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Taiwan Technology

Reuters 2454.TW
Bloomberg 2454 TT

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Taiwan Wtd @ 4,467.5

12M hi/lo NT\$440.10/177.00

12M price target NT\$300.00

±% potential +22%

Target set on 1 Sep 08

Shares in issue 1,073.2m

Free float (est.) 91.0%

Market cap US\$7,966m

3M average daily volume

NT\$2,159.0m (US\$65.3m)

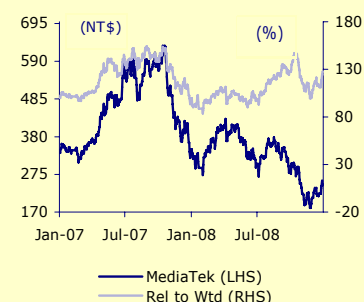
Major shareholders

MK Tsai & Family 8.8%

Foreign s'holding 39.5%

Stock performance (%)

	1M	3M	12M
Absolute	17.1	(12.8)	(28.6)
Relative	22.1	0.2	28.3
Abs (US\$)	17.7	(14.6)	(30.1)



Source: Bloomberg

www.cls.com

Change in direction

We are upgrading MediaTek to BUY from Underperform as share price appears to have factored in the negative outlook for 09. We believe the stimulus plan in China and a more certain 3G roadmap should serve as potential positives for MediaTek in 09-2010 and allow the company to rekindle its growth path. From a balance sheet perspective, MediaTek is also one of the most robust companies around the region and hence ability to distribute dividend should be more secure. Our target price of NT\$300 implies 22% upside with dividend yield of 5.2%.

Distributors signalling slight improvement in Dec

Our checks with distributors suggest that inventory is lean which led to some last-minute order in December. In our view, this is positive as customers are generally unwilling to place orders unless there is genuine demand. Due to lack of inventory, the better demand in December is reflected in MediaTek's December result as the company managed to generate NT\$5.1bn in revenue vs NT\$4bn to 4.5bn widely expected by the market. 4Q08 revenue arrived at NT\$20.5bn, down 26.9% QoQ vs guidance of down 30-33% QoQ.

3G uncertainty removed

China finally announced the issuance of 3G licenses with China Mobile getting TD-SCDMA while Unicom and China Telecom received WCDMA and CDMA 2000 respectively. This removes uncertainty regarding ramp up schedule of 3G which is a positive for 2H09 and 2010. New 3G capacity should lead to more aggressive pricing and handset subsidies which should be positive for overall handset volume and increases replacement rate.

Stimulus plan – long term positive

As part of the plan to keep consumer spending buoyant, Chinese government has announced a 13% subsidies for selected electronics including handsets to be commenced on 1st of February and lasts for four years. This represents a long term opportunity for MediaTek to maintain its presence in 2G despite the imminent ramp of 3G in China.

Upgrade to BUY – a dominator

With the Chinese government working to shore up handset demand, we are now more confident in regards to 09/2010 outlook. With lower share price and a strong balance sheet, MediaTek looks favourable at the current level. We upgrade MediaTek to BUY with target price of NT\$300, upside of 22% with dividend yield of 5.2%.

Financials

Year to 31 Dec	06A	07A	08CL	09CL	10CL
Revenue (NT\$m)	56,397	80,672	90,244	89,195	115,616
Rev forecast change (%)	-	-	(0.8)	(12.6)	(3.1)
Net profit (NT\$m)	22,580	33,593	20,117	20,541	27,387
NP forecast change (%)	-	-	(6.3)	(14.9)	(3.3)
Adj EPS (NT\$) ¹	14.35	20.81	18.94	19.14	25.52
Adj. EPS (% YoY) ¹	32.3	45.0	(9.0)	1.1	33.3
Adj PEx (@NT\$246.0) ¹	17.1	11.8	13.0	12.9	9.6
Adj ROAE (%) ¹	23.7	28.2	22.5	21.4	26.5
Dividend yield (%)	5.7	7.6	5.2	5.3	7.1
Price/book (x)	3.7	3.0	2.9	2.7	2.4
Net gearing (%)	(69)	(59)	(48)	(52)	(53)

Source: CLSA Asia-Pacific Markets

Both Distributors and MediaTek saw better than expected December

Distributors signalling slight improvement in Dec

Our checks with distributors suggest that inventory is lean which led to some last-minute order in December. In our view, this is positive as customers are generally unwilling to place orders unless there is genuine demand. Due to lack of inventory, the better demand in December is reflected in MediaTek's December result as the company managed to generate NT\$5.1bn in revenue vs NT\$4bn to 4.5bn widely expected by the market. 4Q08 revenue arrived at NT\$20.5bn, down 26.9% QoQ vs guidance of down 30-33% QoQ.

Figure 1

Distribution December – beating expectations

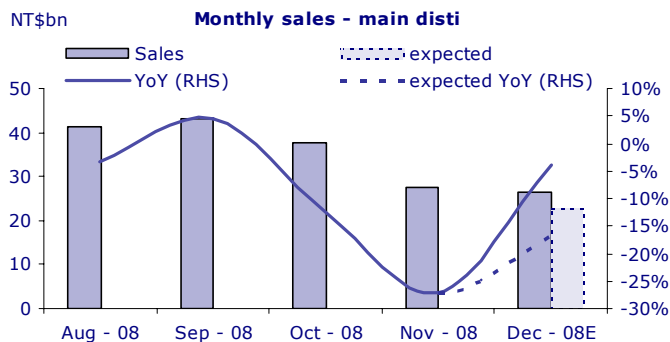
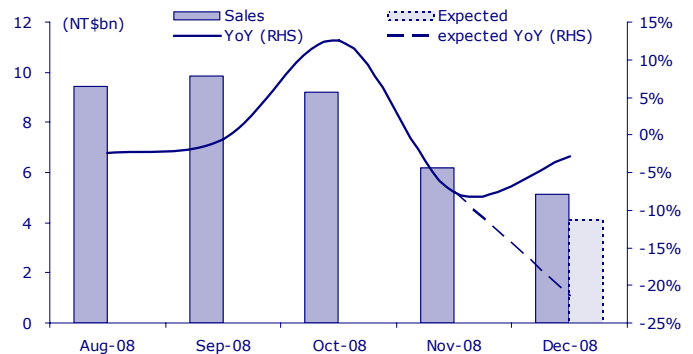


Figure 2

MediaTek December – ahead of reduced expectations



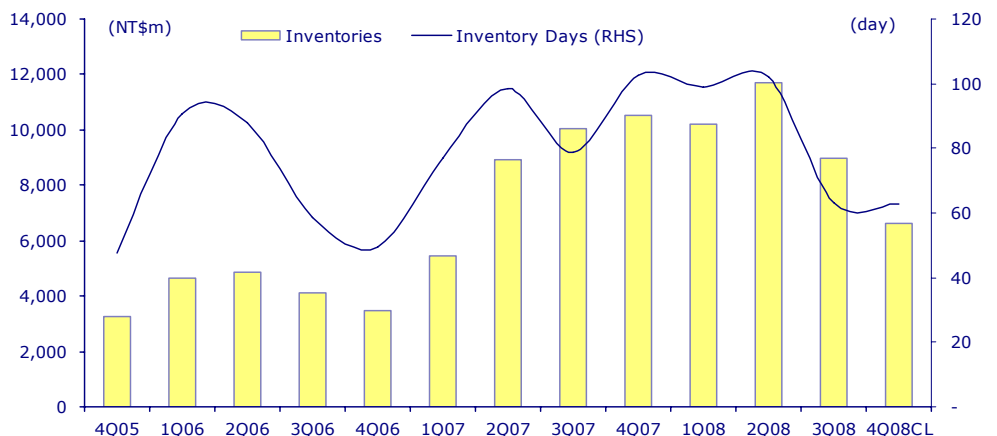
Source: CLSA Asia-Pacific Markets

Inventory effectively reduced in 4Q08

Specifically for MediaTek's own inventory, we believe a efficient reduction has taken place in 4Q08. Inventory, given that production has declined 30% (as much as foundry shipment decline for 4Q08), inventory would decline to NT\$7.1bn at end of 4Q08 from NT\$10.1bn at end of 3Q08. This is implicit of 63 days of inventory which is closer to the lows for MediaTek.

Figure 3

Inventory should be effectively reduced now



Source: CLSA Asia-Pacific Markets

3G is here and expect heavy subsidies

3G uncertainty removed

China finally announced the issuance of 3G licenses with China Mobile getting TD-SCDMA while Unicom and China Telecom received WCDMA and CDMA 2000 respectively. This removes uncertainty regarding ramp up schedule of 3G which is a positive for 2H09 and 2010.

New 3G capacity should lead to more aggressive pricing and handset subsidies. Despite 3G handset price has come down substantially over the last

Government here to help – handset part of the stimulus plan

few years, average price are still around US\$300 (Rmb2,000) for WCDMA. Dual-mode TD-SCDMA/GSM handsets range from Rmb700-6888 with median price at around Rmb2,000. This would suggest subsidies are necessary to entice consumer to migrate towards 3G.

From carriers’ perspective, subsidies are necessary and crucial to 3G success as 3G migration is expensive and hence utilisation rate of these cell towers is a must. Hence, we believe operators will likely have to subsidise 3G handsets to entice users to switch to the new 3G network. These features of the 3G market which should be positive for overall handset volume and force replacement rate to increase as consumers are incentivised to upgrade.

Stimulus plan – long term positive

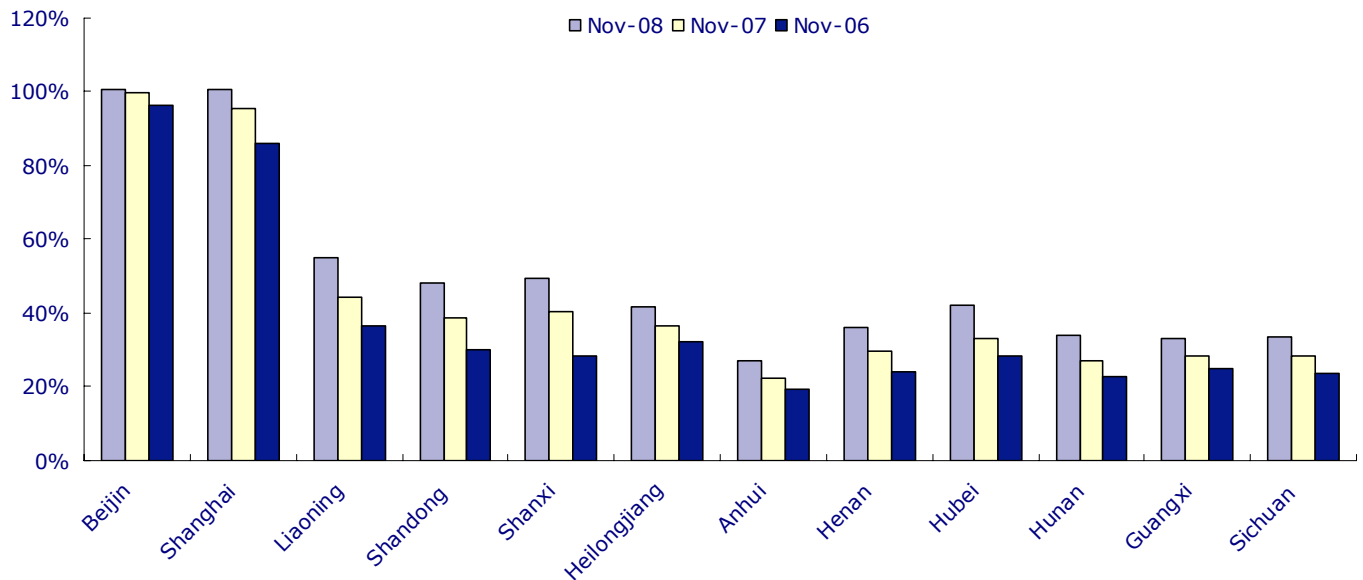
As part of the plan to keep consumer spending buoyant, Chinese government has announced a 13% subsidies for selected electronics including handsets to be commenced on 1st of February and lasts for four years.

Judging from the penetration rate in various provinces (see below figure), we believe there are room for further growth especially as the entry barrier to owning a handset will be reduced by 13% starting in February. We also note that to qualify for subsidies, qualified handset must retail for less than Rmb1,000 which would suggests that MediaTek (who is the largest provider for the Chinese low price handset makers) who benefit disproportionately.

We believe this represents a long term opportunity for MediaTek to maintain its presence in 2G (especially in the rural areas) despite the imminent ramp up of 3G in China (which is aimed most at larger cities in the initial phase).

Figure 4

Penetration rate still have long way to go – new stimulus plan will help



Source: MIIT, CLSA Asia-Pacific Markets

Figure 5

Penetration rate comparison

	Liaoning	Shandong	Shanxi	Heilongji	Anhui	Henan	Hubei	Hunan	Guangxi	Sichuan
Nov-08	55%	48%	49%	42%	27%	36%	42%	34%	33%	34%
Nov-07	44%	39%	41%	37%	22%	30%	33%	27%	28%	28%
Nov-06	37%	30%	28%	32%	19%	24%	28%	23%	25%	23%

Source: MIIT, CLSA Asia-Pacific Markets

Upgrade to BUY – a dominator

With the Chinese government working to shore up handset demand, we are now more confident in regards to 09/2010 outlook. We have lowered our revenue assumption for 2009 by 12.6% and net profit forecast by 14.9% as we are assuming demand will get delayed as people weigh their handset purchasing options with initial launch of 3G (to see new pricing and handset options).

Expect some delay in revenue due to 3G ramp

From a sequential basis, we are currently expecting 21% QoQ decline in 1Q09 judging from our channel checks. The real judge in demand profile remains Chinese New Year which will take place at the last week of January this year. We are however, expecting handset demand to recover by 2Q09 with 28.3% QoQ growth, largely boosted by rural demand owing to the subsidies program. (See model assumption in figure 8).

Dividend should be good

From a balance sheet perspective, we also believe MediaTek is attractive as it is in a net cash position with net cash to equity of 52%. We also note that the company's ability to pay dividend is good even in the unlikely event of a drastic fall in earnings due to the high level of unappropriated retained earnings at NT\$56bn vs projected dividend (08) at NT\$13.6bn. The unappropriated retained earnings is 4 times larger than projected dividend.

Figure 6

Dividend sensitivity - ability to pay is good

	2008	2009		
(NT\$m)	Base	Scenario I Net profit=CLSA forecast	Scenario II Net profit= 70% of CLSA forecast	Scenario II Net profit= 50% of CLSA forecast
4Q08 net profit	3,808			
2008 net profit	20,116			
Dividend payout ratio	68.0%			
Dividend per share	NT\$ 12.7			
Share counts (m)	1,073			
Dividend payout for 2008 (paid in 2009)		-13,679	-13,679	-13,679
Capital stock	10,732	10,732	10,732	10,732
Capital surplus	2,717	2,717	2,717	2,717
Others	-658	-658	-658	-658
Retained earnings	69,379	55,699	55,699	55,699
Retained earnings:legal capital reserve	13,024	15,036	15,036	15,036
Retained earnings:unappropriated	56,354	40,663	40,663	40,663
2009 net profit		20,541	14,379	10,271
Total shareholders' equity (year-end)	82,169	89,031	82,869	78,760
Sensitivity- Dividend payout for 2009 (paid-in 2010)				
Retained earnings:unappropriated +2009 net profit		61,204	55,042	50,934
Dividend payout for 2009 (paid-in 2010)		-13,679	-13,679	-13,679
(Retained earnings :unappropriated earnings +2009 net profit) > dividend payout 2009		Yes	Yes	Yes
Additional amount from retained earnings:legal capital reserve		not necessary	not necessary	not necessary

Source: CLSA Asia-Pacific Markets

With lower share price and a strong balance sheet, MediaTek looks favourable at the current level. We upgrade MediaTek to BUY with target price of NT\$300 our roughly 15x 09 earnings. Our target price implies upside of 22% with dividend yield of 5.2%.

Figure 7

Earnings projection

(NT\$m)	1Q08	2Q08	3Q08	4Q08CL	1Q09CL	2Q09CL	3Q09CL	4Q09CL	2008CL	2009CL	2010CL
Sales	19,378	22,318	28,052	20,496	16,188	20,769	28,027	24,212	90,244	89,195	115,616
QoQ growth	-4.9%	15.2%	25.7%	-26.9%	-21.0%	28.3%	34.9%	-13.6%			
YoY growth	29.8%	21.2%	5.1%	0.6%	-16.5%	-6.9%	-0.1%	18.1%			
COGS	(9,276)	(10,308)	(12,833)	(9,489)	(7,618)	(9,573)	(13,183)	(11,412)	(41,906)	(41,785)	(57,343)
Gross profit	10,102	12,010	15,219	11,007	8,570	11,196	14,843	12,800	48,338	47,410	58,273
Gross margin	52.1%	53.8%	54.3%	53.7%	52.9%	53.9%	53.0%	52.9%	53.6%	53.2%	50.4%
Operating expense	(5,990)	(6,184)	(7,581)	(6,451)	(6,040)	(6,620)	(7,740)	(7,200)	(26,206)	(27,600)	(31,120)
as % of sales	30.9%	27.7%	27.0%	31.5%	37.3%	31.9%	27.6%	29.7%	29.0%	30.9%	26.9%
SG&A	(1,050)	(925)	(1,101)	(1,101)	(1,150)	(1,150)	(1,250)	(1,250)	(4,177)	(4,800)	(5,500)
as % of sales	5.4%	4.1%	3.9%	5.4%	7.1%	5.5%	4.5%	5.2%	4.6%	5.4%	4.8%
R&D	(3,618)	(3,593)	(3,927)	(4,170)	(3,900)	(4,000)	(4,050)	(4,000)	(15,308)	(15,950)	(16,500)
as % of sales	18.7%	16.1%	14.0%	20.3%	24.1%	19.3%	14.5%	16.5%	17.0%	17.9%	14.3%
Bonus share expenses	(1,322)	(1,666)	(2,553)	(1,180)	(990)	(1,470)	(2,440)	(1,950)	(6,721)	(6,850)	(9,120)
as % of sales	6.8%	7.5%	9.1%	5.8%	6.1%	7.1%	8.7%	8.1%	7.4%	7.7%	7.9%
Operating profits	4,112	5,826	7,638	4,556	2,530	4,576	7,103	5,600	22,132	19,810	27,153
Operating margin	21.2%	26.1%	27.2%	22.2%	15.6%	22.0%	25.3%	23.1%	24.5%	22.2%	23.5%
Non-op income	174	333	(71)	(548)	600	600	600	557	(112)	2,357	2,512
Pretax profits	4,286	6,159	7,567	4,008	3,130	5,176	7,703	6,157	22,020	22,167	29,665
Tax	(255)	(1,063)	(385)	(200)	(157)	(776)	(385)	(308)	(1,903)	(1,626)	(2,278)
Tax rate	5.9%	17.3%	5.1%	5.0%	5.0%	15.0%	5.0%	5.0%	8.6%	7.3%	7.7%
Net profits	4,031	5,096	7,182	3,808	2,974	4,400	7,318	5,849	20,117	20,541	27,387
EPS (NT\$)	3.79	4.80	6.76	3.58	2.77	4.10	6.82	5.45	18.94	19.14	25.52

Source: CLSA Asia-Pacific Markets

Figure 8

Model assumptions											
Sales(NT\$m)	1Q08	2Q08	3Q08	4Q08CL	1Q09CL	2Q09CL	3Q09CL	4Q09CL	2008CL	2009CL	2010CL
Consumer segment	3,974	4,238	5,470	4,306	3,936	4,951	8,131	7,034	17,988	24,052	45,159
DVD player	1,297	1,277	897	975	878	1,300	2,600	2,270	4,445	7,047	20,492
DVD-Recordable	1,166	1,137	1,425	1,511	1,466	1,422	1,379	1,338	5,238	5,605	4,962
Digital TV ICs	1,512	1,824	3,148	1,820	1,593	2,230	4,151	3,426	8,304	11,399	19,704
Communication	12,829	15,343	19,334	12,661	9,580	12,934	16,900	14,836	60,167	54,250	58,159
Handset IC	12,829	15,343	19,334	12,661	9,580	12,934	16,900	14,836	60,167	54,250	58,159
PC segment	2,575	2,738	3,073	3,529	2,672	2,884	2,996	2,342	11,915	10,893	12,299
CD-ROM	32	30	16	16	7	7	0	0	94	13	0
CD-RW	213	195	110	109	106	51	50	48	628	255	83
DVD ROM	311	300	348	345	335	325	315	306	1,305	1,281	1,134
Combo	554	515	369	377	274	177	172	0	1,816	624	0
DVD ReW	1,465	1,696	2,230	2,681	1,950	2,324	2,459	1,988	8,072	8,720	11,083
Royalty	-	-	175	-	-	-	-	-	175	-	-
Total Sales	19,378	22,318	28,052	20,496	16,188	20,769	28,027	24,212	90,244	89,195	115,616
% of sales	1Q08	2Q08	3Q08	4Q08CL	1Q09CL	2Q09CL	3Q09CL	4Q09CL	2008CL	2009CL	2010CL
Consumer segment	21	19	20	21	24	24	29	29	20	27	39
DVD player	7	6	3	5	5	6	9	9	5	8	18
DVD-Recordable	6	5	5	7	9	7	5	6	6	6	4
Digital TV ICs	8	8	11	9	10	11	15	14	9	13	17
Communication	66	69	69	62	59	62	60	61	67	61	50
Handset IC	66	69	69	62	59	62	60	61	67	61	50
PC segment	13	12	11	17	17	14	11	10	13	12	11
CD-ROM	0	0	0	0	0	0	-	-	0	0	-
CD-RW	1	1	0	1	1	0	0	0	1	0	0
DVD ROM	2	1	1	2	2	2	1	1	1	1	1
Combo	3	2	1	2	2	1	1	-	2	1	-
DVD ReW	8	8	8	13	12	11	9	8	9	10	10
Shipment (m units)	1Q08	2Q08	3Q08	4Q08CL	1Q09CL	2Q09CL	3Q09CL	4Q09CL	2008CL	2009CL	2010CL
Consumer segment	14	15	14	13	13	16	23	20	55.8	71.0	148.5
DVD player	10	10	6	6	6	8	10	9	31.8	33.0	88.0
DVD-Recordable	2	2	3	3	3	3	3	3	10.0	12.0	12.0
Digital TV ICs	2	3	6	4	4	5	10	8	14.0	26.0	48.5
Communication	42	53	64	41	32	45	60	55	200.0	192.0	234.0
Handset IC	42	53	64	41	32	45	60	55	200.0	192.0	234.0
PC segment	19	21	20	22	16	16	17	14	81.3	62.2	75.7
CD-ROM	1	1	1	1	0	0	-	-	3.0	0.4	-
CD-RW	2	2	1	1	1	1	1	1	5.6	2.5	0.9
DVD ROM	3	3	3	3	3	3	3	3	12.0	12.8	12.8
Combo	3	3	2	2	2	1	1	-	10.2	3.5	-
DVD ReW	10	12	13	15	10	11	12	10	50.5	43.0	62.0

Source: CLSA Asia-Pacific Markets

Recommendation history - MediaTek 2454 TT

Date	Rec level	Closing price	Target
11 January 2009	BUY	246.00	300.00
01 September 2008	U-PF	366.50	300.00
30 July 2008	BUY	320.00	386.00
16 July 2008	BUY	285.15	387.97
16 June 2008	BUY	322.77	396.04
30 April 2008	BUY	396.04	470.30
17 March 2008	BUY	365.35	403.96
30 January 2008	BUY	332.67	420.79
25 January 2008	BUY	293.07	445.54
29 November 2007	BUY	426.73	603.96
07 November 2007	BUY	516.83	673.27
01 October 2007	O-PF	590.10	673.27
02 August 2007	O-PF	563.37	623.76
25 July 2007	O-PF	592.17	528.05
03 July 2007	O-PF	483.73	528.05
03 May 2007	O-PF	406.41	462.05
29 January 2007	U-PF	348.89	278.17

Source: CLSA Asia-Pacific Markets

Key to CLSA investment rankings: **BUY** = Expected to outperform the local market by >10%; **O-PF** = Expected to outperform the local market by 0-10%; **U-PF** = Expected to underperform the local market by 0-10%; **SELL** = Expected to underperform the local market by >10%. Performance is defined as 12-month total return (including dividends).

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