

Headwinds persist, Underperform

PO cut to NT\$36 on weak fundamentals, Underperform

We reiterate Underperform on Everlight and lower 08/09E earnings by 5%/41% to reflect softening near-term fundamentals and weakening 09 outlook. We cut PO from NT\$44 to NT\$36, implying 1.25x PBV or 13.6x 09E, and expect street to have to further lower forecasts. Our checks confirm that 4Q is decelerating rapidly, while 09 visibility remains low amidst an increasingly cautious tone.

4Q sales down ~15% QoQ; GPM remain flat on better mix

Mgmt guided 4Q sales to decline ~15% QoQ, implying Dec sales to drop another 20% MoM. Utilization rate is falling (60% in 4Q vs 70% in 3Q) due to slowing end demand, but mgmt expects GPM will remain flat due to better high-end handset LEDs (ML 25.2% vs 26.3% in 3Q and earnings decline of 20% QoQ, 50% YoY).

09 outlook is guarded due to weak end demand

Mgmt is cautious on 09 due to weak consumer demand (handsets ~35% of sales, CE 15%) and targets high-end handset, netbook, outdoor display/street lamp, and infrared to compensate. We believe this is not enough to offset, and expect sales to fall 9% YoY with GPM erosion and earnings down 45% YoY.

Competition and severe ASP pressure remains a threat

We do not see Everlight as a major beneficiary of LED NB adoption in 09 due to IP issue as well as increased competition from panel makers. History tells us when panel makers bring a component in-house (i.e. polarizer, driver IC, BLU, CCFL, CF), the result is usually greater margin and ASP pressure for outside vendors, and that leaves pure plays on the outside looking in. Everlight also faces challenges from Japanese peers as they expand from higher-end LED products to low-end product (handset, netbook), aiming to phase out Taiwanese makers. The price gap has narrowed from 30-40% earlier this year to 10-15% currently.

Estimates (Dec)

(NT\$)	2006A	2007A	2008E	2009E	2010E
Net Income (mn) Taiwan GAAP	1,892	2,210	1,729	951	1,084
EPS (Pre Bonus)	5.67	6.45	5.54	3.04	3.47
EPS (Post Bonus)	2.80	3.79	4.79	2.63	3.00
EPS Change (YoY)	-22.2%	35.7%	26.2%	-45.0%	14.0%
Dividend / Share	4.20	3.90	2.90	1.59	1.82
Free Cash Flow / Share	6.82	3.77	(0.472)	3.49	1.93

* Taiwan GAAP changed from Pre Bonus to Post Bonus earnings from 2008.

Valuation (Dec)

	2006A	2007A	2008E	2009E	2010E
P/E (Post Bonus)	15.67x	11.55x	9.15x	16.63x	14.58x
Dividend Yield	9.59%	8.90%	6.61%	3.64%	4.15%
Free Cash Flow Yield*	14.39%	8.17%	-1.08%	7.97%	4.40%

* For full definitions of *iQmethod*SM measures, see page 7.



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Stock Data

Price	NT\$43.80
Price Objective	NT\$44.00 to NT\$36.00
Date Established	19-Dec-2008
Investment Opinion	C-3-8
Volatility Risk	HIGH
52-Week Range	NT\$32.70-NT\$128.92
Mrkt Val / Shares Out (mn)	US\$487 / 361.0
Average Daily Volume	4,853,421
ML Symbol / Exchange	EVLEF / TAI
Bloomberg / Reuters	2393 TT / 2393.TW
ROE (2008E)	16.7%
Net Dbt to Eqty (Dec-2007A)	-11.8%
Est. 5-Yr EPS / DPS Growth	-20.0% / -20.0%
Free Float	70.0%



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Refer to important disclosures on page 8 to 9. Analyst Certification on Page 5. Price Objective Basis/Risk on page 5.

iQprofileSM Everlight Electronics Co., Ltd.

Key Income Statement Data (Dec)	2006A	2007A	2008E	2009E	2010E
(NT\$ Millions)					
Sales	7,949	9,853	11,097	10,129	11,342
Gross Profit	2,576	3,033	2,925	2,260	2,465
Sell General & Admin Expense	(615)	(665)	(1,091)	(1,047)	(1,116)
Operating Profit	1,740	2,063	1,417	801	929
Net Interest & Other Income	458	402	537	317	347
Associates	NA	NA	NA	NA	NA
Pretax Income	2,198	2,465	1,953	1,119	1,276
Tax (expense) / Benefit	(311)	(255)	(225)	(168)	(191)
Net Income (Adjusted)	1,892	2,210	1,729	951	1,084
Average Fully Diluted Shares Outstanding	334	343	361	361	361

Key Cash Flow Statement Data

Net Income	1,887	2,210	1,729	951	1,084
Depreciation & Amortization	368	390	428	769	883
Change in Working Capital	(367)	(347)	40	210	(108)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	607	(95)	(167)	130	(163)
Cash Flow from Operations	2,494	2,158	2,030	2,060	1,696
Capital Expenditure	(220)	(866)	(2,200)	(800)	(1,000)
(Acquisition) / Disposal of Investments	139	64	(983)	0	0
Other Cash Inflow / (Outflow)	(181)	(2,680)	(32)	25	(31)
Cash Flow from Investing	(262)	(3,482)	(3,215)	(775)	(1,031)
Shares Issue / (Repurchase)	0	0	0	0	0
Cost of Dividends Paid	(1,084)	(1,510)	(1,369)	(1,054)	(580)
Cash Flow from Financing	327	1,489	(1,756)	(1,054)	(580)
Free Cash Flow	2,275	1,292	(170)	1,260	696
Net Debt	(2,628)	(1,210)	1,530	1,299	1,214
Change in Net Debt	(2,559)	(165)	2,741	(230)	(85)

Key Balance Sheet Data

Property, Plant & Equipment	1,320	1,849	3,621	3,653	3,770
Other Non-Current Assets	3,804	5,814	6,829	6,804	6,835
Trade Receivables	2,204	2,967	2,979	2,747	3,076
Cash & Equivalents	3,971	4,135	1,195	1,426	1,511
Other Current Assets	1,378	2,235	2,530	2,366	2,640
Total Assets	12,677	17,000	17,154	16,995	17,832
Long-Term Debt	1,343	2,925	2,725	2,725	2,725
Other Non-Current Liabilities	406	576	576	576	576
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	2,579	3,240	3,420	3,365	3,697
Total Liabilities	4,328	6,741	6,721	6,666	6,998
Total Equity	8,349	10,259	10,433	10,330	10,834
Total Equity & Liabilities	12,677	17,000	17,154	16,995	17,832

iQmethodSM - Bus Performance*

Return On Capital Employed	17.2%	16.0%	9.7%	5.1%	5.9%
Return On Equity	24.0%	23.8%	16.7%	9.2%	10.2%
Operating Margin	21.9%	20.9%	12.8%	7.9%	8.2%
EBITDA Margin	26.5%	24.9%	16.6%	15.5%	16.0%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	1.3x	1.0x	1.2x	2.2x	1.6x
Asset Replacement Ratio	0.6x	2.2x	5.1x	1.0x	1.1x
Tax Rate (Reported)	14.2%	10.3%	11.5%	15.0%	15.0%
Net Debt-to-Equity Ratio	-31.5%	-11.8%	14.7%	12.6%	11.2%
Interest Cover	NM	NM	16.7x	9.8x	11.4x

Key Metrics

Bonus Adjusted Net Income	932	1,300	1,729	951	1,084
Bonus Adjusted EPS	2.80	3.79	4.79	2.63	3.00
Bonus Adjusted P/E	15.7x	11.5x	9.1x	16.6x	14.6x
Bonus Adjusted ROE	11.8%	14.0%	16.7%	9.2%	10.2%

* For full definitions of iQmethodSM measures, see page 7.

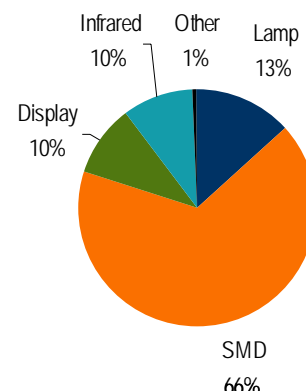
Company Description

Established in 1983, Everlight Electronics Co., Ltd. is one of the leading LED downstream packager in Taiwan, focusing on designing, marketing, and licensing LED packages. The company purchases LED chips from upstream chip makers and packages them into different forms for various applications. Everlight acquired Fairchild's LED division and benefited from Fairchild's international customer bases.

Investment Thesis

09E outlook is guarded due to its exposure to soft handset and consumer electronics end demand. With low utilization rate, as well as poor product mix, ASP pressures from Japan, and less exposure to NB LED, we expect Everlight's earnings will trend down further. Longer-term, competition is set to intensify as LCD makers focus on up and downstream vertical integration.

Chart 1: 08E sales breakdown



Source: Merrill Lynch estimates

Stock Data

Price to Book Value 1.5x

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Table 1: Everlight's quarterly forecast (reported basis)

NT\$m	1Q08A	2Q08A	3Q08A	4Q08E	1Q09E	2Q09E	3Q09E	4Q09E	2007A	2008E	2009E
Sales	2,747	2,812	2,994	2,544	2,226	2,400	2,675	2,828	9,853	11,097	10,129
QoQ/YoY	-2.7%	2.3%	6.5%	-15.0%	-12.5%	7.8%	11.5%	5.7%	23.9%	12.6%	-8.7%
Gross profit	814	682	788	640	520	537	591	612	3,033	2,925	2,260
Gross margin	29.6%	24.3%	26.3%	25.2%	23.3%	22.4%	22.1%	21.6%	30.8%	26.4%	22.3%
Operating profit	500	396	356	272	181	187	217	216	2,063	1,417	801
Operating margin	18.2%	14.1%	11.9%	10.7%	8.1%	7.8%	8.1%	7.6%	20.9%	12.8%	7.9%
Pretax income	419	540	540	454	261	266	296	296	2,465	1,953	1,119
Pretax margin	15.3%	19.2%	18.0%	17.8%	11.7%	11.1%	11.1%	10.5%	25.0%	17.6%	11.0%
Net income	356	502	484	386	221	226	252	251	2,210	1,729	951
QoQ/YoY	-53.8%	40.9%	-3.6%	-20.3%	-42.6%	2.2%	11.2%	-0.2%	17.1%	-21.8%	-45.0%
Net margin	13.0%	17.9%	16.2%	15.2%	10.0%	9.4%	9.4%	8.9%	22.4%	15.6%	9.4%
EPS (NT\$)	0.99	1.39	1.34	1.07	0.61	0.63	0.70	0.70	6.45	4.79	2.63

Source: Company data, Merrill Lynch estimates

Table 2: Everlight's and Epistar's balance sheet comparison

(NT\$m)	Cash *	Total debt	Net debt	Equity	Net debt/ equity	Net debt/ market cap	CCC
Everlight							
3Q08	2,668	4,698	2,030	9,763	21%	12%	53
2Q08	3,969	3,945	(24)	9,289	-0%	-0%	48
Epistar							
3Q08	7,886	3,152	(4,734)	2,603	-21%	-24%	218
2Q08	8,662	3,192	(5,470)	22,495	-24%	-28%	213

Note: * cash includes short-term investment, data are on consolidated base

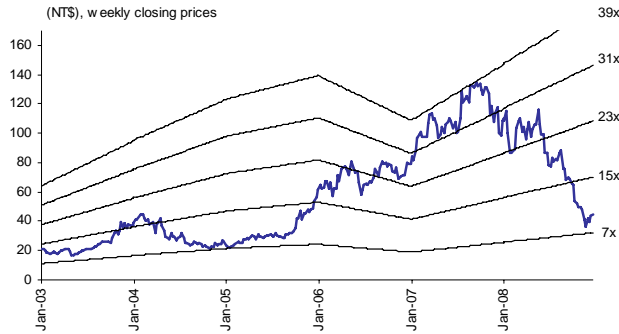
Source: TEJ, Merrill Lynch estimates

Table 3: new vs. old forecast

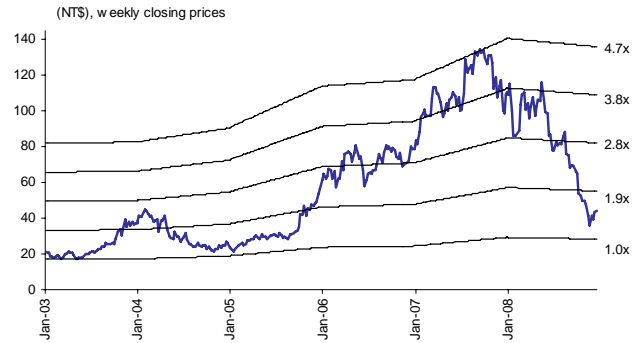
(NT\$ m)	ML08 (E)			ML09 (E)		
	New	Old	Diff (%)	New	Old	Diff (%)
Total sales	11,097	11,419	(2.8)	10,129	11,954	(15.3)
Gross Profit	2,925	3,134	(6.7)	2,260	3,027	(25.3)
<i>Gross margin</i>	26.4%	27.4%		22.3%	25.3%	
Operating income	1,417	1,626	(12.9)	801	1,440	(44.3)
<i>Operating margin</i>	12.8%	14.2%		7.9%	12.0%	
Pretax income	1,953	2,087	(6.4)	1,119	1,882	(40.6)
<i>Pretax margin</i>	17.6%	18.3%		11.0%	15.7%	
Net income	1,729	1,817	(4.9)	951	1,600	(40.6)
<i>Net margin</i>	15.6%	15.9%		9.4%	13.4%	
EPS (NT\$)	4.79	5.03	(4.9)	2.63	4.43	(40.6)

Source: Merrill Lynch estimates

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Chart 2: Everlight's historically bonus-adj PE bands


Source: TEJ, Merrill Lynch estimates

Chart 3: Everlight's historically PB bands


Source: TEJ, Merrill Lynch estimates

Table 4: LED makers' valuation comparison

Company	Ticker	ML Symbol	ML Rating	Price 19-Dec-08	Mkt Cap (US\$m)	EPS growth (%)		PER(x)		PBR(x)		Perform YTD	ROE (%)	
						2008E	2009E	2008E	2009E	2008E	2009E		2008E	2009E
Upstream/Midstream														
Cree*	CREE US	n.a.	Not Rated	US\$15.6	1,374	26.2	18.5	24.6	20.6	1.2	1.2	-43%	2.7	3.1
Toyoda Gosei*	7282 JP	n.a.	Not Rated	JPY 994	1,449	(39.4)	(13.0)	5.9	6.9	0.5	0.5	-74%	7.9	6.6
Epistar	2448 TT	EPIPF	C-3-8 Underpe	NT\$31.3	609	(77.0)	(92.1)	33.3	n.a.	0.9	0.9	-76%	2.5	0.2
AOC*	6289 TT	n.a.	Not Rated	NT\$4.1	28	n.a.	n.a.	n.a.	n.a.	0.4	0.4	-86%	-21.3	-10.8
Formosa Epi*	3061 TT	n.a.	Not Rated	NT\$11.6	72	49.0	6.3	10.0	9.3	0.8	0.7	-63%	8.0	7.4
Opto Tech*	2340 TT	n.a.	Not Rated	NT\$11.2	181	(42.8)	52.2	9.9	6.1	0.9	0.9	-63%	10.6	9.9
Average								16.7	10.7	0.8	0.8		1.7	2.7
Downstream														
Everlight	2393 TT	EVLEF	C-3-8 Underpe	NT\$43.8	497	(25.8)	(45.0)	8.1	15.6	1.5	1.5	-61%	16.7	9.2
Citizen Holdings*	7762 JP	CHCLF	B-1-8 Buy	JPY 324	1,369	70.7	(24.0)	9.0	12.1	0.5	0.4	-69%	4.9	3.8
Stanley Electric*	6923 JP	n.a.	Not Rated	JPY 940	1,984	(8.1)	(9.1)	5.3	5.9	0.0	0.7	-66%	13.5	11.9
Seoul Semi	046890 KS	SLSOF	C-3-7 Underpe	KRW 9,030	364	(54.0)	86.7	54.2	28.6	2.5	2.4	-64%	4.6	8.3
Lite-On Tech	2301 TT	LOTZF	C-2-8 Neutral	NT\$22.2	1,560	(32.0)	(2.7)	7.3	7.6	0.9	0.9	-56%	9.8	9.9
Harvatek*	6168 TT	n.a.	Not Rated	NT\$15.7	85	5.9	(2.7)	7.0	7.2	0.9	0.9	-48%	12.1	11.4
SEMCO	009150 KS	SSEMF	C-3-8 Underpe	KRW 34,200	2,022	(32.2)	46.5	33.7	22.7	1.3	1.3	-30%	3.9	5.5
Bright*	3031 TT	n.a.	Not Rated	NT\$19.2	108	(43.7)	(1.8)	8.9	9.0	1.1	1.1	-74%	12.1	11.4
Average								16.7	13.6	1.1	1.1		9.7	8.9

Source: * Bloomberg IBES, Merrill Lynch estimates

Price objective basis & risk

Everlight Elec (EVLEF)

Our PO of NT\$36 is based on 1.25x 09 PBV, the lower end of its historical range of 1-4.7x since 2003. We believe Everlight will face fundamental headwinds due to the slowing consumer demand, ASP competition from Japanese peers, and less exposure to NB LED due to IP issues. Longer-term, the competition in LED packaging is set to intensify as LCD panel makers such as AUO and CMO are focusing on up and downstream vertical integration and are targeting not only LCD BLUs (like NB), but also general lighting. Upside risks to our thesis are stronger NB LED demand and greater local sourcing, while downside risks arise from faster entrance into LED production from panel makers, IP litigation from global players, oversupply in small and medium panels, and sourcing of NB panels from Taiwan LED suppliers remains slower than expected.

Analyst Certification

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APR - Technology Hardware Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
BUY				
	Acer, Inc	ASIYF	2353 TT	Tony Tseng, CFA
	BYD	BYDDF	1211 HK	Daniel Kim, CFA
	Cheil Industries	CLFUF	001300 KS	Simon Dong-je Woo, CFA
	Compal Electron	CMPLF	2324 TT	Tina Chang, CFA
	Coretronic	CCOCF	5371 TT	Jeffrey Su
	Delta Elect	DLTEF	2308 TT	Jeffrey Su
	Ju Teng Intl	JUTGF	3336 HK	Ronnie Ho
	LG Electronics	LGEAF	066570 KS	Daniel Kim, CFA
	Samsung Techwin	SGTWF	012450 KS	Simon Dong-je Woo, CFA
	Simplo Tech	SPLOF	6121 TT	Tina Chang, CFA
	SSCP CO LTD	SSCPF	071660 KS	Daniel Kim, CFA
	TPV	TPVTF	903 HK	Daniel Kim, CFA
	Venture Corp.	VEMLF	VMS SP	Ronnie Ho
NEUTRAL				
	Alpha Networks I	AHNWF	3380 TT	Laura Chen
	AU Optronics	AUO	AUO US	Jeffrey Su
	AU Optronics	AUOPF	2409 TT	Jeffrey Su
	Foxconn Tech	FXTCF	2354 TT	Tony Tseng, CFA
	Kingboard	KBDCF	148 HK	Ronnie Ho
	Lenovo Group	LNVGF	992 HK	Daniel Kim, CFA
	Lenovo Group	LNVGY	LNVGY US	Daniel Kim, CFA
	Lite-On Tech	LOTZF	2301 TT	Jeffrey Su
	Merry Electron	MMECF	2439 TT	Laura Chen
	Qisda Corp	BNQCF	2352 TT	Jeffrey Su
	Shin Zu Shing	SZUSF	3376 TT	Tina Chang, CFA
	Silitech	SLKCF	3311 TT	Laura Chen
	Wistron	WICOF	3231 TT	Tony Tseng, CFA
	Yageo Corp	YGEQF	2327 TT	Ronnie Ho
UNDERPERFORM				
	Asustek	AKCPF	2357 TT	Tony Tseng, CFA
	Catcher Tech	CHERF	2474 TT	Tony Tseng, CFA
	Chi Mei Opto	CMEOF	3009 TT	Jeffrey Su
	Chicony Elect	CCNYF	2385 TT	Tina Chang, CFA
	Compal Comm	CPCMF	8078 TT	Laura Chen
	Epistar Corp	EPIPF	2448 TT	Jeffrey Su
	Everlight Elec	EVLEF	2393 TT	Jeffrey Su
	Foxconn Intl Hld	FXCNF	2038 HK	Tony Tseng, CFA
	Gemtek Technolog	GTKTF	4906 TT	Laura Chen
	Hon Hai Prec.	HNHAF	2317 TT	Tony Tseng, CFA
	HTC Corp.	HTCCF	2498 TT	Tony Tseng, CFA
	InnoLux	INXDF	3481 TT	Jeffrey Su
	Inventec	IVCJF	2356 TT	Tina Chang, CFA
	Inventec Applian	IVAPF	3367 TT	Tina Chang, CFA
	Largan Precision	LGANF	3008 TT	Laura Chen
	LG Display Co., Ltd.	LPHLF	034220 KS	Daniel Kim, CFA
	LG Display Co., Ltd.-A	LPL	LPL US	Daniel Kim, CFA
	Mitac Intl	MTCXF	2315 TT	Tina Chang, CFA
	Quanta Computer	QUCPF	2382 TT	Tony Tseng, CFA
	Radiant	ROPTF	6176 TT	Jeffrey Su
	Samsung Elec M	SSEMF	009150 KS	Daniel Kim, CFA
	Samsung SDI	SSDIF	006400 KS	Daniel Kim, CFA
	Seoul Semicon	SLSOF	046890 KS	Simon Dong-je Woo, CFA
	Wellypower	XTTWF	3080 TT	Jeffrey Su
	ZTE Corp - H	ZTCOF	763 HK	Ronnie Ho

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iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

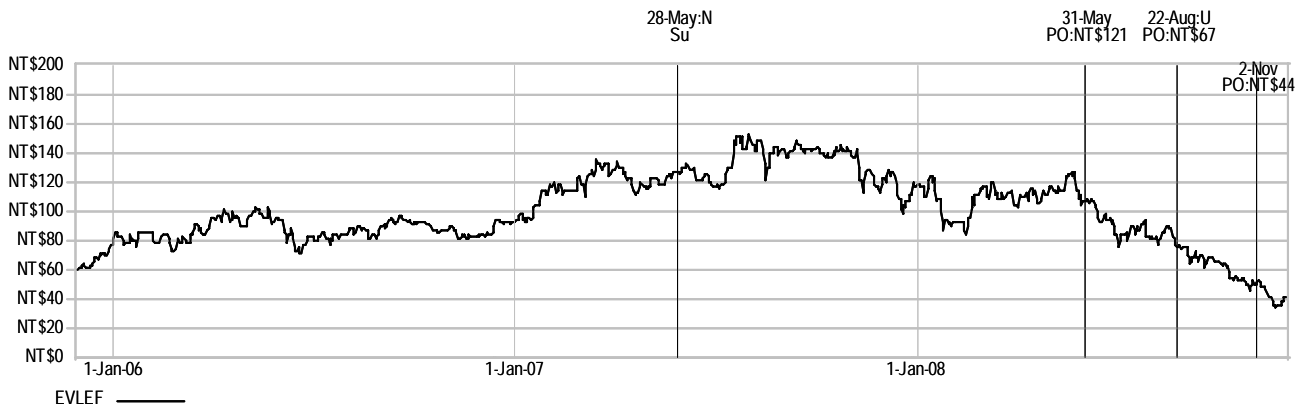
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Important Disclosures

EVLEF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of November 30, 2008 or such later date as indicated.

Investment Rating Distribution: Electronics Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	42	40.00%	Buy	8	20.51%
Neutral	32	30.48%	Neutral	3	11.11%
Sell	31	29.52%	Sell	2	7.41%

Investment Rating Distribution: Global Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1647	45.31%	Buy	429	28.83%
Neutral	858	23.60%	Neutral	240	31.41%
Sell	1130	31.09%	Sell	227	22.02%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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