

COMPANY UPDATE

Formosa Plastics (1301.TW)

Sell

Recent rebound in product prices seems to be only temporary

What's changed

We note that the market has turned more positive on FPC's December sales due to the 5% price rebound in PVC in the past two weeks as well as FPC's recent sales volume increase in PE. However, we think that the price and sales volume increases are only limited to these specific products and are due to short-term inventory re-stocking, and do not represent a recovery in end demand. Therefore, we think the price and sales volume increases are temporary only. Our channel checks also indicate that most chemical companies and their end customers are trying to lower inventory before the Chinese New Year.

Implications

We think the coming major downside surprise to the market will be product margin declines due to high inventory costs rather than further sales declines. Even with potential mom sales growth in December 08 and January 09, we think it is still too early to expect positive earnings growth momentum for the company in the coming two months. Based on inventory levels as of 3Q08, we estimate FPC still has 1.5-2.0 months inventory on hand, therefore, we think that the earliest time for FPC to fully digest the previous high-cost inventory will be after the Chinese New Year. We think there is downside risk to our 2008E net earnings estimates, even though we are already 7% below Reuters consensus.

Valuation

The stock is currently trading at 8.6x 2009E EV/EBITDA, a 43% premium to the Pan-Asian median. We maintain our Sell rating with 12-m P/B based target price of NT\$34.0.

Key risks

Stronger-than-expected demand and oil price rebound.

INVESTMENT LIST MEMBERSHIP

Asia Pacific Sell List

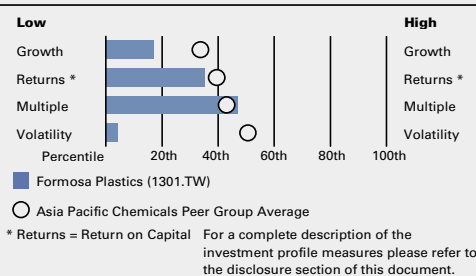
Coverage View: Cautious

Taiwan:
Chemicals

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Investment Profile



Key data	Current
Price (NT\$)	43.40
12 month price target (NT\$)	34.00
Market cap (NT\$ mn / US\$ mn)	248,248.0 / 7,532.9
Foreign ownership (%)	30.4

	12/07	12/08E	12/09E	12/10E
EPS (NT\$)	8.36	6.12	4.01	4.07
EPS growth (%)	54.8	(26.8)	(34.5)	1.6
EPS (diluted) (NT\$)	8.36	6.12	4.01	4.07
EPS (basic pre-ex) (NT\$)	8.36	6.12	4.01	4.07
P/E (X)	5.2	7.1	10.8	10.7
P/B (X)	1.0	1.0	1.0	1.0
EV/EBITDA (X)	6.9	5.9	8.6	8.6
Dividend yield (%)	15.4	11.3	7.4	7.5
ROE (%)	21.6	14.3	9.5	9.4

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	(23.3)	(45.4)	(50.6)
Rel. to Taiwan SE Weighted Index	7.6	(2.4)	(11.0)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 12/23/2008 close.

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Formosa Plastics: 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	181,606.8	193,319.1	165,319.8	167,454.1	Cash & equivalents	93,502.0	59,390.1	55,127.4	56,808.6
Cost of goods sold	(144,840.5)	(158,700.7)	(136,838.6)	(139,650.7)	Accounts receivable	13,049.9	14,830.0	12,682.1	12,845.8
SG&A	(8,376.2)	(8,347.0)	(7,087.0)	(7,183.1)	Inventory	17,926.5	25,662.0	26,302.7	29,481.5
R&D	(352.4)	(352.4)	(352.4)	(352.4)	Other current assets	5,233.1	13,332.4	11,401.4	11,548.6
Other operating profit/(expense)	0.0	0.0	0.0	0.0	Total current assets	129,711.5	113,214.4	105,513.6	110,684.4
EBITDA	28,037.7	25,919.0	21,041.8	20,268.0	Net PP&E	77,759.6	84,147.0	84,070.9	84,064.1
Depreciation & amortization	(9,574.7)	(8,102.3)	(7,826.1)	(7,756.8)	Net intangibles	619.1	619.1	619.1	619.1
EBIT	18,463.0	17,816.7	13,215.6	12,511.2	Total investments	129,853.4	153,537.7	163,650.8	174,936.1
Interest income	420.3	1,032.0	815.9	797.5	Other long-term assets	2,616.7	5,616.7	6,416.7	6,916.7
Interest expense	(1,409.0)	(1,433.9)	(1,677.0)	(1,710.1)	Total assets	340,560.2	357,134.9	360,271.0	377,220.4
Income/(loss) from uncons. subs.	30,553.9	20,684.3	11,113.1	12,285.3	Accounts payable	15,119.3	15,994.8	15,853.7	18,173.5
Others	2,660.9	800.0	2,000.0	2,000.0	Short-term debt	22,021.2	16,802.6	16,737.4	17,464.5
Pretax profits	50,689.1	38,899.1	25,467.7	25,883.9	Other current liabilities	6,708.2	10,739.9	10,332.5	11,163.6
Income tax	(2,878.5)	(3,889.9)	(2,546.8)	(2,588.4)	Total current liabilities	43,848.7	43,537.4	42,923.6	46,801.6
Minorities	0.0	0.0	0.0	0.0	Long-term debt	41,033.7	67,210.5	66,949.8	69,857.9
Net income pre-preferred dividends	47,810.6	35,009.2	22,920.9	23,295.5	Other long-term liabilities	6,377.5	6,567.4	6,764.4	6,968.8
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	47,411.2	73,777.8	73,714.2	76,826.7
Net income (pre-exceptionals)	47,810.6	35,009.2	22,920.9	23,295.5	Total liabilities	91,259.9	117,315.2	116,637.8	123,628.3
Post-tax exceptionals	0.0	0.0	0.0	0.0	Preferred shares	0.0	0.0	0.0	0.0
Net income	47,810.6	35,009.2	22,920.9	23,295.5	Total common equity	249,300.3	239,819.7	243,633.3	253,592.0
EPS (basic, pre-except) (NT\$)	8.36	6.12	4.01	4.07	Minority interest	0.0	0.0	0.0	0.0
EPS (basic, post-except) (NT\$)	8.36	6.12	4.01	4.07	Total liabilities & equity	340,560.2	357,134.9	360,271.0	377,220.4
EPS (diluted, post-except) (NT\$)	8.36	6.12	4.01	4.07	BVPS (NT\$)	43.58	41.92	42.59	44.33
DPS (NT\$)	6.69	4.90	3.21	3.26					
Dividend payout ratio (%)	80.0	80.0	80.0	80.0					
Free cash flow yield (%)	5.4	(0.8)	6.9	5.3					
Growth & margins (%)	12/07	12/08E	12/09E	12/10E	Ratios	12/07	12/08E	12/09E	12/10E
Sales growth	23.2	6.4	(14.5)	1.3	ROE (%)	21.6	14.3	9.5	9.4
EBITDA growth	44.0	(7.6)	(18.8)	(3.7)	ROA (%)	15.3	10.0	6.4	6.3
EBIT growth	68.5	(3.5)	(25.8)	(5.3)	ROACE (%)	23.6	14.6	8.8	8.7
Net income growth	54.8	(26.8)	(34.5)	1.6	Inventory days	43.7	50.1	69.3	72.9
EPS growth	54.8	(26.8)	(34.5)	1.6	Receivables days	23.1	26.3	30.4	27.8
Gross margin	20.2	17.9	17.2	16.6	Payable days	27.3	35.8	42.5	44.5
EBITDA margin	15.4	13.4	12.7	12.1	Net debt/equity (%)	(12.2)	10.3	11.7	12.0
EBIT margin	10.2	9.2	8.0	7.5	Interest cover - EBIT (X)	18.7	44.3	15.3	13.7
Cash flow statement (NT\$ mn)	12/07	12/08E	12/09E	12/10E	Valuation	12/07	12/08E	12/09E	12/10E
Net income pre-preferred dividends	47,810.6	35,009.2	22,920.9	23,295.5	P/E (analyst) (X)	5.2	7.1	10.8	10.7
D&A add-back	9,574.7	8,102.3	7,826.1	7,756.8	P/B (X)	1.0	1.0	1.0	1.0
Minorities interests add-back	0.0	0.0	0.0	0.0	EV/EBITDA (X)	6.9	5.9	8.6	8.6
Net (inc)/dec working capital	(3,267.4)	(12,707.6)	2,889.6	(338.8)	Dividend yield (%)	15.4	11.3	7.4	7.5
Other operating cash flow	(17,779.2)	(17,684.3)	(8,113.1)	(9,285.3)					
Cash flow from operations	36,338.8	12,719.6	25,523.5	21,428.3					
Capital expenditures	(12,015.0)	(14,239.8)	(7,500.0)	(7,500.0)					
Acquisitions	(3,073.4)	(6,000.0)	(2,000.0)	(2,000.0)					
Divestitures	0.0	0.0	0.0	0.0					
Others	2,392.1	(3,591.3)	(1,050.0)	(750.0)					
Cash flow from investments	(12,696.3)	(23,831.1)	(10,550.0)	(10,250.0)					
Dividends paid (common & pref)	8,932.2	(44,148.5)	(19,107.3)	(13,336.8)					
Inc/(dec) in debt	(4,583.3)	20,958.2	(325.9)	3,635.2					
Common stock issuance (repurchase)	0.0	0.0	0.0	0.0					
Other financing cash flows	(136.8)	189.9	197.0	204.4					
Cash flow from financing	4,212.0	(23,000.4)	(19,236.2)	(9,497.2)					
Total cash flow	27,854.5	(34,111.9)	(4,262.7)	1,681.1					

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

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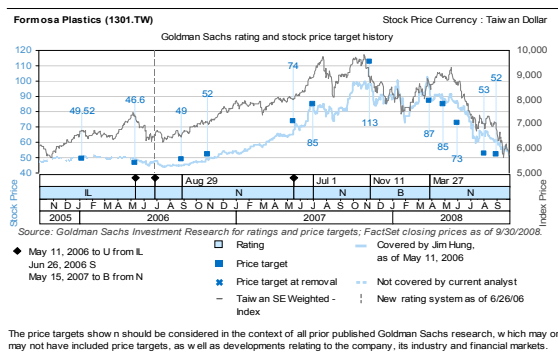
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