

Asia Taiwan

Technology Semiconductor & Semiconductor Equipment

Deutsche Bank



24 October 2008

UMC

Reuters: **2303.TW** Bloomberg: **2303 TT** Exchange: **TAI** Ticker: **2303**

Long-term structural negatives; retain Sell

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More sluggish outlook

We cut our EPS forecasts by 75% for 2008, 22% for 2009, and 24% for 2010 to factor in a higher investment loss in 3Q08 and a broad-based demand weakness. We believe its market share loss led by slow progress in ramping 65/55/45nm nodes should cause more earnings downside risks from 2009. We reduce our TP from NT\$9 to NT\$7 and retain our Sell rating.

Net loss in 2H08

Sales declined 2% QoQ in 3Q08, in line with our estimate and guidance. We expect GM to fall 3.6ppt to 19.4% in 3Q08, in line with guided high teen point. However, EPS may come in at NT\$0.02 loss in 3Q08, worse than consensus of NT\$0.15 due to impairment loss of NT\$3.2bn from SiS, KYEC, and SpringSoft. We expect the company to guide for sales to decrease 17-20% QoQ vs. consensus of 4% QoQ decline and GM to fall to 11-13% in 4Q08 owing to more order cuts on concerns over weaker demand. As such, EPS may suffer another net loss of NT\$0.02 in 4Q08.

Poor execution in advanced technology nodes

We expect a slower ramp-up of advanced technologies to trigger more earnings downside risks in 2009 and beyond. We estimate the company's market share in foundry industry to fall to 18% in 2008 and 17% in 2009 from 21% in 2007 due to an uncompetitive yield rate and fewer product qualifications in advanced technology nodes (65/55/45nm).

Not too late to Sell

Our revised TP of NT\$7 implies 16% downside potential and is based on 14x US GAAP 2009E EPS, which is below the average of 22.5x during 2003-06. This can be merited by its 2009E-10E earnings CAGR of 81%, which is lower than 320% during 2003-06. Our TP also implies 0.5x 2009 PB. We believe this can be justified by its 4% ROE in 2009, lower than the cost of equity of 9.3%. Upside risks include a better execution in advanced technologies, a higher investment income, and a stronger demand.

Forecasts and ratios

Year End Dec 31	2006A	2007A	2008E	2009E	2010E
Sales (TWDm)	104,098.6	106,771.1	94,271.2	83,958.2	92,332.9
EBITDA (TWDm)	50,417.3	44,560.0	40,668.8	33,837.9	34,861.6
Reported NPAT (TWDm)	32,619.3	16,961.8	2,136.9	6,926.8	7,031.6
Reported EPS FD(TWD)	2.35	1.22	0.15	0.50	0.51
DB EPS FD(TWD)	1.57	-0.67	0.15	0.50	0.51
DB EPS growth (%)	-	-	-	224.2	1.5
PER (x)	17.4	-	54.4	16.8	16.5
EV/EBITDA (x)	10.0	10.5	2.9	3.4	3.3
DPS (net) (TWD)	0.70	0.75	0.10	0.33	0.34
Yield (net) (%)	2.6	2.9	1.2	3.9	4.1

Source: Deutsche Bank estimates, company data

¹ DB EPS is fully diluted and excludes non-recurring items² Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Recommendation/Estimate

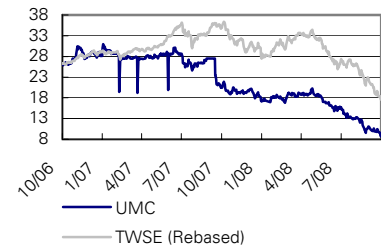
Sell

Price at 24 Oct 2008 (TWD)	8.37
Price target - 12mth (TWD)	7.00
52-week range (TWD)	21.85 - 8.67
TWSE	4,731

Key changes

Price target	9.00 to 7.00	↓	-22.2%
Sales (FYE)	95,292 to 94,271	↓	-1.1%
Op prof margin (FYE)	3.9 to 3.7	↓	-3.4%
Net profit (FYE)	8,657.8 to 2,136.9	↓	-75.3%

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-18.6	-44.8	-57.8
TWSE	-23.5	-35.3	-50.2

Stock data

Market cap (TWDm)	116,277
Market cap (USDm)	3,489
Shares outstanding (m)	15,618.5
Major shareholders	Shun Jay (3.06%)
Free float (%)	85
Avg daily value traded (USDm)	15.3

Key indicators (FY1)

ROE (%)	1.0
Net debt/equity (%)	-4.3
Book value/share (TWD)	12.43
Price/book (x)	0.7
Net interest cover (x)	-
Operating profit margin (%)	3.7

Deutsche Bank AG/Hong Kong

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Model updated: 24 October 2008

Running the numbers**Asia****Taiwan****Semiconductor & Semiconductor****UMC**

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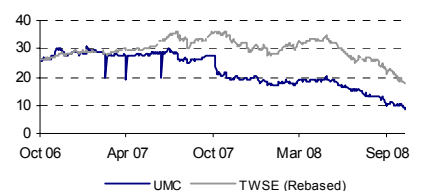
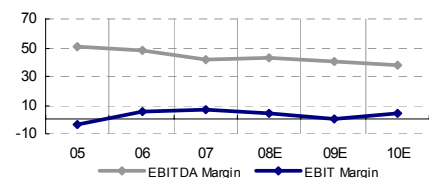
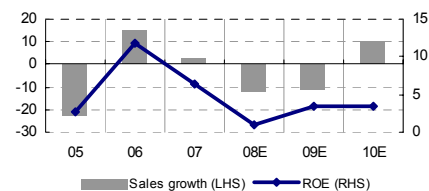
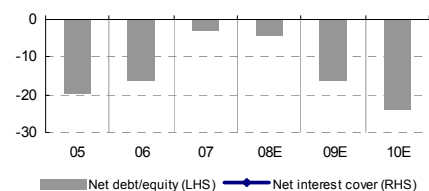
Bloomberg: 2303 TT

Sell

Price (24 Oct 08)	TWD 8.37
Target price	TWD 7.00
52-week Range	TWD 8.67 - 21.85
Market Cap (m)	TWDm 116,277 USDm 3,489

Company Profile

United Microelectronics Corporation designs, manufactures, and markets integrated circuits (ICs) and related electronic products. The Company's main products are consumer electronic ICs, memory ICs, personal computer peripheral ICs, and communication ICs.

Price Performance**Margin Trends****Growth & Profitability****Solvency****Michael Chou**

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Fiscal year end 31-Dec

	2005	2006	2007	2008E	2009E	2010E
Financial Summary						
DB EPS (TWD)	-1.13	1.57	-0.67	0.15	0.50	0.51
Reported EPS (TWD)	0.51	2.35	1.22	0.15	0.50	0.51
DPS (TWD)	0.40	0.70	0.75	0.10	0.33	0.34
BVPS (TWD)	15.3	15.8	13.1	12.4	15.3	14.6

Weighted average shares (m)	16,828	18,411	18,051	15,619	13,169	13,892
Average market cap (TWDm)	453,959	502,341	467,237	116,277	116,277	116,277
Enterprise value (TWDm)	453,959	502,341	467,237	116,277	116,277	116,277

Valuation Metrics

P/E (DB) (x)	nm	17.4	nm	54.4	16.8	16.5
P/E (Reported) (x)	53.3	11.6	21.2	54.4	16.8	16.5
P/BV (x)	1.72	1.84	1.54	0.67	0.55	0.57
FCF Yield (%)	6.1	3.0	4.0	18.1	23.1	17.1
Dividend Yield (%)	1.5	2.6	2.9	1.2	3.9	4.1
EV/Sales (x)	5.0	4.8	4.4	1.2	1.4	1.3
EV/EBITDA (x)	9.9	10.0	10.5	2.9	3.4	3.3
EV/EBIT (x)	nm	82.0	68.7	33.0	298.6	28.1

Income Statement (TWDm)

Sales revenue	90,775	104,099	106,771	94,271	83,958	92,333
Gross profit	59,712	64,987	60,261	53,831	45,570	47,362
EBITDA	48,517	44,293	44,560	40,669	33,838	34,862
Depreciation	48,517	44,293	37,755	37,148	33,448	30,724
Amortisation	0	0	0	0	0	0
EBIT	-2,669	6,124	6,805	3,521	389	4,138
Net interest income/(expense)	27	822	1,000	520	536	670
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinary	0	-1,189	0	0	0	0
Other pre-tax income/(expense)	9,669	30,070	11,762	-1,837	6,771	3,005
Profit before tax	7,028	37,016	19,566	2,204	7,696	7,813
Income tax expense	1	3,208	2,605	67	770	781
Minorities	0	0	0	0	0	0
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	7,027	32,619	16,962	2,137	6,927	7,032
DB adjustments (including dilution)	-22,696	-10,823	-26,226	0	0	0
DB Net profit	-15,669	21,797	-9,264	2,137	6,927	7,032

Cash Flow (TWDm)

Cash flow from operations	46,012	46,049	46,784	39,319	38,308	34,202
Net Capex	-18,457	-30,955	-27,867	-15,645	-12,800	-14,300
Free cash flow	27,555	15,094	18,917	23,674	25,508	19,902
Equity raised/(bought back)	0	0	-53,911	0	0	0
Dividends paid	-1,759	-7,156	-12,462	-9,297	-1,389	-4,584
Net inc/(dec) in borrowings	7,754	-10,250	2,260	-22,261	-1,705	-166
Other investing/financing cash flows	-20,301	-10,890	3,774	-1,516	465	-48
Net cash flow	13,249	-13,202	-45,942	-9,401	22,878	15,103
Change in working capital	-3,319	7,916	-4,918	-1,911	-1,076	-2,358

Balance Sheet (TWDm)

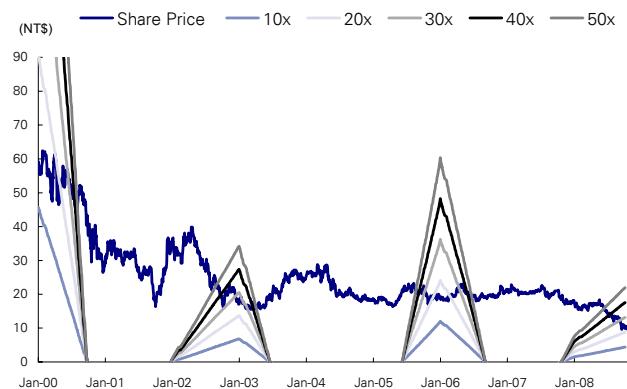
Cash and other liquid assets	96,597	83,395	37,453	28,052	50,930	66,600
Tangible fixed assets	149,810	142,647	129,815	104,496	83,469	66,977
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	39,974	92,259	86,229	67,184	66,358	66,214
Other assets	39,841	36,928	37,266	34,936	39,819	43,620
Total assets	326,221	355,229	290,763	234,668	240,576	243,411
Interest bearing debt	46,259	35,739	30,385	19,648	17,989	17,825
Other liabilities	21,679	28,325	23,911	20,851	21,730	22,272
Total liabilities	67,938	64,064	54,296	40,499	39,719	40,097
Shareholders' equity	258,284	291,165	236,467	194,169	200,857	203,315
Minorities	0	0	0	0	0	0
Total shareholders' equity	258,284	291,165	236,467	194,169	200,857	203,315
Net debt	-50,338	-47,656	-7,068	-8,404	-32,941	-48,775

Key Company Metrics

Sales growth (%)	-22.6	14.7	2.6	-11.7	-10.9	10.0
DB EPS growth (%)	-10.1	na	na	na	224.2	1.5
EBITDA Margin (%)	50.5	48.4	41.7	43.1	40.3	37.8
EBIT Margin (%)	-2.9	5.9	6.4	3.7	0.5	4.5
Payout ratio (%)	95.8	39.5	79.8	73.1	62.7	67.2
ROE (%)	2.7	11.9	6.4	1.0	3.5	3.5
Capex/sales (%)	20.5	30.0	26.3	16.6	15.2	15.5
Capex/depreciation (x)	0.4	0.7	0.7	0.4	0.4	0.5
Net debt/equity (%)	-19.5	-16.4	-3.0	-4.3	-16.4	-24.0
Net interest cover (x)	nm	nm	nm	nm	nm	nm

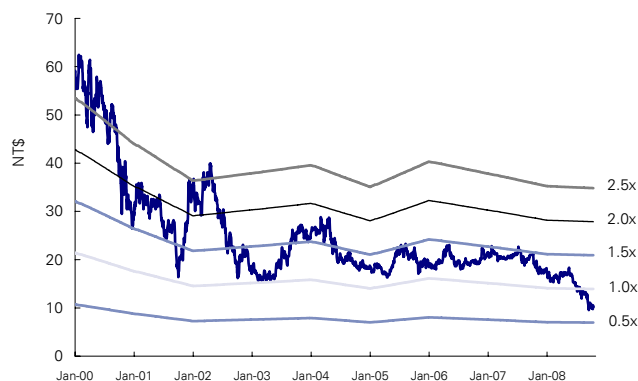
Source: Company data, Deutsche Bank estimates

Figure 1: Forward PE band for UMC – US GAAP



Source: Company data; Deutsche Bank estimates

Figure 2: Forward PB band for UMC – US GAAP



Source: Company data; Deutsche Bank estimates

Figure 3: Earnings model for UMC – US GAAP

NT\$m	1Q08	2Q08	3Q08E	4Q08E	2008E	1Q09E	2Q09E	3Q09E	4Q09E	2009E
Net Sales	24,003	25,238	24,754	20,276	94,271	18,539	19,816	22,140	23,464	83,958
Gross Profit	3,576	5,795	4,795	2,517	16,683	1,634	2,409	3,647	4,431	12,121
Depreciation & Amortization	(9,605)	(9,400)	(9,263)	(8,880)	(37,148)	(8,692)	(8,455)	(8,288)	(8,013)	(33,448)
Operating profit	190	2,340	1,453	(463)	3,521	(1,100)	(434)	614	1,310	389
PBT	261	2,461	(240)	(278)	2,204	193	1,233	3,256	3,015	7,696
PAT	206	2,397	(216)	(250)	2,137	174	1,109	2,930	2,713	6,927
EPS (NT\$)	0.01	0.17	(0.02)	(0.02)	0.15	0.01	0.08	0.21	0.20	0.50
Margin (%)										
Gross Margin	14.9%	23.0%	19.4%	12.4%	17.7%	8.8%	12.2%	16.5%	18.9%	14.4%
Depreciation	40.0%	37.2%	37.4%	43.8%	39.4%	46.9%	42.7%	37.4%	34.1%	39.8%
Operating margin	0.8%	9.3%	5.9%	-2.3%	3.7%	-5.9%	-2.2%	2.8%	5.6%	0.5%
Net Margin	0.9%	9.5%	-0.9%	-1.2%	2.3%	0.9%	5.6%	13.2%	11.6%	8.3%
Growth (%)										
Sales YoY	4%	1%	-20%	-27%	-12%	-23%	-21%	-11%	16%	-11%
PAT YoY	nm	nm	-108%	nm	nm	-16%	-54%	nm	nm	224%
Sales QoQ	-13%	5%	-2%	-18%	-9%	7%	12%	6%		
PAT QoQ	nm	1065%	-109%	nm	nm	539%	164%	-7%		

Source: Deutsche Bank estimates

Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
UMC	2303.TW	8.67 (TWD) 23 Oct 08	2,6,14

*Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies.

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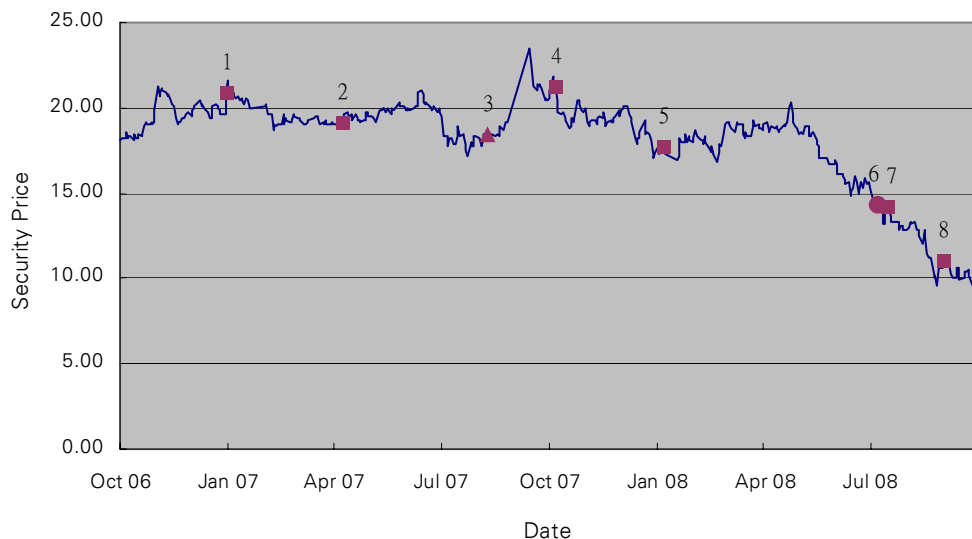
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Historical recommendations and target price: UMC (2303.TW)

(as of 10/23/2008)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

*New Recommendation Structure as of September 9, 2002

1.	24/1/2007:	Hold, Target Price Change TWD23.00	5.	30/1/2008:	Buy, Target Price Change TWD23.00
2.	2/5/2007:	Hold, Target Price Change TWD21.00	6.	30/7/2008:	Downgrade to Sell, Target Price Change TWD11.00
3.	3/9/2007:	Upgrade to Buy, Target Price Change TWD24.00	7.	8/8/2008:	Sell, Target Price Change TWD10.50
4.	31/10/2007:	Buy, Target Price Change TWD25.50	8.	25/9/2008:	Sell, Target Price Change TWD9.00

Equity rating key **Equity rating dispersion and banking relationships**

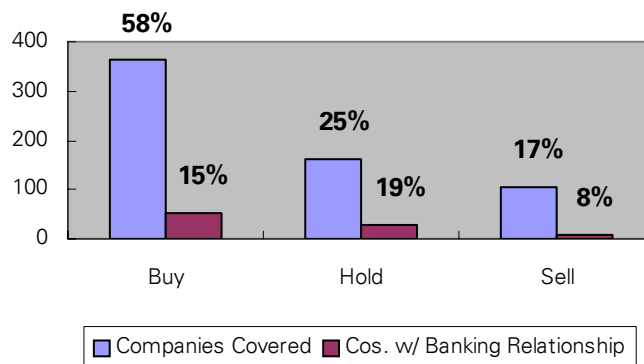
Buy: Based on a current 12- month view of total shareholder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield) , we recommend that investors buy the stock.

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Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

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1. Newly issued research recommendations and target prices always supersede previously published research.
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 - Buy: Expected total return (including dividends) of 10% or more over a 12-month period
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Asia-Pacific Universe

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