

Globe Union (9934.TW/9934 TT)

Beneficiary of US housing market recovery

NT\$22.2

Outperform
from Underperform

Company update
Rating upgrade

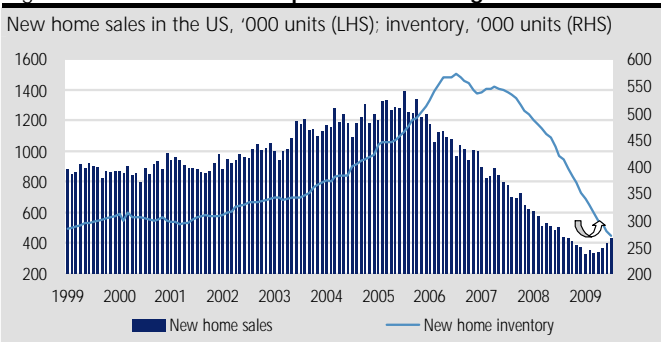
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- **Both new & existing home sales have improved in the US over the past four months**
- **Benefiting from low-price raw material inventory**
- **12M target price set at NT\$26; upgrade to Outperform**

US housing market showing signs of recovery

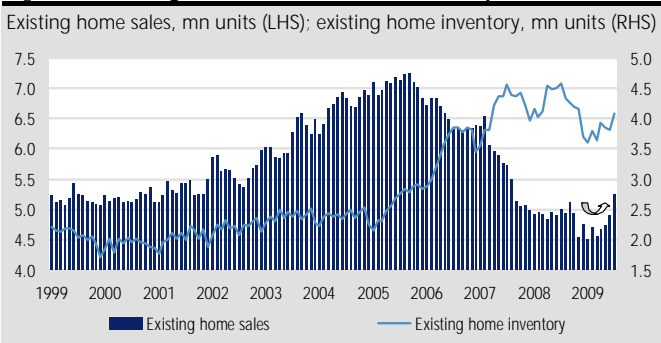
In July, US new home sales jumped by 9.6% MoM to 433k units, the fourth consecutive monthly rise and the highest level since September 2008. Sales have rebounded by 30% from the historical low last April. New home inventory has decreased for 27 straight months and fell another 3.2% MoM in July to 271k units, shortening inventory turnover to 7.5 months. Sales of existing homes rose 7.2% MoM to 5.24mn units in July, also marking the fourth consecutive monthly rise and a new high since August 2007. The US housing market seems to be making a recovery, with new and existing home sales both up for four months straight.

Figure 1: New home sales up for fourth straight month



Source: Bloomberg; KGI Securities

Figure 2: Existing home sales in the US back up to 2007 levels



Source: Bloomberg; KGI Securities

With home prices down sharply and the offer of a tax credit of up to US\$8,000 for first-time home buyers expiring on December 1, we expect home sales to hold up well over the next few months. Since Globe Union is a world-class designer and manufacturer of

faucets, fixtures and accessories for the kitchen and bath industry, we expect the company to benefit directly from the recovery of US housing market.

2H09 pretax income up 18.9% YoY

Globe Union registered consolidated 1H09 sales of NT\$10.2bn, down 15.2% YoY. With lower operating expenses and a forex gain of NT\$53mn, 1H09 pretax income grew 18.9% YoY to NT\$393mn. However, 1H09 net profit declined 21.9% YoY to NT\$156mn, for EPS of NT\$0.54, mainly due to an additional one-time tax expense of NT\$87mn from the change of tax rate. Regarding 2Q09 data, Globe Union registered consolidated sales of NT\$5.25bn, down 14.1% YoY but up 6.5% QoQ. Gross margin improved to 30.8% in 2Q09, from 29.5% in 1Q09, mainly due to lower priced raw materials inventory. Accompanied with better cost controls, Globe Union registered 2Q09 operating profits of NT\$235mn, up 93.6% QoQ and 90.3% YoY. Overall, 2Q09 net profit declined 7.3% QoQ to NT\$75mn due to the abovementioned one-time tax expense of NT\$87mn.

Benefiting from the low price raw materials inventory

The price of copper dropped to as low as US\$3,000 per metric ton (mt) in December 2008, from over US\$8,000/mt in June 2008, but has recently rebounded to over US\$6,000/mt. Since copper accounts for 35-40% of COGS for Globe Union, the company registered valuation loss on inventory of NT\$251mn in 4Q08 due to the sharp drop in raw materials prices. If the price of copper remains high, Globe Union should see gains from the reversal of its loss on inventory. In addition, management says the low price copper inventory can be used till November. As a result, we expect Globe Union to enjoy a high gross margin in 3Q09. For 2009, we expect sales to decline 4.9% YoY to NT\$21.8bn and net profits to grow 62.0% to NT\$488mn, for EPS of NT\$1.66. For 2010, we forecast sales of NT\$24.6bn, up 12.7% YoY, and net profits of NT\$593mn, up 21.5%, for EPS of NT\$2.01.

Valuation and Recommendation

Globe Union should benefit greatly from the recovery in the US housing market since its main business is directly linked to the housing market there. Shares of Globe Union are currently trading at 13.4x and 11.0x our respective 2009 and 2010 EPS estimates, still in the mid-to-low end of the company's historical PE band. Based on our 2010 EPS estimate of NT\$2.01 and a target PE of 13x, we have set our 12-month target price for Globe Union at NT\$26 and upgraded our rating to Outperform from Underperform.

Year-end	Sales	Gross profit	EBIT	Net income	EPS	Pre-bonus EPS
	NT\$m	NT\$m	NT\$m	NT\$m	NT\$/share	NT\$/share
2007A	23,077	6,358	1,022	709	2.48	2.48
2008A	22,903	6,957	975	301	1.02	1.02
2009F	21,790	6,482	985	488	1.66	1.66
2010F	24,558	7,243	1,200	593	2.01	2.01
Year-end	EV/sales	EV/EBITDA	PER	Pre-bonus PER	EV/Inv. C.	ROAE
	(x)	(x)	(x)	(x)	(x)	(%)
2007A	0.5	7.9	14.7	14.7	0.8	10.6
2008A	0.3	5.9	21.7	21.7	0.6	4.1
2009F	0.3	5.3	13.4	13.4	0.6	6.5
2010F	0.3	4.6	11.0	11.0	0.5	7.5
Sector	Others		52-week trading range (NT\$)		11.4 - 25	
12M target price (NT\$/shr)	26.0		Mkt cap-NT\$ bn/US\$ mn		7/199	
Upside/downside (%)	17.1		Outstanding shares (mn)		294	
The percentile of excess return (%)	81		Free floating shares (mn)		294	
Dividend yield-12/09E (%)	4.5		Foreign ownership (mn)		63.9	
Book value/shr-12/09E (NT\$)	26.2		3M avg. daily trading (mn)		0.5	
P/B-12/09E (x)	0.8		Abs. Performance (3,6,12M)(%)		-8.6; 59.1; 1.6	
Net debt/equity-12/09E (%)	11.3		Rel. Performance (3,6,12M)(%)		-13; 4.2; -4.2	

Note: On consolidated basis

Figure 3: Company overview

Globe Union is a world-class designer and manufacturer of faucets, fixtures and accessories for the kitchen and bath industry. Founded in 1979, Globe Union has grown to become North America's largest import supplier of quality faucets and plumbing accessories. ODM accounts for 57% of sales and OBM for the remaining 43%.

Source: KGI Securities

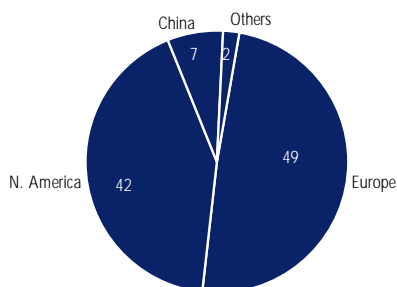
Figure 4: One of Globe Union's Danze brand faucets



Source: Company data

Figure 5: N. America & Europe are Globe Union's major markets

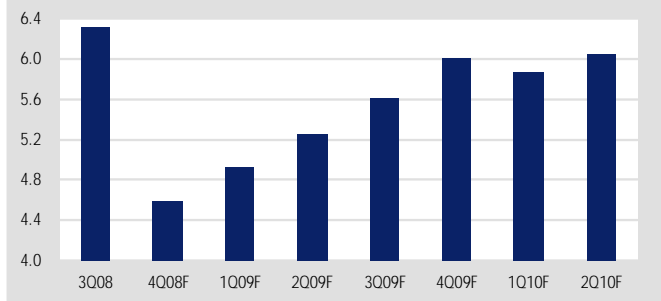
Consolidated sales breakdown by destination, 2008, percent



Source: Company data

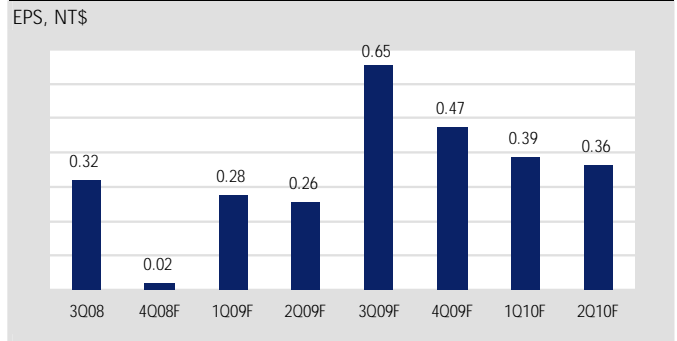
Figure 6: Sales bottomed in 4Q08

Consolidated sales, NT\$billion



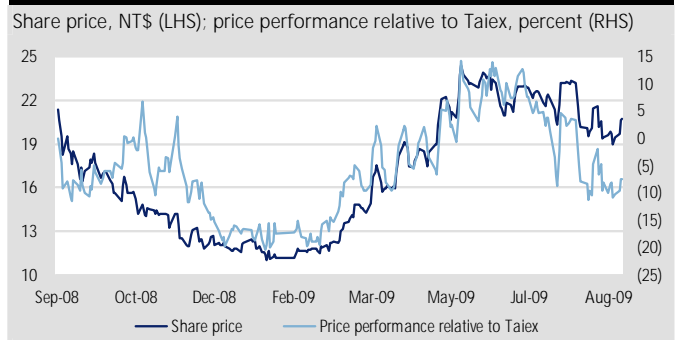
Source: KGI Securities estimates

Figure 7: Earnings to show improvement



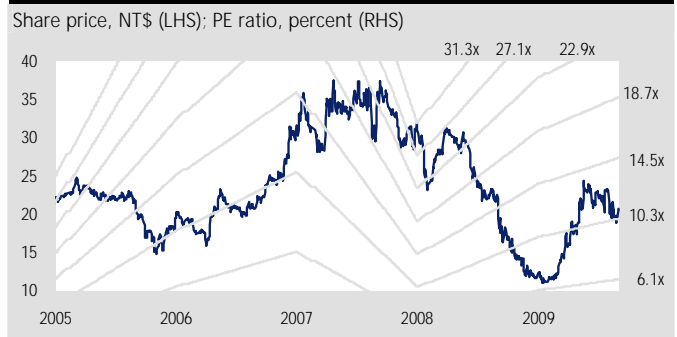
Source: KGI Securities estimates

Figure 8: Globe Union share price chart



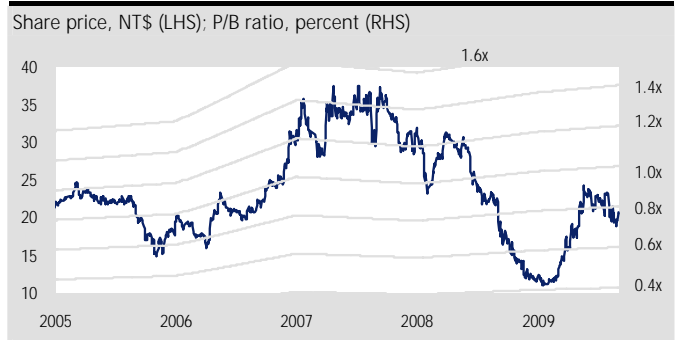
Source: KGI Securities estimates

Figure 9: Globe Union's 12M forward PE band



Source: KGI Securities estimates

Figure 10: Globe Union's 12M forward PB band



Source: KGI Securities estimates

Balance Sheet

As of 31 Dec (NT\$m)	2006A	2007A	2008A	2009F	2010F
Total Assets	11,195	19,459	18,239	18,531	19,814
Current Assets	8,945	13,881	12,725	12,952	14,154
Cash & ST Investments	3,357	3,616	3,800	4,419	4,519
Inventories	2,918	4,666	4,655	4,463	5,048
Accounts Receivable	2,326	4,369	3,504	3,343	3,768
Others	344	1,229	766	726	819
Non-current Assets	2,250	5,579	5,514	5,579	5,660
LT Investments	15	15	15	15	15
Net fixed Assets	1,558	1,909	2,527	2,564	2,645
Others	677	3,655	2,972	3,000	3,000
Total Liabilities	5,272	11,976	11,008	10,813	11,797
Current Liabilities	5,123	7,284	8,272	8,047	9,056
Accounts Payable	1,570	3,946	3,616	3,481	3,937
ST Borrowings	2,370	1,333	2,730	2,750	3,072
Others	1,184	2,005	1,927	1,816	2,047
Long-term Liabilities	149	4,693	2,736	2,766	2,741
Long-term Debts	104	4,493	2,509	2,539	2,514
Others	45	200	227	227	227
Shareholders' Equity	5,923	7,483	7,231	7,718	8,017
Common Stock	2,513	2,798	2,944	2,944	2,944
Capital Surplus	2,629	3,589	3,334	3,334	3,334
Retained Earnings	781	1,096	953	1,441	1,739
Preferred Stock	0	0	0	0	0

Source: Company data; KGI Securities estimates

Key Ratios

Year to 31 Dec (NT\$m)	2006A	2007A	2008A	2009F	2010F
Growth (% YoY)					
Sales	31.8	80.1	(0.8)	(4.9)	12.7
OP	88.8	21.1	(4.6)	1.1	21.8
EBITDA	63.2	30.7	(3.9)	3.4	19.9
NP	129.6	41.7	(57.5)	62.0	21.5
EPS	116.3	43.1	(58.8)	62.0	21.5
Profitability (%)					
Gross Margin	31.4	27.6	30.4	29.7	29.5
Operating Margin	6.6	4.4	4.3	4.5	4.9
EBITDA Margin	8.4	6.1	5.9	6.4	6.8
Net Profit Margin	3.9	3.1	1.3	2.2	2.4
ROAA	4.7	4.6	1.6	2.7	3.1
ROAE	8.9	10.6	4.1	6.5	7.5
Stability					
Gross Debt/Equity (%)	41.8	77.9	72.4	68.5	69.7
Net Debt/Equity (%)	Net cash	29.5	19.9	11.3	13.3
Interest Coverage (x)	7.4	5.6	2.3	4.2	4.3
Interest & ST Debt Coverage (x)	0.4	1.0	0.3	0.4	0.4
Cash Flow Interest Coverage (x)	0.6	(1.4)	4.3	3.7	2.2
Cash Flow/Interest & ST Debt (x)	0.0	(0.2)	0.5	0.3	0.2
Current Ratio (x)	1.7	1.9	1.5	1.6	1.6
Quick Ratio (x)	1.2	1.3	1.0	1.1	1.0
Net Debt (NT\$m)	(888)	663	1,824	1,154	968
Per Share Data (NT\$)					
EPS	1.73	2.48	1.02	1.66	2.01
CFPS	2.53	3.81	2.29	3.04	3.61
BVPS	20.54	25.47	24.56	26.22	27.23
SPS	44.43	78.56	77.80	74.02	83.42
EBITDA/Share	2.93	3.58	3.31	3.35	4.08
DPS	1.42	1.50	N.D.	1.00	1.50
Activity					
Asset Turnover (x)	1.2	1.5	1.2	1.2	1.3
Days Receivables	66.3	69.1	55.8	56.0	56.0
Days Inventory	83.1	73.8	74.2	74.8	75.0
Days Payable	44.7	62.4	57.6	58.3	58.5
Cash Cycle	104.7	80.5	72.4	72.4	72.5

Source: Company data; KGI Securities estimates

Profit & Loss

Year to 31 Dec (NT\$m)	2006A	2007A	2008A	2009F	2010F
Sales	12,810	23,077	22,903	21,790	24,558
Cost of Goods Sold	8,787	16,719	15,946	15,309	17,315
Gross Profit	4,023	6,358	6,957	6,482	7,243
Operating Expenses	3,180	5,337	5,982	5,496	6,043
Operating Profit	844	1,022	975	985	1,200
Net Interest Income	(76)	(227)	(296)	(230)	(240)
Interest Income	48	54	73	53	50
Interest Expense	124	281	369	282	290
Net Investment Income/(Loss)	0	0	0	0	0
Net other Non-op. Income/(Loss)	27	491	(204)	156	0
Pretax Income	795	1,285	475	912	960
Income Taxes	218	310	81	363	240
Net Extraordinaries	(77)	(266)	(92)	(62)	(128)
Net Profit	500	709	301	488	593
EBITDA	1,072	1,401	1,346	1,392	1,670
EPS (NT\$)	1.73	2.48	1.02	1.66	2.01

Source: Company data; KGI Securities estimates

Cash Flow

Year to 31 Dec (NT\$m)	2006A	2007A	2008A	2009F	2010F
Operating Cash Flow	78	(391)	1,604	1,041	647
Net Profit	500	709	301	488	593
Depreciation & Amortization	229	380	372	407	470
Change in Working Capital	(651)	(1,479)	931	147	(415)
Others	(0)	0	0	0	0
Investment Cash Flow	(31)	(3,709)	(307)	(472)	(550)
Net CAPEX	(365)	(625)	(893)	(344)	(450)
Change in LT Investment	463	0	0	0	0
Change in Other Assets	(129)	(3,083)	586	(128)	(100)
Free Cash Flow	48	(4,100)	1,298	569	97
Financing Cash Flow	139	4,359	(1,114)	50	3
Change in Share Capital	57	851	(554)	(0)	(294)
Net Change in Debt	196	3,352	(588)	50	297
Change in Other LT Liab.	(114)	155	27	0	0
Net Cash Flow	187	259	184	620	100

Source: Company data; KGI Securities estimates

Rates of Return on Invested Capital

Year	1- $\frac{\text{COGS}}{\text{Revenue}}$	+ $\frac{\text{Depreciation}}{\text{Revenue}}$	+ $\frac{\text{Operating Exp.}}{\text{Revenue}}$	= Operating Margin
2006A	66.8%	1.8%	24.8%	6.6%
2007A	70.8%	1.6%	23.1%	4.4%
2008A	68.0%	1.6%	26.1%	4.3%
2009F	68.4%	1.9%	25.2%	4.5%
2010F	68.6%	1.9%	24.6%	4.9%
Year	1/ $\frac{\text{Working Capital}}{\text{Revenue}}$	+ $\frac{\text{Net PPE}}{\text{Revenue}}$	+ $\frac{\text{Other Assets}}{\text{Revenue}}$	= Capital Turnover
2006A	0.3	0.1	0.1	2.2
2007A	0.2	0.1	0.2	2.1
2008A	0.2	0.1	0.1	2.3
2009F	0.2	0.1	0.1	2.2
2010F	0.2	0.1	0.1	2.3
Year	Operating Margin	x Capital Turnover	x Cash Tax Rate	= After-tax Return on Inv. Capital
2006A	6.6%	2.2	72.6%	10.7%
2007A	4.4%	2.1	75.8%	7.0%
2008A	4.3%	2.3	82.9%	8.1%
2009F	4.5%	2.2	60.3%	6.0%
2010F	4.9%	2.3	75.0%	8.6%

Source: Company data; KGI Securities estimates