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June 9, 2009

Stock Rating  
**Underweight**

Industry View  
**In-Line**

## Asustek Computer Inc.

### Recovering but Structural Issues Cap Growth

#### What's Changed

Price Target **NT\$25.00 to NT\$38.00**  
2009e/2010e **Up 5%/13%**

**Investment conclusion:** We stay UW on Asustek but are raising our PT to NT\$38 (or 15x one-year forward P/E) from NT\$25 as we have increased our 2009-10E EPS and reduced our COE estimates to factor in lower credit and political risks. We believe the company's efforts to rectify mis-execution will lead to a breakeven 2Q. However, we are concerned that the company is still affected by several structural issues that could partially offset the benefits from the PC replacement cycle and cap an earnings recovery. These issues include: 1) the market size of its cash-cow consumer MB business (~30% of profits) should continue to shrink given accelerated NB replacement over DT in the consumer PC space; 2) Asustek will have to adjust its premium pricing strategy for the NB business to cater to the low-price PC trend, which implies that its GM may not be able to return to previous highs, and 3) conflict of interest issues remain as it still holds 100% of Pegatron/Unihan.

**What's new:** Asustek unveiled its CULV NB – U series – at Computex. Some may argue that Asustek's CULV NBs have a more appealing product outlook, but we believe Acer's CULV NBs have a better price/performance ratio. Asustek introduced mid- to high-end CULV NBs first, and these models are priced at 20-30% premiums vs. Acer's mainstream CULV NB models. Asustek's 14" and 15" feature four to five hours of battery life vs. Acer's eight+ hours.

**What's next:** Asustek's May shipments should be below expectations due mainly to panel shortages. We believe key component management and pricing strategies will be key to its performance in 2H09.

**Where we differ:** Our 2010 EPS forecast is 18% below consensus. We are more cautious about Asustek's margin recovery in view of the structural concerns.

#### Key Ratios and Statistics

Reuters: 2357.TW Bloomberg: 2357 TT

#### Taiwan Hardware Technology

Price target	NT\$38.00
Upside to price target (%)	(13)
Shr price, close (Jun 8, 2009)	NT\$43.80
52-Week Range	NT\$83.20-29.50
Sh out, dil, curr (mn)	4,246
Mkt cap, curr (mn)	NT\$185,977
EV, curr (mn)	NT\$165,008
Avg daily trading value (mn)	NT\$1,666

Fiscal Year ending	12/08	12/09e	12/10e	12/11e
ModelWare EPS (NT\$)	3.96	2.09	2.99	3.09
Prior ModelWare EPS (NT\$)	-	1.98	2.66	2.81
Consensus EPS (NT\$)§	3.90	2.02	3.52	3.70
Revenue, net (NT\$ mn)	266,880	233,104	257,083	285,845
EBITDA (NT\$ mn)	12,405	2,626	8,559	8,867
ModelWare net inc (NT\$ mn)	16,456	8,855	12,716	13,137
P/E	9.3	21.0	14.6	14.2
P/BV	0.9	1.1	1.1	1.0
RNOA (%)	5.7	0.8	4.2	3.8
ROE (%)	9.1	5.3	7.6	7.5
EV/EBITDA	10.9	57.5	18.8	17.2
Div yld (%)	5.4	2.4	3.3	2.8
FCF yld ratio (%)	(12.7)	8.4	(6.9)	4.0
Leverage (EOP) (%)	(14.2)	(22.6)	(16.0)	(20.1)

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).

§ = Consensus data is provided by FactSet Estimates.

e = Morgan Stanley Research estimates

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Asustek Computer Inc.

## Asustek Computer Inc.: Consolidated Financial Summary

### Income Statements

NT\$m (Year End Dec)	2008	2009E	2010E	2011E
<b>Net sales</b>	<b>266,880</b>	<b>233,104</b>	<b>257,083</b>	<b>285,845</b>
COGS	(229,865)	(212,454)	(228,448)	(255,614)
<b>Gross profit</b>	<b>37,015</b>	<b>20,650</b>	<b>28,635</b>	<b>30,231</b>
Operating expenses	(25,610)	(19,083)	(21,235)	(22,623)
<b>Operating income</b>	<b>11,405</b>	<b>1,568</b>	<b>7,401</b>	<b>7,609</b>
Non-operating income	9,180	8,373	7,559	7,847
Interest income	98	41	80	85
(Interest Expenses)	-	-	-	-
Investment income	3,991	4,078	4,479	4,612
Disposal of investment	-	-	-	-
Disposal of fixed assets	-	-	-	-
Exchange gain	559	1,397	-	-
Other	4,532	2,857	3,000	3,150
<b>Pre-tax income</b>	<b>20,585</b>	<b>9,940</b>	<b>14,959</b>	<b>15,455</b>
Income tax	(4,129)	(1,085)	(2,244)	(2,318)
Minority interests	-	-	-	-
<b>Net income</b>	<b>16,456</b>	<b>8,855</b>	<b>12,716</b>	<b>13,137</b>
<b>ModelWare EPS (NT\$)</b>	<b>3.96</b>	<b>2.09</b>	<b>2.99</b>	<b>3.09</b>

### Balance Sheets

NT\$m (Year End Dec)	2008	2009E	2010E	2011E
Cash	23,704	37,834	28,008	36,632
Mkt securities	-	-	-	-
AR/NR	43,221	35,125	45,782	46,988
Inventory	41,821	24,447	35,675	35,016
Others	10,888	9,452	10,424	11,590
<b>Current Assets</b>	<b>119,634</b>	<b>106,858</b>	<b>119,890</b>	<b>130,226</b>
Long-term investments	111,496	115,574	120,053	124,665
Fixed assets	3,736	3,178	2,520	1,762
Other assets	1,608	1,608	1,608	1,608
<b>Total Assets</b>	<b>236,474</b>	<b>227,218</b>	<b>244,070</b>	<b>258,261</b>
S/T borrowings	-	-	-	-
AP/NP	27,469	23,979	29,252	32,744
Other ST liabilities	39,448	33,301	36,726	40,835
<b>Total current liabilities</b>	<b>66,917</b>	<b>57,280</b>	<b>65,978</b>	<b>73,579</b>
L/T debt	-	-	-	-
Other LT liabilities	2,735	2,735	2,735	2,735
<b>Total Liabilities</b>	<b>69,652</b>	<b>60,015</b>	<b>68,713</b>	<b>76,314</b>
Common shares	42,461	42,461	42,461	42,461
Retained Earnings	91,000	91,381	99,536	106,124
Other SH Equity	33,361	33,361	33,361	33,361
<b>Shareholders' equity</b>	<b>166,822</b>	<b>167,203</b>	<b>175,358</b>	<b>181,946</b>
<b>Total Liab./SH Equity</b>	<b>236,474</b>	<b>227,218</b>	<b>244,070</b>	<b>258,261</b>

E = Morgan Stanley Research estimates

Source: Morgan Stanley Research, company data

### Cash Flow Statements

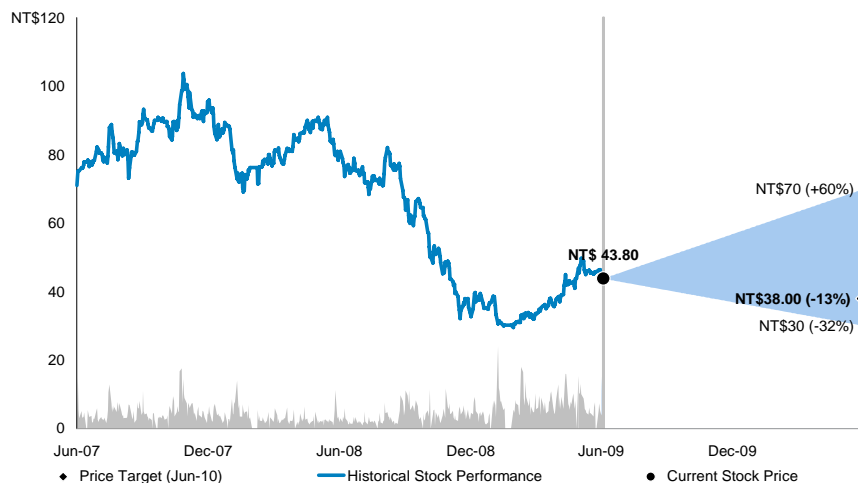
NT\$m (Year End Dec)	2008	2009E	2010E	2011E
<b>Cash flow from operations</b>	<b>13,465</b>	<b>23,105</b>	<b>(4,765)</b>	<b>15,672</b>
Net Profits	16,456	8,855	12,716	13,137
Depreciation & Amortization	1,000	1,058	1,158	1,258
Equity invest. losses (income)	(3,991)	(4,078)	(4,479)	(4,612)
Change in Working Capital	-	21,980	(16,613)	2,946
Other adjustments	-	(4,711)	2,453	2,943
<b>Cash flow from investing</b>	<b>(201)</b>	<b>(4,578)</b>	<b>(4,979)</b>	<b>(5,112)</b>
Change of FA (capex)	(201)	(500)	(500)	(500)
Change of L/T investment	-	(4,078)	(4,479)	(4,612)
Other adjustments	-	-	-	-
<b>Cash flow from financing</b>	<b>(4,924)</b>	<b>(4,397)</b>	<b>(82)</b>	<b>(1,937)</b>
<b>Increase in L/T debt</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Increase in S/T debt</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Proceed from new issues of shares</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Cash Dividend paid</b>	<b>(9,352)</b>	<b>(8,475)</b>	<b>(4,561)</b>	<b>(6,549)</b>
<b>Other adjustments</b>	<b>4,428</b>	<b>4,078</b>	<b>4,479</b>	<b>4,612</b>
<b>Net change in cash</b>	<b>8,340</b>	<b>14,130</b>	<b>(9,826)</b>	<b>8,624</b>

### Financial Ratios

	2008	2009E	2010E	2011E
<b>Margins (%)</b>				
Gross margin	13.9	8.9	11.1	10.6
Operating margin	4.3	0.7	2.9	2.7
Pretax margin	7.7	4.3	5.8	5.4
Net margin	6.2	3.8	4.9	4.6
<b>YoY growth (%)</b>				
Sales	17.5	-12.7	10.3	11.2
Operating profits	NA	-86.3	372.1	2.8
Pretax profits	NA	-51.7	50.5	3.3
Net profits	-15.2	-46.2	43.6	3.3
<b>Others (%)</b>				
Cash div payout ratio	34.2	51.5	51.5	51.5
Net Debt/Equity	-14.2	-22.6	-16.0	-20.1
Liabilities/Equity	41.8	35.9	39.2	41.9
Liabilities/Assets	29.5	26.4	28.2	29.5
ROAE	10.1	5.3	7.4	7.4
ROAA	7.1	3.8	5.4	5.2
AR/NR Turnover (days)	59	61	57	59
Inventory Turnover (days)	66	57	48	50
AP/NP Turnover (days)	46	47	45	47
Cash conversion cycle (days)	79	71	60	62

## Risk-Reward Snapshot: Asustek (2357.TW, NT\$43.8, UW, PT NT\$38)

### Higher Fixed Cost and Likely Greater Margin Erosion Cap Upside



### Why Underweight?

- Asustek's premium brand positioning looks susceptible in a downturn on top of its higher gearing to desktops (DT) and unresolved conflict of interest issues at Pegatron.
- We do not expect the gross margin to return to previous high levels given the change in the business model and accelerated ASP erosion.
- Component price hikes are weighing on margin recovery.
- Valuation does not seem justified at 21x/15x 2009e/10e EPS.

### Key Value Drivers

- Global PC demand growth.
- Brand-name NB and eeePC growth momentum.
- MB shipment momentum.

### Potential Catalysts

- Monthly sales trends.
- OEM order wins for Pegatron/Unihan and faster progress for spin-off.
- New product introduction.

### Key Risks

- Upside risks: stronger global PC demand, faster-than-expected margin recovery.
- Downside risks: worse-than-expected global economic slowdown, hurting global PC demand, and margin contraction due to keen competition.

#### Price target NT\$38

Derived from our base-case residual income model.

**Bull case** Implies 18x 1-yr forward P/E  
**NT\$70**

**Successful business model adjustments on top of reducing shareholding on Pegatron to alleviate conflict of interests:** Assumes Asustek not only resumes market share gains through successful new product launches but achieves faster OPM recovery from business model adjustments. In addition, a meaningful shareholding dilution on Pegatron alleviates concerns that conflict of interest will likely trigger a re-rating.

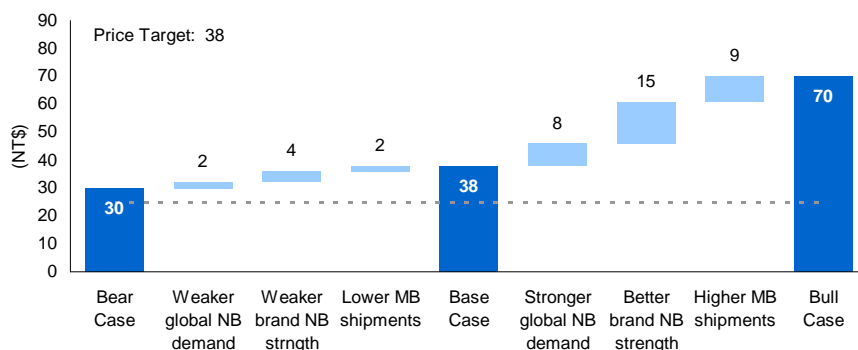
**Base case** Implies 14x 1-yr forward P/E  
**NT\$38**

**Rectify mis-execution, but structural issues cap earnings recovery:** We expect Asustek to break even in 2Q09 with steady OPM recovery. We forecast OPM in 2010 to recover to 2.9% from 2009's 0.7%, but is unable to return to the previous above-5% level.

**Bear case** Implies 12x 1-yr forward P/E  
**NT\$30**

**Slower business model adjustment to fit the low-price PC trend:** Assumes margin recovery turns out to be slower than expected as its still high-cost structure remains uncompetitive in an accelerated low price PC trend.

### NB and eeePC the Key Drivers for Brand-Name Business



Source: FactSet, Morgan Stanley Research

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## Earnings and Price Target Revision

We reiterate our UW rating on Asustek but are raising our PT to NT\$38 (or 15x one-year forward P/E) from NT\$25. Our UW rating is based on our concerns about the structural issues that we believe could cap the company's growth and lead to an unattractive valuation. We are raising our 0209 and 2010 EPS forecasts by 5% and 13%, respectively, to factor in management's efforts to correct earlier mis-execution and the potential for a speeding up of the replacement cycle. Asustek is now trading at 21x and 15x our 2009 and 2010 EPS forecasts, respectively, at the mid- to high end of its historical trading band, which does not appear to be attractive to us.

Our price target is derived from our RI income model under the assumption of 3% terminal growth rate, a 6% mid-term growth rate, and a 7.5% cost of equity (lower than our previous assumption of 9% to factor in lower credit and political risks).

The upside risks to our forecasts include stronger NB shipment strength driven by better feedback from new product launch and faster margin recovery from cost-reduction efforts and gross margin improvements.

### Exhibit 1

## Earnings Revisions

Year to Dec. 31 (NT\$m)	New	Old	Diff. %	New	Old	Diff. %
P&L Summary	2009E	2009E		2010E	2010E	
Net sales	233,104	229,194	2%	257,083	245,850	5%
COGS	(212,454)	(208,879)	-2%	(228,448)	(219,521)	-4%
Gross profit	20,650	20,315	2%	28,635	26,329	9%
Operating expenses	(19,083)	(19,141)	0%	(21,235)	(20,156)	-5%
Operating income	1,568	1,175	33%	7,401	6,174	20%
Non-operating income	8,373	8,229	2%	7,559	7,097	7%
Pre-tax income	9,940	9,403	6%	14,959	13,270	13%
Income tax	(1,085)	(1,004)	-8%	(2,244)	(1,991)	-13%
Net income	8,855	8,399	5%	12,716	11,280	13%
EPS (NT\$)	2.09	1.98	5%	2.99	2.66	13%
Margins						
Gross margin (%)	8.9	8.9		11.1	10.7	
Operating margin (%)	0.7	0.5		2.9	2.5	
Pretax margin (%)	4.3	4.1		5.8	5.4	
Net margin (%)	3.8	3.7		4.9	4.6	

Source: Company data, Morgan Stanley Research; E=Morgan Stanley estimates

### Exhibit 2

## Asustek: Residual Income Model

NT\$m	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Total Equity	188,268	196,548	203,039	212,410	222,298	232,729	243,733	255,344	267,592	280,514	294,147
Net Profit - post bonus	8,855	12,716	13,137	13,820	14,580	15,382	16,228	17,120	18,062	19,055	20,103
Return on Equity (%)	4.7	6.6	6.6	6.7	6.7	6.8	6.8	6.9	6.9	7.0	7.0
EBS Dilution (%)	-7.1	-5.1	-5.1	-5.4	-5.4	-5.4	-5.4	-5.4	-5.4	-5.4	-5.4
Beta	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Equity Risk Premium (Rm-Rf) (%)	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Risk Free Rate (Rf) (%)	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Cost of Equity (%)	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5
WACC											
Beginning Equity Capital	188,268										
PV of Forecast Period	(11,196)										
PV of Continuing Value	(15,684)										
Equity Value	161,387										
No. of Shares	4,246										
Projected Price (EoY)	38										

Source: Company data, Morgan Stanley Research; E = Morgan Stanley estimates

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Exhibit 3

**Asustek: Consolidated Quarterly Earnings Projection for Brand Business**

	1Q08A	2Q08A	3Q08A	4Q08A	1Q09A	2Q09E	3Q09E	4Q09E	2008E	2009E	2010E
Net sales	62,967	58,062	78,259	67,592	46,213	51,266	64,221	71,404	266,880	233,104	257,083
COGS	(51,834)	(47,691)	(65,905)	(64,435)	(44,851)	(46,160)	(57,431)	(64,011)	(229,865)	(212,454)	(228,448)
Gross profit	11,133	10,371	12,354	3,157	1,362	5,106	6,789	7,393	37,015	20,650	28,635
Operating expenses	(4,468)	(5,974)	(6,940)	(8,228)	(4,469)	(4,575)	(4,826)	(5,213)	(25,610)	(19,083)	(21,235)
SG&A, R&D exp.	(3,855)	(5,546)	(6,425)	(8,780)	(4,442)	(4,460)	(4,624)	(4,998)	(24,606)	(18,524)	(20,431)
Employee Bonus	(613)	(428)	(515)	552	(27)	(115)	(202)	(214)	(1,004)	(558)	(804)
Operating income	6,665	4,397	5,414	(5,071)	(3,107)	531	1,963	2,181	11,405	1,568	7,401
Non-operating income	2,770	2,220	2,082	2,108	3,163	1,600	1,805	1,805	9,180	8,373	7,559
Net interest income	108	9	26	(45)	(20)	20	20	20	98	41	80
Investment income	838	980	1,842	331	1,108	900	1,035	1,035	3,991	4,078	4,479
Disposal of investment	0	0	0	0	0	0	0	0	0	0	0
Gain (loss) Disposal of Fixed Assets	0	0	0	0	0	0	0	0	0	0	0
Exchange gain	(137)	180	(450)	966	1,397	0	0	0	559	1,397	0
Other	1,961	1,051	664	856	677	680	750	750	4,532	2,857	3,000
Pre-tax income	9,435	6,617	7,496	(2,963)	56	2,131	3,768	3,986	20,585	9,940	14,959
Income tax	(2,205)	(973)	(1,116)	165	398	(320)	(565)	(598)	(4,129)	(1,085)	(2,244)
Net income	7,230	5,644	6,380	(2,798)	454	1,811	3,203	3,388	16,456	8,855	12,716
Minority interest paid/received	0	0	0	0	0	0	0	0	0	0	0
Net inc. after min.	7,230	5,644	6,380	(2,798)	454	1,811	3,203	3,388	16,456	8,855	12,716
Adj.wtd.avg.shrs( m)	4,158	4,158	4,158	4,158	4,246	4,246	4,246	4,246	4,158	4,246	4,246
EPS (NT\$)	1.74	1.36	1.53	(0.67)	0.11	0.43	0.75	0.80	3.96	2.09	2.99
<b>Margins</b>											
Gross margin (%)	17.7	17.9	15.8	4.7	2.9	10.0	10.6	10.4	13.9	8.9	11.1
Operating margin (%)	10.6	7.6	6.9	-7.5	-6.7	1.0	3.1	3.1	4.3	0.7	2.9
Pretax margin (%)	15.0	11.4	9.6	-4.4	0.1	4.2	5.9	5.6	7.7	4.3	5.8
Net margin (%)	11.5	9.7	8.2	-4.1	1.0	3.5	5.0	4.7	6.2	3.8	4.9
<b>Sequential growth (%)</b>											
Sales (%)	-13	-8	35	-14	-32	11	25	11	17	-13	10
Gross profits (%)	NA	-7	19	-74	-57	275	33	9	NA	-44	39
Op profits (%)	NA	-34	23	-194	39	-117	270	11	NA	-86	372
Pre-tax profits (%)	NA	-30	13	-140	102	3740	77	6	NA	-52	50
Net profits (%)	57	-22	13	-144	116	299	77	6	-15	-46	44

Source: Company data, Morgan Stanley Research; E=Morgan Stanley estimates

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(as of May 31, 2009)

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June 9, 2009

Asustek Computer Inc.

Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
<b>Overweight/Buy</b>	<b>690</b>	<b>31%</b>	<b>214</b>	<b>35%</b>	<b>31%</b>
<b>Equal-weight/Hold</b>	<b>1022</b>	<b>45%</b>	<b>288</b>	<b>47%</b>	<b>28%</b>
<b>Not-Rated/Hold</b>	<b>32</b>	<b>1%</b>	<b>7</b>	<b>1%</b>	<b>22%</b>
<b>Underweight/Sell</b>	<b>510</b>	<b>23%</b>	<b>99</b>	<b>16%</b>	<b>19%</b>
<b>Total</b>	<b>2,254</b>		<b>608</b>		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

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**Overweight (O or Over)** - The stock's total return is expected to exceed the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

**Equal-weight (E or Equal)** - The stock's total return is expected to be in line with the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

**Not-Rated (NR)** - Currently the analyst does not have adequate conviction about the stock's total return relative to the relevant country MSCI Index on a risk-adjusted basis, over the next 12-18 months.

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Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

### Analyst Industry Views

**Attractive (A):** The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

**In-Line (I):** The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

**Cautious (C):** The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

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**Industry Coverage: Taiwan Hardware Technology**

Company (Ticker)	Rating (as of)	Price (06/08/2009)
<b>Anya Chang</b>		
Nan Ya PCB (8046.TW)	E (03/31/2009)	NT\$90
Tripod Technology (3044.TW)	E (04/30/2008)	NT\$57.9
Unimicron (3037.TW)	E (02/16/2009)	NT\$25.5
<b>Grace Chen</b>		
Acer Inc. (2353.TW)	O (07/11/2007)	NT\$58.7
Asustek Computer Inc. (2357.TW)	U (01/09/2009)	NT\$43.8
Compal Electronics (2324.TW)	U (01/07/2009)	NT\$26.5
Delta Electronics Inc. (2308.TW)	O (06/08/2009)	NT\$74
Mitac International Corp. (2315.TW)	E (07/30/2007)	NT\$14.5
Paragon Tech. (3518.TW)	O (11/28/2007)	NT\$88
Quanta Computer Inc. (2382.TW)	E (04/30/2007)	NT\$49.7
Wistron Corporation (3231.TW)	O (07/21/2008)	NT\$49.25
<b>Jasmine Lu</b>		
HTC Corporation (2498.TW)	E (11/20/2008)	NT\$460
Hon Hai Precision (2317.TW)	O (03/16/2009)	NT\$107.5
Largan Precision (3008.TW)	O (05/06/2009)	NT\$388
<b>Sharon Shih</b>		
Catcher Technology (2474.TW)	O (03/11/2009)	NT\$85
Cheng Uei Precision (2392.TW)	U (02/14/2008)	NT\$50.5
Compal Communications (8078.TW)	U (03/02/2007)	NT\$29.3
D-Link Corporation (2332.TW)	E (09/30/2008)	NT\$28
Epistar (2448.TW)	U (09/30/2008)	NT\$89.3
Everlight Electronics Co., Ltd. (2393.TW)	U (03/18/2009)	NT\$84
Foxconn Technology (2354.TW)	O (03/11/2009)	NT\$99
Gemtek Technology (4906.TW)	E (02/17/2009)	NT\$58
Merry Electronics (2439.TW)	U (03/23/2009)	NT\$34.05
Silitech Technology (3311.TW)	E (12/22/2008)	NT\$68.2

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