

Company Flash

16 January 2009 | 9 pages

Chi Mei Opto (3009.TW)

 Estimate change

Correction: Sell: Warning – Inventory Losses Might Be Expanded in 4Q08E

- Corrects the bold lead-in, as highlighted, below.
- **Reiterate Sell** — We reiterate our Sell (3L) on CMO based on its higher gearing ratio on the balance sheet and large contraction in its book value amid the short-term negative outlook. In addition, we see likely one-off inventory losses following panel prices decline in 4Q08.
- **Inventory losses of NT\$6-8bn** — Given concerns of a nearly 15-20% qoq drops in panel price, falling below cost level during 4Q08, we believe CMO might need to book an NT\$6-8bn (or NT\$0.82-NT\$1.09 EPS) inventory write-off as raw materials, work in progress, and finished goods are well below cost, or net realizable value no matter whether applying old accounting rules or the new SFAS No. 10.
- **Estimates revisions** — Factoring in this loss of inventory value resulting from the fall in panel prices, we further revise down our 4Q08 EPS estimate to a loss of NT\$2.78 (from a loss of NT\$1.90) while slightly revising up 1Q09 sales upon the panel price recovery and development in China for the stimulus plan in rural areas. Our new EPS is NT\$0.65 for full-year 2008 (previously NT\$1.54) and a loss of NT\$7.97 for this year (previously a loss of NT\$8.02).

Sell/Low Risk	3L
Price (16 Jan 09)	NT\$10.30
Target price	NT\$7.50
Expected share price return	-27.2%
Expected dividend yield	0.0%
Expected total return	-27.2%
Market Cap	NT\$75,256M US\$2,255M

Price Performance (RIC: 3009.TW, BB: 3009 TT)



Figure 1. CMO Statistical Abstract

Year to 31-Dec	Net profit (NT\$ Mils.)	EPS (NT\$)	EPS Growth (%)	P/E (x)	ROE (%)	P/B (x)	Bimg (NT\$)	% diff
2006	3,045	0.43	-67%	24.0	2%	0.42		
2007	35,717	5.01	1066%	2.1	19%	0.35		
2008E	4,740	0.65	-87%	15.9	2%	0.37	1.19	-45%
2009E	(56,858)	(7.97)	NM	-1.3	-33%	0.51	(5.63)	-42%
2010E	(23,408)	(2.53)	NM	-4.1	4%	0.78	(2.40)	-6%

Source: Company Reports and CIR estimates

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See Appendix A-1 for Analyst Certification and important disclosures.

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¹Citigroup Global Markets Taiwan Securities Co. Limited

Fiscal year end 31-Dec	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	24.0	2.1	15.9	-1.3	-4.1
EV/EBITDA adjusted (x)	3.9	2.2	2.9	10.7	4.1
P/BV (x)	0.4	0.4	0.4	0.5	0.8
Dividend yield (%)	1.0	14.6	0.0	0.0	0.0
Per Share Data (NT\$)					
EPS adjusted	0.43	5.01	0.65	-7.97	-2.53
EPS reported	0.43	5.01	0.65	-7.97	-2.53
BVPS	24.35	29.21	27.64	20.35	13.15
DPS	0.10	1.50	0.00	0.00	0.00
Profit & Loss (NT\$M)					
Net sales	187,052	302,473	315,868	165,529	223,704
Operating expenses	-178,939	-258,237	-299,314	-216,845	-237,852
EBIT	8,113	44,236	16,554	-51,316	-14,147
Net interest expense	-2,987	-5,388	-5,812	-8,857	-10,357
Non-operating/exceptionals	-1,580	-774	-6,299	-550	-550
Pre-tax profit	3,546	38,075	4,443	-60,723	-25,054
Tax	-3	-1,903	296	3,865	1,646
Extraord./Min.Int./Pref.div.	-498	-454	0	0	0
Reported net income	3,045	35,717	4,740	-56,858	-23,408
Adjusted earnings	3,045	35,717	4,740	-56,858	-23,408
Adjusted EBITDA	41,392	91,505	82,191	24,930	64,892
Growth Rates (%)					
Sales	22.4	61.7	4.4	-47.6	35.1
EBIT adjusted	-21.0	445.2	-62.6	-410.0	72.4
EBITDA adjusted	27.2	121.1	-10.2	-69.7	160.3
EPS adjusted	-67.3	nm	-87.1	nm	68.3
Cash Flow (NT\$M)					
Operating cash flow	62,348	81,195	67,894	24,417	52,581
Depreciation/amortization	33,279	47,269	65,636	76,246	79,039
Net working capital	24,689	-2,293	-2,482	5,029	-3,050
Investing cash flow	-140,217	-116,838	-100,100	-35,100	-35,100
Capital expenditure	-127,365	-124,911	-100,000	-35,000	-35,000
Acquisitions/disposals	-8,852	5,077	0	0	0
Financing cash flow	107,032	15,577	52,128	100,000	0
Borrowings	71,285	19,194	71,642	100,000	0
Dividends paid	-512	-649	-10,181	0	0
Change in cash	29,163	-20,067	19,922	89,317	17,481
Balance Sheet (NT\$M)					
Total assets	412,420	502,435	573,311	580,407	568,639
Cash & cash equivalent	50,366	30,948	61,051	150,368	167,849
Accounts receivable	27,979	58,366	56,250	29,478	39,838
Net fixed assets	267,311	345,115	379,578	338,433	294,493
Total liabilities	224,137	279,300	356,395	420,349	431,989
Accounts payable	37,830	70,679	76,124	55,903	61,419
Total Debt	154,386	173,580	245,222	345,222	345,222
Shareholders' funds	188,283	223,135	216,915	160,058	136,650
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	22.1	30.3	26.0	15.1	29.0
ROE adjusted	2.0	18.8	2.3	-32.8	-17.6
ROIC adjusted	3.4	13.4	4.5	-12.9	-3.9
Net debt to equity	55.2	63.9	84.9	121.7	129.8
Total debt to capital	45.1	43.8	53.1	68.3	71.6

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Figure 2. Quarterly Revisions Table

	1Q08	2Q08	3Q08	4Q08E	1Q09E	2Q09E	3Q09E	4Q09E
Original forecast								
Revenue	93,312	96,875	81,988	44,907	28,329	32,277	44,919	55,019
Gross profit	23,270	21,533	2,451	-9,021	-15,061	-13,226	-8,637	-2,192
Gross margin(%)	25%	22%	3%	-20%	-53%	-41%	-19%	-4%
Op profit	17,853	15,415	-3,474	-13,021	-18,261	-16,426	-11,837	-5,392
Op margin (%)	19%	16%	-4%	-29%	-64%	-51%	-26%	-10%
Net profit	15,204	13,845	-3,965	-13,857	-19,388	-17,428	-13,300	-7,306
Net margin (%)	16%	14%	-5%	-31%	-68%	-54%	-30%	-13%
Net EPS (NT\$)	2.08	1.89	-0.54	-1.90	-2.71	-2.43	-1.86	-1.02
Annual EPS (NT\$)				1.54				-8.02
Bloomberg EPS				1.63)	(1.93)	(1.83)	(1.27)	(0.47)
New forecast								
Revenue	93,312	96,875	81,988	43,693	32,043	33,549	44,919	55,019
Gross profit	23,270	21,533	2,451	-9,239	-14,690	-12,998	-8,637	-2,192
Gross margin(%)	25%	22%	3%	-21%	-46%	-39%	-19%	-4%
Op profit	17,853	15,415	-3,474	-13,239	-17,890	-16,198	-11,837	-5,392
Op margin (%)	19%	16%	-4%	-30%	-56%	-48%	-26%	-10%
Net profit	15,204	13,845	-3,965	-20,344	-19,039	-17,213	-13,300	-7,306
Net margin (%)	16%	14%	-5%	-47%	-59%	-51%	-30%	-13%
Net EPS (NT\$)	2.08	1.89	-0.54	-2.78	-2.67	-2.41	-1.87	-1.02
Annual EPS (NT\$)				0.65				-7.97
Bloomberg EPS				(1.63)	(2.31)	(2.34)	(1.73)	(1.06)
% Revision								
Sales	0%	0%	0%	-3%	13%	4%	0%	0%
Gross profit	0%	0%	0%	-2%	2%	2%	0%	0%
Op profit	0%	0%	0%	-2%	2%	1%	0%	0%
Net profit	0%	0%	0%	-47%	2%	1%	0%	0%
Annual EPS				-58%				1%

Source: Company Reports and CIR estimates

Figure 3. CMO Quarterly Income Statement (NT\$ Million, Percent)

	2008E					2009E					2010E					
	FYE '07	1QA	2QA	3QA	4Q	FYE '08	1Q	2Q	3Q	4Q	FYE '09	1Q	2Q	3Q	4Q	FYE '10
NET REVENUES	302,473	93,312	96,875	81,988	43,693	315,868	32,043	33,549	44,919	55,019	165,529	49,663	58,474	61,117	54,450	223,704
Depreciation	-47,108	-15,156	-16,384	-16,892	-17,104	-65,536	-17,894	-19,036	-19,417	-19,798	-76,146	-18,551	-19,735	-20,130	-20,524	-78,939
Other cost of good sold	-191,966	-54,886	-58,958	-62,645	-35,828	-212,317	-28,838	-27,510	-34,138	-37,413	-127,900	-31,784	-36,839	-38,504	-38,115	-145,242
GROSS PROFIT	63,399	23,270	21,533	2,451	-9,239	38,015	-14,690	-12,998	-8,637	-2,192	-38,516	-672	1,901	2,484	-4,189	-477
R&D	-8,271	-1,907	-2,035	-2,100	-1,500	-7,542	-1,200	-1,200	-1,200	-1,200	-4,800	-1,242	-1,462	-1,528	-1,361	-5,593
SG&A	-10,892	-3,511	-4,082	-3,825	-2,500	-13,918	-2,000	-2,000	-2,000	-2,000	-8,000	-1,987	-2,047	-2,139	-1,906	-8,078
Operating expenses	-19,163	-5,418	-6,118	-5,925	-4,000	-21,460	-3,200	-3,200	-3,200	-3,200	-12,800	-3,228	-3,508	-3,667	-3,267	-13,671
OPERATING INCOME	44,236	17,853	15,415	-3,474	-13,239	16,554	-17,890	-16,198	-11,837	-5,392	-51,316	-3,900	-1,608	-1,183	-7,456	-14,147
Int&other inc/(exp)	-5,900	-1,544	-871	-1,293	-8,403	-12,111	-2,364	-2,114	-2,464	-2,464	-9,407	-2,739	-2,489	-2,839	-2,839	-10,907
PRETAX INCOME	38,336	16,309	14,545	-4,767	-21,643	4,443	-20,254	-18,312	-14,301	-7,856	-60,723	-6,639	-4,097	-4,022	-10,295	-25,054
Tax Credit(exp)& Min Int	-2,165	-1,104	-700	802	1,299	296	1,215	1,099	1,001	550	3,865	398	246	282	721	1,646
NET INCOME BEF PRE DIV	36,171	15,204	13,845	-3,965	-20,344	4,740	-19,039	-17,213	-13,300	-7,306	-56,858	-6,241	-3,851	-3,741	-9,575	-23,408
NET INCOME AFT PRE DIV	35,717	15,204	13,845	-3,965	-20,344	4,740	-19,039	-17,213	-13,300	-7,306	-56,858	-6,241	-3,851	-3,741	-9,575	-23,408
NET EPS IN NT\$	5.01	2.08	1.89	-0.54	-2.78	0.65	-2.67	-2.41	-1.87	-1.02	-7.97	-0.67	-0.42	-0.40	-1.04	-2.53
Fully diluted shares (mn)	7,127	7,306	7,306	7,306	7,306	7,306	7,130	7,130	7,130	7,130	7,130	9,248	9,248	9,248	9,248	9,248
Operating Ratios																
Gross margins	21%	25%	22%	3%	-21%	12%	-46%	-39%	-19%	-4%	-23%	-1%	3%	4%	-8%	0%
Operating margin	15%	19%	16%	-4%	-30%	5%	-56%	-48%	-26%	-10%	-31%	-8%	-3%	-2%	-14%	-6%
Pre-tax margin	13%	17%	15%	-6%	-50%	1%	-63%	-55%	-32%	-14%	-37%	-13%	-7%	-7%	-19%	-11%
Net margin	12%	16%	14%	-5%	-47%	2%	-59%	-51%	-30%	-13%	-34%	-13%	-7%	-6%	-18%	-10%
Year-to-Year %																
Net revenues	62%	98%	59%	-7%	-59%	4%	-66%	-65%	-45%	26%	-48%	55%	74%	36%	-1%	35%
Gross profit	193%	478%	133%	-89%	N/A	-40%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Operating income	445%	2848%	248%	N/A	N/A	-63%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Pretax income	981%	N/A	338%	N/A	N/A	-88%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Net income	921%	N/A	318%	N/A	N/A	-87%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Qtr-to-Qtr %																
Net revenues		-12%	4%	-15%	-47%		-27%	5%	34%	22%		-10%	18%	5%	-11%	
Gross profit		-19%	-7%	-89%	N/A		N/A	N/A	N/A	N/A		N/A	N/A	31%	N/A	
Operating income		-21%	-14%	N/A	N/A		N/A	N/A	N/A	N/A		N/A	N/A	N/A	N/A	
Net income		-25%	-9%	N/A	N/A		N/A	N/A	N/A	N/A		N/A	N/A	N/A	N/A	

Source: Citi Investment Research estimates

Chi Mei Opto

Company description

Established in December 1997 and listed in late August 2002, Chi Mei Optoelectronics (CMO) is the second-largest TFT LCD panel manufacturer in Taiwan, and is a subsidiary of the Chi Mei Group.

Investment strategy

Despite breaking below its prior trailing trough P/BV, we rate CMO shares Sell / Low Risk (3L) with a NT\$7.50 target price as we believe it brings greater downside risks to investors by carrying higher gearing ratio, weaker cash flow, and larger book value contraction. Company-specific concerns include: 1) CMO has much higher net debt to equity ratio of 70-75% vs. AUO/LGD's 10-20% level, suggesting larger refinancing risks; 2) By spending higher capex without better ROE/ROA, CMO reported gross FCF margin of -18% vs. AUO/LGD's -5% in the past five years; 3) We estimate larger book value contraction for CMO than AUO for the next 3-4 quarters.

Valuation

Our target price for CMO is NT\$7.50 or nearly 0.4x 2009E-10E book. We use P/B as our primary valuation method due to earnings volatility in the sector. Over the past five years, CMO traded at 1.5x average trailing book with an average ROE of 10%. Given that we expect CMO's ROE to contract to 0% (cut from 4-5%) for the next five years, we expect long-term average P/BV to come down to 0.4-0.6x. However, if CMO can improve its free cash flow position and do better cash flow and capital management to return its long-term ROE back to the 10-12% level, we do not rule out a re-rating. But, we do not have any visibility on when this will happen.

Risks

We rate CMO shares Low Risk based on our quantitative risk-rating system, which tracks historical 260-day share price volatility. Upside risks that could cause the shares to continue to trade above our target price include: 1) Stronger-than-expected panel price rebound; 2) a dramatic cut in capex to improve its FCF and to lower its net debt to equity ratio; and 3) Share gains from competitors such as LGD and AUO.

Appendix A-1

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Analyst: Andrew Lu

Covered since October 17 2008

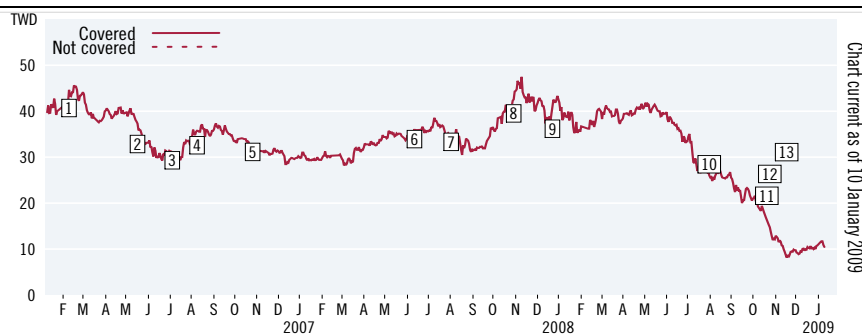


Chart current as of 10 January 2009

	Date	Rating	Target Price	Closing Price
1	9-Feb-06	1L	*57.67	44.65
2	17-May-06	1L	*52.43	37.31
3	5-Jul-06	1L	*46.31	30.67
4	9-Aug-06	1L	*46.70	35.76
5	26-Oct-06	1L	*40.29	31.14

	Date	Rating	Target Price	Closing Price
6	12-Jun-07	1L	*43.96	36.08
7	2-Aug-07	1L	*42.86	33.71
8	30-Oct-07	1L	*48.57	42.57
9	23-Dec-07	1L	*53.33	39.43
10	31-Jul-08	1L	*45.50	26.05

	Date	Rating	Target Price	Closing Price
11	21-Oct-08	*3L	*15.00	16.35
12	24-Oct-08	3L	*12.00	14.75
13	18-Nov-08	3L	*7.50	8.15

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 31 Dec 2008

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