

Company Flash

4 February 2009 | 8 pages

ASUSTeK Computer (2357.TW)

Sell: Navigating New Opportunities for Handset Business

- What's new?** — Garmin and Asustek today announced a strategic alliance that will leverage the companies' navigation and Smart Phone expertise to design, manufacture and distribute co-branded LBS-centric mobile phones. Garmin and Asustek have begun joint development on a diverse mobile phone product line, which will be named as the Garmin-Asus nüvifone series. The companies expect to bring to market several Garmin-Asus nüvifone models in 2009, and a new Garmin-Asus nüvifone model will be announced at 3GSM in Feb.
- Synergies for both parties?** — Garmin has been cooperating with Asustek for over a year on the initial nüvifone that was announced in 2008 on the basis of an ODM relationship. To further leverage Asustek's design capability of Smart Phone and channel network in emerging markets, Garmin decided to expand the relationship from ODM to co-branding. Going forward, Asustek's handset team (700-800 people) will focus on developing and selling Garmin-Asus LBS-centric mobile phones. Garmin will leverage its strength in navigation and extensive channel network to promote Garmin-Asus LBS-centric phones. Garmin has 54%/20%+ share in the North American/European GPS markets.
- A reasonable move for Garmin to expand into LBS-centric mobile phone market** — The continued commoditization of GPS and falling prices are forcing Garmin to seek new growth opportunities from the LBS-centric mobile phone market. However, it's very likely that competitors will soon follow this example and launch similar products. In addition, how Garmin partners with a tier-1 carrier to boost its sales volume remains to be seen. If Garmin plans to use its existing channel network to promote LBS-Centric mobile phones, it's likely to see increasing marketing costs.
- Still some uncertainties ahead** — Asustek's handset business contributed limited revenue to its branded business, with annual shipments less than 1m. Given intensifying competition in the Smart Phone market and lack of economies of scale, the strategic alliance with Garmin could help Asustek's handset team leverage growth opportunities. In addition, we think Asustek would like to leverage Garmin's strong position to further promote the ASUS brand in the US market after Eee PC. However, how Garmin and Asustek share responsibility and cost/profit remains unclear to investors. We retain our Sell (3M) on Asustek shares and note the unclear outlook for this strategic alliance. Asustek's valuation looks stretched at 13x 2009E EPS.

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

Sell/Medium Risk	3M
Price (04 Feb 09)	NT\$30.50
Target price	NT\$24.00
Expected share price return	-21.3%
Expected dividend yield	3.8%
Expected total return	-17.5%
Market Cap	NT\$129,505M US\$3,837M

Price Performance (RIC: 2357.TW, BB: 2357 TT)



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Fiscal year end 31-Dec	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	8.2	6.3	7.9	12.8	9.6
EV/EBITDA adjusted (x)	3.8	2.9	3.8	3.9	3.0
P/BV (x)	0.8	0.7	0.8	0.7	0.7
Dividend yield (%)	4.9	8.2	3.8	2.3	3.1
Per Share Data (NT\$)					
EPS adjusted	3.72	4.83	3.85	2.37	3.19
EPS reported	5.64	7.41	3.85	2.37	3.19
BVPS	38.88	43.17	39.79	41.01	43.49
DPS	1.49	2.49	1.15	0.71	0.96
Profit & Loss (NT\$M)					
Net sales	560,235	755,361	778,294	712,451	763,834
Operating expenses	-539,882	-726,690	-760,050	-696,924	-742,023
EBIT	20,353	28,671	18,245	15,527	21,811
Net interest expense	772	832	310	-104	-110
Non-operating/exceptionals	7,168	9,081	8,295	6,771	6,086
Pre-tax profit	28,293	38,584	26,850	22,195	27,787
Tax	-6,611	-7,828	-5,322	-4,439	-5,557
Extraord./Min.Int./Pref.div.	-2,460	-3,132	-5,187	-7,675	-8,680
Reported net income	19,221	27,623	16,340	10,081	13,550
Adjusted earnings	12,678	18,014	16,340	10,081	13,550
Adjusted EBITDA	26,275	36,780	28,674	28,759	37,768
Growth Rates (%)					
Sales	56.6	34.8	3.0	-8.5	7.2
EBIT adjusted	3.5	40.9	-36.4	-14.9	40.5
EBITDA adjusted	13.3	40.0	-22.0	0.3	31.3
EPS adjusted	-10.9	29.8	-20.4	-38.3	34.4
Cash Flow (NT\$M)					
Operating cash flow	9,003	28,405	17,105	24,942	25,322
Depreciation/amortization	5,922	8,109	10,429	13,232	15,957
Net working capital	-30,878	-15,373	-14,630	152	-6,530
Investing cash flow	-20,635	-17,810	-21,750	-21,844	-24,266
Capital expenditure	-18,897	-14,868	-18,290	-17,678	-18,953
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	13,268	-1,539	7,707	-4,902	-3,024
Borrowings	16,454	3,238	12,086	0	0
Dividends paid	-3,456	-6,244	-2,753	-4,902	-3,024
Change in cash	871	8,894	3,058	-1,804	-1,968
Balance Sheet (NT\$M)					
Total assets	363,743	385,742	393,828	411,491	433,102
Cash & cash equivalent	43,914	56,998	61,352	59,548	57,580
Accounts receivable	132,392	129,135	86,908	94,724	100,607
Net fixed assets	52,199	63,177	72,438	79,994	86,956
Total liabilities	220,584	204,440	204,503	216,986	228,072
Accounts payable	166,860	141,565	119,034	128,972	136,730
Total Debt	24,339	24,228	33,626	33,626	33,626
Shareholders' funds	143,159	181,302	189,326	194,504	205,030
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	4.7	4.9	3.7	4.0	4.9
ROE adjusted	10.7	12.3	9.9	5.9	7.6
ROIC adjusted	15.1	16.5	8.9	7.1	9.9
Net debt to equity	-13.7	-18.1	-14.6	-13.3	-11.7
Total debt to capital	14.5	11.8	15.1	14.7	14.1

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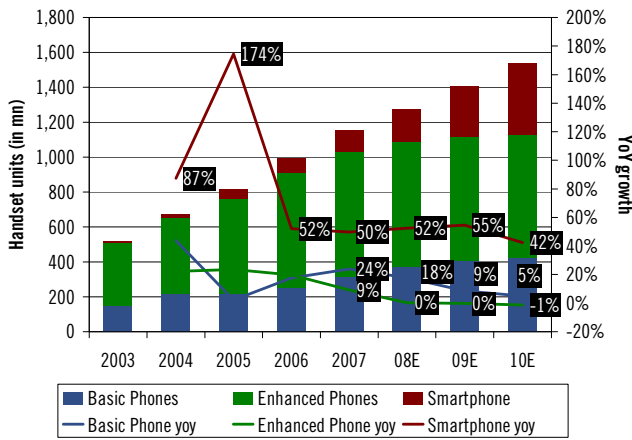


Figure 1. Statistical Abstract

Year to December	Net profit (NT\$ mn)	Bonus Adj. EPS	Bonus Adj. EPS YoY	Bonus Adj. B/S	Bonus Dilution	P/E (x)	P/B (x)	ROE (%)	I/B/E/S (NT\$)	% diff
2005	17,275	4.18	4%	33.84	29%	7.3x	0.9x	13%		
2006	19,221	3.72	-11%	36.96	34%	8.2x	0.8x	11%		
2007	27,623	4.83	30%	40.59	35%	6.3x	0.8x	12%		
2008E	16,340	3.85	-20%	39.79	0%	7.9x	0.8x	10%	4.20	-8%
2009E	10,081	2.37	-38%	41.01	0%	12.8x	0.7x	6%	3.16	-25%
2010E	13,550	3.19	34%	43.49	0%	9.6x	0.7x	8%	3.90	-18%

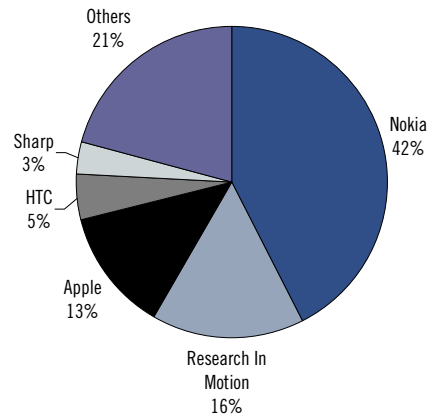
Source: Company Reports and CIR estimates

Figure 2. Global Handset Units by Form Factor



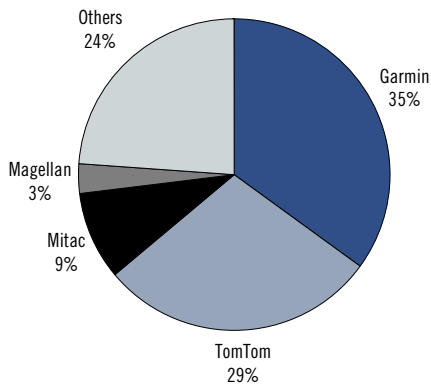
Source: Gartner and Citi Investment Research

Figure 3. 3Q08 Global Smart Phone Market Share



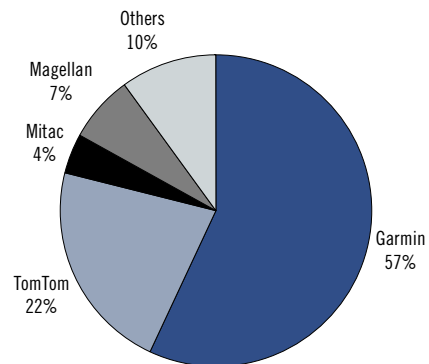
Source: Gartner and Citi Investment Research

Figure 4. 3Q08 Global GPS/PND Market Share



Source: Canals and Citi Investment Research

Figure 5. 3Q08 US GPS/PND Market Share



Source: Canals and Citi Investment Research

ASUSTeK Computer

Company description

Established in 1990, Asustek has built its reputation in motherboards and tapped the notebook arena in 1997. Asustek enjoys a leading position in the motherboard market with a 2007 total worldwide market share (including branded and ODM MB shipments) of 38%. Meanwhile, its global NB market share reached 4.3% in 2007 and ranked No.7 NB brand worldwide, after HP, Acer, Dell, Toshiba, Lenovo, and Fujitsu. Asustek also manufactures handheld devices, graphic cards, and other consumer electronics. In 2H07, it decided to spin off non-branded units as two subsidiaries, namely Pegatron and Unihan. However, Asustek still holds a 100% of Pegatron.

Investment strategy

We rate Asustek shares Sell / Medium Risk (3M) on the following concerns: 1) weak execution on opex and inventory control; 2) challenges in product positioning; 3) tougher year for Pegatron, Asustek's 100%-owned ODM business; and 4) unclear sell-down of shares in Pegatron (Asustek hoped this would start when it decided to spin off its ODM business, but we have yet to see evidence of this).

Valuation

Our DCF-based target price is NT\$24. Our DCF assumes sustained revenue growth of 7% until 2018E, as Asustek should be able to leverage its brand to expand product lines. We apply a cost of capital of 8.17%, which assumes a risk-free rate of 2.6%, a market risk premium of 6.0%, borrowing cost of 3%, and an equity beta of 1.14. We base our assumptions on the 10-year bond yield, historical return on TAIEX, Asustek's average borrowing costs in 09E, and the average beta we use for the Taiwan hardware coverage universe. Our target price is equivalent to 10.1x FY09E EPS. At our target price, the stock would trade below the low end of Asustek's employee bonus adjusted 3-year forward P/E trading band of 13x-30x, which we think is reasonable given deteriorating profitability and continuous disappointment in earnings/shipments.

Risks

We assign a Medium Risk rating to Asustek shares based on our quantitative risk-rating system that tracks 260-day historical share price volatility. Upside risks that may cause the shares to continue to trade above our target price include: 1) better demand for NB and motherboard; 2) strong execution on cutting expenses and inventory control; and 3) improving performance from Pegatron and Unihan on the back of major project wins.

Appendix A-1

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ASUSTeK Computer (2357.TW)

Ratings and Target Price History Fundamental Research

Analyst: Eve Jung

Covered since August 1 2008



Chart current as of 31 January 2009

	Date	Rating	Target Price	Closing Price
1	22-Mar-06	*3L	*70.09	72.84
2	1-May-06	3L	*66.94	69.54
3	21-May-06	3L	*51.97	58.75
4	28-Aug-06	3L	*54.57	59.68
5	3-Sep-06	*2L	*70.17	66.79
6	23-Oct-06	*1L	*79.69	64.97
7	3-Jan-07	1L	*96.15	77.18

* Indicates change

	Date	Rating	Target Price	Closing Price
8	25-Jul-07	1L	*113.48	84.89
9	4-Sep-07	1L	*118.21	89.48
10	15-Oct-07	1L	*124.58	84.30
11	29-Jan-08	1L	*113.67	74.11
12	18-Feb-08	Coverage suspended		
13	1-Aug-08	*3M	*69.11	71.84
14	18-Sep-08	*1M	*74.00	62.00

	Date	Rating	Target Price	Closing Price
15	9-Oct-08	1M	*68.00	50.10
16	30-Oct-08	1M	*58.00	48.65
17	9-Dec-08	1M	*50.00	36.90
18	4-Jan-09	*3M	*28.00	36.80
19	8-Jan-09	3M	*24.00	35.90

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 31 Dec 2008

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% of companies in each rating category that are investment banking clients	48%	43%	38%

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