

COMPANY UPDATE

Taiwan Fertilizer (1722.TW)

Sell

Slightly positive on urea, yet no strong earnings momentum; Sell**What's changed**

We believe the recent rebound in the share price was mainly triggered by positive market sentiment on the urea price as there is a high correlation (0.73 during the past 5 years) between the two. We note that the urea price has increased by around 14% to US\$225/t during the past 3 weeks due to the Russian government cutting natural gas supply to Ukrainian producers, substantial production shutdowns in India because of strikes at several urea plants and 1Q generally being the peak season for fertilizer demand.

Implications

Even with the recent rebound in the urea spot price, we do not expect the urea price to go above US\$350/t in the near term given our belief that the fertilizer market is experiencing oversupply, leading to limited upside potential for urea prices. We have revised up 2009E/2010E EPS by 9.6%/8.0% on the back of our higher urea price assumptions in both years (from US\$300/t in both years to US\$350/t and US\$344/t in 2009E and 2010E). However, even with our upward net earnings revision, we still do not see net earnings growth momentum in 2009E. Moreover, we think further delays in the company's property development projects will cap further share price outperformance, therefore, we suggest investors sell into the recent strength given the current unjustified, in our view, valuation (1.0x P/B with 2009E ROE of just 5.7%).

Valuation

We have changed our target price methodology from SOTP to P/B on the back of our rising concerns about earnings quality. We maintain our Sell rating and revise up our 12-m TP from NT\$40.0 to NT\$44.0 (based on 0.8x 2009E P/B).

Key risks

Stronger-than-expected demand for the fertilizer business as well as improving liquidity in the financial market.

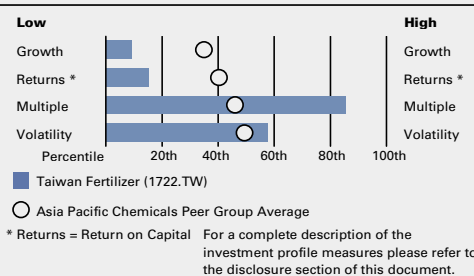
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Asia Pacific Sell List

Coverage View: NeutralTaiwan:
Chemicals

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Investment Profile

Key data	Current
Price (NT\$)	54.40
12 month price target (NT\$)	44.00
Market cap (NT\$ mn / US\$ mn)	53,312.0 / 1,598.3
Foreign ownership (%)	50.3

	12/07	12/08E	12/09E	12/10E
EPS (NT\$) New	3.85	3.12	3.07	2.96
EPS revision (%)	0.0	0.3	9.6	8.0
EPS growth (%)	3.6	(18.9)	(1.5)	(3.5)
EPS (dil) (NT\$) New	3.85	3.12	3.07	2.96
P/E (X)	14.1	17.4	17.7	18.4
P/B (X)	1.0	1.0	1.0	1.0
EV/EBITDA (X)	103.4	37.6	33.1	34.8
Dividend yield (%)	5.5	4.3	4.2	4.1
ROE (%)	7.4	5.8	5.7	5.4

Price performance chart

Share price performance (%)	3 month	6 month	12 month
Absolute	23.4	(49.9)	(48.4)
Rel. to Taiwan SE Weighted Index	40.1	(21.7)	(3.4)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 1/19/2009 close.

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Taiwan Fertilizer: 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	11,799.2	18,115.4	22,210.8	20,297.9	Cash & equivalents	13,669.8	13,056.9	8,905.8	7,893.8
Cost of goods sold	(10,708.4)	(15,787.5)	(19,614.6)	(17,906.1)	Accounts receivable	1,182.4	2,977.9	3,651.1	2,780.5
SG&A	(581.1)	(1,257.4)	(1,254.6)	(1,087.4)	Inventory	2,369.1	2,696.9	3,337.8	3,063.9
R&D	0.0	0.0	0.0	0.0	Other current assets	702.4	1,811.5	2,221.1	2,537.2
Other operating profit/(expense)	0.0	0.0	0.0	0.0	Total current assets	17,923.7	20,543.3	18,115.7	16,275.4
EBITDA	509.7	1,070.5	1,341.5	1,304.5	Net PP&E	30,588.8	31,299.1	33,307.0	34,849.8
Depreciation & amortization	(202.2)	(394.0)	(412.0)	(477.2)	Net intangibles	0.0	0.0	0.0	0.0
EBIT	307.4	676.5	929.5	827.3	Total investments	15,664.6	16,000.0	17,001.0	18,001.0
Interest income	155.0	56.8	43.3	54.7	Other long-term assets	210.6	150.0	150.0	600.0
Interest expense	0.0	0.0	0.0	0.0	Total assets	64,387.6	67,992.3	68,572.8	69,725.3
Income/(loss) from uncons. subs.	4,069.1	3,977.4	2,589.7	2,392.0	Accounts payable	891.5	1,551.7	1,097.4	1,007.3
Others	26.0	(636.0)	94.3	255.6	Short-term debt	0.0	0.0	0.0	0.0
Pretax profits	4,557.5	4,074.8	3,656.9	3,529.6	Other current liabilities	748.7	1,207.5	1,480.5	1,353.0
Income tax	(788.6)	(1,018.7)	(647.3)	(624.7)	Total current liabilities	1,640.2	2,759.3	2,578.1	2,360.5
Minorities	0.0	0.0	0.0	0.0	Long-term debt	0.0	0.0	0.0	0.0
Net income pre-preferred dividends	3,768.9	3,056.1	3,009.6	2,904.8	Other long-term liabilities	10,625.3	12,346.8	12,356.2	13,000.0
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	10,625.3	12,346.8	12,356.2	13,000.0
Net income (pre-exceptionals)	3,768.9	3,056.1	3,009.6	2,904.8	Total liabilities	12,265.5	15,106.2	14,934.2	15,360.5
Post-tax exceptionals	0.0	0.0	0.0	0.0	Preferred shares	0.0	0.0	0.0	0.0
Net income	3,768.9	3,056.1	3,009.6	2,904.8	Total common equity	52,122.1	52,886.1	53,638.5	54,364.8
EPS (basic, pre-except) (NT\$)	3.85	3.12	3.07	2.96	Minority interest	0.0	0.0	0.0	0.0
EPS (basic, post-except) (NT\$)	3.85	3.12	3.07	2.96	Total liabilities & equity	64,387.6	67,992.3	68,572.8	69,725.3
EPS (diluted, post-except) (NT\$)	3.85	3.12	3.07	2.96	BVPS (NT\$)	53.19	53.97	54.73	55.47
DPS (NT\$)	3.00	2.34	2.30	2.22					
Dividend payout ratio (%)	78.0	75.0	75.0	75.0					
Free cash flow yield (%)	(0.9)	(6.9)	(6.4)	(0.6)					
Growth & margins (%)	12/07	12/08E	12/09E	12/10E	Ratios	12/07	12/08E	12/09E	12/10E
Sales growth	5.6	53.5	22.6	(8.6)	ROE (%)	7.4	5.8	5.7	5.4
EBITDA growth	(13.2)	110.0	25.3	(2.8)	ROA (%)	5.9	4.6	4.4	4.2
EBIT growth	3.5	120.0	37.4	(11.0)	ROACE (%)	9.6	7.7	7.0	6.3
Net income growth	3.6	(18.9)	(1.5)	(3.5)	Inventory days	74.7	58.6	56.1	65.2
EPS growth	3.6	(18.9)	(1.5)	(3.5)	Receivables days	40.9	41.9	54.5	57.8
Gross margin	9.2	12.9	11.7	11.8	Payable days	28.1	28.2	24.6	21.5
EBITDA margin	4.3	5.9	6.0	6.4	Net debt/equity (%)	(26.2)	(24.7)	(16.6)	(14.5)
EBIT margin	2.6	3.7	4.2	4.1	Interest cover - EBIT (X)	NM	NM	NM	NM
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	3,768.9	3,056.1	3,009.6	2,904.8	P/E (analyst) (X)	14.1	17.4	17.7	18.4
D&A add-back	202.2	394.0	412.0	477.2	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)	103.4	37.6	33.1	34.8
Net (inc)/dec working capital	(668.1)	(2,113.3)	(1,904.9)	610.7	Dividend yield (%)	5.5	4.3	4.2	4.1
Other operating cash flow	(4,095.3)	(3,977.4)	(2,589.7)	(2,392.0)					
Cash flow from operations	(792.2)	(2,640.6)	(1,073.0)	1,600.8					
Capital expenditures	19.6	(1,084.3)	(2,400.0)	(2,000.0)					
Acquisitions	0.0	0.0	0.0	0.0					
Divestitures	0.0	0.0	0.0	0.0					
Others	3,396.1	3,682.6	1,569.7	922.0					
Cash flow from investments	3,415.7	2,598.3	(830.3)	(1,078.0)					
Dividends paid (common & pref)	(1,732.1)	(2,292.1)	(2,257.2)	(2,178.6)					
Inc/(dec) in debt	0.0	0.0	0.0	0.0					
Common stock issuance (repurchase)	0.0	0.0	0.0	0.0					
Other financing cash flows	(595.0)	1,721.6	9.3	643.8					
Cash flow from financing	(2,327.1)	(570.5)	(2,247.9)	(1,534.8)					
Total cash flow	296.4	(612.9)	(4,151.1)	(1,012.0)					

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

Analyst Contributors

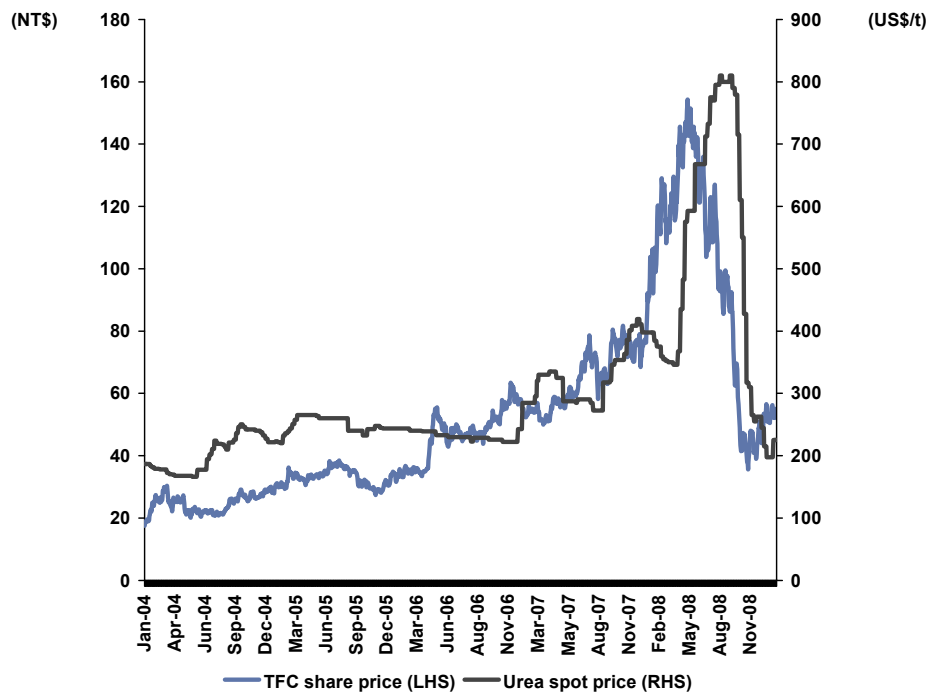
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Exhibit 1: TFC's share price vs. Urea spot price



Source: TEJ, Datastream.

Exhibit 2: Earnings revision

NT\$ mn	2008E			2009E			2010E		
	New	Old	Change (%)	New	Old	Change (%)	New	Old	Change (%)
Sales	18,115.4	18,115.4	0.0%	22,210.8	22,210.8	0.0%	20,297.9	20,297.9	0.0%
Gross profit	1,933.9	1,933.9	0.0%	2,184.1	2,184.1	0.0%	1,914.6	1,914.6	0.0%
Operating profit	676.5	676.5	0.0%	929.5	929.5	0.0%	827.3	827.3	0.0%
Pre-tax income	4,074.8	4,066.7	0.2%	3,656.9	3,334.2	9.7%	3,529.6	3,265.6	8.1%
Net earnings	3,056.1	3,050.0	0.2%	3,009.6	2,744.0	9.7%	2,904.8	2,687.6	8.1%
EPS (NT\$)	3.12	3.11	0.3%	3.07	2.80	9.6%	2.96	2.74	8.0%

Note: The gross profit calculated in this table includes depreciation and amortization while gross profit in summary financials excludes these items.

Source: Company data, TEJ, Goldman Sachs Research estimates.

Reg AC

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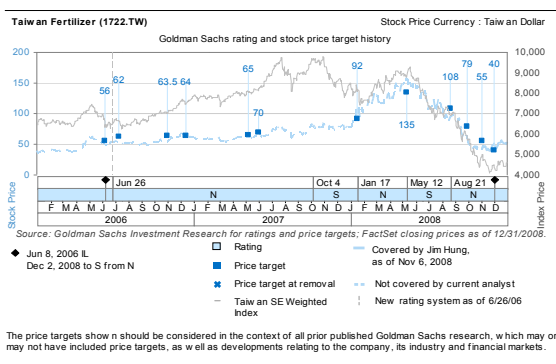
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Price target and rating history chart(s)



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