

COMPANY UPDATE

Compal Communications (8078.TW)

Buy

One of the few bright spots within handset sector; maintain Buy

What's changed

Despite low order visibility and earnings uncertainty across the handset supply chain, our industry checks continue to indicate a positive trend for Compal Comm's (CCI) improvement in customer diversification and product offering expansion over the next 12 months.

Implications

Although some investors focus on CCI's potential near-term weakness in 1Q2009 (we estimate unit shipment -30% qoq, rev -27% qoq) and view it as a long-term short, we maintain our positive stance, as: **(1)** CCI has gradually lowered its customer concentration risk in Motorola (which did not happen before) since 4Q2008, and we expect this trend to continue, with Nokia, LGE, and potentially more projects ramping up in the next 2-3 quarters; **(2)** we think the current competitive environment in the ODM market, driven by, in our view, irrational competition from Chi Mei Comm (a subsidiary of FIH—2038.HK, Sell) and Cheng Uei (2392.TW, Neutral), would not last long because the potential quality issue (from the usage of inferior components to save cost) could backfire and result in unsustainable competitive edges; **(3)** system makers such as CCI are now in a superior position to pass on the pricing pressure to component suppliers as most of the components are in an oversupply scenario now and CCI does not have to bear the component inventory risk; **(4)** CCI now seems to be one of the few ODMs to have strong and sufficient cash/R&D resources to take up multiple projects; **(5)** CCI appears to be an attractive value stock as >70% of its market cap is cash.

Valuation

We maintain our Buy rating, our earnings estimates, and 12-month target price of NT\$27 based on 11X 2009E EPS, supported by DCF.

Key risks

Slower outsourcing from its key customers, irrational pricing competition.

INVESTMENT LIST MEMBERSHIP

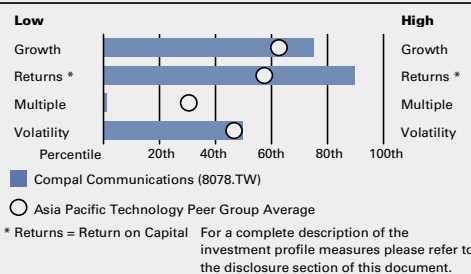
Asia Pacific Buy List

Coverage View: Neutral

Taiwan:
Hardware

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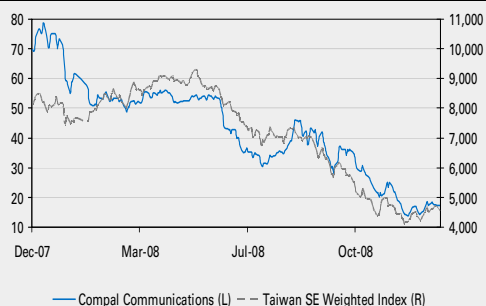
Investment Profile



Key data	Current
Price (NT\$)	17.30
12 month price target (NT\$)	27.00
Market cap (NT\$ mn / US\$ mn)	10,313.2 / 317.1
Foreign ownership (%)	14.0

	12/07	12/08E	12/09E	12/10E
EPS (NT\$)	6.84	2.35	2.55	3.17
EPS growth (%)	(26.4)	(65.6)	8.2	24.7
EPS (diluted) (NT\$)	6.84	2.35	2.55	3.17
EPS (basic pre-ex) (NT\$)	6.84	2.35	2.55	3.17
P/E (X)	2.5	7.4	6.8	5.5
P/B (X)	0.8	1.1	1.0	0.9
EV/EBITDA (X)	10.3	1.7	0.9	0.6
Dividend yield (%)	33.6	21.8	7.7	8.3
ROE (%)	31.9	13.0	15.9	17.6

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	(46.7)	(59.6)	(73.9)
Rel. to Taiwan SE Weighted Index	(28.2)	(29.7)	(54.2)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 12/22/2008 close.

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Compal Communications: 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	48,691.6	37,348.8	40,187.5	50,941.1	Cash & equivalents	10,551.5	7,549.6	8,468.5	8,841.2
Cost of goods sold	(43,358.2)	(33,722.2)	(36,309.5)	(46,279.8)	Accounts receivable	7,401.7	9,148.0	10,331.3	13,191.2
SG&A	(558.9)	(658.5)	(646.6)	(701.6)	Inventory	2,079.0	4,237.1	4,939.4	6,343.8
R&D	(1,860.2)	(2,214.5)	(2,138.0)	(2,474.3)	Other current assets	774.9	832.9	917.6	1,013.9
Other operating profit/(expense)	0.0	0.0	0.0	0.0	Total current assets	20,807.1	21,767.6	24,656.7	29,390.1
ESO expense	--	--	--	--	Net PP&E	2,806.1	2,218.7	1,784.9	1,758.9
EBITDA	3,773.9	1,632.0	2,027.2	2,372.7	Net intangibles	84.0	84.0	84.0	84.0
Depreciation & amortization	(859.6)	(878.4)	(933.8)	(887.3)	Total investments	1.0	27.9	496.8	1,041.8
EBIT	2,914.3	753.6	1,093.4	1,485.4	Other long-term assets	167.1	157.8	178.0	204.9
Interest income	366.9	243.6	258.0	335.9	Total assets	23,865.4	24,256.0	27,200.4	32,479.8
Interest expense	0.0	0.0	0.0	0.0	Accounts payable	8,730.6	10,930.2	11,946.9	15,315.3
Income/(loss) from uncons. subs.	0.0	11.9	48.9	65.0	Short-term debt	0.0	0.0	0.0	0.0
Others	1,238.6	639.7	466.3	545.0	Other current liabilities	1,954.9	3,477.4	4,293.0	4,702.3
Pretax profits	4,519.8	1,648.8	1,866.5	2,431.3	Total current liabilities	10,685.5	14,407.6	16,239.9	20,017.6
Income tax	(561.0)	(228.1)	(300.3)	(474.2)	Long-term debt	0.0	0.0	0.0	0.0
Minorities	(0.3)	(18.8)	(48.9)	(65.0)	Other long-term liabilities	680.2	724.9	805.9	888.8
Net income pre-preferred dividends	3,958.5	1,401.9	1,517.4	1,892.1	Total long-term liabilities	680.2	724.9	805.9	888.8
Preferred dividends	0.0	0.0	0.0	0.0	Total liabilities	11,365.8	15,132.4	17,045.8	20,906.4
Net income (pre-exceptionals)	3,958.5	1,401.9	1,517.4	1,892.1	Preferred shares	0.0	0.0	0.0	0.0
Post-tax exceptionals	0.0	0.0	0.0	0.0	Total common equity	12,499.7	9,068.2	10,050.3	11,404.1
Net income	3,958.5	1,401.9	1,517.4	1,892.1	Minority interest	0.0	55.3	104.2	169.3
EPS (basic, pre-except) (NT\$)	6.84	2.35	2.55	3.17	Total liabilities & equity	23,865.4	24,256.0	27,200.4	32,479.8
EPS (basic, post-except) (NT\$)	6.84	2.35	2.55	3.17	BVPS (NT\$)	21.60	15.21	16.86	19.13
EPS (diluted, post-except) (NT\$)	6.84	2.35	2.55	3.17					
EPS excl. ESO expense (basic) (NT\$)	6.84	2.73	2.91	3.61					
EPS excl. ESO expense (dil.) (NT\$)	6.84	2.73	2.91	3.61					
DPS (NT\$)	5.81	3.77	1.33	1.44					
Dividend payout ratio (%)	85.0	160.2	52.4	45.5					
Free cash flow yield (%)	3.4	(2.4)	22.2	18.7					
					Ratios	12/07	12/08E	12/09E	12/10E
Growth & margins (%)	12/07	12/08E	12/09E	12/10E	ROE (%)	31.9	13.0	15.9	17.6
Sales growth	(32.1)	(23.3)	7.6	26.8	ROA (%)	15.3	5.8	5.9	6.3
EBITDA growth	(38.7)	(56.8)	24.2	17.0	ROACE (%)	505.1	68.8	82.8	76.4
EBIT growth	(45.0)	(74.1)	45.1	35.9	Inventory days	22.6	34.2	46.1	44.5
Net income growth	(24.4)	(64.6)	8.2	24.7	Receivables days	54.4	80.9	88.5	84.3
EPS growth	(26.4)	(65.6)	8.2	24.7	Payable days	90.8	106.4	115.0	107.5
Gross margin	11.0	9.7	9.6	9.2	Net debt/equity (%)	(84.4)	(83.3)	(84.3)	(77.5)
EBITDA margin	7.8	4.4	5.0	4.7	Interest cover - EBIT (X)	NM	NM	NM	NM
EBIT margin	6.0	2.0	2.7	2.9					
					Valuation	12/07	12/08E	12/09E	12/10E
Cash flow statement (NT\$ mn)	12/07	12/08E	12/09E	12/10E	P/E (analyst) (X)	2.5	7.4	6.8	5.5
Net income pre-preferred dividends	3,958.5	1,401.9	1,517.4	1,892.1	P/B (X)	0.8	1.1	1.0	0.9
D&A add-back	859.6	878.4	933.8	887.3	EV/EBITDA (X)	10.3	1.7	0.9	0.6
Minorities interests add-back	0.3	18.8	48.9	65.0	Dividend yield (%)	33.6	21.8	7.7	8.3
Net (inc)/dec working capital	(3,187.0)	(1,704.8)	(868.8)	(896.0)					
Other operating cash flow	(44.0)	(798.1)	942.4	570.8					
Cash flow from operations	1,587.3	(203.8)	2,573.7	2,519.2					
Capital expenditures	(224.5)	(249.6)	(500.0)	(861.4)					
Acquisitions	0.0	(36.5)	(440.2)	(506.9)					
Divestitures	150.6	0.0	0.0	0.0					
Others	(245.7)	(222.9)	0.0	0.0					
Cash flow from investments	(319.6)	(509.0)	(940.2)	(1,368.3)					
Dividends paid (common & pref)	(3,364.6)	(2,246.5)	(795.6)	(861.1)					
Inc/(dec) in debt	0.0	0.0	0.0	0.0					
Common stock issuance (repurchase)	(198.0)	0.0	0.0	0.0					
Other financing cash flows	(8.4)	(42.5)	81.0	82.9					
Cash flow from financing	(3,571.0)	(2,289.0)	(714.6)	(778.2)					
Total cash flow	(2,303.3)	(3,001.8)	918.9	372.7					

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

Analyst Contributors

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Exhibit 1: CCI's quarterly profit model (consolidated; NT\$m)

Non-GAAP basis

Summary P&L (non-GAAP)	1Q2008	2Q2008	3Q2008	4Q2008E	1Q2009E	2Q2009E	3Q2009E	4Q2009E	2007	2008E	2009E	2010E
Net sales	9,506	8,123	8,425	11,295	8,304	8,921	10,461	12,502	48,692	37,349	40,187	50,941
Cost of good sold (COGS)	(8,580)	(7,302)	(7,648)	(10,190)	(7,543)	(8,050)	(9,431)	(11,284)	(43,358)	(33,720)	(36,307)	(46,277)
Gross profits	927	820	778	1,105	761	871	1,031	1,218	5,333	3,629	3,880	4,664
Operating expenses	(578)	(654)	(655)	(727)	(589)	(613)	(617)	(707)	(2,419)	(2,614)	(2,526)	(2,856)
SG&A	(159)	(169)	(150)	(151)	(145)	(151)	(155)	(167)	(559)	(630)	(618)	(666)
R&D	(419)	(485)	(505)	(575)	(444)	(463)	(461)	(540)	(1,860)	(1,984)	(1,909)	(2,190)
Operating profits	349	166	122	378	172	258	414	510	2,914	1,015	1,354	1,808
Non-operating income/(loss)	168	273	268	186	167	181	201	224	1,605	895	773	946
Earnings before tax (EBT)	517	440	390	564	339	439	614	734	4,520	1,910	2,127	2,754
Income tax credit/(expense)	(73)	(64)	(49)	(79)	(50)	(68)	(100)	(125)	(561)	(264)	(342)	(537)
Extraordinary gain/(loss)	-	-	-	-	-	-	-	-	-	-	-	-
Minority interests	(2)	5	(10)	(12)	(10)	(11)	(13)	(15)	(0)	(19)	(49)	(65)
Earnings after tax (EAT)	443	380	331	473	279	360	502	595	3,958	1,627	1,736	2,152
EPS (NT\$)	0.74	0.64	0.55	0.79	0.47	0.60	0.84	1.00	6.84	2.73	2.91	3.61
EPS (NT\$, fully diluted)	0.74	0.64	0.55	0.79	0.47	0.60	0.84	1.00	6.84	2.73	2.91	3.61
Ratio analysis and assumptions												
As % of sales												
Gross margin	9.7%	10.1%	9.2%	9.8%	9.2%	9.8%	9.9%	9.7%	11.0%	9.7%	9.7%	9.2%
Operating expense ratio	-6.1%	-8.1%	-7.8%	-6.4%	-7.1%	-6.9%	-5.9%	-5.7%	-5.0%	-7.0%	-6.3%	-5.6%
Operating margin	3.7%	2.0%	1.5%	3.3%	2.1%	2.9%	4.0%	4.1%	6.0%	2.7%	3.4%	3.5%
Pre-tax margin	5.4%	5.4%	4.6%	5.0%	4.1%	4.9%	5.9%	5.9%	9.3%	5.1%	5.3%	5.4%
Tax rate (as % of EBT)	14.0%	14.6%	12.5%	14.0%	14.7%	15.4%	16.2%	17.0%	12.4%	13.8%	16.1%	19.5%
Net margin	4.7%	4.7%	3.9%	4.2%	3.4%	4.0%	4.8%	4.8%	8.1%	4.4%	4.3%	4.2%
Qoq growth (%)												
Sales	-8.9%	-14.6%	3.7%	34.1%	-26.5%	7.4%	17.3%	19.5%				
Gross profits	-20.6%	-11.5%	-5.2%	42.1%	-31.1%	14.5%	18.3%	18.2%				
Operating profits	-30.7%	-52.3%	-26.5%	209.3%	-54.4%	49.6%	60.7%	23.3%				
Non-operating profits	-66.0%	62.7%	-2.2%	-30.4%	-10.3%	8.6%	10.6%	11.8%				
Pre-tax profits	-48.2%	-14.9%	-11.3%	44.8%	-39.9%	29.4%	40.0%	19.5%				
Net profits	-49.1%	-14.0%	-13.1%	43.1%	-41.1%	29.1%	39.5%	18.5%				
EPS (weighted averaged)	-50.6%	-14.0%	-13.1%	43.1%	-41.1%	29.1%	39.5%	18.5%				
YoY growth (%)												
Sales	-37.9%	-27.3%	-28.4%	8.2%	-12.6%	9.8%	24.2%	10.7%	-32.1%	-23.3%	7.6%	26.8%
Gross profits	-42.7%	-30.1%	-43.5%	-5.4%	-17.9%	6.2%	32.6%	10.2%	-32.2%	-32.0%	6.9%	20.2%
Operating profits	-65.7%	-70.5%	-85.3%	-24.8%	-50.6%	55.0%	238.7%	35.0%	-45.0%	-65.2%	33.4%	33.6%
Non-operating profits	-53.1%	-39.0%	-12.4%	-62.3%	-0.6%	-33.7%	-25.0%	20.4%	210.8%	-44.2%	-13.6%	22.3%
Pre-tax profits	-62.4%	-56.5%	-65.7%	-43.4%	-34.4%	-0.2%	57.7%	30.2%	-22.2%	-57.7%	11.4%	29.5%
Net profits	-64.4%	-57.7%	-65.1%	-45.6%	-37.0%	-5.4%	51.8%	25.7%	-24.4%	-58.9%	6.7%	24.0%
EPS (weighted averaged)	-65.4%	-59.0%	-66.1%	-47.2%	-37.0%	-5.4%	51.8%	25.7%	-26.4%	-60.1%	6.7%	24.0%
Dividend policies												
Cash dividends (NT\$ per share)									5.81	3.77	1.33	1.44
Payout ratio (%)									64.3%	56.8%	56.8%	56.8%

Source: Company data, Goldman Sachs Research estimates.

Exhibit 2: CCI's quarterly profit model (consolidated; NT\$m)

GAAP basis

Summary P&L (GAAP)	1Q2008	2Q2008	3Q2008	4Q2008E	1Q2009E	2Q2009E	3Q2009E	4Q2009E	2007	2008E	2009E	2010E
Net sales	9,506	8,123	8,425	11,295	8,304	8,921	10,461	12,502	48,692	37,349	40,187	50,941
Cost of good sold (COGS)	(8,580)	(7,303)	(7,648)	(10,191)	(7,543)	(8,050)	(9,431)	(11,285)	(43,365)	(33,722)	(36,310)	(46,280)
Gross profits	926	820	777	1,104	761	871	1,030	1,217	5,327	3,627	3,878	4,661
Operating expenses	(651)	(717)	(708)	(797)	(630)	(667)	(691)	(796)	(3,231)	(2,873)	(2,785)	(3,176)
S&A	(167)	(176)	(156)	(159)	(149)	(157)	(164)	(177)	(650)	(659)	(647)	(702)
R&D	(484)	(541)	(552)	(638)	(481)	(510)	(528)	(619)	(2,582)	(2,215)	(2,138)	(2,474)
Operating profits	275	102	69	307	130	204	339	421	2,095	754	1,093	1,485
Non-operating income/(loss)	168	273	268	186	167	181	201	224	1,605	895	773	946
Earnings before tax (EBT)	443	376	336	493	297	385	539	645	3,701	1,649	1,867	2,431
Income tax credit/(expense)	(62)	(55)	(42)	(69)	(44)	(59)	(87)	(110)	(460)	(228)	(300)	(474)
Extraordinary gain/(loss)	-	-	-	-	-	-	-	-	-	-	-	-
Minority interests	(2)	5	(10)	(12)	(10)	(11)	(13)	(15)	(0)	(19)	(49)	(65)
Earnings after tax (EAT)	379	326	284	412	243	314	439	521	3,240	1,402	1,517	1,892
EPS (pro forma, NT\$)	0.64	0.55	0.48	0.69	0.41	0.53	0.74	0.87	5.60	2.35	2.55	3.17
EPS (pro forma, fully diluted, N)	0.64	0.55	0.48	0.69	0.41	0.53	0.74	0.87	5.60	2.35	2.55	3.17
Ratio analysis and assumptions												
As % of sales												
Gross margin	9.7%	10.1%	9.2%	9.8%	9.2%	9.8%	9.8%	9.7%	10.9%	9.7%	9.6%	9.2%
Operating expense ratio	-6.8%	-8.8%	-8.4%	-7.1%	-7.6%	-7.5%	-6.6%	-6.4%	-6.6%	-7.7%	-6.9%	-6.2%
Operating margin	2.9%	1.3%	0.8%	2.7%	1.6%	2.3%	3.2%	3.4%	4.3%	2.0%	2.7%	2.9%
Pre-tax margin	4.7%	4.6%	4.0%	4.4%	3.6%	4.3%	5.2%	5.2%	7.6%	4.4%	4.6%	4.8%
Tax rate (as % of EBT)	14.0%	14.6%	12.5%	14.0%	14.7%	15.4%	16.2%	17.0%	12.4%	13.8%	16.1%	19.5%
Net margin	4.0%	4.0%	3.4%	3.6%	2.9%	3.5%	4.2%	4.2%	6.7%	3.8%	3.8%	3.7%
QoQ growth (%)												
Sales	-8.9%	-14.6%	3.7%	34.1%	-26.5%	7.4%	17.3%	19.5%				
Gross profits	-20.6%	-11.5%	-5.2%	42.1%	-31.1%	14.5%	18.3%	18.2%				
Operating profits	-14.8%	-62.8%	-32.7%	345.1%	-57.5%	56.2%	66.3%	24.4%				
Non-operating profits	-66.0%	62.7%	-2.2%	-30.4%	-10.3%	8.6%	10.6%	11.8%				
Pre-tax profits	-45.7%	-15.2%	-10.5%	46.6%	-39.7%	29.4%	40.0%	19.7%				
Net profits	-46.7%	-14.1%	-12.8%	45.0%	-41.0%	29.2%	39.7%	18.6%				
EPS (weighted averaged)	-48.3%	-14.1%	-12.8%	45.0%	-41.0%	29.2%	39.7%	18.6%				
Yoy growth (%)												
Sales	-37.9%	-27.3%	-28.4%	8.2%	-12.6%	9.8%	24.2%	10.7%	-32.1%	-23.3%	7.6%	26.8%
Gross profits	-42.7%	-30.0%	-43.4%	-5.3%	-17.9%	6.2%	32.5%	10.2%	-32.1%	-31.9%	6.9%	20.2%
Operating profits	-63.8%	-72.8%	-89.2%	-5.0%	-52.6%	98.6%	390.9%	37.2%	-42.0%	-64.0%	45.1%	35.9%
Non-operating profits	-53.1%	-39.0%	-12.4%	-62.3%	-0.6%	-33.7%	-25.0%	20.4%	210.8%	-44.2%	-13.6%	22.3%
Pre-tax profits	-60.3%	-54.4%	-64.3%	-39.6%	-32.9%	2.4%	60.2%	30.8%	-10.3%	-55.4%	13.2%	30.3%
Net profits	-62.4%	-55.6%	-63.7%	-42.1%	-35.9%	-3.6%	54.5%	26.3%	-12.8%	-56.7%	8.2%	24.7%
EPS (weighted averaged)	-63.5%	-56.9%	-64.8%	-43.8%	-35.9%	-3.6%	54.5%	26.3%	-15.1%	-58.0%	8.2%	24.7%
Dividend policies												
Cash dividends (NT\$ per share)									5.81	3.77	1.33	1.44
Payout ratio (%)									64.3%	56.8%	56.8%	56.8%

Source: Company data, Goldman Sachs Research estimates.

Reg AC

I, Robert Chen, 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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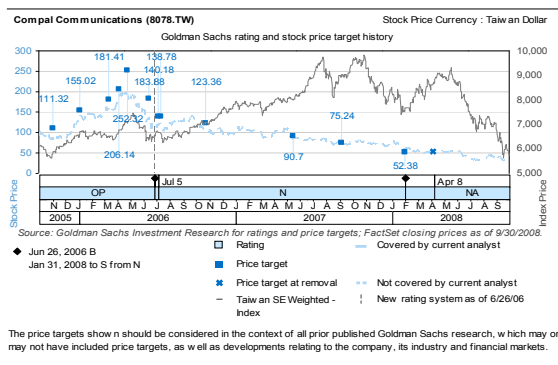
Distribution of ratings/investment banking relationships

Goldman Sachs Investment Research global coverage universe

	Rating Distribution			Investment Banking Relationships		
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Price target and rating history chart(s)



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