

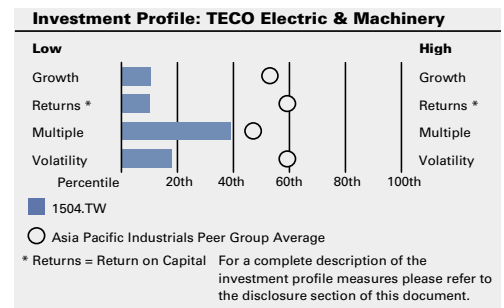


ACTION
Removed from Asia Pacific Buy List
TECO Electric & Machinery (1504.TW)

Disappointing 3Q08 results, downgrade to Neutral

What happened

TECO released its 3Q08 results—sales fell 9% qoq to NT\$7.2bn, gross profit fell 13% qoq to NT\$1.2bn, OP dropped 45% qoq to NT\$210mn, net income decreased 16% qoq to NT\$540mn. 1Q08-3Q08 NI of NT\$1.7bn has reached 76% of our 2008E net income estimate. We cut our 08E-10E EPS estimates 26%-48% as we think the stable sales and margin in the motor division will not be sustainable in 4Q08 and 2009E. We downgrade the stock to Neutral. TECO's share price has fallen 46% since we raised the stock to Buy on Aug 29, 2008, vs. a 38% drop for TWSE during the same period. Over the last 12 months, the share price has dropped 58% vs. a 54% decline for TWSE.



Current view

The stock underperformed the market because its earnings momentum did not pick up as we expected. We attribute the 0.82ppt and 1.88ppt qoq decline in 3Q08's GM and OM to the home appliance product sales volume drop, inventory loss and higher promotion expenses during the period. While the company's industrial motor division retained stable sales and margin up to 3Q08, we think this may not be sustainable into 4Q08 and 2009E, given increasing capex cuts globally across different industries. We note that home appliance division still made a loss in 3Q, given that it lacks economy of scale, suffered panel inventory losses, and incurred higher promotional expenses.

We lower 2009E P/E multiple we use to derive core business value from 9x to 8x to reflect the trough cycle valuation and cut our 2009E NAV per share estimate from NY\$20.3 to NT\$12.2. We also widen the discount to NAV from 20% to 25%, given rising investor concerns over volatility of non-listed equity investment values. Therefore, we lower our 12-m SOTP-based TP from NT\$16.0 to NT\$9.0 and cut the rating from Buy to Neutral given we do not see any near-term catalysts to trigger share price re-rating.

Upside risks: stronger-than-expected demand in the home appliance products; rising global capex to lead to more demand in motors. Downside risk: further margin squeeze.

INVESTMENT LIST MEMBERSHIP
 Neutral

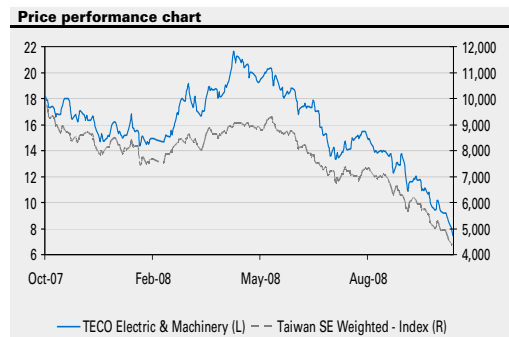
Coverage View: Neutral

Taiwan:
 Capital Goods

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Key data	Current
Price (NT\$)	7.50
12 month price target (NT\$)	9.00
Market cap (NT\$ mn / US\$ mn)	14,179.3 / 423.2
Foreign ownership (%)	32.8

	12/07	12/08E	12/09E	12/10E
EPS (NT\$) New	1.42	1.21	1.17	1.12
EPS revision (%)	0.0	(25.7)	(37.9)	(47.8)
EPS growth (%)	17.3	(14.4)	(3.4)	(4.4)
EPS (dil) (NT\$) New	1.42	1.21	1.17	1.12
P/E (X)	5.3	6.2	6.4	6.7
P/B (X)	0.4	0.4	0.4	0.4
EV/EBITDA (X)	28.3	11.3	10.4	9.6
Dividend yield (%)	13.3	11.3	10.9	10.5
ROE (%)	7.3	6.2	5.9	5.6



Share price performance (%)	3 month	6 month	12 month
Absolute	(46.8)	(63.7)	(58.1)
Rel. to Taiwan SE Weighted Index	(12.6)	(25.1)	(8.3)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 10/28/2008 close.

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TECO Electric & Machinery: Summary financials

Profit model (NT\$ mn)	12/07	12/08E	12/09E	12/10E	Balance sheet (NT\$ mn)	12/07	12/08E	12/09E	12/10E
Total revenue	27,858.3	29,103.0	28,645.8	28,415.5	Cash & equivalents	2,319.9	2,779.7	2,828.8	3,840.1
Cost of goods sold	(23,131.6)	(23,891.5)	(23,557.0)	(23,406.9)	Accounts receivable	6,152.7	5,980.1	6,278.5	6,617.3
SG&A	(3,246.2)	(3,346.9)	(3,222.7)	(3,154.1)	Inventory	5,381.2	5,501.9	6,113.6	6,404.3
R&D	0.0	0.0	0.0	0.0	Other current assets	1,548.4	3,063.5	3,015.3	3,157.3
Other operating profit/(expense)	0.0	0.0	0.0	0.0	Total current assets	15,402.2	17,325.1	18,236.3	20,019.0
EBITDA	1,480.6	1,864.7	1,866.1	1,854.5	Net PP&E	3,740.8	3,262.1	2,764.8	2,235.3
Depreciation & amortization	(589.5)	(866.9)	(897.3)	(929.5)	Net intangibles	0.0	0.0	0.0	0.0
EBIT	891.1	997.8	968.9	925.1	Total investments	35,949.4	34,151.9	32,444.3	30,822.1
Interest income	29.8	38.2	42.1	50.0	Other long-term assets	3,093.3	3,402.6	3,742.9	4,117.2
Interest expense	(266.0)	(221.2)	(178.0)	(154.2)	Total assets	58,186.0	58,141.7	57,188.3	57,193.6
Income/(loss) from uncons. subs.	1,517.1	1,000.0	900.0	810.0	Accounts payable	5,696.1	5,426.5	5,359.8	5,334.0
Others	846.3	600.0	600.0	600.0	Short-term debt	1,800.0	2,901.5	2,439.7	2,255.8
Pretax profits	3,018.3	2,414.9	2,332.9	2,230.9	Other current liabilities	2,529.5	3,880.4	3,819.4	3,788.7
Income tax	(309.4)	(120.7)	(116.6)	(111.5)	Total current liabilities	10,025.6	12,208.4	11,619.0	11,378.5
Minorities	0.0	0.0	0.0	0.0	Long-term debt	9,299.5	6,770.1	5,692.7	5,263.5
Net income pre-preferred dividends	2,708.9	2,294.1	2,216.2	2,119.4	Other long-term liabilities	1,961.3	2,059.3	2,162.3	2,270.4
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	11,260.8	8,829.4	7,855.0	7,533.8
Net income (pre-exceptionals)	2,708.9	2,294.1	2,216.2	2,119.4	Total liabilities	21,286.5	21,037.8	19,474.0	18,912.3
Post-tax exceptionals	0.0	0.0	0.0	0.0	Preferred shares	0.0	0.0	0.0	0.0
Net income	2,708.9	2,294.1	2,216.2	2,119.4	Total common equity	36,899.6	37,103.9	37,714.3	38,281.3
EPS (basic, pre-except) (NT\$)	1.42	1.21	1.17	1.12	Minority interest	0.0	0.0	0.0	0.0
EPS (basic, post-except) (NT\$)	1.42	1.21	1.17	1.12	Total liabilities & equity	58,186.0	58,141.7	57,188.3	57,193.6
EPS (diluted, post-except) (NT\$)	1.42	1.21	1.17	1.12	BVPS (NT\$)	19.31	19.63	19.95	20.25
DPS (NT\$)	1.00	0.85	0.82	0.78					
Dividend payout ratio (%)	70.5	70.0	70.0	70.0					
Free cash flow yield (%)	3.8	8.6	4.9	6.4					
Growth & margins (%)	12/07	12/08E	12/09E	12/10E	Ratios	12/07	12/08E	12/09E	12/10E
Sales growth	2.9	4.5	(1.6)	(0.8)	ROE (%)	7.3	6.2	5.9	5.6
EBITDA growth	2.1	25.9	0.1	(0.6)	ROA (%)	4.6	3.9	3.8	3.7
EBIT growth	6.7	12.0	(2.9)	(4.5)	ROACE (%)	6.3	5.5	5.4	5.2
Net income growth	17.3	(15.3)	(3.4)	(4.4)	Inventory days	83.5	83.1	90.0	97.6
EPS growth	17.3	(14.4)	(3.4)	(4.4)	Receivables days	78.6	76.1	78.1	82.8
Gross margin	17.0	17.9	17.8	17.6	Payable days	86.1	85.0	83.6	83.4
EBITDA margin	5.3	6.4	6.5	6.5	Net debt/equity (%)	23.8	18.6	14.1	9.6
EBIT margin	3.2	3.4	3.4	3.3	Interest cover - EBIT (X)	3.8	5.5	7.1	8.9
Cash flow statement (NT\$ mn)	12/07	12/08E	12/09E	12/10E	Valuation	12/07	12/08E	12/09E	12/10E
Net income pre-preferred dividends	2,708.9	2,294.1	2,216.2	2,119.4	P/E (analyst) (X)	5.3	6.2	6.4	6.7
D&A add-back	589.5	866.9	897.3	929.5	P/B (X)	0.4	0.4	0.4	0.4
Minorities interests add-back	0.0	0.0	0.0	0.0	EV/EBITDA (X)	28.3	11.3	10.4	9.6
Net (inc)/dec working capital	(145.8)	(381.6)	(989.7)	(828.0)	Dividend yield (%)	13.3	11.3	10.9	10.5
Other operating cash flow	(1,153.9)	(1,000.0)	(900.0)	(810.0)					
Cash flow from operations	1,998.7	1,779.4	1,223.9	1,410.8					
Capital expenditures	(519.7)	(388.1)	(400.0)	(400.0)					
Acquisitions	1,686.0	2,797.5	2,607.6	2,432.2					
Divestitures	0.0	0.0	0.0	0.0					
Others	335.8	(309.3)	(339.9)	(374.3)					
Cash flow from investments	1,502.1	2,100.0	1,867.3	1,657.9					
Dividends paid (common & pref)	(3,043.6)	(2,089.8)	(1,605.9)	(1,552.4)					
Inc/(dec) in debt	(485.6)	(1,427.9)	(1,539.1)	(613.2)					
Common stock issuance (repurchase)	0.0	0.0	0.0	0.0					
Other financing cash flows	315.1	98.1	103.0	108.1					
Cash flow from financing	(3,214.0)	(3,419.6)	(3,041.7)	(2,057.5)					
Total cash flow	286.7	459.8	49.5	1,011.3					

Note: Last actual year may include reported and estimated data.
Source: Company data, Goldman Sachs Research estimates.

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Exhibit 1: Earnings revision

NT\$ mn	2008E			2009E			2010E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Sales	30,897	29,103	-5.8%	34,097	28,646	-16.0%	37,541	28,416	-24.3%
Gross profit	4,581	4,345	-5.2%	5,226	4,192	-19.8%	5,913	4,079	-31.0%
Operating profit	1,028	998	-2.9%	1,304	969	-25.7%	1,596	925	-42.0%
Pre-tax income	3,248	2,415	-25.7%	3,754	2,333	-37.9%	4,274	2,231	-47.8%
Net earnings	3,086	2,294	-25.7%	3,567	2,216	-37.9%	4,059	2,118	-47.8%
EPS (NT\$)	1.63	1.21	-25.7%	1.89	1.17	-37.9%	2.15	1.12	-47.8%

Note: The gross profit calculated in this table includes depreciation and amortization while the gross profit in the summary financials excludes these items.

Source: Company data, TEJ, Goldman Sachs Research estimates

Exhibit 2: Previous NAV calculation

Equity investment values are market values based on the closing price of September 25, 2008

	Ownership (%)	Estimated Value (NT\$m)	Per share value (NT\$)	Contribution to total equity value (%)
Core business value (9x 2009E P/E)	100.00%	23,332	12.3	60.82%
United Microelectronics Corp. (2303.TW)	0.44%	149,655	0.3	1.72%
TECOM (2321.TW)	27.11%	3,211	0.5	2.27%
AU Optronics (2409.TW)	0.03%	312,159	0.0	0.24%
Lien Chang Electronic (2431.TW)	31.30%	582	0.1	0.47%
Cathay Financial Holding (2882.TW)	0.01%	451,821	0.0	0.12%
Industrial Bank of Taiwan (2897.TW)	2.17%	14,892	0.2	0.84%
TPO Displays (3195.TWO)	5.82%	12,884	0.4	1.95%
Far EastOne Telecommunications (4904.TW)	0.07%	133,435	0.0	0.24%
TECO Electro Devices (8041.TWO)	62.87%	340	0.1	0.56%
Cando Corporation (8056.TWO)	6.51%	6,172	0.2	1.05%
Taiwan Cogeneration Corporation (8926.TW)	2.00%	6,563	0.1	0.34%
Listed equity investment value (market value)			2.0	9.81%
Taiwan High Speed Rail (book value)	100.00%	4,400	2.3	11.47%
Other non-listed equity investment (book value)	100.00%	10,034	5.3	26.16%
Non-listed equity investment (book value)			7.6	37.63%
Idle land holdings (book value)	100.00%	1,726	0.9	4.50%
Net debt	100.00%	4,894	2.6	-12.76%
Total equity value			20.3	100.00%

Source: Company data, TEJ, Goldman Sachs Research estimates

Exhibit 3: New NAV calculation

Equity investment values are market values based on the closing price of October 28, 2008

	Ownership (%)	Estimated Value (NT\$m)	Per share value (NT\$)	Contribution to total equity value (%)
Core business value (8x 2009E P/E)	100.00%	15,645	8.3	67.57%
United Microelectronics Corp. (2303.TW)	0.44%	101,305	0.2	1.93%
TECOM (2321.TW)	27.11%	3,776	0.5	4.42%
AU Optronics (2409.TW)	0.03%	193,930	0.0	0.25%
Lien Chang Electronic (2431.TW)	31.30%	414	0.1	0.56%
Cathay Financial Holding (2882.TW)	0.01%	292,126	0.0	0.13%
Industrial Bank of Taiwan (2897.TW)	2.17%	9,538	0.1	0.89%
TPO Displays (3195.TWO)	5.82%	10,349	0.3	2.60%
Far EasTone Telecommunications (4904.TW)	0.07%	113,395	0.0	0.34%
TECO Electro Devices (8041.TWO)	62.87%	232	0.1	0.63%
Cando Corporation (8056.TWO)	6.51%	3,508	0.1	0.99%
Taiwan Cogeneration Corporation (8926.TW)	2.00%	5,558	0.1	0.48%
Listed equity investment value (market value)			1.6	13.22%
Non-listed equity investment (book value)	100.00%	8,027	4.2	34.67%
Idle land holdings (book value)	100.00%	1,726	0.9	7.45%
Net debt	100.00%	5,304	2.8	-22.90%
Total equity value			12.2	100.00%

Source: Company data, TEJ, Goldman Sachs Research estimates

Exhibit 4: 3Q08 result

NT\$m	3Q07	1Q08	2Q08	3Q08	qoq	yoy	1Q08-3Q08	2008E GS estimates	Full year achievement rate
Sales	7,034	7,031	7,880	7,176	-9%	2%	22,087	29,103	76%
Gross profit	1,017	1,111	1,352	1,172	-13%	15%	3,636	4,345	84%
Operating profit	209	279	379	210	-45%	1%	868	998	87%
Investment income	504	294	797	458	-42%	-9%	1,550	1,000	155%
Pre-tax earnings	1,026	633	438	587	34%	-43%	1,659	2,294	72%
Net earnings	979	560	642	540	-16%	-45%	1,741	2,294	76%
EPS (NT\$)	0.53	0.30	0.35	0.30	-14%	-43%	0.95	1.21	79%
Gross margin (%)	14%	16%	17%	16%	-0.82pp	1.88ppt	16%	15%	
Operating margin (%)	3%	4%	5%	3%	-1.88pp	-0.04pp	4%	3%	
Net margin (%)	14%	8%	8%	8%	-0.63pp	-6.40pp	8%	8%	

Note: The gross profit calculated in this table includes depreciation and amortization while the gross profit in the summary financials excludes these items.

Source: Company data, TEJ, Goldman Sachs Research estimates

Exhibit 5: Share price performance versus peer group

Price as of the close on October 28, 2008

Company	Ticker	Primary analyst	Price currency	Price as of 10/28/08	Price performance since 08/29/08	3 month price performance	6 month price performance	12 month price performance
Asia Pacific Industrials Peer Group								
TECO Electric & Machinery	1504.TW	Jim Hung	NT\$	7.50	-46.2%	-46.8%	-63.7%	-58.1%
Akzo Nobel	AKZO.AS	Richard Logan, CFA	€	25.53	-38.9%	-40.6%	-52.4%	-53.1%
BASF AG	BASF.DE	Richard Logan, CFA	€	19.95	-49.3%	-52.3%	-57.7%	-59.2%
Bayer AG	BAYG.DE	Richard Logan, CFA	€	37.84	-29.9%	-32.4%	-31.6%	-35.1%
Ciba SC	CIBN.VX	Richard Logan, CFA	SFr	45.04	65.5%	57.6%	25.4%	-18.2%
Clariant	CLNVX	Richard Logan, CFA	SFr	6.10	-38.6%	-42.9%	-37.0%	-57.3%
DSM	DSMN.AS	Richard Logan, CFA	€	21.73	-44.7%	-36.4%	-34.8%	-43.2%
Givaudan	GMV.VX	Richard Logan, CFA	SFr	743.00	-19.1%	-17.4%	-28.8%	-34.5%
Johnson Matthey	JMAT.L	Richard Logan, CFA	£	791.50	-51.4%	-53.6%	-59.9%	-55.1%
Linde AG	LIND.DE	Richard Logan, CFA	€	52.24	-39.3%	-43.3%	-44.5%	-42.2%
Lonza Group	LONN.VX	Richard Logan, CFA	SFr	99.30	-40.1%	-38.1%	-33.9%	-30.4%
Rhodia	RHA.PA	Richard Logan, CFA	€	5.72	-57.1%	-47.5%	-57.5%	-78.2%
Solvay	SOLB.BR	Richard Logan, CFA	€	63.31	-24.4%	-25.3%	-29.0%	-38.7%
Syngenta	SYNN.VX	Richard Logan, CFA	SFr	169.00	-42.9%	-41.5%	-46.3%	-38.9%
Umicore	UMI.BR	Richard Logan, CFA	€	11.25	-62.5%	-60.9%	-63.2%	-68.1%
Taiwan SE Weighted - Index				4.400	-37.6%	-39.2%	-51.5%	-54.3%

Note: Prices as of most recent available close, which could vary from the price date indicated above.

This table shows movement in absolute share price and not total shareholder return. Results presented should not and cannot be viewed as an indicator of future performance.

Source: Factset, Quantum database.

Reg AC

I, Jim Hung, hereby certify that all of the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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The precise calculation of each metric may vary depending on the fiscal year, industry and region but the standard approach is as follows:

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.

Quantum

Quantum is Goldman Sachs' proprietary database providing access to detailed financial statement histories, forecasts and ratios. It can be used for in-depth analysis of a single company, or to make comparisons between companies in different sectors and markets.

Disclosures

Coverage group(s) of stocks by primary analyst(s)

Jim Hung: Asia Pacific Chemicals, Asia Pacific Energy, Taiwan Mid-Caps.

Asia Pacific Chemicals: Chambal Fertilisers and Chemicals, Cheil Industries, Far Eastern Textile, Formosa Chemicals & Fibre, Formosa Plastics, Hanwha Chemical, Honam Petrochemical, Kingboard Chemical Holdings, Kingboard Laminates Holdings, Korea Petrochemical, KP Chemical, LG Chem, Nagarjuna Fertilisers & Chemicals, Nan Ya Plastics, Rashtriya Chemicals & Fertilisers, Sinopec Yizheng Chemical Fibre (A), Sinopec Yizheng Chemical Fibre (H), Tata Chemicals, Titan Chemicals, United Phosphorus.

Asia Pacific Energy: Aban Offshore, Bharat Petroleum, Cairn India Ltd., Chennai Petroleum Corporation, China Gas Holdings, China Petroleum & Chemical (A), China Petroleum and Chemical (ADS), China Petroleum and Chemical (H), CNOOC, CNOOC (ADR), Formosa Petrochemical Corp., Gas Authority of India, Great Offshore, GS Holdings, Gujarat Gas Company, Gujarat State Petronet, Hindustan Petroleum, Indian Oil Corp., Indraprastha Gas, Mangalore Refinery & Petrochemicals, Oil & Gas Development Co. Ltd., Oil & Gas Development Co. Ltd. (GDS), Oil & Natural Gas Corp., PetroChina (A), PetroChina (ADR), PetroChina (H), Petronet LNG, PTT Public Company, PTTEP, Reliance Industries, Reliance Industries (GDR), Reliance Petroleum, S-Oil Corp., SK Energy, Xinao Gas Holdings.

Taiwan Mid-Caps: Asia Cement, E-Ton Solar Technology, Farglory Developers, Goldsun Development and Construction, Motech Industries, Sino-American Silicon Products, Taiwan Cement, Taiwan Fertilizer, TECO Electric & Machinery.

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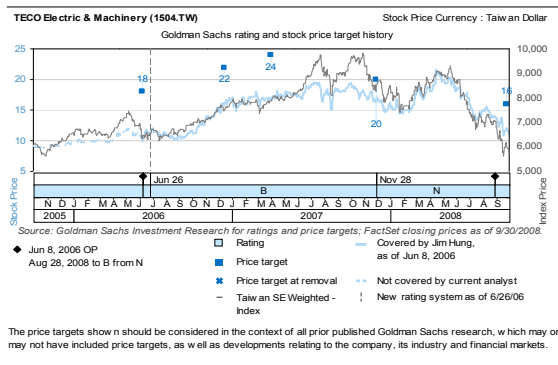
Distribution of ratings/investment banking relationships

Goldman Sachs Investment Research global coverage universe

	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)



Regulatory disclosures

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