95	160	Adjusted Earnings	m	7,374	3,649	2,520	2,229
EBITDA	m	410	327	304	350	EBITDA	m	1,631	1,629	1,401	1,683
EPS (rep)	NT\$	0.33	0.04	0.06	0.10	EPS (rep)	NT\$	4.38	2.17	1.50	1.32
EPS pcg growth (rep)	%	-82.7	-57.0	-46.4	-94.4	EPS growth (rep)	%	116.6	-50.5	-30.9	-11.6
EPS (rep bonus exp)	NT\$	0.33	0.04	0.06	0.10	EPS (rep bonus exp)	NT\$	4.38	2.17	1.50	1.32
EPS pcg growth (rep bonus exp)	%	-82.7	-57.0	-46.4	-94.4	EPS growth (rep bonus exp)	%	116.6	-50.5	-30.9	-11.6
EPS (adj)	NT\$	0.33	0.04	0.06	0.10	EPS (adj)	NT\$	4.38	2.17	1.50	1.32
EPS pcg growth (adj)	%	-82.7	-57.0	-46.4	-94.4	EPS growth (adj)	%	116.6	-50.5	-30.9	-11.6
Revenue pcg growth	%	5.1	-8.6	-25.6	-11.7	PE (rep)	x	3.9	7.8	11.3	12.8
Operating Income pcg growth	%	5.9	-10.8	-64.3	-63.0	PE (rep bonus adj)	x	3.9	7.8	11.3	12.8
Reported Earnings pcg growth	%	-82.7	-57.0	-46.4	-94.4	PE (adj)	x	3.9	7.8	11.3	12.8
Gross Profit Margin	%	8.8	8.4	9.0	9.0	Total DPS	NT\$	3.20	1.62	1.20	1.12
Operating Income Margin	%	2.3	1.3	1.2	1.5	Total Div Yield	%	18.9	9.6	7.1	6.6
Reported Earnings Margin	%	7.2	1.0	1.7	2.7	Weighted Average Shares	m	1,685	1,685	1,685	1,685
EBITDA Margin	%	5.3	4.9	5.5	5.8	Period End Shares	m	1,685	1,685	1,685	1,685
Profit and Loss Ratios		2007A	2008E	2009E	2010E	Cashflow Analysis		2007A	2008E	2009E	2010E
Revenue Growth	%	5.1	-2.1	-16.2	1.4	Reported Earnings	m	7,374	3,649	2,520	2,229
Gross Profit Growth	%	-0.9	-9.4	-17.2	10.9	Depreciation & Amortisation	m	861	926	1,031	1,125
Operating Income Growth	%	-10.7	-8.6	-47.4	50.8	Chgs in Working Cap	m	-824	157	1,031	18
Reported Earnings Growth	%	116.6	-50.5	-30.9	-11.6	Other	m	-4,190	-814	-757	-981
EBITDA Growth	%	-3.9	-0.1	-14.0	20.1	Operating Cashflow	m	3,221	3,917	3,826	2,390
Gross Profit Margin	%	9.9	9.2	9.0	9.9	Acquisitions	m	4,531	0	0	0
Operating Income Margin	%	2.6	2.5	1.5	2.3	Capex	m	-1,518	-1,000	-800	-800
Reported Earnings Margin	%	25.2	12.7	10.5	9.2	Asset Sales	m	0	0	0	0
EBITDA Margin	%	5.6	5.7	5.8	6.9	Other	m	754	0	0	0
Payout Ratio	%	73.1	75.0	80.0	85.0	Investing Cashflow	m	3,767	-1,000	-800	-800
EV/EBITDA	x	7.0	7.6	9.4	9.8	Dividend (Ordinary)	m	-2,359	-5,392	-2,737	-2,016
EV/EBIT	x	8.4	9.4	12.8	14.0	Equity Raised	m	0	0	0	0
Balance Sheet Ratios						Debt Movements	m	-4,161	3,000	0	500
ROE	%	13.4	7.2	6.3	5.6	Other	m	-24	0	0	0
ROA	%	1.1	1.1	0.7	1.0	Financing Cashflow	m	-6,544	-2,392	-2,737	-1,516
ROIC	%	1.2	0.9	0.7	1.1	Net Chg in Cash/Debt	m	444	525	290	74
Net Debt/Equity	%	11.0	22.9	22.3	23.3	Free Cashflow	m	1,703	2,917	3,026	1,590
Interest Cover	x	2.5	3.4	1.4	1.9	FCF per Share	NT\$	1.01	1.73	1.80	0.94
Price/Book	x	0.5	0.7	0.7	0.7	P/FCF	x	16.8	9.8	9.4	18.0
Book Value per Share	NT\$	36.1	23.7	23.6	23.7	Balance Sheet		2007A	2008E	2009E	2010E
						Cash	m	753	1,278	1,568	1,642
						Receivables	m	2,924	2,863	2,401	2,433
						Inventories	m	5,341	5,273	4,427	4,445
						Investments	m	1,337	1,337	1,337	1,337
						Fixed Assets	m	8,792	8,866	8,635	8,309
						Intangibles	m	0	0	0	0
						Other Assets	m	53,872	35,536	36,305	37,300
						Total Assets	m	73,019	55,154	54,673	55,466
						Payables	m	2,119	2,092	1,756	1,763
						Short Term Debt	m	249	249	249	249
						Long Term Debt	m	7,176	10,176	10,176	10,676
						Provisions	m	0	0	0	0
						Other Liabilities	m	2,665	2,733	2,804	2,878
						Total Liabilities	m	12,209	15,250	14,986	15,567
						Total S/H Equity	m	60,810	39,903	39,687	39,900
						Total Liab & S/H Funds	m	73,019	55,154	54,673	55,466

All figures in NT\$ unless noted.

Source: Company data, Macquarie Research, November 2008

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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 – return 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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