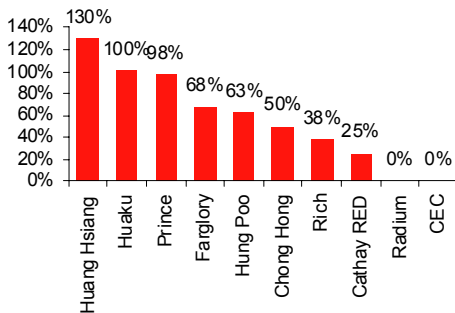


TAIWAN

Taiwan property sector

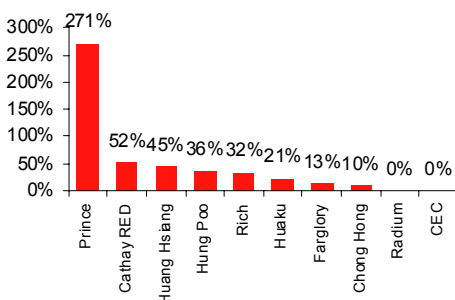
29 October 2008

% of 2Q08 BV of house inventory and land banks acquired after 2007



Source: Macquarie Research, October 2008

% of 2009E earnings impact based on scenario analysis



Source: Macquarie Research, October 2008

Valuation summary

Name	Code	Price NT\$	Rating	TP NT\$	Upside
Cathay RED	2501 TT	6.3	O	11.5	82%
Huaku	2548 TT	27.1	N	33.0	22%
Hung Poo	2536 TT	15.2	N	15.0	-1%
Prince Housing	2511 TT	4.7	U	4.5	-4%
Huang Hsiang	2545 TT	11.0	U	10.0	-9%
Farglory Land	5522 TT	18.2	U	16.0	-12%

Source: Bloomberg, Macquarie Research, October 2008

Analyst

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Potential inventory losses in 2009

Event

- We believe there could be potential inventory losses in 2009 after the stricter accounting method on inventory value assessment to start effective on 1 January 2009, according to the revised Statement of Financial Accounting Standards (SFAS) No 10.

Impact

- Stricter accounting method on inventory value assessment:** The inventories of Taiwanese developers, including land, houses for sale and property under construction, are usually booked at cost in the balance sheet and there have been few cases of inventory losses. However, the revised accounting method, SFAS No 10, requires inventory to be evaluated at the lower of cost or net realizable value. Our discussion with developers indicate there should be potential inventory losses in 1Q09's financial result but the actual impact is too early to assess as there is yet a standard way to evaluate the net realizable value of property inventory.
- Higher risk to inventory losses for sites acquired after 2007:** Based on the accounting standards, those sold at contract price should be evaluated at contract price (please refer to the appendix on page 3 for full translation of SFAS No 10). It indicates developers with more projects presold should be relatively less influenced by the new accounting method. However, we think developers that aggressively acquired sites after 2007 but have not presold the projects should face higher risk-to-inventory losses. We calculated Huang Hsiang, Huaku, Prince and Farglory have higher book value in sites acquired after 2007, accounting for 130%, 100%, 98% and 68% of their respective book values in 2Q08.
- Scenario analysis on earnings impact:** We have not included the estimated inventory losses in our earnings forecast of the Taiwanese developers as the actual practice is still unclear. However, based on our scenario analysis, the impact on 2009E earnings would be highest for Prince, Cathay RED, Huang Hsiang, and Hung Poo, if we assume they need to book 5% and 10% inventory losses on the book value of land bank acquired in 2007 and 2008 respectively. We calculated the potential earnings impact to be 271%, 52%, 45% and 36% for Prince, Cathay RED, Huang Hsiang and Hung Poo in 2009E. Please refer to Figure 1 on page 2 for more details.

Outlook

- While the change in accounting method will not influence our NAV as it has no major impact on cashflows, it will negatively influence the dividends as DPS is usually capped by accounting EPS. It will thus have some negative impact on share prices as some investors are attracted by the high dividend yield of developers. In addition, developers with a higher portion of land acquired after 2007 would be more vulnerable to property price decline.
- We remain cautious on the Taiwan property sector, given the weak industry outlook amid global economic slowdown and higher financial risk in tightening liquidity.

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

Fig 1 Inventory loss scenario analysis

NT\$m	Huang		Prince	Farglory	Hung Poo	Chong		Cathay		CEC
	Hsiang	Huaku				Hong	Rich	RED	Radium	
	2545 TT	2548 TT	2511 TT	5522 TT	2536 TT	5534 TT	5512 TT	2501 TT	2547 TT	2526 TT
Land acquired in 2007*	6,537	2,147	7,973	9,224	2,673	2,419	1,559	3,441	0	0
Land acquired in 1H08*	0	3,162	0	1,150	2,285	0	948	673	0	0
House-for-sale inventory	1,046	0	1,646	0	88	0	0	849	0	0
Subtotal	7,582	5,309	9,619	10,374	5,046	2,419	2,507	4,963	0	0
% of total inventory, 2Q08	32%	25%	62%	33%	32%	21%	15%	28%	0%	0%
% of total BV, 2Q08	130%	100%	98%	68%	63%	50%	38%	25%	0%	0%
Potential inventory loss if:										
Land acquired in '07 ↓ 5%	-327	-107	-399	-461	-134	-121	-78	-172	0	0
Land acquired in '08 ↓ 10%	0	-316	0	-115	-229	0	-95	-67	0	0
House-for-sell inventory ↓ 10%	-105	0	-165	0	-9	0	0	-85	0	0
Total inventory loss	-431	-424	-563	-576	-371	-121	-173	-324	0	0
% of '09 earning	45%	21%	-271%	13%	36%	10%	32%	52%	0%	0%

*Only includes un-presold land bank

Source: Company data, Macquarie Research, October 2008

Fig 2 Valuation summary

Name	Code	Market			TP	RNAV			PER			07-10		Div yield	Net gearing	
		cap	Price	Rating		Upside	Premium	08E	09E	10E	EPS	P/BV	ROE			
		US\$m	NT\$		NT\$		NT\$		08E	09E	10E	CAGR	08E	08E	08E	08E
Sinyi Realty	9940 TT	314	34.5	U	35.5	3%	nmf	nmf	10.3	14.7	12.1	-15%	2.2	23%	3.7%	13%
Cathay RED	2501 TT	315	6.3	O	11.5	82%	14.5	-56%	13.1	16.7	7.7	41%	0.5	4%	7.1%	-1%
Radium	2547 TT	165	10.8	O	14.5	34%	29.0	-63%	10.9	9.6	12.4	-15%	0.7	3%	1.0%	62%
CEC	2526 TT	163	6.3	O	10.0	58%	12.5	-49%	7.6	7.6	9.9	-4%	0.3	4%	8.2%	60%
Huaku	2548 TT	190	27.1	N	33.0	22%	50.5	-46%	2.6	3.2	7.2	-24%	1.0	41%	20.3%	112%
Chong Hong	5534 TT	100	17.9	N	23.0	29%	46.0	-61%	2.3	2.6	3.6	-2%	0.6	28%	19.4%	128%
Hung Poo	2536 TT	132	15.2	N	15.0	-1%	30.0	-49%	2.1	4.2	6.5	-19%	0.5	26%	25.5%	66%
Rich	5512 TT	60	4.2	U	4.0	-3%	11.5	-64%	2.8	2.9	2.5	8%	0.2	9%	8.4%	143%
Prince Housing	2511 TT	131	4.7	U	4.5	-4%	9.0	-48%	mnf	mnf	mnf	-201%	0.4	-7%	0.0%	179%
Huang Hsiang	2545 TT	94	11.0	U	10.0	-9%	20.0	-45%	3.1	3.3	4.8	-33%	0.5	17%	9.3%	269%
Farglory Land	5522 TT	385	18.2	U	16.0	-12%	32.0	-43%	3.0	3.0	4.3	-17%	0.7	24%	19.3%	99%
Total/Average		2,047				21%		-43%	6.3	7.7	7.2	-18%	0.8	17%	11.2%	79%

Note: Pricing as of 29 October 2008.

Source: Bloomberg, Macquarie Research, October 2008

Appendix: Statement of Financial Accounting Standards No 10

Source: Accounting Research and Development Foundation (20 May 1987; revised 29 Nov 2007).

Inventories

I Introduction

- (1) This Statement establishes the accounting standards for inventories.
- (2) This Standard applies to all inventories, except:
 - (a) Work in progress arising under long-term construction contracts, including directly related service contracts (follow the principles set out in the Statement of Financial Accounting Standards No. 11, *Long-term Construction Contracts*); and
 - (b) Financial instruments (follow the principles set out in the Statement of Financial Accounting Standards No. 34, *Financial Instruments: Recognition and Measurement* and No. 36, *Financial Instruments: Disclosure and Presentation*).

II Definitions

- (3) The definitions of terms used in this Statement are as follows:
 - (a) Inventory: assets (i) held for sale in the ordinary course of business; (ii) in the process of production for such sale; or (iii) in the form of materials or supplies to be consumed in the production process or in the rendering of services.
 - (b) Direct raw materials: (also known as direct materials) the materials that can be reasonably identified as being consumed for the production of finished goods or become part of the finished goods. Materials with trivial costs are excluded.
 - (c) Direct labour: labour costs that can be reasonably identified as being incurred for the production of finished goods.
 - (d) Manufacturing overhead: all the manufacturing costs except direct raw materials and direct labour (eg, indirect raw materials, indirect labour, the depreciation and maintenance expenses of plant assets, and factory operating expenses, etc).
 - (e) Replacement cost: the current cost of purchasing the same inventory.
 - (f) Net realizable value: the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.
 - (g) Standard cost: cost per unit of finished goods that should be incurred under the established efficiency standard.
 - (h) Fair value: the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

III Explanation

- (4) Inventories are among the most important assets of many companies. The measurement and presentation of inventories have significant influence on the appropriate presentation of the financial conditions and operating performance of a company.

Measurement of inventories

Initial measurement of inventories

- (5) The costs of merchandise, raw materials, and supplies inventory include the purchase prices of inventory (less purchase discounts and allowances) and other necessary expenditure and charges for bringing the inventory to the salable and useable condition and location.

The fixed and indirect variable costs incurred in the production process are usually considered necessary in bringing inventory to its salable location and condition, thus they should be regarded as manufacturing overhead.

(6) Fixed costs must be allocated on the basis of the normal capacity of the production equipment instead of the actual capacity. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. Unallocated overheads due to low production or idle plant are recognized as costs of sales in the period in which they are incurred; therefore, the amount of fixed overhead allocated to each unit of production is not increased. In periods of abnormally high production, the amount of fixed overhead is allocated on the basis of the actual capacity so that inventories are not measured above cost.

Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

(7) A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when a main product and a by-product are produced. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production. When by-products are immaterial, they are often measured at net realizable value and this value is deducted from the cost of the main product.

(8) Examples of costs excluded from the cost of inventories and recognized as expenses in the period in which they are incurred are:

- (a) abnormal amounts of wasted materials, labour or other production costs;
- (b) storage costs, unless those costs are necessary in the production process;
- (c) expenditure that does not contribute to bringing inventories to their present condition and location; and
- (d) selling expenses.

Subsequent measurement of inventories

(9) When there is an impairment of asset value due to a decline in the net realizable value of inventories, inventories shall be measured at the lower of cost and net realizable value.

(10) Net realizable value refers to the net amount that an entity expects to realize from the sale of inventory in the ordinary course of business. Fair value reflects the amount for which the same inventory could be exchanged between knowledgeable and willing buyers and sellers in the marketplace. The former is an entity-specific value; the latter is not. Net realizable value for inventories may not equal net fair value (fair value less costs to sell).

(11) Inventories are usually written down to net realizable value item by item. It is not appropriate to write inventories down on the basis of a classification of inventory such as all finished goods or all the inventories in a particular operating segment. In some circumstances, however, it may be appropriate to group similar or related items. Items of inventory could be classified in the same group if, and only if:

- (a) they are relating to the same product line that have similar purposes or end uses;
- (b) they are produced and marketed in the same geographical area; and
- (c) they cannot be practicably evaluated separately from other items in that product line.

Service providers generally accumulate costs in respect of each service for which a separate selling price is charged. Therefore, each such service is treated as a separate item.

(12) Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when a decline in the price of materials indicates that the cost of the finished products exceeds net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value.

(13) The cost of inventories may not be recoverable if those inventories are damaged or obsolete, if the estimated costs of completion have increased, if their selling expenses have increased, or if their selling prices have declined. When cost of inventories exceeds net realizable value of them, inventories shall be written down below cost to net realizable value. This application is consistent with the view that assets should not be carried in excess of amounts expected to be realized from their sale or use.

Measurement of cost

(14) Specific identification of cost means that specific costs are attributed to identified items of inventory. This is the appropriate treatment for bought or produced items that are segregated for a specific project. However, specific identification of costs is inappropriate when there are large numbers of items of inventory that are ordinarily interchangeable, since the method may make it easier to manage earnings.

(15) Inventories used in one operating segment may have a use to the entity different from the same type of inventories used in another operating segment. However, a difference in geographical location of inventories or in the respective tax rules, by itself, is not sufficient to justify the use of different cost formulas.

Financial Statements disclosure requirements

(16) Cost of sales consists of those costs previously included in the measurement of inventory that has now been sold and unallocated production overheads, abnormal amounts of production costs of inventories, and loss for value decline (or gains from value recovery). The circumstances of the entity may also warrant the inclusion of other amounts, such as distribution costs.

(17) The sub-classifications of inventories in the financial statements help readers understand the dollar amount and the periodic changes of inventories. The common sub-classifications are raw materials, supplies, work-in-progress, finished goods and merchandise.

IV Accounting standards

Measurement of inventories

Initial measurement of inventories

(18) The costs of inventories are necessary expenditures and charges for bringing the inventory to the salable and useable condition and location.

(19) The costs of finished goods and work-in-progress inventory must include direct raw materials, direct labour and manufacturing overhead. Manufacturing overhead shall be allocated according to a rational and systematic method. Fixed costs must be allocated on the basis of the normal capacity of the production equipment. The actual level of production may be used if it approximates normal capacity. Unallocated overheads resulted from low production or idle plant are recognized as costs of sales in the period in which they are incurred. In periods of abnormally high production, the amount of fixed overhead is allocated on the basis of the actual capacity.

Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

(20) To the extent that service providers have inventories, they measure them at the costs of their production. These costs consist primarily of the labour and other costs of personnel directly engaged in providing the service and attributable overheads. Labour and other costs relating to sales and general administrative personnel are not included but are recognized as expenses in the period in which they are incurred. The costs of inventories of a service provider do not include profit margins or non-attributable overheads.

Subsequent measurement of inventories

(21) Inventories shall be measured at the lower of cost and net realizable value. Inventories are usually written down to net realizable value item by item. However, the comparison of cost and market value could be made on the basis of classified items in accordance with paragraph 11. The chosen approach shall be applied consistently to each period. The amount of any write-down of inventories to net realizable value shall be recognized as cost of sales.

(22) Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or indicates that the cost of the finished products exceeds net realizable value, the materials are written down to net realizable value.

(23) A new assessment is made of net realizable value in each subsequent period. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in net realizable value because of changed economic circumstances, the amount of the write-down is reversed (ie the reversal is limited to the amount of the original write-down). The amount of any reversal of any write-down of inventories shall be recognized as a reduction in cost of sales in the period in which the reversal occurs.

(24) When unusual circumstances occur, such as a flood or fire, and result in the loss of the accounting certificates and records and the computation of costs becomes difficult, inventory may be valued by the gross profit method.

(25) If the net realizable value of inventory is lower than the cost due to damage or obsolescence, it is necessary to reduce the cost to the level of the net realizable value.

Measurement of cost

(26) The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects shall be assigned by using specific identification of their individual costs.

The cost of inventories, other than those described above, shall be assigned by using the first-in, first-out (FIFO) or weighted average cost formula other than specific identification.

(27) An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified.

(28) Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate cost. Standard costs take into account normal levels of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions.

(29) The retail method is often used in the retail industry for measuring inventories of large numbers of rapidly changing items with similar margins for which it is impracticable to use other costing methods mentioned in paragraph 26. The cost of the inventory is determined by reducing the sales value of the inventory by the appropriate percentage gross margin. The percentage used takes into consideration the effect of the measurement of the lower of cost and net realizable value. An average percentage for each retail department is often used.

Measurement of net realizable value

(30) Net realizable value should be determined on the balance sheet date. Estimates of net realizable value are based on the most reliable evidence available at the time the estimates are made. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period.

(31) The calculation of net realizable value should be based on the estimated selling price in the normal course of business. However, if the inventory is held for sales contracts, its valuation must be based on the contract price.

Disposal of inventories

(32) When inventories are sold, the carrying amount of those inventories shall be recognized as cost of sales in the period in which the related revenue is recognized. The amount of any loss of inventories shall be recognized as an expense in the period the loss occurs.

Financial Statements disclosure requirements

(33) The financial statements shall disclose the following information related to inventories:

- (a) the accounting policies adopted in measuring inventories, including the cost formula used.
- (b) the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity. Common classifications of inventories are merchandise, materials, production supplies, work in progress and finished goods. The inventories of a service provider may be described as work in progress.
- (c) the amount of inventories recognized as an expense during the period.
- (d) the amount of any write-down of inventories recognized as cost of sales during the period.
- (e) the amount of any reversal of any write-down that is recognized as a reduction in cost of sales during the period.
- (f) the circumstances or events that led to the reversal of a write-down of inventories.
- (g) the carrying amount of inventories pledged as security for liabilities.

V Notes

(34) This Statement was issued on May 20, 1987, with the first revision on November 29, 2007. The first revised provision of this Statement shall be effective for financial statements with fiscal years beginning on or after January 1, 2009. Earlier adoption is permitted.

Entities which originally prepared the financial statements in accordance with this Statement and applied the Last-in, first-out (LIFO) cost formula shall recalculate cost of inventories by using the first-in, first-out (FIFO) or weighted average cost formula, when they adopt this first revised provision. The difference between the result of recalculation and the carrying amount shall be recognized as the cumulative effect of a change in accounting principle; restatement, however, is not necessary. Entities need not to measure the cumulative effect of any other change in accounting principle due to the adoption of this first revised provision.

(35) After this first revised provision is effective, changes need to be made in the following Statements: all references to the phrase "Statement of Financial Accounting Standards No.10, Valuation and Presentation of Inventory" appearing in other Statements shall hereby be replaced by the phrase "Statement of Financial Accounting Standards No.10, Inventories"; all references to the phrase "the Last-in, first-out (LIFO) cost formula" appearing in other Statements shall hereby be deleted; all references to the phrase "market value of inventories" appearing in other Statements shall hereby be replaced by the phrase "net realizable value of inventories"; paragraph 105 of the Statement of Financial Accounting Standards No. 1 "Conceptual Framework for Financial Accounting and Preparation of Financial Statements" shall be deleted.

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 – 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 historic 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 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%

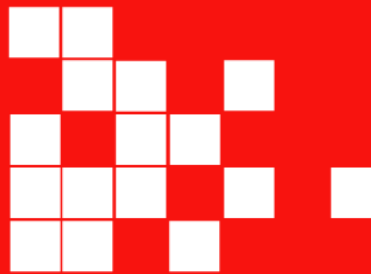
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