



E. Sun FHC (2884 TT)

BUY

Financial

Initiation

ML Research Team

Equity Analyst

Shuling Ho

shulingho@masterlink.com.tw

886.2.2731 3888 ext 632

Recommendation

Buy

Date: June 30, 2005

Share Price (NT\$): 25.40

Price Target (NT\$): 30.15

Percent Change: 18.70%

52-wk range (NT\$): 17.98~26.40

TWSE: 6231

Company Data

Capital Size (NT\$): 29,306mn

Market Cap (NT\$): 74,431mn

Market Cap (US\$): 2,355mn

Outstanding Shrs: 2,930mn

Free Floating Shrs: 2,731mn

PER ('06E): 10.90x

PBR ('06E): 1.48x

Foreign Ownership: 34.47%

Major Shareholder: E. Sun Bank, 6.43%

Performance

Absolute 1-m 3-m 6-m

Relative to TAIEX -2% -2% -5%

-6% -6% -7%

Key Changes

Recommendation Buy NA

Price Target (NT\$) 30.15 NA

Revenue (NT\$bn) 7,222 NA

Gross Margin (%) 100% NA

Oper. Margin (%) 97.51% NA

EPS (NT\$) 2.33 NA

Price Catalysts (+,-)

(+ Robust loan book growth

(+ Upgraded RoAA & RoAE

Related Research

Taiwan Financial Reform Jun. 14, 2005 Review

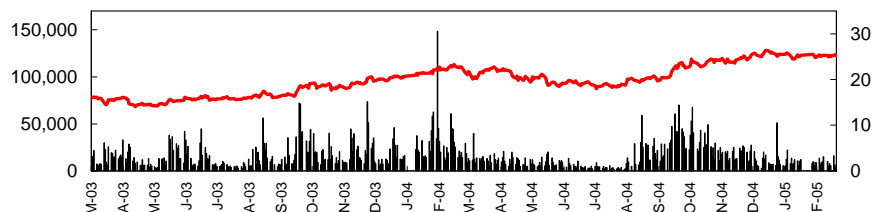
First FHC Jun. 09, 2005

Shin Knog FHC (2888 TT) Jun. 07, 2005

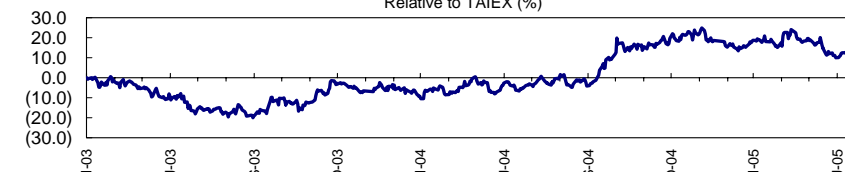
Time to accumulate

- We are initiating coverage on E. Sun Financial Holding Company, E. Sun FHC, with a buy rating of NT\$30.15 target price in 12 months. Although the share movement seems capped in 1.50~1.65 BV multiple for the past 6 months to reflect on-going Kaohsiung Business Bank (KBB) integration, we expect the stock to move upward as we are marching toward the completion of the KBB integration in 2006 end.
- Exceptional performance** E. Sun bank's loan book has been growing in a faster rate than the industry average without sacrificing the asset quality. The bank has achieved YoY 33.77% loan growth for the first five months this year, vs. 7.41% from all local banks. Broad-based NPL remained superior at 0.98% at the month end, vs. industrial average of 3.75%.
- Number 3 branch network among local private banks** KBB acquisition has boosted up E. Sun's domestic branch location to 114, only after Taipei Fubon's 119 and Sinopac FHC (2890 TT, NR)'s 129, among local private banks. We are expecting to see robust growth after the competition of KBB integration in 2006.
- Risk factors** Although we agree mortgage account will form a good basis for wealth management business, we are concerned E. Sun Bank might give out too much interest margin to obtain extra mortgage business.
- Earnings estimate** Our forecast shows the FHC's EPS will increase by 8.89% to NT\$1.96 in 2005 and by 18.88% to NT\$2.33 in 2006. Per share BV plus cash dividend will mark at NT\$16.22 and NT\$17.22, respectively at end of 2005 and 2006.
- Accumulate** Although, we think short-term (3 months) share movement will remain static, our one-year target share price is NT\$ 30.15, or multiple of 1.75x 2006 BV plus cash dividend, implying 18.70% upside from NT\$25.40, June 30, 2005 closing price.

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



Relative to TAIEX (%)



Investment Keynotes

E. Sun FHC Recent Development

E. Sun FHC is a commercial bank centric FHC. As of 1Q05 the FHC has generated NT\$0.49 EPS, 25.79% of NT\$ 1.90 yearly target. Regardless banking unit's 19.11% revenue increase, the FHC actually expects for a lower EPS, NT\$1.90, to factor in the on-going KBB integration process. For the same period, the banking subsidiary's pretax earnings dropped by 15.93% YoY,

which is anticipated due to KBB goodwill amortization and hiring expansion. On the other hand, E.Sun Bills operation grew better and delivered 21.7% more net earnings YoY for higher bond trading gains. Earnings contribution to the FHC thus reached 16.8%, up from 11.0% in 2004 end. Securities unit, although reported a net loss of NT\$17mn, for the first quarter, management stated the subsidiary should begin to deliver profitability by 1H05.

Figure 1: SK FHC controlling assets & subsidiaries contribution

	Assets under Control		Total Revenue Generated				Earnings Contribution			
	2005/03		2004		2005/03		2004		2005/03	
E. Sun Bank	433.321	86.99%	4.178	84.69%	21.202	90.53%	1.178	82.32%	4.507	87.07%
E. Sun Bills	58.750	11.79%	488	9.89%	1.409	6.02%	241	16.84%	611	11.81%
E. Sun Securities	5.901	1.18%	233	4.72%	688	2.94%	(6)	-0.42%	(17)	-0.33%
E. Sun Insurance Brokerage	166	0.03%	34	0.69%	122	0.52%	18	1.26%	75	1.45%
Total	498.138	100.00%	4.933	100.00%	23.421	100.00%	1.431	100.00%	5.176	100.00%

Source: Company data; MasterLink Securities

E. Sun Bank

Established in 1992, E. Sun was formed by a team of local banking professionals. As of May 2005, the bank occupied 1.96% loan market share, which was ranked in the 15th place out of 47 domestic banks. Moreover, the bank's loan book has been growing in a faster rate than the industry average without sacrificing the asset quality. Management stated the superior performance was attributed to the company's accent on long-term customer relationship management with the proven in-house credit control system co-developed with Mercer Oliver Wyman, a leading risk management consulting firm.

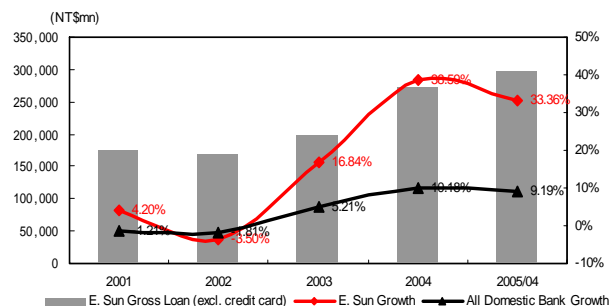
Figure 3: E. Sun Bank Asset Quality

	Loan Growth YoY As of 05/2005	B.B NPL	Loan Loss Coverage	Capital Adequacy
Market Avg.	7.41%	3.75%	40.14%	8% (min. requirement)
E. Sun	33.77%	0.98%	77.26%	11.51%

Source: BoMA; MasterLink Securities

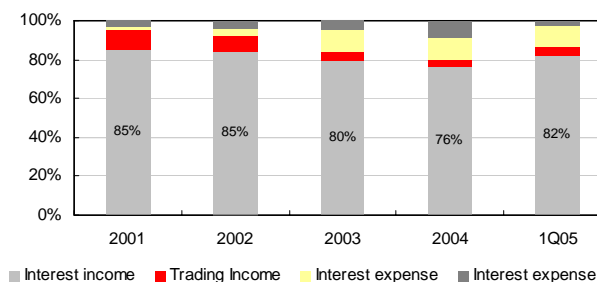
We consider E. Sun Bank a traditional consumer banking institution, with 80% interest income and 63.56% consumer loan. Looking more closely, mortgage lending accounts for 73.23% consumer loan portfolio, thus we believe E. Sun Bank is exempted from the raising concerns of consumer credit risks that are mostly related to un-secured consumer lending.

Figure 2: E. Sun Bank Gross Loan Growth



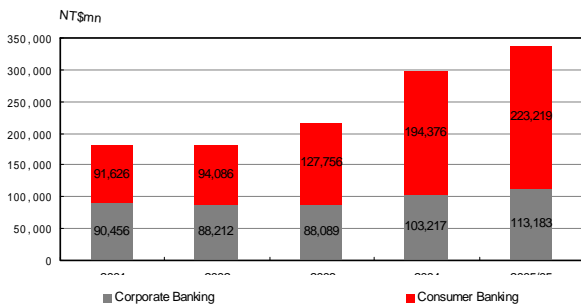
Source: Company data, MasterLink Securities

Figure 4: E. Sun Bank Revenue Breakdown



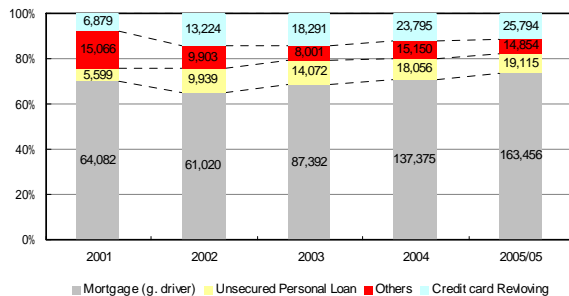
Source: Company data; MasterLink Securities

Figure 5: E. Sun Bank Loan Mix



Source: Company data; MasterLink Securities

Figure 6: E. Sun Bank Consumer Loan Mix

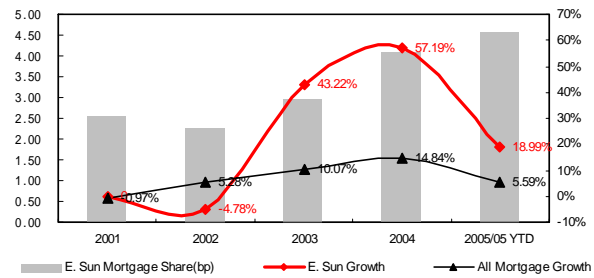


Source: Company data; MasterLink Securities

Mortgage lending, the highest weight among all consumer borrowing, has been the bank's key growth driver that delivered more than 40% growth since 2003. Company management explained the business growth came both from new house buyers and account transferring; moreover, a centralized processing system is adopted since 2000 to accelerate loan review procedure to compete. A goal of 30% mortgage growth is set for this year, and YTD growth for the first five months has reached 18.99%. As of May 2005, the bank's mortgage market standing was 2.69%, up from 1.84% in 2003.

Moreover, we believe the mortgage accounts will provide a good basis for up-coming deployment of wealth management business. Thus we are expecting future pickup on fee income.

Figure 7: E. Sun Bank Mortgage Lending Growth



Source: Company data; MasterLink Securities

Credit card business, 7.67% of gross loan book, is selling robustly over the recent years; regardless slipping per card spending growth. Although E. Sun's card in-force ratio is higher than the industry average, 68% vs. 54%, we see limited catalyst for the business under an extremely competitive industry environment.

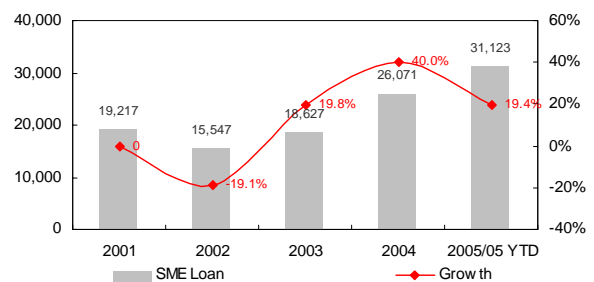
Figure 8: E. Sun Bank Credit Card

	2001	2002	2003	2004	2005/05
Card in force ('000)	1,021	1,709	2,052	2,409	2,537
Revolv. Balanc./inforce (NTS K)	6.74	7.74	8.91	9.88	10.17
Growth	n.a.	14.85%	15.20%	10.81%	7.04%
Spending/inforce (NTS K)	25.58	20.20	23.65	25.38	11.42
Growth	n.a.	-21.05%	17.09%	7.33%	7.94%

Source: Company data; MasterLink Securities, 2005/05 growth is annualized calculation

SME loan also rose rapidly. Management stated that it is bank's strategy to focus on SME customers, as big corporate accounts take longer time to penetrate and SME accounts yields better spread margins. According to the company, 30% SME is guaranteed by government's Small & Medium Business backed Credit Guarantee Fund. We estimate E. Sun's SME loan increment for 2005 will exceed company's guidance, 20%, as it has achieved 19.38% growth in May.

Figure 9: E. Sun Bank SME Loan Growth



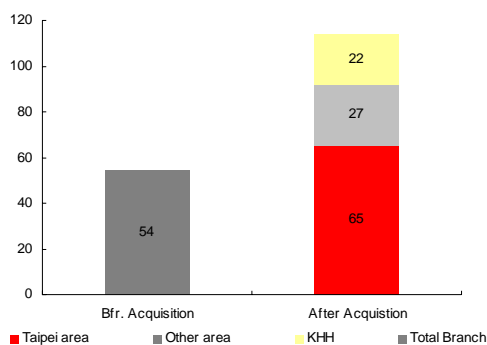
Source: Company data; MasterLink Securities

KBB acquisition strengthened E. Sun Bank's sales channels

To expand the branch network, Kaohsiung Business Bank, KBB, was acquired in 3Q03. The transaction has added in 60 branches, in which 35 of them are in operation now after the restructuring and relocation and the residual 25 branches will be in place by 2006 end, to bring up its branch network to 114 in total. Please see the below figure for branch allocation. On the other hand, E. Sun had to record NT\$1,003mn goodwill amortization expense per annum to reconcile the difference between the KBB's book value and asset market value.

Management revealed a new branch takes about 6~12 months to reach breakeven point, thus we anticipate to see robust growth starting from 2007.

Figure 10: E. Sun Bank Branch Network



Source: Company data; MasterLink Securities

Figure 11: KBB Acquisition (NT\$m)

Goodwill recorded@ acquisition	6,117
2004 one time writeoff	1,103
4Q04 annual amortization	352
Annual amortization	981
Loan assumed	15,034
Deposit assumed	46,312

Source: Company data; MasterLink Securities

Earnings Forecast

Figure 12: Bank Key Assumptions

	2002	2003	2004	2005E	2006E
Average Loan Rate					
Earned	5.2%	3.8%	3.4%	3.9%	4.2%
Average Deposit					
Rate Paid	2.5%	1.6%	1.4%	1.8%	2.0%
Loan Growth	-4.8%	16.6%	38.3%	25.8%	17.9%
Deposit Growth	0.3%	9.4%	34.0%	22.2%	18.3%

Source: Company data; MasterLink Securities

Figure 13: Other Key Assumptions

	2002	2003	2004	2005E	2006E
Bill Net Earnings (NT\$ mn)	571	966	611	686	900
Securities Net Earnings (NT\$ mn)	13	98	-17	173	200
Insurance Brokerage					
Net Earnings (NT\$ mn)	n.a.	59	75	63	70
FHC DSP (NT\$)	0.00	1.09	1.10	0.80	1.20

Source: Company data; MasterLink Securities

Risk Factors

We like E. Sun bank's concentration on mortgage accounts to form a good basis for wealth management business. However, as mortgage is a highly competitive market, we are worried E. Sun will need to sacrifice a lot more interest margin before seeing meaningful contribution from wealth management.

Valuation and Recommendation

The share movement has been sluggish within PB band of 1.50x~1.65x for the past 6 months. We think this is to reflect the current integration of KBB and expect the stock to move upward as we march toward the end of the integration in 2006 end. Moreover, we believe the stock to receive higher valuation to justify upgraded RoE and RoA. Although, we think short-term (3 months) share movement will remain static, our one-year target share price is NT\$ 30.15, or multiple of 1.75x 2006 BV plus cash dividend, implying 18.70% upside from NT\$25.40, June 30, 2005 closing price.

Figure 14: E. Sun FHC PB Band



Source: Company data; MasterLink Securities

E. Sun Bank P&L					NT\$mn
Year to December	2002	2003	2004	2005E	2006E
Interest income	12,115	11,058	14,049	18,142	22,282
Trading, dividend, investment income	1,125	618	653	1,790	1,500
Fee income	469	1,541	2,080	2,600	2,860
Other income	608	682	1,642	600	600
Total income	14,316	13,898	18,424	23,132	27,243
Interest expense	5,581	3,851	3,987	6,404	8,137
Trading, dividend, investment loss	-	-	-	-	-
Commission paid	310	596	627	690	400
Provision	9,433	826	22	1,093	2,542
Credit card & other expenses	(10)	62	922	1,014	1,115
Total operating cost	15,313	5,335	5,557	9,201	12,194
Operating margin bfr. provision	8,435	9,389	12,889	15,024	17,590
Operating margin	(998)	8,563	12,867	13,931	15,049
Total SG&A	3,668	4,355	6,101	6,406	6,502
Net operating income	(4,666)	4,209	6,766	7,525	8,546
Net non-operating income	(75)	(18)	(1,172)	(981)	(981)
Pretax income	(4,740)	4,191	5,594	6,543	7,565
Tax expense	(1,229)	794	1,088	1,440	1,513
Net income	(3,511)	3,396	4,507	5,104	6,052
EPS NT\$	(1.93)	1.87	2.35	2.40	2.71
DPS NT\$	0.70	1.20	1.34	1.00	1.00

E. Sun Bank Balance Sheet					NT\$mn
Year to December	2002	2003	2004	2005E	2006E
Cash	14,883	4,535	5,620	8,389	10,208
Money mkt & interbank	17,877	18,220	29,951	31,459	37,122
S/T investment	38,886	42,870	60,385	68,161	80,430
All loans	170,775	199,070	275,360	346,334	408,484
Receivables & other current assets	18,139	24,961	30,828	39,324	49,496
L/T investment	4,755	10,513	11,625	11,535	13,611
Fixed assets	5,018	9,395	8,992	8,991	8,820
Other non-current assets	2,309	1,433	10,561	10,125	10,524
Total assets	272,643	310,998	433,321	524,318	618,696
Deposit	225,740	247,016	330,972	404,592	478,574
Interbank borrowings	13,620	21,664	32,245	44,567	60,013
Accrued expenses & other current liab.	5,080	5,462	7,054	9,438	9,280
L/T liab.	10,122	15,140	29,814	29,600	29,600
Special reserve & other non-current liab.	169	406	591	1,082	2,628
Total liabilities	254,730	289,688	400,676	489,278	580,096
Common Shares	18,175	18,175	20,175	22,314	24,545
Reserve	3,471	234	5,253	5,763	6,368
Retained Earnings	(3,237)	3,396	7,341	7,093	7,630
Adjustments	3	3	(124)	(129)	56
Total Equity	17,913	21,309	32,645	35,040	38,599
Total Liabilities & Equity	272,643	310,998	433,321	524,318	618,696
BV NT\$	9.86	11.72	16.18	15.70	15.73
RoAA (%)	0.73	1.16	-1.30	1.07	1.06
RoAE (%)	8.45	17.32	-17.24	15.08	16.44
Loan/Deposit (%)	77.67	78.23	82.08	84.14	84.84
CAR (%)	10.38	9.97	11.51	13.50	12.27
Broad-based NPL (%)	1.36	1.73	1.36	1.00	1.00

E. Sun FHC total assets controlled					NT\$mn
Year to December	2002	2003	2004	2005E	2006E
E. Sun Bank	272,643	310,998	433,321	524,318	618,696
E. Sun Bills	10,065	18,074	58,750	59,136	60,036
E. Sun Securities	8,279	7,207	5,901	5,874	6,074
E. Sun Insurance Brokerage	-	90	166	179	249
Total	290,987	336,369	498,138	589,507	685,055

E. Sun FHC P&L (unconsolidated)					NT\$mn
Year to December	2002	2003	2004	2005E	2006E
E. Sun Bank	(3,511)	3,396	4,507	5,104	6,052
E. Sun Bills	571	966	611	686	900
E. Sun Securities	13	98	(17)	173	200
E. Sun Insurance Brokerage	-	59	75	63	70
Total Income	(3,054)	4,549	4,783	6,026	7,222
E. Sun Bank	114.9%	74.7%	94.2%	84.7%	83.8%
E. Sun Bills	-18.7%	21.2%	12.8%	11.4%	12.5%
E. Sun Securities	-0.4%	2.2%	-0.4%	2.9%	2.8%
E. Sun Insurance Brokerage	0.0%	1.3%	1.6%	1.0%	1.0%
Total Income	100.0%	100.0%	100.0%	100.0%	100.0%
Operating Expenses	24	16	50	160	180
Operating Income	(3,078)	4,533	4,733	5,866	7,042
Non Operating (Net)	(13)	(4)	(10)	(36)	(20)
Pretax Earnings	(3,091)	4,529	4,723	5,830	7,022
Tax Expense	-	-	(113)	-	-
Net Earnings	(3,091)	4,529	4,837	5,830	7,022
EPS NT\$	(1.25)	1.82	1.78	1.96	2.33

E. Sun FHC Balance Sheet					NT\$mn
Year to December	2002	2003	2004	2005E	2006E
Cash & Equivalent	14	5,693	56	147	180
Marketable Security	-	364	-	-	-
Total Other Current Assets	-	147	968	1,288	1,162
Long-term Investment	23,587	27,935	43,423	46,196	51,186
Total Fixed Assets	-	58	2	1	1
Total Assets	23,602	34,197	44,450	47,631	52,529
S/T Borrowings	-	-	-	-	-
Payables & Other Current Liab.	13	6,504	1,690	2,469	2,960
Total L/T Liab.	-3,091	888	401	200	0
Total Liab.	-3,078	7,392	2,091	2,669	2,960
Common Shares	24,700	25,064	29,306	30,185	30,185
Reserve	24,699	1,769	8,114	8,697	9,399
Retained Earnings	0	4,529	5,042	6,186	10,091
Others	(5,806)	(54)	(103)	(106)	(106)
Treasury Stocks	(3,091)	(4,503)	-	-	-
Total Equity	40,501	26,805	42,359	44,962	49,569
Total Liabilities & Equity	37,423	34,197	44,450	47,631	52,529
BV NT\$	16.40	10.77	15.58	15.12	16.42
RoAA	-13.10	15.67	12.30	12.66	14.02
RoAE	-7.63	13.46	13.99	13.35	14.86
DSP (NT\$)	0.00	1.09	1.10	0.80	1.20

MasterLink Securities – Stock Rating System

BUY: Total return expected to appreciate 15% or more over a 3-month period.

HOLD: Total return expected to be between 15% to –15% over a 3-month period.

SELL: Total return expected to depreciate 15% or more over a 3-month period.

Additional Information Available on Request

©2005 MasterLink Securities. All rights reserved.

This information has been compiled from sources we believe to be reliable, but we do not hold ourselves responsible for its completeness or accuracy. It is not an offer to sell or solicitation of an offer to buy any securities. MasterLink and its affiliates and their officers and employees may or may not have a position in or with respect to the securities mentioned herein. This firm (or one of its affiliates) may from time to time perform investment banking or other services or solicit investment banking or other business from any company mentioned in this report. All opinions and estimates included in this report constitute our judgment as of this date and are subject to change without notice. MasterLink has produced this report for private circulation to professional and institutional clients only. All information and advice is given in good faith but without any warranty.
