



Yulon Motor (2201 TT)

BUY

Automobile

Company Update

ML Research Team

Non-tech Analyst

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Recommendation

BUY
Date: 26 January 2005
Share Price (NT\$): 36.8
Price Target (NT\$): 45.3
Percent Change: 23.1%
52-wk range (NT\$): 52.5-28.2
TWSE: 5835.37

Company Data

Capital Size (NT\$): 13.92bn
Market Cap (NT\$): 51.36bn
Market Cap (US\$): 1.61bn
Outstanding Shrs: 1.39bn
Free Floating Shrs: 411.7mn
PER ('05E): 8.12x
PBR ('05E): 1.09x
Foreign Ownership: 4.20%
Major Shareholder: Taiyuan Textile 19.3%
China Motor 16.0%

Performance	1-m	3-m	6-m
Absolute	1.94	4.55	12.85
Relative to TAIEX	4.57	1.46	3.11

Key Changes	Current	Prev.
Recommendation	BUY	NA
Price Target (NT\$)	45.3	NA
Revenue (NT\$ bn)	42.85	NA
Gross Margin (%)	10.26	NA
Oper. Margin (%)	6.03	NA
EPS (NT\$)	4.53	NA

Price Catalysts (+,-)

(+) Dramatic increase in sales for January
(+) Asset play that would increase BVPS

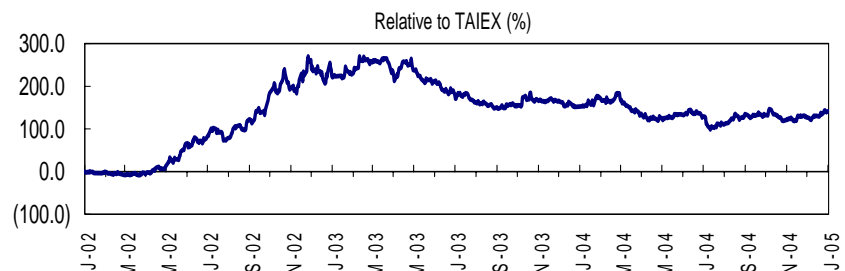
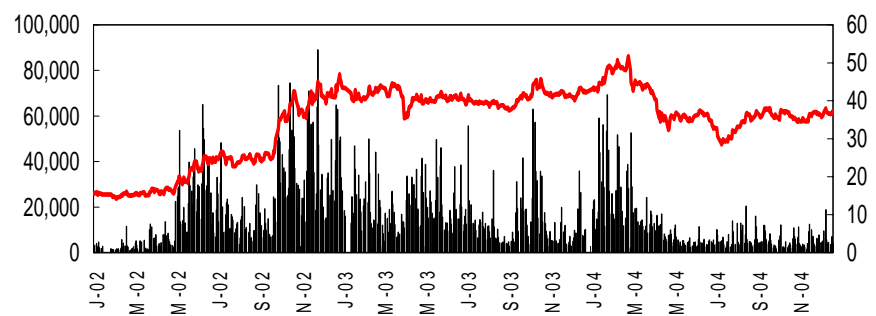
Related Research

China Motor (2204 TT) Aug. 6, '04
Sanyang Motor (2206 TT) Sept. 9, '04

Loaded gun

- **Upcoming Chinese New Year would boost sales.** Historically, Yulon Motor's sales have been severely concentrated in 1Q, which is a time period when people have spare money to spend in their pockets. Yulon Motor's quarterly sales breakdown reveals that 1Q usually accounts for 33.1% of Yulon Motor's whole year sales, of which 52.2% is derived from January sales.
- **Restructuring and JV with GM outline future growth.** Yulon Motor's recent JV with General Motors would add flexibility to the company's current business model. In addition, the company's JV with GM would also improve economies of scale.
- **Property development plans increase BVPS.** Currently, Yulon Motor has 2 parcels of land in Hsindian waiting to be developed. If the land are fully developed, the book value of the land would surge from the current NT\$4.3bn to at least NT\$14.2bn, which indicates a NT\$7.0 increase in BVPS, based on the current outstanding 1.39bn shares.
- **BUY with a target price of NT\$45.3.** We are positive on Yulon Motor's future prospects due to (1) the upcoming explosive sales in January (2) JV with General Motors should be able to add more flexibility to current business model (3) a possible inflation of BVPS by NT\$7.0. We have a BUY recommendation for Yulon Motor with a 3-month target price of NT\$45.3, which is 10.0x our 2005 forecasted EPS.

Average daily volume ('000, LHS) and share price (NT\$, RHS)



Investment Keynotes

2005 performance expected to improve

Yulon Motor recorded sales of NT\$41.4bn in 2004, down 3.0% YoY, with pretax earnings reaching NT\$6.1bn, down 28.6% YoY. Overall, Yulon Motor has beaten its earlier 2004 guidance on both top-line and bottom line, reaching 103.8% for sales and 122.4% for pretax earnings.

Yulon Motor's sales and gross margin were slightly affected in 4Q04 due to new competitive models launched in the market, such as Mitsubishi Grunder and Ford Focus, thereby leading to higher sales and marketing expenses. However, based on our forecast, sales and earnings should see an improvement in 2005, with sales totaling NT\$42.8bn, up 4.2% YoY, and earnings reaching NT\$6.3bn, up 13.8% YoY, suggesting an EPS of NT\$4.53. Yulon Motor's 2005 performance should see an improvement since (1) its new sedan Teana would replace the dated Cefiro and should stimulate demand, albeit fierce competition in the market, and (2) gross margin would improve as a result of less sales promotion in 2005.

Figure 1: Yulon Motor's hot selling sedan — Teana (Maxima model in the US market)



Source: Company data; MasterLink Securities

Sales should pick up in Chinese New Year

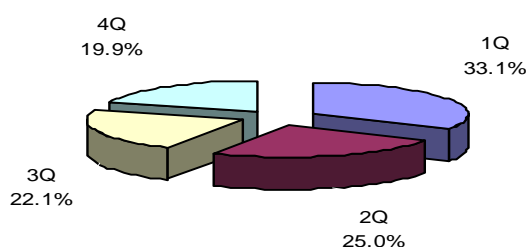
Historically, Yulon Motor's sales have been severely concentrated in 1Q, due to end-consumers' year-end bonuses that entice consumptions. In 2004, 1Q sales constituted 32.0% of Yulon Motor's total sales, and January sales also accounted for 16.3% of the total. A closer inspection at Yulon Motor's quarterly sales breakdown reveals that 1Q usually accounts for 33.1% of Yulon Motor's whole year sales, of which 52.2% is derived from January sales.

Yulon Motor's historical sales pattern largely supports our

belief that sales would dramatically pick up in 1Q05, especially in January. In addition, Yulon Motor guides a monthly average of 1,600-2,000 unit sales in 2005 for its new Teana model, which also strengthened our belief for a strong 1Q05 performance.

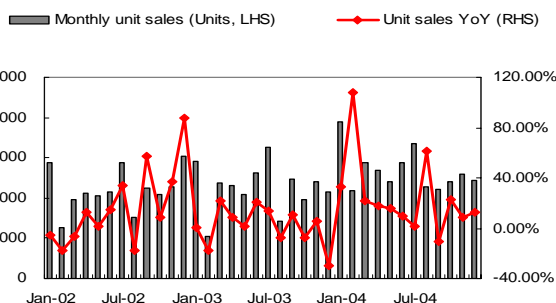
Moreover, based on Ministry of Transportation's figures, auto unit sales for the first 20 days in Taiwan totaled 43.8k units and total automobile sales for January would reach 65k units. Yulon Motor's also sold 1,800 units of Teana in first 20 days, and a total of 2,400-2,600 units may be expected for January.

Figure 2: 1999-2004 average of Yulon Motor's QoQ sales breakdown



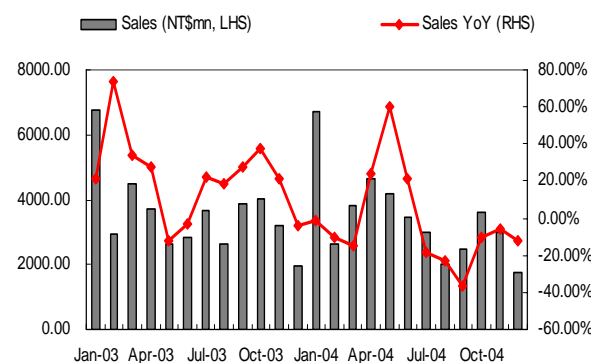
Source: TEJ; MasterLink Securities

Figure 3: Monthly domestic unit sales in Taiwan



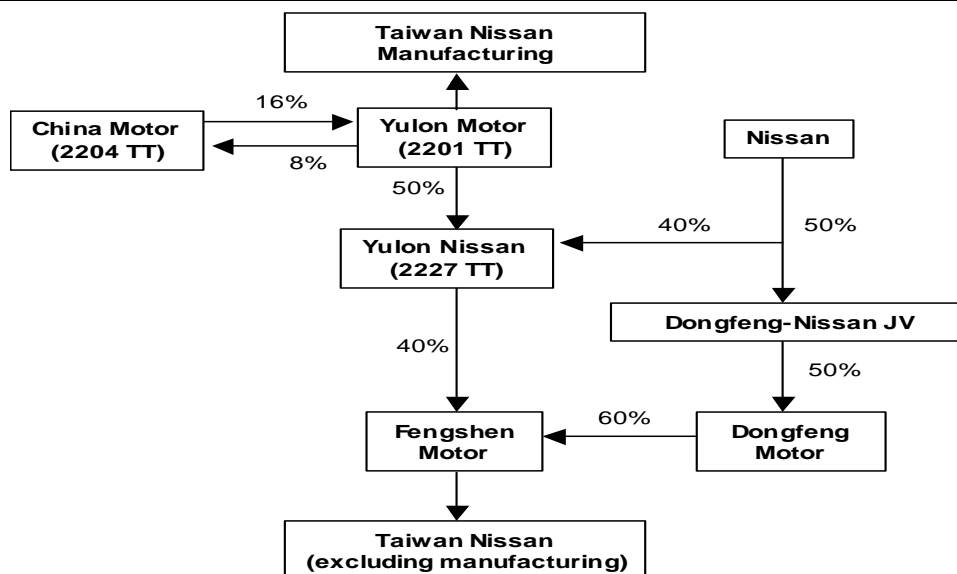
Source: TEJ; MasterLink Securities

Figure 4: Yulon Motor's monthly sales and YoY growth



Source: TEJ; MasterLink Securities

Figure 5: Yulon Group's Corporate Structure



Source: Company data; MasterLink Securities

New business model for Yulon Motor

In 2003, Yulon Nissan (2227 TT, NT\$107.5, NR) spun off from Yulon Motor as part of the restructuring plan. After the restructuring, Yulon Nissan would market Nissan and Infinity vehicles, while Yulon Motor would be responsible for the production and maintenance/repair of the vehicles. Yulon Nissan is currently 40% held by Nissan and 50% owned by Yulon Motor (10% released to the public during the IPO in December 2004). Yulon Nissan also owns a 40% stake in Fengshen Motor in China.

Under the new structure, the most lucrative business, the high margin marketing and distribution arm of Nissan Group, is now rested in Yulon Nissan's hands, leading the market to believe that Yulon Motor's earnings growth momentum would be constricted in the future; based on our estimates, Yulon Nissan's gross margin for 2004 is projected to reach 16.4%, compared to Yulon Motor's 9.9%. We, however, believe Yulon Motor should be slightly impacted by this issue; Yulon Motor has an annual capacity of 150k automobiles, but due to Nissan's encumbrance, Yulon Motor was only capable of running at 50% of its full capacity. After the restructuring, Yulon Motor would get more flexibility in finding different business partners and possibly be able to produce at full capacity.

JV with General Motors

Recently, Yulon Motor successfully imported a new business partner, General Motors. According to the terms of agreement, Yulon Motor and General Motors would start up a new company called Yulon General Motors, and Yulon Motor would own 51% of the JV enterprise.

At the initial stage of the collaboration, Yulon Motor would become the sole distributor of GM's models such as Cadillac, Buick and OPEL in Taiwan. A further step would involve Yulon Motor becoming the contract manufacturer of Buick cars in Taiwan for General Motors. We are positive on Yulon Motor's JV with General Motors since (1) Yulon Motor would be able to have a higher utilization rate of its capacity and thus better achieve economies of scale (2) Yulon Motor would have more brand names to let consumers choose among, and be capable of loosening Nissan's tight grip, and (3) Yulon Group as a whole, should be able to crowd out competitors in the market, since Yulon Motor now owns the full support of 2 major players in the auto market. Usually engines, transmissions, and other essential car components account for over 40% of a car's total cost. Therefore, Yulon Motor, with full supports from its JV partners, would be able to produce at a relatively lower cost compared to peers.

Nonetheless, Yulon Motor's JV with General Motors should not significantly improve Yulon Motor's sales in 2005; the actual benefits of the synergy should kick in

2006 since (1) Taiwan's market preference for Japanese cars and the saturation of the domestic car market, which would need more time to make consumers accept American vehicles, (2) a need for excellent locations for the new distribution centers in Taiwan, and (3) internal management also need adjustments to American standards.

Property development would increase BVPS

Yulon Motor, since its establishment in 1953, was also known for its hefty land assets in Taiwan. Currently Yulon Motor has 2 parcels of land in Hsindian City, Taipei County, that would become a prosperous land development project.

The first parcel of land, which has an area of 11,106 ping (1 ping equals 3.3058 square meters), is partially rented to Carrefour Hypermarket, and should bring in an annual rental income of NT\$110-120mn for Yulon Motor. The residual land (6106 ping) would be rented out to other companies in the Yulon Group, and may also be fractioned out to build a modern auto maintenance/repair plant.

Figure 6: Yulon Motor's land rent to Carrefour Hypermarket in Hsindian



Source: Company data; MasterLink Securities

The second parcel of land, located adjacent to the Carrefour Hypermarket, is currently denominated for industrial use. The land has an area of 27,396 ping and has a book value of NT\$4.3bn. However, if the land rezoning permit has been approved by the government, Yulon Motor would be able to develop the land as commercial buildings and residential housings. We believe a partial of the total, or 9,300 ping, with a fair market value of NT\$11.2bn, would be allocated to commercial buildings. Another 7,500 ping, with a possible

fair market value of NT\$3.0bn, would be planned for real estate development. If the land is fully developed, the book value of the land would surge from the current NT\$4.3bn to at least NT\$14.2bn, which indicates a NT\$7.0 increase in BVPS, based on the current outstanding shares of 1.39bn shares.

Cash dividend yield of 6-7%

Historically, Yulon Motor paid out 50-60% of total earnings as dividends, of which 80-90% comes as cash. For 2005, Yulon Motor is likely to pay NT\$2.3 per share as cash dividend, which implies a cash dividend yield of 6.3% based on the current share price of NT\$36.8. In addition, based on our estimates, Yulon Motor should be able to record an EPS of NT\$4.53 in 2005. Therefore, for 2006, we forecast the company to payout similar ratios, which would imply a cash dividend range of 6-7% as well.

Peer Comparison

Compared to peers, Yulon Motor's sales growth momentum in 2005 is not the most attractive. Nonetheless, Yulon Motor's earnings should improve due to the introduction of Teana and its new JV with GM. We believe the new models launched would share market away from Toyota's Camry as Camry is in its third model year. Camry currently has a 5-6% market share and because Toyota would not be introducing new models in 2005, Hotai (2207 TT, NT\$62.5, NR) may be forced to use more sales promotion and other incentive packages to attract customers; the result would be a bloated sales for Hotai Motor in 2005, with gross margin declining.

Figure 7: Peer comparison table

Ticker	Company	Sales (NT\$mn)			EPS (NT\$)	
		2004	2005E	YoY	2004E	2005E
2201 TT	Yulon Motor	41,429	42,849	4.2%	4.0	4.5
2204 TT	China Motor	56,569	58,934	4.2%	4.3	4.0
2207 TT	Hotai Motor	77,480	87,550	13.0%	6.3	6.3
2227 TT	Yulon Nissan	49,564	50,754	2.4%	10.0	10.2

Source: TEJ; MasterLink Securities

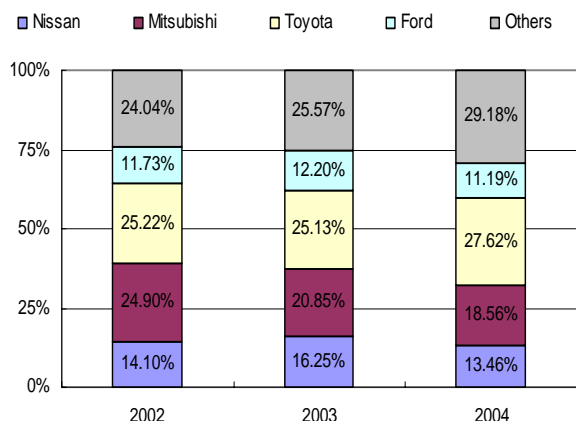
Risk concern

A saturated market

The synergy of Yulon Motor with General Motors would possibly bring in additional sales in 2006, but Taiwan's saturated market also leaves little room and space for market penetration. A review of the past 3 years' data shows that domestic auto sales are severely concentrated by the top four auto companies in Taiwan. For the past 3 years, other brand names had only been able to capture 24-29% of the total market share, collectively.

Therefore, skeptics would also question Yulon General Motor's ability to gain more market share, and the ability for this JV enterprise to substantially improve Yulon Motor's sales in the future.

Figure 8: Taiwan's domestic auto unit sales market share



Source: TEJ; MasterLink Securities

Valuations and recommendation

BUY with a target price of NT\$45.3

Yulon Motor historically has been trading between 4.5-12.0x P/E and is currently trading at 8.12x our 2005 estimated EPS. Due to (1) the upcoming explosive sales in January (2) JV with General Motors that should be able to add more flexibility to current business model (3) a possible inflation of BVPS by NT\$7.0, we have a BUY recommendation for Yulon Motor with a 3-month target price of NT\$45.3, which is based on 10.0x our 2005 estimated EPS of NT\$4.53. Our recommendation is supported by the company's past 3 years' PER in

January, in the PER of 9.5-11.5x.

Figure 9: P/E band graph



Source: TEJ; MasterLink Securities

Income Statement (Yulon Motor, 2201 TT)					NT\$m
Year to December	2001	2002	2003	2004E	2005E
Net Sales	37,561	35,360	42,679	41,131	42,849
Operating Cost	32,317	30,657	35,597	37,055	38,453
Unrealized Sales to Subsidiaries	8	-41	55	0	0
Gross Profits	5,252	4,662	7,137	4,076	4,396
Operating Expenses	3,830	3,553	3,763	2,176	1,813
Selling	983	1,152	1,046	958	997
Administration	1,088	896	1,188	1,129	1,151
R&D	1,759	1,505	1,529	1,376	1,445
Operating Profits	1,422	1,110	3,375	1,900	2,583
Total non-op. Profits	2,633	4,439	5,203	4,213	4,477
Net Interest	54	-7	27	68	79
Investment income	1,899	4,679	4,363	3,948	4,185
FX Gains (Loss)	173	-332	274	196	213
Others	506	98	540	0	0
Pretax Profits	4,055	5,549	8,577	6,113	7,060
Tax	1,011	88	799	541	719
Net Profits	3,045	5,461	7,778	5,572	6,341
EPS (NT\$)	1.78	3.03	4.48	4.04	4.53
Adj. EPS (NT\$)	2.21	3.96	5.64	4.04	4.60
Shares Outstanding (mn shrs)	1,709	1,800	1,738	1,378	1,399
Depreciation & Amortization	1,842	1,818	1,179	1,229	1,279
EBITDA	5,912	7,383	9,776	8,571	9,618
Year-on-year change (%)					
Sales	(18.97)	(5.86)	20.70	(3.63)	4.18
Gross Profits	(16.62)	(11.23)	53.09	(42.89)	7.85
Operating Profits	(44.73)	(21.99)	204.16	(43.69)	35.92
Pretax Profits	(4.06)	36.83	54.58	(28.73)	15.49
Net Profits	(9.63)	79.36	42.42	(28.36)	13.81
Ratios (%)					
ROE	8.40	13.26	18.38	12.48	13.26
ROA	5.91	9.39	12.88	8.93	9.65
Gross Margin	13.98	13.18	16.72	9.91	10.26
Operating Margin	3.79	3.14	7.91	4.62	6.03
Net Margin	8.11	15.44	18.22	13.55	14.80
EBITDA Margin	15.74	20.88	22.90	20.84	22.45
Balance Sheet (Yulon Motor, 2201 TT)					NT\$m
Year-end	2001	2002	2003	2004E	2005E
Cash	4,304	5,710	7,900	5,793	8,576
Marketable Securities	22	2,148	0	0	0
AR and NR	1,514	1,397	2,346	2,285	2,380
Inventory	3,737	3,315	4,753	4,524	4,713
Other	582	477	491	491	491
Current Assets	10,159	13,046	15,491	13,094	16,161
Long-term Investments	20,224	25,075	25,818	30,124	30,274
Fixed Assets	9,216	8,803	15,878	15,999	16,120
Other Assets	11,896	11,226	3,189	3,179	3,179
Total Assets	51,495	58,150	60,375	62,395	65,733
ST Borrowings	0	0	0	0	0
AP and NP	2,415	3,861	4,854	4,524	4,713
Other ST Liabilities	2,693	2,510	3,193	3,193	3,193
Other Liabilities	10,137	10,587	10,020	10,020	10,020
LT Debt	0	0	0	0	0
Total Liabilities	15,246	16,958	18,066	17,737	17,926
Common Shares	17,263	18,291	13,712	13,876	14,153
Other Shareholders' Equity	18,986	22,901	28,597	30,772	33,654
Total Equity	36,249	41,192	42,309	44,658	47,808
Total Liab. & Equity	51,495	58,150	60,375	62,395	65,734
Ratios					
Debt/Equity (%)	23.46	12.72	12.56	16.61	9.70
Current Ratio (%)	198.87	204.79	192.51	169.67	204.41
Quick Ratio (%)	125.73	152.74	133.44	111.04	144.79
Sales/Fixed Assets (%)	407.56	401.68	268.80	257.09	265.82
Inventory Turns (x)	10	11	9	9	9
Receivable Turns (x)	24.81	25.32	18.19	18.00	18.00
Collection Period (Days)	14.71	14.42	20.06	20.28	20.28

Statement of Cash Flows (Yulon Motor, 2201 TT)					NT\$mn
Year to December	2001	2002	2003	2004E	2005E
Cash flow from operating activities	2,979	6,047	7,211	2,556	7,525
Net profits	3,045	5,461	7,778	5,572	6,341
Plus depreciation	1,842	1,818	1,179	1,229	1,279
Minus associates; plus dividends	(1,387)	(4,060)	(1,479)	(4,206)	0
Other adjustments	(521)	2,828	(268)	(39)	(95)
Cash flow from investing activities	(1,469)	(4,149)	(2,169)	(220)	(1,550)
Purchase of fixed assets (CAPEX)	(587)	(443)	(959)	(1,350)	(1,400)
Proceeds from sales of fixed assets	330	11	26	0	0
Investment in associates	(574)	(990)	(69)	(100)	(150)
Sale of investments	69	10	257	1,230	0
Other adjustments	(706)	(2,737)	(1,424)	0	0
Cash flow from financing activities	(1,316)	(493)	(2,851)	(2,924)	(3,191)
Short-term borrowings	0	0	0	0	0
Long-term loans	(13)	0	0	0	0
Payment on long-term loans	0	0	0	0	0
Dividend paid	(1,139)	(343)	(2,739)	(3,222)	(3,191)
Shares issued	0	0	0	0	0
Other adjustments	(164)	(150)	(112)	298	0
FX effects	0	0	0	10	0
Net changes in cash	194	1,405	2,190	(589)	2,783
Cash at the end of the period	4,304	5,710	7,900	5,793	8,576

MasterLink Securities – Stock Rating System

BUY: Total return expected to appreciate 10% or more over a 3-month period.

HOLD: Total return expected to be between 10% to –10% over a 3-month period.

SELL: Total return expected to depreciate 10% or more over a 3-month period.

Additional Information Available on Request

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