Quanta Display Inc. (3012 TT)

HOLD

TFT-LCD

Company Update

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Recommendation

HOLD

Date:	September 30, 2005
Share Price (NT$):	12.05
Price Target (NT$):	13.0
Percent Change:	7.9%
52-wk range (NT$):	20.2-10.7
TWSE:	6118.61

Company Data

Capital Size (NT$):	45.64bn
Market Cap (NT$):	54.99bn
Market Cap (US$):	16.66bn
Outstanding Shrs:	4.56bn
Free Floating Shrs:	3.33bn
PER ('05E):	N/M
PBR ('05E)	0.91
Foreign Ownership:	10.10%
Major Shareholder:	Quanta Computer 17.83%

Performance	1-m	3-m	6-m
Absolute (%)	4.78	(21.09)	(21.55)
Relative to TAIEX	3.30	(19.50)	(23.61)

Key Changes	Current	Prev.
Recommendation	HOLD	HOLD
Price Target (NT$)	13.0	17.4
Revenue (NT$mn)	59,183	65,340
Gross Margin (%)	(8.57)	(1.51)
Oper. Margin (%)	(17.62)	(8.97)
EPS (NT$)	(2.37)	(1.66)

Price Catalysts (+,-)

(-) Downward TFT-LCD industry trend

(-) Weaker 6G capacity schedule

(+) Popular M&A target

Related Research

AUO (2409 TT)	Aug. 12, '05
QDI (3012 TT)	Jun. 6, '05

Bumpy Road Ahead

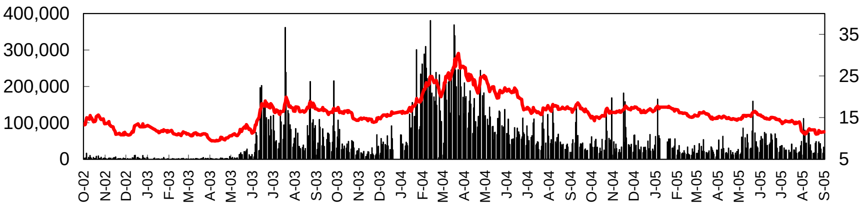
- **NB panel focused panel maker.** As a member of Quanta Computer (2382 TT, NT$54.40, HOLD), Quanta Display Inc.'s (QDI) NB panel consists of 70% of its total product mix in 2005. With NB panel ASP hitting the trough in 2Q05, the 20% QoQ raise in 3Q05 and the back-to-school demand would lead to an improving top line of NT$15.90bn in 3Q05, up 17.6% QoQ. Meanwhile, its 6G fab will enter volume production, raising its total capacity by 31.25% QoQ in 3Q05 and 35.10% QoQ in 4Q05. The depreciation of 6G fab, estimated to be NT$300mn per month, will be book in 4Q05, resulting in a pretax loss of NT$781mn in 4Q05.

- **Weaker 6G capacity schedule.** QDI's capacity ramp-up schedule is behind its peers, such as Samsung (006400.KS, KRW108,500, NR), LPL (LPL, US$20.92, NR), and AUO (2409 TT, NT$43.00, HOLD). QDI's current 6G fab schedule will miss the peaking LCD TV demand. In addition, with the limited learning curve in 6G experience and TV panel technology, QDI will not radically increase its 6G input capacity. Therefore, with smaller economies of scale and a ramp-up schedule behind others, QDI's competition is clearly weaker than its peers.

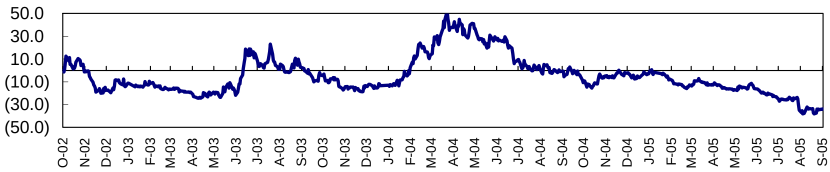
- **M&A Speculation.** QDI is the best M&A target among the second-tier players due to 1) its low cost capital of acquisition and 2) its strong customers relations with global NB brands. We hold a conservative view on the synergy generated from the possible merge between QDI and CPT (2475 TT, NT$9.55, SELL). Instead, we believe the merge between QDI and a first-tier player will generate higher synergy in both capacity design and financial composition.

- **HOLD**. QDI has been traded between 0.76-2.30x PBR and is currently trading at the historical low-end PBR range. Due to 1) the downward business cycle, 2) QDI's weaker 6G capacity schedule, 3) being a popular M&A target, we base on 1.0x PBR of our 2005E BVPS of NT$13.18 and conclude a 3-month target price of NT$13.0. This suggests only an 7.9% upside potential, thus we recommend to HOLD.

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



Relative to TAIEX (%)



Investment Keynotes

Company Background

As a member of Quanta Computer (2382 TT, NT$54.40, HOLD), the biggest NB maker in the world, Quanta Display Inc.'s (QDI) NB panel consists of 70% of its product mix in 2005. QDI's main customers are Quanta Computer, Dell, (DELL, US$34.45, NR) and HPQ (HPQ, US$28.94, NR), each accounted for roughly 20% of its sales.

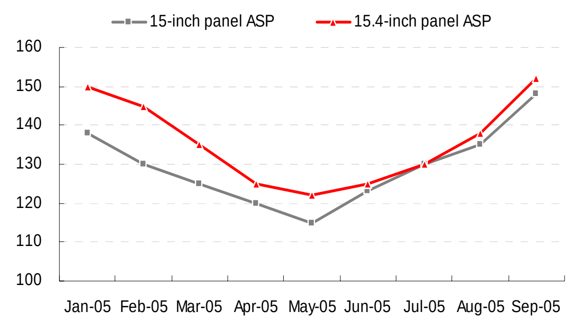
Figure 1: QDI's Product Mix

Panel type	Product mix (%)	Sizes (inch)
NB	70	14.1"/ 15"/15.4" (70% NB shipment)
Monitor	23	15"/ 17" (80% Monitor shipment)
TV	5	23" (50% TV shipment)/ 26"

Source: Company data; MasterLink Securities

According to WitsView Technology, the industrial average 15" NB panel ASP has hit the trough in 2Q05 to the level of NT$120, resulting in a disappointing 2Q05 financial performance from QDI. However, as the industrial average NB panel ASP begun to pick up in June 2005, the 20% QoQ raise in 3Q05 to NT$150 and the rising back-to-school demand would lead to an improving top line, up 17.60% QoQ from NT$13.52bn in 2Q05 to NT$15.90bn in 3Q05. Moreover, we expect the price hike for QDI's NB panel ASP will last till October to the US$150 range. As a result, 4Q05 top line should close at NT$17.7bn, up 11.32% QoQ. Meanwhile, we expect the depreciation of 6G fab, estimated to be NT$300mn per month given the current production level, will be booked in 4Q05. In our forecast, the pretax loss in 4Q05 will be NT$871mn, with an EPS of -NT$0.19.

Figure 2: NB Panel ASP (unit: US$)



Source: WitsView Technology; MasterLink Securities

Weaker 6G Capacity Schedule

QDI's latest 6G fab has entered the production in June 2005 with an input capacity of 10K per month and will raise a capacity to 30K per month by year-end. We expect this will raise the total capacity by 31.25% QoQ in 3Q05 and another 35.10% QoQ in 4Q05. The phase I plan for 6G fab is to cut 32- and 26-inch TV panel, while in phase II, it will cut 37-inch and 17-inch panel.

Figure 3: Fab Capacity Design (unit: K/month)

Fab	1Q05	2Q05	3Q05	4Q05	Panel Cut (inch)
3.5G	51	51	51	51	2"/ 2.2"/ 3.5"/ 7"/ 14.1"
5G	60	68	75	75	15"/ 17"
6G	0	0	10	30	17"/ 26"/ 32"/ 37"

Source: Company data; MasterLink Securities

QDI's capacity ramp-up schedule is behind its peers, such as Samsung (006400.KS, KRW108,500, NR), LPL (LPL, US$20.92, NR), and AUO (2409 TT, NT$43.00, HOLD), who already had 6G or greater fab entering production in 1H05. These tier-one panel makers' improving 2Q05 sales is a clear evident of the right timing of the new capacity introduced. However, QDI's 6G fab will not enter mass production until 4Q05 and will miss the peaking LCD TV demand. In addition, with the limited learning curve in 6G experience and TV panel technology, QDI will not radically increase its 6G input capacity. Therefore, with smaller economies of scale and a ramp-up schedule behind others, QDI's competition is clearly weaker than its peers.

M&A Speculation

Among the second-tier players, including QDI, CPT (2475 TT, NT$9.55, SELL), and HannStar (6116 TT, NT$7.60, SELL), we believe QDI is the best M&A target because of 1) its low cost of acquisition and 2) its strong customers relations with global NB brands. If M&A does take place among Taiwanese panel makers, it will result in a healthier TFT-LCD industry dynamic with better financial funding and economies of scale.

We believe a successful panel M&A should consider the synergy from both capacity design and financial composition. Currently, the M&A among any of the second-tier players in Taiwan can create a panel maker with a capacity of AUO's level, pushing it to the first-tier group. However, most of the second-tier panel makers have only mastered in NB and monitor panel production and have limited know-how in TV panel experiences. As a result, merging two second-tier players, for example QDI and CPT, the most popular combination in the market, would not necessary generate synergy in their TV panel production. Since both companies each have a 6G fab kicking off in 4Q05, without the support from TV panel, the existing NB and monitor panel orders will not satisfy the massive 6G fabs capacity.

Figure 4: Panel Maker Fab Information (by 1H07)

Company	3G	3.5G	4G	4.5G	5G	5.5G	6G	7.5G
AUO		3	1		3		1	1
CMO		1	1		2	1		1
CPT	1		1	2			1	
QDI		1			1		1	
HannStar	2				1		1	

Source: Company data; MasterLink Securities

Financially, the merge between QDI and CPT will also generate limited upside. The combined long-term and short-term debt from both companies will hit NT$130bn. This suggests more than NT$350mn interest expense per year, higher than AUO's NT$130mn. In short, both capacity design and financial situation suggest a merge between QDI and CPT is not the best pick. Nor do we think the combination of any other second-tier players would lead to a better result.

Figure 5: Panel Maker 2Q05 comparison (unit: %)

	AUO	CMO	CPT	QDI	HannStar
ROA	2.47	1.13	-0.28	-1.75	-0.27
ROE	0.37	-1.48	-3.71	-8.02	-4.79
Current Ratio	93.66	139.6	101.89	114.14	90.64
Debt Ratio	52.52	43.73	53.3	63.61	50.81
Interest Coverage Ratio	3.4	-2.44	-10.58	-35.27	-13.95

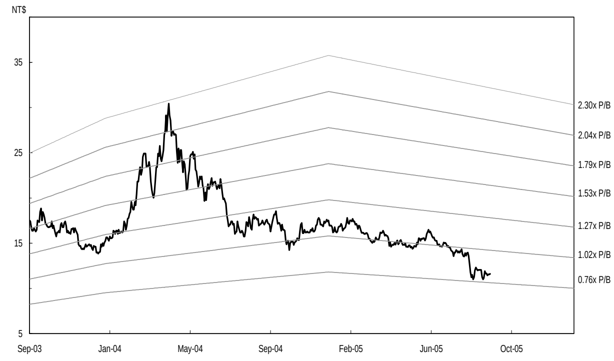
Source: Company data; MasterLink Securities

We think a successful panel M&A should consider how the companies can leverage each other's forte to create the highest outcome. Since QDI is highly focused on NB panel production, we believe QDI will be better off by merging with either AUO or CMO (3009 TT, NT$36.65, HOLD), who are already established in TV panel production. Therefore, we are only positive with a merge between QDI and a first-tier player. The new company will then have strong financial ability and a versatile capacity in NB, monitor, and TV panel.

Valuations and Recommendation

QDI has been traded between 0.76-2.30x PBR in the past two years, and it is currently trading at the historical low-end PBR range. Since 1) TFT-LCD industry is moving into a downward trend in its business cycle, and 2) QDI's capacity design is weaker than its peers, we hold a conservative view on the company's outlook. QDI is, however, a popular M&A target due to its low cost of acquisition and strong customer relation with global NB brands. Therefore, we base on 1.0x PBR of our 2005E BVPS of NT$13.18 and conclude a 3-month target price of NT$13.0, suggesting only an 7.9% upside potential, thus recommend to HOLD.

Figure 6: QDI's P/B band



Source: TEJ; MasterLink Securities

Figure 7: Consolidated Statement of Operations (NT$ mn)

Year to December	2002	2003	2004	2005E
Revenue	15,746	27,581	58,198	59,183
Cost of Goods Sold	14,412	25,358	49,374	64,258
Gross Profit	1,334	2,223	8,824	(5,075)
Operating Exp.	893	2,174	3,101	5,353
Operating Income	441	49	5,698	(10,428)
Total Non-op. Exp.	143	973	1,540	728
Total Non-op. Income	1,124	719	1,955	1,271
Pretax Income	(538)	302	5,282	(10,971)
Net Income	(173)	575	5,766	(10,823)
Adjusted EPS (NT$)	(0.09)	0.24	1.55	(2.37)

Source: MasterLink Securities

Figure 8: Income Statement (%)

Year to December	2002	2003	2004	2005E
Gross Profit	8.47	8.06	15.16	(8.57)
Operating Exp.	5.67	7.88	5.33	9.04
Operating Income	2.80	0.18	9.79	(17.62)
EBIT	(3.42)	1.09	9.08	(18.54)

Source: MasterLink Securities

Figure 9: Income Statement (% Growth)

Year to December	2002	2003	2004	2005E
Revenue	2928.08	75.16	111.01	1.69
Pretax Income	(69.98)	(156.13)	1649.01	(307.71)
Net Income	(87.64)	(432.37)	902.78	(287.70)

Source: MasterLink Securities

Figure 10: 2005 Quarterly Earnings Estimates (NT$ mn)

Quarter	1Q05	2Q05	3Q05E	4Q05E
Revenue	12,061	13,522	15,900	17,700
Cost of Goods Sold	14,540	16,590	16,062	17,065
Gross Profit	(2,479)	(3,069)	(162)	635
Operating Exp.	1,158	1,329	1,377	1,488
Operating Income	(3,638)	(4,398)	(1,540)	(853)
Total Non-op. Exp.	362	162	102	102
Total Non-op. Income	928	104	120	120
Pretax Income	(4,203)	(4,340)	(1,558)	(871)
Net Income	(4,055)	(4,340)	(1,558)	(871)
Adjusted EPS (NT$)	(0.89)	(0.95)	(0.34)	(0.19)

Source: MasterLink Securities

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