

TAIWAN

Realtek Semiconductor

4 February 2009

2379 TT **Underperform**

Stock price as of 03 Feb 09	NT\$	35.70
12-month target	NT\$	25.00
Upside/downside	%	-30.0
Valuation	NT\$	20.00-30.00
- PER		

GICS sector	semiconductors & semiconductor equipment	
Market cap	NT\$m	16,730
30-day avg turnover	NT\$m	329.7
Market cap	US\$m	496
Number shares on issue	m	468.6

Investment fundamentals

Year end 31 Dec		2007A	2008E	2009E	2010E
Total revenue	m	15,709	16,744	15,020	16,598
Reported profit	m	1,877	881	952	1,250
Profit bonus exp	m	981	881	952	1,250
Bon exp/rep prof	%	47.7	0.0	0.0	0.0
Adjusted profit	m	981	881	952	1,250
EPS rep	NT\$	4.07	1.88	2.03	2.67
EPS rep growth	%	-30.3	-53.8	8.1	31.3
EPS bonus exp	NT\$	2.13	1.88	2.03	2.67
EPS bonus growth	%	-34.2	-11.6	8.1	31.3
PE rep	x	8.8	19.0	17.6	13.4
PE bonus exp	x	16.8	19.0	17.6	13.4
Total DPS	NT\$	2.84	1.49	1.61	2.04
Total div yield	%	8.0	4.2	4.5	5.7
ROA	%	16.3	12.1	9.1	10.2
ROE	%	5.3	5.5	6.2	8.0
EV/EBITDA	x	2.7	24.0	5.9	5.0
Net debt/equity	%	-31.5	-31.0	-29.9	-29.9
Price/book	x	1.0	1.1	1.1	1.1

2379 TT rel Taix performance, & rec history



Source: FactSet, Macquarie Research, February 2009 (all figures in NT\$ unless noted)

Analyst

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Don't get too excited

Event

- Realtek provided its better-than-expected 1Q09 sales outlook today, but we maintain our Underperform rating as we believe the recent sales recovery is not sustainable and we still see substantial earnings downside. Our new TP is NT\$25 (from NT\$30), still based on the ROE-g/COE-g fair value appraisal.

Impact

- MACQ vs consensus.** While the street may cheer the better-than-expected 1Q09 sales guidance (flat or slightly up QoQ vs. -10% QoQ consensus), we hold a more cautious view. The order book for Jan-Feb looks solid due largely to clients' inventory restocking, but the sustainability remains a question given the current soft end-demand. We are looking at a 5% QoQ sales decline.
- Equally important is that Realtek's days of inventory (DOIs) has surged to 110+ days exiting 4Q08 due to sales shortfall, and DOIs may continue at above 3-months at end-1Q09. Realtek has indicated ASP pressure for 2009 will be more severe than that in 2008 (-10-15% YoY generally), and therefore its GM may be at risk due to price erosion and potential inventory loss.
- Cost base stays high.** Management indicated OPEX may still stay at NT\$1-1.2bn per quarter, implying a 2-3ppts OPM contraction. Realtek also expect its overseas R&D team to remain high at US\$200m loss per quarter, implying a NT\$0.4 loss per share every quarter. Realtek needs to review its cost base carefully to preserve its profitability, in our view.
- 2009 business outlook remains soft.** Realtek expects its GbE ICs, WiFi 11n SoC, LCD TV ICs, and DVR ICs to outperform its other products in 2009. Nevertheless, the end market for the former may see YoY decline and the latter three are too small (only 10% of Realtek's sales in 4Q08). We have yet to see any meaningful growth drivers for Realtek in 2009, in our view.
- 4Q08 net loss per share was NT\$0.24**, due largely to investment impairment loss (NT\$200m+) and inventory provision loss (NT\$200m+). OPEX stayed at NT\$1bn+ if we remove back the NT\$50m reversal of bonus expense. GM of 43% was due to better product mix (higher communication ICs). 2008 EPS of NT\$1.88 was -10% YoY and 35% below MACQ.

Earnings revision

- We cut our 2009-10E EPS by 42% and 32%, respectively (Figure 6).

Price catalyst

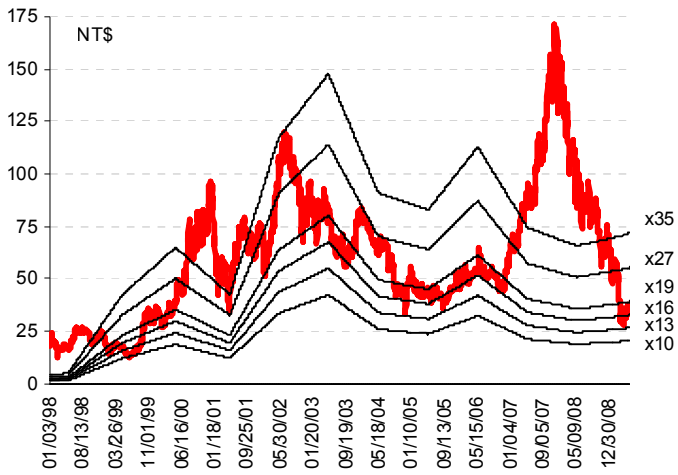
- 12-month price target: NT\$25.00 based on a ROE-g/COE-g methodology.
- Catalyst: Softer-than-expected sales and deteriorating of profit margins.

Action and recommendation

- The stock price may react positively to its 1Q09 sales outlook, but we believe it is just temporarily and suggest investors take the chance to take profits. The 18x 2009F EPS also looks demanding to us. We would stay on the sidelines until we see growth resume and/or an improvement of its profitability from better cost management.

Please refer to the important disclosures and analyst certification on inside back cover of this document, or on our website www.macquarie.com.au/research/disclosures.

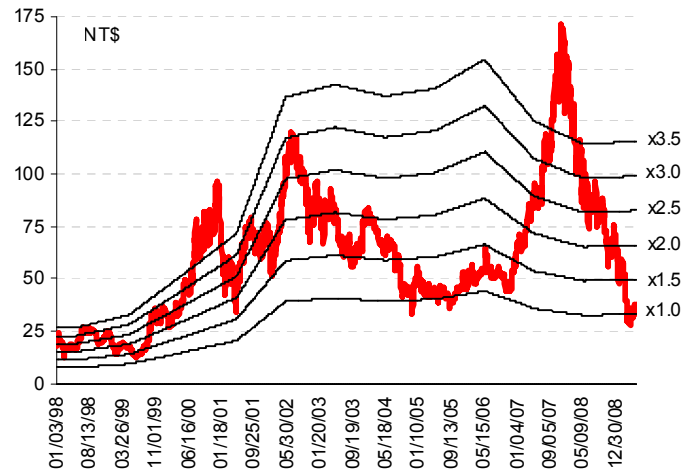
Fig 1 Realtek's PER – bonus expensed



Red line refers to the stock price.

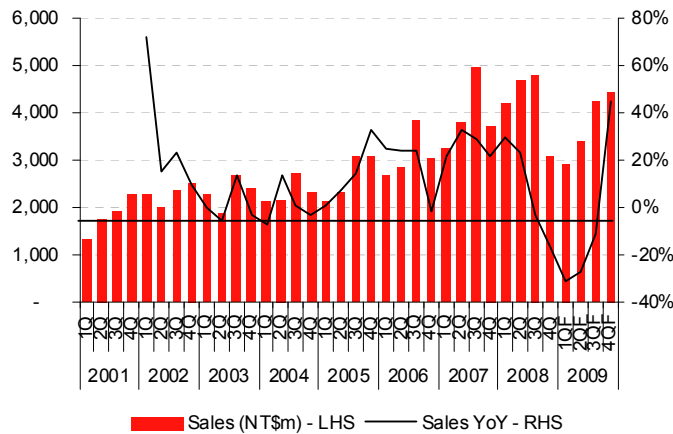
Source: TEJ, Macquarie Research, February 2009

Fig 2 Realtek's P/BV



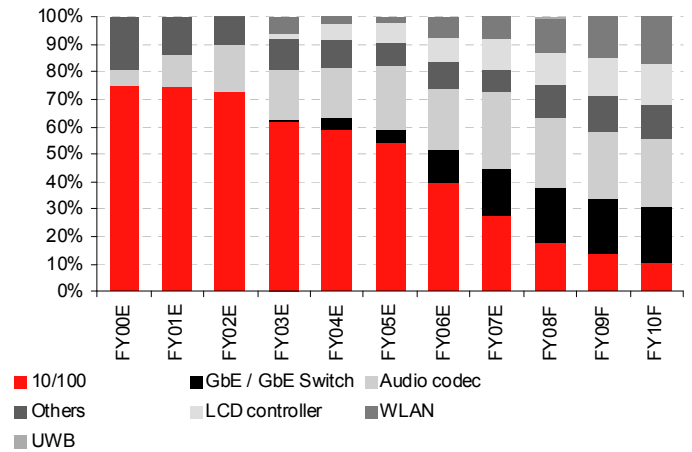
Source: Company data, Macquarie Research, February 2009

Fig 3 Realtek's quarterly sales momentum



Source: TEJ, Macquarie Research, February 2009

Fig 4 Realtek's sales breakdown



Source: Company data, Macquarie Research, February 2009

Fig 5 MACQ's ROE-g/COE-g fair value appraisal for Realtek

Beta	1.0
Cost of equity / discount rate	8.9
Average ROE 08-10 (%)	7.1
Perpetuity growth rate (%)	2.0
ROE-g	5.1
COE-g	6.9
Ratio	0.7
FY09F BVPS	33.0
Fair value	24.5

Source: Macquarie Research, February 2009

Fig 6 MACQ's earnings revision for Realtek

		2008E			2009E			2010E		
		Current	Previous	Var (%)	Current	Previous	Var (%)	Current	Previous	Var (%)
Sales	NT\$m	16,744	17,320	-3.3	15,020	16,944	-11.4	16,598	17,955	-7.6
Gross profit	NT\$m	7,051	7,243	-2.7	6,195	6,968	-11.1	6,903	7,481	-7.7
OP profit	NT\$m	2,378	2,415	-1.5	1,723	2,091	-17.6	1,983	2,273	-12.7
Net profit	NT\$m	881	1,344	-34.5	952	1,655	-42.5	1,250	1,834	-31.9
EPS	NT\$	1.88	2.87	-34.5	2.03	3.53	-42.5	2.67	3.91	-31.9
GM	%	42.1	41.8	0.3	41.2	41.1	0.1	41.6	41.7	-0.1
OP margin	%	14.2	13.9	0.3	11.5	12.3	-0.9	11.9	12.7	-0.7
net margin	%	5.3	7.8	-2.5	6.3	9.8	-3.4	7.5	10.2	-2.7

Source: Macquarie Research, February 2009

Fig 7 Macquarie's P&L model for Realtek

		1Q08A	2Q08A	3Q08A	4Q08F	1Q09F	2Q09F	3Q09F	4Q09F	FY07A	FY08F	FY09F	FY10F
<i>Forex</i>		31.50	30.50	31.70	33.00	33.50	33.50	33.50	33.50	32.74	31.55	33.50	33.00
PRE BONUS EXP.		1Q08A	2Q08A	3Q08A	4Q08F	1Q09F	2Q09F	3Q09F	4Q09F	FY07A	FY08F	FY09F	FY10F
Net sales	NT\$m	4,200	4,674	4,790	3,080	2,906	3,404	4,260	4,450	15,709	16,744	15,020	16,598
COGS	NT\$m	2,400	2,731	2,807	1,756	1,700	2,008	2,513	2,603	8,299	9,694	8,825	9,695
Gross profit	NT\$m	1,800	1,943	1,983	1,325	1,206	1,396	1,747	1,847	7,410	7,051	6,195	6,903
OP expense	NT\$m	948	1,215	1,153	1,001	988	987	1,044	1,068	3,844	4,317	4,087	4,414
Op income	NT\$m	852	729	830	323	218	409	703	779	3,566	2,734	2,108	2,489
Net non-op income	NT\$m	-31	-865	-81	-489	-165	-176	-169	-172	-1,597	-1,465	-682	-608
Pretax income	NT\$m	821	-136	749	-165	53	233	534	607	1,969	1,269	1,426	1,881
Tax expenses	NT\$m	17	8	13	-6	2	35	24	27	92	32	89	125
Net income	NT\$m	804	-144	737	-159	51	197	510	579	1,877	1,237	1,337	1,755
EPS	NT\$	1.71	-0.31	1.57	-0.34	0.11	0.42	1.09	1.24	4.07	2.64	2.85	3.75
Profit margins													
Gross margin	%	42.9	41.6	41.4	43.0	41.5	41.0	41.0	41.5	47.2	42.1	41.2	41.6
Op margin	%	20.3	15.6	17.3	10.5	7.5	12.0	16.5	17.5	22.7	16.3	14.0	15.0
Net margin	%	19.1 -	3.1	15.4 -	5.2	1.7	5.8	12.0	13.0	11.9	7.4	8.9	10.6
YoY													
Sales	%	29.5	22.9	-3.2	-17.1	-30.8	-27.2	-11.1	44.5	26.4	6.6	-10.3	10.5
Op profit	%	22.4	-17.6	-36.8	-51.9	-74.4	-43.9	-15.3	140.8	28.0	-23.3	-22.9	18.1
Net profit	%	17.0	-116.6	-43.0	-83.6	-93.7	-237.2	-30.8	-463.9	-30.8	-34.1	8.1	31.3
QoQ													
Sales	%	13.1	11.3	2.5	-35.7	-5.7	17.1	25.1	4.5				
Op profit	%	26.7	-14.4	13.9	-61.0	-32.6	87.4	72.1	10.8				
Net profit	%	-183.0	-117.9	-612.1	-121.6	-131.9	288.3	158.3	13.6				
BONUS EXPENSED.		1Q08A	2Q08A	3Q08A	4Q08F	1Q09F	2Q09F	3Q09F	4Q09F	FY07A	FY08F	FY09F	FY10F
Net sales	NT\$m	4,200	4,674	4,790	3,080	2,906	3,404	4,260	4,450	15,709	16,744	15,020	16,598
COGS	NT\$m	2,400	2,731	2,807	1,756	1,700	2,008	2,513	2,603	8,299	9,694	8,825	9,695
Gross profit	NT\$m	1,800	1,943	1,983	1,325	1,206	1,396	1,747	1,847	7,410	7,051	6,195	6,903
OP expense	NT\$m	1,175	1,184	1,359	955	1,003	1,044	1,191	1,235	4,740	4,673	4,472	4,919
Op income	NT\$m	625	760	624	369	203	352	556	612	2,670	2,378	1,723	1,983
Net non-op income	NT\$m	-31	-865	-81	-489	-165	-176	-169	-172	-1,597	-1,465	-682	-608
Pretax income	NT\$m	594	-105	543	-120	39	176	387	440	1,073	913	1,041	1,375
Tax expenses	NT\$m	-17	-8	-13	6	-2	-35	-24	-27	-92	-32	-89	-125
Net income	NT\$m	577	-113	530	-113	36	140	363	412	981	881	952	1,250
EPS	NT\$	1.23	-0.24	1.13	-0.24	0.08	0.30	0.77	0.88	2.13	1.88	2.03	2.67
Profit margins													
Gross margin	%	42.9	41.6	41.4	43.0	41.5	41.0	41.0	41.5	47.2	42.1	41.2	41.6
Op margin	%	14.9	16.2	13.0	12.0	7.0	10.3	13.1	13.7	17.0	14.2	11.5	11.9
Net margin	%	13.7 -	2.4	11.1 -	3.7	1.2	4.1	8.5	9.3	6.2	5.3	6.3	7.5
YoY													
Sales	%	29.5	22.9	-3.2	-17.1	-30.8	-27.2	-11.1	44.5	26.4	6.6	-10.3	10.5
Op profit	%	69.9	60.8	-10.4	-67.4	-67.5	-53.7	-10.9	65.7	69.4	-11.0	-27.5	15.1
Net profit	%	60.6	-125.0	-21.5	-77.6	-93.7	-224.2	-31.6	-463.9	-34.7	-10.2	8.1	31.3
QoQ													
Sales	%	13.1	11.3	2.5	-35.7	-5.7	17.1	25.1	4.5				
Op profit	%	-44.9	21.5	-17.9	-40.8	-44.9	72.9	58.1	10.0				
Net profit	%	-213.9	-119.6	-568.9	-121.4	-131.9	288.3	158.3	13.6				

Source: Company data, Macquarie Research, February 2009

Realtek Semiconductor (2379 TT, Underperform, Target price: NT\$25.00)

Quarterly Results		3Q/08A	4Q/08E	1Q/09E	2Q/09E	Profit & Loss		2007A	2008E	2009E	2010E
Revenue	m	4,790	3,080	2,906	3,404	Revenue	m	15,709	16,744	15,020	16,598
Gross Profit	m	1,983	1,325	1,206	1,396	Gross Profit	m	7,410	7,051	6,195	6,903
Operating Expenses	m	-1,359	-955	-1,003	-1,044	Operating Expenses	m	-3,844	-4,673	-4,472	-4,919
Operating Income	m	624	369	203	352	Operating Income	m	3,566	2,378	1,723	1,983
Net Non-operating income	m	-81	-489	-165	-176	Net Non-operating income	m	-1,597	-1,465	-682	-608
Pre-Tax Income	m	543	-120	39	176	Pre-Tax Income	m	1,969	913	1,041	1,375
Tax Expense	m	-13	6	-2	-35	Tax Expense	m	-92	-32	-89	-125
Exceptionals	m	0	0	0	0	Exceptionals	m	0	0	0	0
Minority Interests	m	0	0	0	0	Minority Interests	m	0	0	0	0
Reported Earnings	m	530	-113	36	140	Reported Earnings	m	1,877	881	952	1,250
Reported Earnings (bonus exp)	m	530	-113	36	140	Reported Earnings (bonus exp)	m	981	881	952	1,250
Bonus exp / Reported Earnings	%	0.0	0.0	0.0	0.0	Bonus exp / Reported Earnings	%	47.7	0.0	0.0	0.0
Adjusted Earnings	m	530	-113	36	140	Adjusted Earnings	m	981	881	952	1,250
EBITDA	m	864	600	436	590	EBITDA	m	4,343	3,317	2,673	2,948
EPS (rep)	NT\$	1.13	-0.24	0.08	0.30	EPS (rep)	NT\$	4.07	1.88	2.03	2.67
EPS pcg growth (rep)	%	-59.6	88.5	-93.7	nmf	EPS growth (rep)	%	-30.3	-53.8	8.1	31.3
EPS (rep bonus exp)	NT\$	1.13	-0.24	0.08	0.30	EPS (rep bonus exp)	NT\$	2.13	1.88	2.03	2.67
EPS pcg growth (rep bonus exp)	%	-22.7	78.0	-93.7	nmf	EPS growth (rep bonus exp)	%	-34.2	-11.6	8.1	31.3
EPS (adj)	NT\$	1.13	-0.24	0.08	0.30	EPS (adj)	NT\$	2.13	1.88	2.03	2.67
EPS pcg growth (adj)	%	-22.7	78.0	-93.7	nmf	EPS growth (adj)	%	-34.2	-11.6	8.1	31.3
Revenue pcg growth	%	-3.2	-17.1	-30.8	-27.2	PE (rep)	x	8.8	19.0	17.6	13.4
Operating Income pcg growth	%	-52.5	-45.0	-67.5	-53.7	PE (rep bonus adj)	x	16.8	19.0	17.6	13.4
Reported Earnings pcg growth	%	-59.0	88.3	-93.7	nmf	PE (adj)	x	16.8	19.0	17.6	13.4
Gross Profit Margin	%	41.4	43.0	41.5	41.0	Total DPS	NT\$	2.84	1.49	1.61	2.04
Operating Income Margin	%	13.0	12.0	7.0	10.3	Total Div Yield	%	8.0	4.2	4.5	5.7
Reported Earnings Margin	%	11.1	-3.7	1.2	4.1	Weighted Average Shares	m	461.6	468.6	468.6	468.6
EBITDA Margin	%	18.0	19.5	15.0	17.3	Period End Shares	m	461.6	468.6	468.6	468.6
Profit and Loss Ratios		2007A	2008E	2009E	2010E	Cashflow Analysis		2007A	2008E	2009E	2010E
Revenue Growth	%	26.4	6.6	-10.3	10.5	Reported Earnings	m	1,877	881	952	1,250
Gross Profit Growth	%	26.4	-4.8	-12.1	11.4	Depreciation & Amortisation	m	777	939	950	965
Operating Income Growth	%	28.0	-33.3	-27.5	15.1	Chgs in Working Cap	m	4,580	70	183	246
Reported Earnings Growth	%	-30.8	-53.1	8.1	31.3	Other	m	-2,454	2,027	-834	-842
EBITDA Growth	%	20.4	-23.6	-19.4	10.3	Operating Cashflow	m	4,780	3,918	1,251	1,618
Gross Profit Margin	%	47.2	42.1	41.2	41.6	Acquisitions	m	-641	-1,697	-202	-210
Operating Income Margin	%	22.7	14.2	11.5	11.9	Capex	m	-661	-903	-116	-120
Reported Earnings Margin	%	11.9	5.3	6.3	7.5	Asset Sales	m	3	0	1	1
EBITDA Margin	%	27.6	19.8	17.8	17.8	Other	m	-192	-227	-110	-119
Payout Ratio	%	133.6	79.0	79.3	76.3	Investing Cashflow	m	-1,491	-2,826	-427	-449
EV/EBITDA	x	2.7	24.0	5.9	5.0	Dividend (Ordinary)	m	-5,644	-1,358	-696	-754
EV/EBIT	x	3.3	-22.9	12.0	8.9	Equity Raised	m	0	0	0	0
Balance Sheet Ratios						Debt Movements	m	0	0	0	0
ROE	%	5.3	5.5	6.2	8.0	Other	m	-88	-197	-239	-381
ROA	%	16.3	12.1	9.1	10.2	Financing Cashflow	m	-5,732	-1,555	-935	-1,135
ROIC	%	26.3	20.3	14.9	16.6	Net Chg in Cash/Debt	m	-2,443	-464	-111	34
Net Debt/Equity	%	-31.5	-31.0	-29.9	-29.9	Free Cashflow	m	4,118	3,014	1,135	1,498
Interest Cover	x	nmf	nmf	nmf	nmf	FCF per Share	NT\$	8.92	6.43	2.42	3.20
Price/Book	x	1.0	1.1	1.1	1.1	P/FCF	x	4.0	5.5	14.7	11.2
Book Value per Share	NT\$	35.8	32.6	33.0	33.3	Balance Sheet		2007A	2008E	2009E	2010E
						Cash	m	5,204	4,740	4,629	4,663
						Receivables	m	2,090	1,775	2,902	2,555
						Inventories	m	1,481	1,909	1,666	1,439
						Investments	m	1,943	727	741	755
						Fixed Assets	m	2,363	2,846	2,962	3,082
						Intangibles	m	0	0	0	0
						Other Assets	m	7,953	6,266	6,571	6,893
						Total Assets	m	21,033	18,263	19,472	19,388
						Payables	m	1,754	1,657	2,563	2,214
						Short Term Debt	m	0	0	0	0
						Long Term Debt	m	0	0	0	0
						Provisions	m	0	0	0	0
						Other Liabilities	m	2,761	1,311	1,439	1,582
						Total Liabilities	m	4,515	2,968	4,003	3,797
						Total S/H Equity	m	16,518	15,295	15,469	15,591
						Total Liab & S/H Funds	m	21,033	18,263	19,472	19,388

All figures in NT\$ unless noted.

Source: Company data, Macquarie Research, February 2009

Important disclosures:

Recommendation definitions	Volatility index definition*	Financial definitions				
<p>Macquarie - Australia/New Zealand Outperform – return >5% in excess of benchmark return Neutral – return within 5% of benchmark return Underperform – return >5% below benchmark return</p> <p>Macquarie – Asia/Europe Outperform – expected return >+10% Neutral – expected return from -10% to +10% Underperform – expected return <-10%</p> <p>Macquarie First South - South Africa Outperform – expected return >+10% Neutral – expected return from -10% to +10% Underperform – expected return <-10%</p> <p>Macquarie - Canada Outperform – return >5% in excess of benchmark return Neutral – return within 5% of benchmark return Underperform – return >5% below benchmark return</p> <p>Macquarie - USA Outperform (Buy) – return >5% in excess of benchmark return Neutral (Hold) – return within 5% of benchmark return Underperform (Sell) – return >5% below benchmark return</p> <p>Recommendations – 12 months Note: Quant recommendations may differ from Fundamental Analyst recommendations</p>	<p>Volatility index definition* This is calculated from the volatility of historical price movements.</p> <p>Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.</p> <p>High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.</p> <p>Medium – stock should be expected to move up or down at least 30–40% in a year.</p> <p>Low–medium – stock should be expected to move up or down at least 25–30% in a year.</p> <p>Low – stock should be expected to move up or down at least 15–25% in a year. * Applicable to Australian/NZ/Canada stocks only</p>	<p>Financial definitions All "Adjusted" data items have had the following adjustments made: Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests</p> <p>EPS = adjusted net profit / efpowa* ROA = adjusted ebit / average total assets ROA Banks/Insurance = adjusted net profit / average total assets ROE = adjusted net profit / average shareholders funds Gross cashflow = adjusted net profit + depreciation *equivalent fully paid ordinary weighted average number of shares</p> <p>All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).</p>				
Recommendation proportions – For quarter ending 31 December 2008						
	AU/NZ	Asia	RSA	USA	CA	EUR
Outperform	38.55%	50.61%	64.52%	53.13%	65.55%	43.00%
Neutral	41.82%	15.92%	25.81%	40.63%	27.73%	48.00%
Underperform	19.64%	33.47%	9.68%	6.25%	6.72%	9.00%

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