

TAIWAN

Tripod Technology Corp

28 October 2008

3044 TT **Outperform**

Stock price as of 24 Oct 08	NT\$	43.20
12-month target	NT\$	60.00
Upside/downside	%	+38.9
Valuation	NT\$	56.00-64.00
- ROE-g/COE-g		

GICS sector	technology hardware & equipment	
Market cap	NT\$m	19,988
30-day avg turnover	NT\$m	42.5
Market cap	US\$m	598
Foreign ownership	%	54.4
Number shares on issue	m	462.7

Investment fundamentals

Year end 31 Dec		2007A	2008E	2009E	2010E
Total revenue	m	27,342	31,783	33,481	39,028
Reported profit	m	4,002	3,262	3,274	3,646
Profit bonus exp	m	3,244	3,262	3,274	3,646
Bon exp/rep prof	%	18.9	0.0	0.0	0.0
Adjusted profit	m	4,002	3,262	3,274	3,646
EPS rep	NT\$	8.84	7.10	7.08	7.88
EPS rep growth	%	25.3	-19.7	-0.4	11.3
EPS bonus exp	NT\$	7.17	7.10	7.08	7.88
EPS bonus growth	%	30.9	-0.9	-0.4	11.3
PE rep	x	4.9	6.1	6.1	5.5
PE bonus exp	x	6.0	6.1	6.1	5.5
Total DPS	NT\$	2.27	2.38	2.31	2.68
Total div yield	%	5.2	5.5	5.4	6.2
ROA	%	15.8	9.9	10.0	10.6
ROE	%	34.4	22.2	19.2	18.8
EV/EBITDA	x	3.3	3.4	3.1	2.7
Net debt/equity	%	30.6	12.2	-0.8	-14.9
Price/book	x	1.5	1.3	1.1	1.0

3044 TT rel Taix performance, & rec history



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

Analyst

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Conservative outlook

Event

- We reaffirm our Outperform rating, but reduce our TP from NT\$103 to NT\$60 to reflect earnings estimate reductions and a lower valuation multiple due to weak market sentiment and limited earning growth.

Impact

- Global PCB sector: intensifying price competition.** According to the local press, Prismark expects the global PCB market to decline by 6.5% YoY in 2009, after expanding for six years. Even though we expect PCB capacity growth to continue slowing, we expect price competition to intensify with ASP erosions.
- Tripod to stand out as low-cost manufacturer.** Tripod is known for being a low-cost PCB manufacturer with its in-house ERP system and strong execution. We believe the low-cost structure is enabling Tripod to remain profitable in the downturn. In addition, as hardware manufacturers try to cost-down their products and seek cheaper solutions, the low-cost suppliers (such as Tripod) could be preferred.
- 3Q08: strong operating profit growth.** 3Q08 operating income was in line with our expectations at NT\$949m, +33% QoQ, driven by margin recovery from NT depreciation, a better product mix and higher utilization. With the absence of forex gains, 3Q08 net income fell short of our forecast at NT\$877m, +15% QoQ, for EPS of NT\$2.2. 1-3Q08 EPS totalled NT\$5.4.
- Lacklustre 4Q08 outlook.** We expect Tripod's 4Q08 sales to decline by 4% QoQ, mainly due to weak demand in the TFT and DRAM sector. The margin decline from lower utilization could be offset by falling raw material prices.
- Improving financial structure.** Realizing the slowing economy ahead, Tripod has been lowering its capex plan. With improving operating cashflow, FCF is turning positive and is improving its financial structure. We expect the net gearing ratio to continue declining from the current 26%.

Earnings revision

- We reduce our FY08-09E profit by 14% and 21%, respectively, to reflect lower revenue growth from the global economic slowdown.

Price catalyst

- 12-month price target: NT\$60.00 based on an ROE-g/COE-g methodology.
- Catalyst: Attractive valuation and improving cashflows.

Action and recommendation

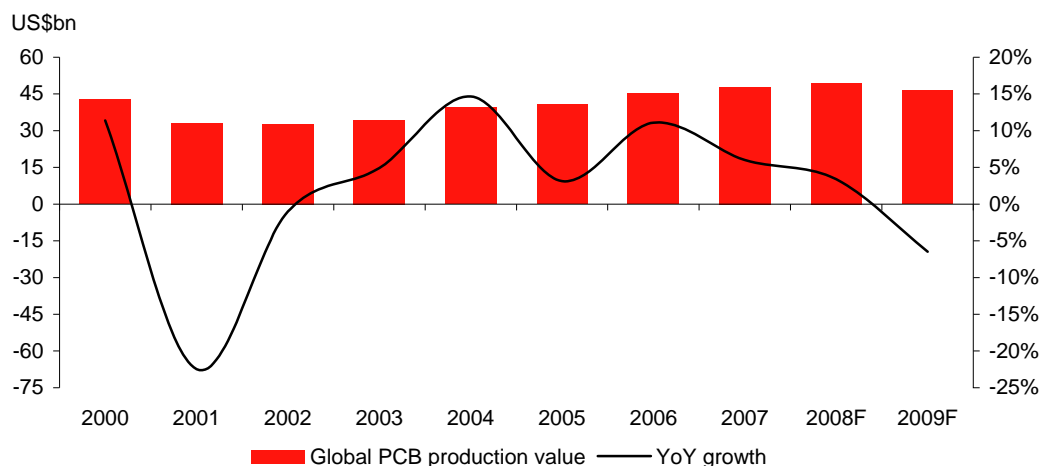
- Tripod's share price declined by 37% and underperformed the Taix by 11% during the past month due to limited liquidity and the company's exposure to DRAM and TFT. We believe the stock has been oversold at less than a 6x PER (lower end of PCB peer trading range), despite Tripod's strong execution, low-cost structure and improving balance sheet. Tripod is our top pick in the PCB space, and our TP NT\$60 is derived from its average 2008/09 ROE-g/COE-g with a 30% discount, implying a 2008/09E PER of 8.5x.

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.

Negative growth for the PCB sector in FY09

According to the local press, Prismark expects the global PCB market (in terms of production value) to decline by 6.5% YoY in FY09, following growth of 3–4% in FY08. This is the first time since FY01 that the market is expected to post negative growth and is a result of the global economic slowdown, which affects demand for electronic products. Although we expect PCB capacity growth to continue slowing, with small players exiting the market, intensifying price competition with ASP erosion seems to be inevitable.

Fig 1 Global PCB market



Source: Macquarie Research, October 2008

Low-cost manufacture wins

Tripod is known for being a low-cost PCB manufacturer with its in-house ERP system and strong execution. We believe the low-cost structure is enabling Tripod to remain profitable in the downturn. In addition, as hardware manufacturers try to cost-down their products and seek cheaper solutions, the low-cost suppliers (such as Tripod) could be preferred.

3Q08: strong operating profit growth

Tripod reported its 3Q08 results, which were in line with market expectations. 3Q08 revenue was driven mostly by NB and HDI applications, while both DRAM and TFT PCB declined. The gross margin improved to 20% in 3Q08 from 18% in 2Q08, due to NT depreciation, a better product mix and higher utilization. 3Q08 operating income was in line with our expectation at NT\$949m, +33% QoQ as opex was maintained at the 2Q08 level. In the absence of forex gains, 3Q08 net income of NT\$877m, +15% QoQ, fell short of our forecast, for EPS of NT\$2.2; 1–3Q08 EPS totalled NT\$5.4.

Fig 2 Tripod 3Q08 results comparison

(NT\$ m)	3Q08A	3Q08E	2Q08	3Q07	QoQ	YoY	+/-
Revenue	8,522	8,662	7,815	7,167	9%	19%	-2%
Gross profits	1,715	1,752	1,433	1,644	20%	4%	-2%
Operating profits	949	955	714	1,085	33%	-13%	-1%
Non-op profits	59	197	184	129	-68%	-54%	-70%
Pretax profits	1,008	1,151	898	1,214	12%	-17%	-12%
Net profits	877	990	762	1,076	15%	-18%	-11%
EPS	1.90	2.14					
Gross margin	20.1%	20.2%	18.3%	22.9%			
Operating margin	11.1%	11.0%	9.1%	15.1%			
Pretax margin	11.8%	13.3%	11.5%	16.9%			
Net margin	10.3%	11.4%	9.7%	15.0%			

Source: Company data, Macquarie Research, October 2008

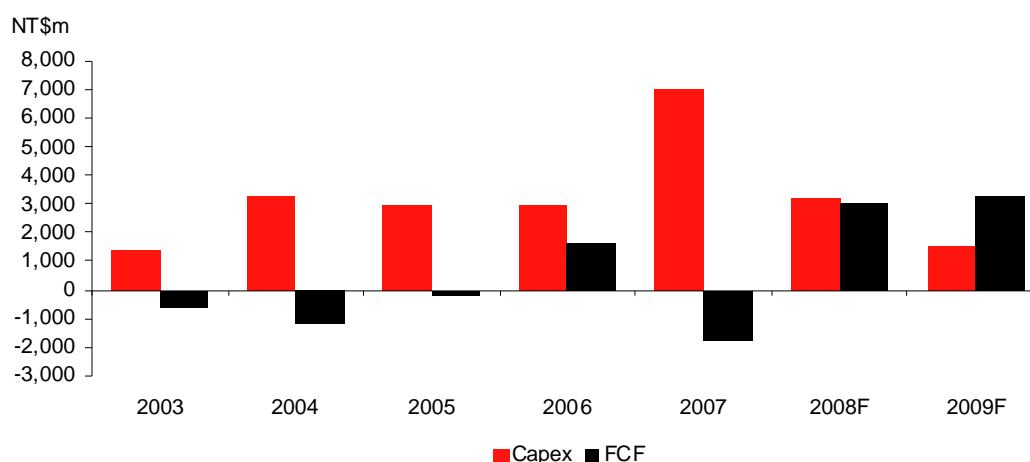
Lacklustre 4Q08 outlook

Given the weak economic outlook and limited visibility, we expect Tripod's 4Q08 sales to decline by 4% QoQ, mainly due to weak demand in the TFT and DRAM segments. Growth in HDI and PC applications could be limited vs a high base in 3Q08. We expect margins to decline slightly to 20% because the negative effect from lower utilization could be offset by falling raw material prices.

Improving financial structure

Recognizing the slowing economy ahead, most Taiwan PCB companies are cutting back on their capex plans. Although capacity intensity is lower, a reduction in capex should also improve FCF. As is true for its peers, Tripod is reducing its capex by 50% for FY08 and plans to cut another 50% in FY09. With an improving operating cashflow, Tripod's FCF is turning positive and is improving its financial structure. In addition, its negative gearing ratio declined to 26% at the end of 3Q08 from 31% at the end of FY07, and we expect the ratio to decline further in the coming quarters.

Fig 3 Tripod capex and FCF



Source: TEJ, Macquarie Research, October 2008

ROE-g/COE-g valuations: TP of NT\$60

Our target price of NT\$60 is derived from an ROE-g/COE-g valuation approach with a 30% discount. We arrive at this value by applying a 4% risk-free rate, 10% cost of equity, 2008/09 average ROE of 20.8% and a 2% long-term growth rate. Although we arrive at a fair price of NT\$86, we take a 30% discount as we note the company's limited earnings growth and exposure to TFT/DRAM sectors. After the discount, the target price of NT\$60 implies an average 2008/09E PER of 8.5x. We do not consider this valuation target to be aggressive given Tripod's strong execution and improving financial structure.

Fig 4 ROE-g/COE-g assumption

Net asset value approach

ROE - 2008-09	20.78
COE (%)	10.00
g (%)	2.00
ROE-g/COE-g	2.35
BVPS 2008-09	36.8
Net asset value (NT\$ per share)	86.3
30% discount	60

Source: Macquarie Research, October 2008

Shares have been oversold

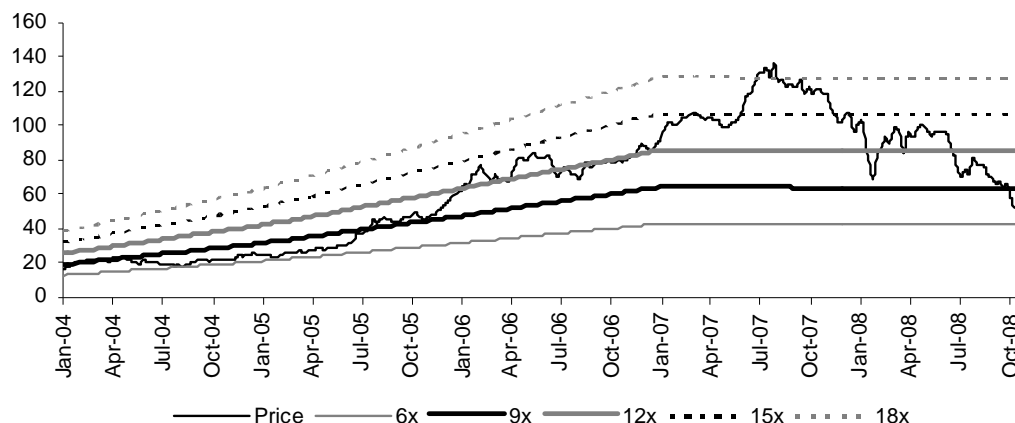
Over the past month, Tripod’s share price has declined by 37% and underperformed the Taiex by 11%. The underperformance could be a result of limited liquidity and the company’s exposure to the DRAM and TFT sectors. The company currently trades at a PER of less than 6x, which is at the lower end of the PCB peer trading range. Because we expect the global PCB sector to post negative growth and several PCB companies to continue suffering from losses, our top pick in the PCB sector is Tripod given its strong execution, low-cost structure, improving financial structure and undemanding valuation.

Fig 5 Tripod earnings revision table

	FY08E			FY09E		
	New	Old	+/-	New	Old	+/-
Revenue	31,783	33,496	-5.1%	33,481	40,016	-16.3%
Gross Profit	6,136	6,620	-7.3%	6,646	7,998	-16.9%
Operating Profit	3,196	3,536	-9.6%	3,590	4,364	-17.7%
Pretax Profit	3,794	4,387	-13.5%	3,875	4,884	-20.7%
Net Profit	3,271	3,780	-13.5%	3,274	4,127	-20.7%
Gross Margin	19.3%	19.8%		19.8%	20.0%	
Operating Margin	10.1%	10.6%		10.7%	10.9%	
Net Margin	10.3%	11.3%		9.8%	10.3%	

Source: Macquarie Research, October 2008

Fig 6 Tripod 1-year forward PER band



Source: Macquarie Research, October 2008

Tripod Technology Corp (3044 TT, Outperform, Target price: NT\$60.00)

Quarterly Results					Profit & Loss						
		2Q/08A	3Q/08E	4Q/08E	1Q/09E		2007A	2008E	2009E	2010E	
Revenue	m	7,815	8,522	8,194	7,435	Revenue	m	27,342	31,783	33,481	39,028
Gross Profit	m	1,433	1,715	1,635	1,370	Gross Profit	m	6,189	6,097	6,646	7,727
Operating Expenses	m	-719	-766	-762	-699	Operating Expenses	m	-2,163	-2,940	-3,056	-3,511
Operating Income	m	714	949	873	672	Operating Income	m	4,026	3,157	3,590	4,216
Net Non-operating income	m	184	59	32	24	Net Non-operating income	m	566	623	285	230
Pre-Tax Income	m	898	1,008	905	696	Pre-Tax Income	m	4,593	3,780	3,875	4,446
Tax Expense	m	-138	-130	-127	-108	Tax Expense	m	-587	-525	-601	-800
Exceptionals	m	0	0	0	0	Exceptionals	m	0	0	0	0
Minority Interests	m	2	4	0	0	Minority Interests	m	-3	6	0	0
Reported Earnings	m	762	881	778	588	Reported Earnings	m	4,002	3,262	3,274	3,646
Reported Earnings (bonus exp)	m	762	881	778	588	Reported Earnings (bonus exp)	m	3,244	3,262	3,274	3,646
Bonus exp / Reported Earnings	%	0.0	0.0	0.0	0.0	Bonus exp / Reported Earnings	%	18.9	0.0	0.0	0.0
Adjusted Earnings	m	762	881	778	588	Adjusted Earnings	m	4,002	3,262	3,274	3,646
EBITDA	m	1,521	1,778	1,724	1,524	EBITDA	m	6,448	6,416	7,079	7,962
EPS (rep)	NT\$	1.67	1.90	1.68	1.27	EPS (rep)	NT\$	8.84	7.10	7.08	7.88
EPS pcg growth (rep)	%	-18.4	-19.4	-35.0	-31.1	EPS growth (rep)	%	25.3	-19.7	-0.4	11.3
EPS (rep bonus exp)	NT\$	1.67	1.90	1.68	1.27	EPS (rep bonus exp)	NT\$	7.17	7.10	7.08	7.88
EPS pcg growth (rep bonus exp)	%	0.7	-0.5	-19.8	-31.1	EPS growth (rep bonus exp)	%	30.9	-0.9	-0.4	11.3
EPS (adj)	NT\$	1.67	1.90	1.68	1.27	EPS (adj)	NT\$	8.84	7.10	7.08	7.88
EPS pcg growth (adj)	%	-18.4	-19.4	-35.0	-31.1	EPS growth (adj)	%	25.4	-19.6	-0.4	11.3
Revenue pcg growth	%	22.4	18.9	1.0	2.5	PE (rep)	x	4.9	6.1	6.1	5.5
Operating Income pcg growth	%	-24.1	-12.5	-23.8	8.2	PE (rep bonus adj)	x	6.0	6.1	6.1	5.5
Reported Earnings pcg growth	%	-17.3	-18.1	-34.0	-30.0	PE (adj)	x	4.9	6.1	6.1	5.5
Gross Profit Margin	%	18.3	20.1	20.0	18.4	Total DPS	NT\$	2.27	2.38	2.31	2.68
Operating Income Margin	%	9.1	11.1	10.7	9.0	Total Div Yield	%	5.2	5.5	5.4	6.2
Reported Earnings Margin	%	9.7	10.3	9.5	7.9	Weighted Average Shares	m	452.6	459.1	462.7	462.7
EBITDA Margin	%	19.5	20.9	21.0	20.5	Period End Shares	m	455.5	462.7	462.7	462.7
Profit and Loss Ratios		2007A	2008E	2009E	2010E	Cashflow Analysis		2007A	2008E	2009E	2010E
Revenue Growth	%	32.8	16.2	5.3	16.6	Reported Earnings	m	4,002	3,262	3,274	3,646
Gross Profit Growth	%	28.2	-1.5	9.0	16.3	Depreciation & Amortisation	m	2,422	3,260	3,489	3,746
Operating Income Growth	%	26.5	-21.6	13.7	17.4	Chgs in Working Cap	m	-1,634	-1,231	-2,429	-1,830
Reported Earnings Growth	%	31.1	-18.5	0.4	11.3	Other	m	-283	121	-43	199
EBITDA Growth	%	35.3	-0.5	10.3	12.5	Operating Cashflow	m	4,507	5,411	4,291	5,761
Gross Profit Margin	%	22.6	19.2	19.8	19.8	Acquisitions	m	6	0	0	0
Operating Income Margin	%	14.7	9.9	10.7	10.8	Capex	m	-7,001	-3,212	-1,500	-2,000
Reported Earnings Margin	%	14.6	10.3	9.8	9.3	Asset Sales	m	0	0	0	0
EBITDA Margin	%	23.6	20.2	21.1	20.4	Other	m	0	0	0	0
Payout Ratio	%	25.7	33.5	32.7	34.0	Investing Cashflow	m	-6,996	-3,212	-1,500	-2,000
EV/EBITDA	x	3.3	3.4	3.1	2.7	Dividend (Ordinary)	m	-595	-1,093	-1,101	-1,071
EV/EBIT	x	5.3	6.9	6.1	5.2	Equity Raised	m	0	330	0	0
Balance Sheet Ratios						Debt Movements	m	2,330	964	450	600
ROE	%	34.4	22.2	19.2	18.8	Other	m	-362	-208	-95	-127
ROA	%	15.8	9.9	10.0	10.6	Financing Cashflow	m	1,372	-7	-746	-598
ROIC	%	32.1	15.5	17.0	19.2	Net Chg in Cash/Debt	m	-1,368	2,192	2,045	3,163
Net Debt/Equity	%	30.6	12.2	-0.8	-14.9	Free Cashflow	m	-2,494	2,199	2,791	3,761
Interest Cover	x	34.8	16.1	18.0	26.3	FCF per Share	NT\$	-5.51	4.79	6.03	8.13
Price/Book	x	1.5	1.3	1.1	1.0	P/FCF	x	-7.8	9.0	7.2	5.3
Book Value per Share	NT\$	29.4	34.4	39.1	44.7	Balance Sheet		2007A	2008E	2009E	2010E
						Cash	m	624	3,351	5,731	9,084
						Receivables	m	7,895	9,168	10,302	12,009
						Inventories	m	3,519	3,667	5,151	6,004
						Investments	m	0	0	0	0
						Fixed Assets	m	16,985	17,214	15,354	13,780
						Intangibles	m	0	0	0	0
						Other Assets	m	728	838	888	956
						Total Assets	m	29,751	34,239	37,426	41,832
						Payables	m	3,994	4,199	4,387	5,117
						Short Term Debt	m	1,526	1,847	1,997	2,197
						Long Term Debt	m	3,200	3,448	3,598	3,798
						Provisions	m	0	0	0	0
						Other Liabilities	m	7,621	8,820	9,346	10,047
						Total Liabilities	m	16,340	18,313	19,327	21,158
						Total S/H Equity	m	13,411	15,925	18,099	20,674
						Total Liab & S/H Funds	m	29,751	34,239	37,426	41,832

All figures in NT\$ unless noted.
Source: Macquarie Research, October 2008

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 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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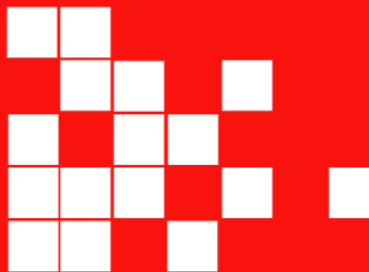
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