

- We are the first on the Street to forecast that UMC will suffer heavily from its main clients' inventory issues.
- Historically, UMC's share price has always underperformed during industry downturns.

Net Profit 09 TWD4.4b
..... (From Net Loss TWD2.3b)

Diff from Consensus (12.1%)
Consensus (mean) TWD5.0b
Consensus (momentum) ↓

Target Price TWD8.80
..... (From TWD10.60)

Diff from Consensus (38.5%)
Consensus (median) TWD14.30
Consensus (momentum)..... ↑

Current Price TWD8.00
Upside/(Downside)..... 10.0%

HOLD
(Unchanged)

Recs in the Market

Positive **2**
Neutral **12**
Negative **7**
Consensus (momentum)..... ← →

Sources: Thomson One Analytics; Bloomberg; BNP Paribas estimates

- We believe UMC's ROE could fall further during this downcycle.
- Our update on valuation is to reflect the valuation de-rating of foundry makers and its impairment loss.
- TP cut to TWD8.80 (based on 0.6x P/BV as we believe UMC will suffer from reduction in discretionary consumption).

Suffers on core and non-core business

New target price of TWD8.80

We lower our target price to TWD8.80 (TWD10.60 earlier), which is based on 0.6x P/BV from the previous 0.7x. Our new valuation reflects: 1) 15% valuation de-rating of foundry manufacturers in the past four weeks; and 2) UMC's potential risk from ProMOS investment. We maintain HOLD for UMC. We believe UMC's ROE will fall further during the downcycle.

Potential risk on ProMos investment

UMC identified impairment loss of TWD3.22b (based on long-term investment value), which will impact EPS by TWD0.24. UMC also allocated investment loss of TWD1.2b from ProMos investment. However, we notice unrealized potential loss arising from valuation of ProMOS shares (UMC acquired TWD471.4m of ProMOS at an average TWD10 vs its current share price of TWD1.88). This indicates potential loss of TWD4b, which should lead to TWD0.33 cut in EPS, if UMC decides to recognise its holding in ProMOS.

4Q08 is probably not the end

UMC guided its 4Q08 wafer shipments will be down 25% q-q (ASP is quite flat), which mainly suffered from global slowdown in semiconductor industry. On the other hand, we believe UMC is likely to suffer more serious order cuts during the downcycle as its clients' base for 65nm is comparatively limited (TI, Nvidia and Altera are the three major 65nm process clients).

Downside risk during downturn

We believe UMC is likely to underperform its 1Q09 outlook. Our 1Q09 revenue forecast for UMC is 8% q-q down. We believe UMC's ROE could fall further in the 4Q08-1Q09 downcycle. We believe UMC is likely to see further significant order cuts because of its weaker position in foundry industry (we notice its market share at 65nm process is behind Chartered).

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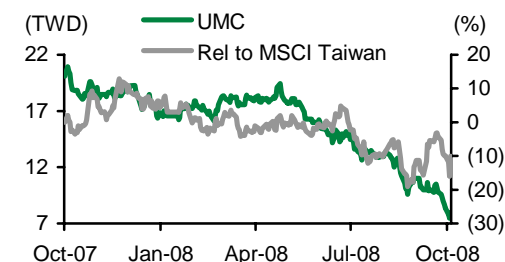
(Team list inside)

Earnings Estimates And Valuation Ratios

YE Dec (TWD m)	2007	2008E	2009E	2010E
Revenue	106,771	92,107	73,415	79,289
Reported net profit	16,962	948	4,358	4,792
Recurring net profit	16,962	948	4,358	4,792
Previous rec net profit	16,962	1,003	(2,300)	(2,361)
Chg from previous (%)	—	(5.4)	—	—
Recurring EPS (TWD)	1.09	0.07	0.33	0.36
Prev rec EPS (TWD)	1.09	0.08	(0.17)	(0.18)
Rec EPS growth (%)	(39.3)	(93.4)	359.6	10.0
Recurring P/E (x)	7.4	111.5	24.3	22.1
Dividend yield (%)	11.8	9.5	—	—
EV/EBITDA (x)	1.8	2.4	2.1	2.2
Price/book (x)	0.4	0.5	0.5	0.5
ROE (%)	6.4	0.4	2.1	2.2
Net debt/equity (%)	(3.0)	(10.6)	(13.5)	(0.8)

Sources: UMC; BNP Paribas estimates

Share Price Daily vs MSCI



Next results/event	January 2009
Market cap (USD m)	2.954
12m avg daily turnover (USD m)	18.6
Free float (%)	91
Major shareholder	Hsun Chieh Investment (3%)
12m high/low (TWD)	20.91/7.48
ADR (USD)	3.23
Avg daily turnover (USD m)	19.6
Discount/premium (%)	18.6
Disc/premium vs 52-wk avg (%)	10.7

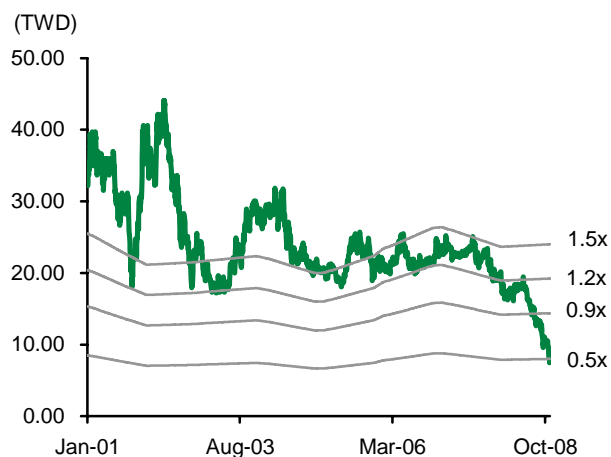
Source: Datastream

Exhibit 1: 2Q08 Results Review

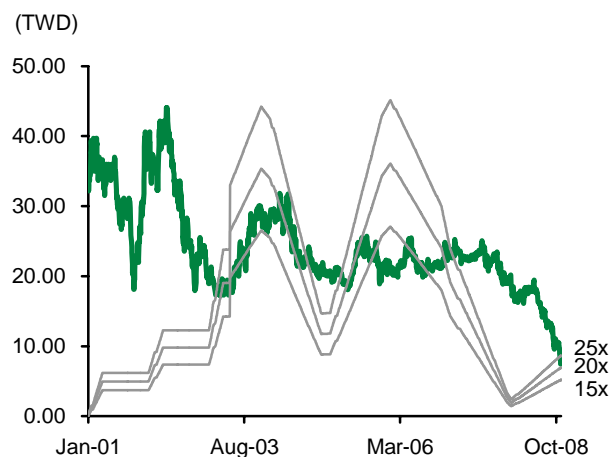
Year-end 31 Dec	3Q08 (TWD m)	3Q08E (TWD m)	Change (q-q %)	4Q08E (TWD m)
Net sales	24,748	24,748	—	18,118
Gross profit	4,368	4,456	(2.0)	1,862
Gross margin (%)	17.6	18.1	—	10.3
Operating profit	947	985	(3.9)	(1,360)
Pretax profit	(1,158)	(898)	29.0	(260)
Net profit	(1,413)	(990)	42.7	(242)
EPS (TWD)	(0.11)	(0.07)	57.1	(0.02)

Note: We assumed 55% of employee bonus expense is allocated in cost of good sold and 45% of employee bonus expense is allocated in SG&A in 1Q08.

Sources: UMC; BNP Paribas estimates

Exhibit 2: Forward P/BV Band Chart

Sources: UMC; BNP Paribas estimates

Exhibit 3: Forward P/E Band Chart

Sources: UMC; BNP Paribas estimates

FINANCIAL STATEMENTS

UMC

Profit and Loss (TWD m)					
Year Ending December	2006A	2007A	2008E	2009E	2010E
Revenue	104,099	106,771	92,107	73,415	79,289
Cost of sales ex depreciation	(37,025)	(46,558)	(39,627)	(32,112)	(34,654)
Gross profit ex depreciation	67,073	60,213	52,480	41,304	44,635
Other operating income	-	-	-	-	-
Operating costs	(14,570)	(15,701)	(13,482)	(11,935)	(12,981)
Operating EBITDA	52,503	44,512	38,997	29,369	31,653
Depreciation	(44,194)	(37,707)	(36,879)	(33,184)	(35,673)
Goodwill amortisation	-	-	-	-	-
Operating EBIT	8,309	6,805	2,118	(3,815)	(4,019)
Net financing costs	822	1,000	484	415	448
Associates	2,735	4,439	(2,461)	2,070	2,236
Recurring non operating income	27,335	7,322	1,163	6,000	6,480
Non recurring items	-	-	-	-	-
Profit before tax	39,201	19,566	1,304	4,670	5,144
Tax	(3,208)	(2,605)	(355)	(312)	(353)
Profit after tax	35,993	16,962	948	4,358	4,792
Minority interests	-	-	-	-	-
Preferred dividends	-	-	-	-	-
Other items	(1,189)	-	-	-	-
Reported net profit	34,804	16,962	948	4,358	4,792
Non recurring items & goodwill (net)	-	-	-	-	-
Recurring net profit	34,804	16,962	948	4,358	4,792
Per share (TWD)					
Recurring EPS *	1.79	1.09	0.07	0.33	0.36
Reported EPS	1.79	1.09	0.07	0.33	0.36
DPS	0.37	0.94	0.76	-	-
Growth					
Revenue (%)	14.7	2.6	(13.7)	(20.3)	8.0
Operating EBITDA (%)	14.5	(15.2)	(12.4)	(24.7)	7.8
Operating EBIT (%)	neg	(18.1)	(68.9)	neg	neg
Recurring EPS (%)	368.5	(39.3)	(93.4)	359.6	10.0
Reported EPS (%)	368.5	(39.3)	(93.4)	359.6	10.0
Operating performance					
Gross margin inc depreciation (%)	22.0	21.1	16.9	11.1	11.3
Operating EBITDA margin (%)	50.4	41.7	42.3	40.0	39.9
Operating EBIT margin (%)	8.0	6.4	2.3	(5.2)	(5.1)
Net margin (%)	33.4	15.9	1.0	5.9	6.0
Effective tax rate (%)	8.2	13.3	27.3	6.7	6.9
Dividend payout on recurring profit (%)	20.9	86.8	1059.6	-	-
Interest cover (x)	na	na	na	na	na
Inventory days	99.0	84.1	92.9	96.4	87.7
Debtor days	43.3	44.4	48.0	50.7	46.1
Creditor days	40.0	34.6	38.2	42.8	43.3
Operating ROIC (%)	5.3	4.6	1.7	(3.3)	(3.3)
Operating ROIC - WACC (%)	(3.6)	(4.2)	(7.2)	(12.1)	(12.2)
ROIC (%)	16.7	7.7	0.4	2.3	2.3
ROIC - WACC (%)	7.9	(1.1)	(8.4)	(6.6)	(6.6)
ROE (%)	12.7	6.4	0.4	2.1	2.2
ROA (%)	10.0	4.9	0.2	1.6	1.7

Profitability is under pressure in the current downcycle

UMC's top-line growth turns negative in 2008-09

* Pre exceptional, pre-goodwill and fully diluted

Sources: UMC; BNP Paribas estimates

Cash Flow (TWD m)					
Year Ending December	2006A	2007A	2008E	2009E	2010E
Recurring net profit	34,804	16,962	948	4,358	4,792
Depreciation	44,194	37,707	36,879	33,184	35,673
Associates & minorities	-	-	-	-	-
Other non-cash items	(28,552)	(7,810)	(14,100)	(10,065)	(10,065)
Recurring cash flow	50,446	46,859	23,727	27,477	30,399
Change in working capital	(4,400)	(119)	8,033	4,742	(214)
Capex - maintenance	533	479	(139)	-	-
Capex - new investment	(30,955)	(27,866)	(19,800)	(28,000)	(25,000)
Free cash flow to equity	15,624	19,353	11,822	4,218	5,185
Net acquisitions & disposals	150	-	-	-	-
Dividends paid	(7,156)	(12,461)	(10,046)	-	-
Non recurring cash flows	14,391	3,690	18,567	5,057	(32,194)
Net cash flow	23,010	10,582	20,343	9,275	(27,009)
Equity finance	0	(53,910)	-	-	-
Debt finance	(36,129)	(2,505)	(28,592)	(11,650)	(1,092)
Movement in cash	(13,119)	(45,833)	(8,249)	(2,375)	(28,102)

Per share (TWD)

Recurring cash flow per share	2.59	3.00	1.80	2.08	2.30
FCF to equity per share	0.80	1.24	0.89	0.32	0.39

Balance Sheet (TWD m)

Year Ending December	2006A	2007A	2008E	2009E	2010E
Working capital assets	35,035	30,800	22,863	20,807	21,848
Working capital liabilities	(24,705)	(20,263)	(17,964)	(20,649)	(21,475)
Net working capital	10,331	10,537	4,900	158	372
Tangible fixed assets	142,647	129,815	110,580	118,197	122,925
Operating invested capital	152,978	140,351	115,479	118,355	123,297
Goodwill	-	-	-	-	-
Other intangible assets	-	-	-	-	-
Investments	82,746	81,429	62,862	57,806	90,000
Other assets	11,405	11,266	11,405	11,405	11,861
Invested capital	247,129	233,047	189,746	187,565	225,158
Cash & equivalents	(83,395)	(37,453)	(30,063)	(36,971)	(10,377)
Short term debt	5,356	22,889	452	446	464
Long term debt *	30,383	7,495	7,496	7,871	8,186
Net debt	(47,656)	(7,068)	(22,115)	(28,655)	(1,727)
Deferred tax	-	-	-	-	-
Other liabilities	3,620	3,648	3,761	3,761	3,912
Total equity	291,165	236,467	208,100	212,458	222,973
Minority interests	-	-	-	-	-
Invested capital	247,129	233,047	189,746	187,565	225,158

* Includes convertibles and preferred stock which is being treated as debt

Per share (TWD)

Book value per share	15.22	17.89	15.75	16.08	16.87
Tangible book value per share	15.22	17.89	15.75	16.08	16.87

Financial strength

Net debt/equity (%)	(16.4)	(3.0)	(10.6)	(13.5)	(0.8)
Net debt/total assets (%)	(13.4)	(2.4)	(9.3)	(11.7)	(0.7)
Current ratio (x)	3.9	1.6	2.9	2.7	1.5
CF interest cover (x)	na	na	na	na	na

Valuation	2006A	2007A	2008E	2009E	2010E
Recurring P/E (x) *	4.5	7.4	111.5	24.3	22.1
Recurring P/E @ target price (x) *	4.9	8.1	122.7	26.7	24.3
Reported P/E (x)	4.5	7.4	111.5	24.3	22.1
Dividend yield (%)	4.7	11.8	9.5	-	-
P/CF (x)	3.1	2.7	4.5	3.8	3.5
P/FCF (x)	10.0	6.5	8.9	25.1	20.4
Price/book (x)	0.5	0.4	0.5	0.5	0.5
Price/tangible book (x)	0.5	0.4	0.5	0.5	0.5
EV/EBITDA (x) **	1.3	1.8	2.4	2.1	2.2
EV/EBITDA @ target price (x) **	1.5	2.0	2.7	2.4	2.5
EV/invested capital (x)	0.4	0.4	0.4	0.4	0.5

* Pre exceptional, pre-goodwill and fully diluted

** EBITDA includes associate income and recurring non-operating income

Sources: UMC; BNP Paribas estimates

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*In most cases, the target price will equal the analyst's assessment of the current fair value of the stock. However, if the analyst doesn't think the market will reassess the stock over the specified time horizon due to a lack of events or catalysts, then the target price may differ from fair value. In most cases, therefore, our recommendation is an assessment of the mismatch between current market price and our assessment of current fair value.

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