

ISDN Ltd

20 Aug 2008

Business outlook remains positive

Snapshot		P&L				Key ratios (FY08F)	
Recommendation	Buy	(Y/E Dec)	FY2006	FY2007	FY2008F	PER	10.8x
Current Price	S\$0.595	Revenue (\$m)	74.5	102.9	123.4	P/BV	2.2x
Target Price	S\$0.68	EBIT	8.1	8.5	11.0	Div yield	5.4%
No of Shares	196.2m	Earnings	6.2	5.6	10.8	ROE	21%
Market Cap	S\$110m	EPS (Scts)	4.2	3.0	5.5	Net gearing	Cash
Year Hi/Lo	S\$0.63/0.37	EPS growth (%)	10.2	-20.5	90.6	Current ratio	1.6x

Source: SIAS Research, Bloomberg

1H08 Results

- ISDN unveiled a good set of 1H08 results with net profit of S\$4.4m rising 71% from the same period last year on the back of higher revenue. Some of the growth came from the contribution from newly acquired Dirak (ISDN owns 49% shares). We expect the company is on track to fulfill our full year target of S\$9.9m with a stronger second half.

S\$m	1H 07	2H 07	1H 08
Revenue	43.3	59.6	57.4
Cost of sales	(31.5)	(44.5)	(41.1)
Gross profit	11.7	15.1	16.4
Distribution costs	(1.3)	(1.3)	(1.6)
Admin Exp	(6.6)	(8.4)	(8.4)
Other Exp	(0.4)	(0.4)	(0.5)
Operating Profit	4.2	5.1	6.3
Finance costs	(0.2)	(0.2)	(0.2)
Other Income	0.7	0.1	0.5
Associate income	0.1	0.0	0.0
Tax payable	(0.8)	(1.0)	(1.1)
Minorities	(0.7)	(0.7)	(0.7)
Net profit	2.6	3.2	4.4

Source: Company, SIAS Research

* Net profit after minority interests

- ISDN continues to build a brand in the high-end motion control and industrial computing market in China. Despite the credit tightening, it achieved a 33% increase in revenue to S\$57.4m. Meanwhile, its gross margin and operation margin are well supported at 28.5% and 11% respectively, at the high end of the historical range.

Project Update

- Fits well with China's Industrial Modernization:** ISDN is able to shield away from the negative business environment right now in China, induced by high inflation, weaker consumer demand and shrinking export. In fact, ISDN thrives on China's transition from low-cost business model to industrial modernization. The Chinese government has encouraged business investment to the industries that can improve energy and resource use efficiency as well as labor productivity. This means many factories will upgrade their operating system and this is where ISDN's motion control and industrial computing solutions can help.
- Olympic Showcase:** On 8th August 2008, China opened the most expensive Olympics in history with a mix of traditional performance and technological wizardry designed to showcase the country's transition into a modern powerhouse. ISDN's Maxonmotor products helped behind the scene, from precisely welding a mass of latticed steel structure of the giant bird's nest to flawlessly controlling hundreds of projectors to generate a smooth visual effect of a giant rolling picture.
- Diversification Reaped Benefits:** ISDN has distinguished itself in the high-end industrial market segment in China. The company has diversified into health, energy and offshore marine industries, where it is less affected by the risks related with semi-conductor cycles.

- In 1H08, ISDN delivered 30 units of motion control systems for China's East-West Gas Pipeline Project. Follow-up orders worth RMB151m should come in the next few years.
- The ambitious East-West Gas Pipeline Project, when completed, will transport clean fuel from Xinjiang to energy-hungry Yangtze River Delta. ISDN will provide automated welding equipment that provides cutting, welding and cleaning functions used in constructing pipelines.

Recent Events

- ISDN is reaping decent reward for its China expansion with 52 sales offices across the country. To further strengthen its footprint in China, the group is in process of building an ISDN Industrial Park in a strategic location in Wujiang, within hours to Shanghai and Suzhou by car.
- The 840-acre piece of land of is acquired "at a very good price", according to Mr. Teo, Managing Director of ISDN. When construction of the industrial property is completed in 2010, rental income will start to contribute to the bottom line, together with cost savings from consolidating manufacturing bases.
- We mentioned in our previous report that more news could come from the M&A front in 2008. In June, ISDN concluded the acquisition of 61.2% stake in TDS Technology at a cost of S\$3.5m. A one year profit guarantee of S\$1m is served

for this deal. The acquisition of TDS is expected to benefit ISDN to deepen its presence in industrial control and factory automation market.

Forecast & Recommendation

- ISDN has uncovered attractive opportunities from China's economic transformation and industrial modernisation process. It is now aggressively building up its presence in other industries and countries. New initiatives include new product offering to Auto industries and a possible entrance to the India market.
- In view of its positive revenue outlook and margin strengthening, we adjusted upward our FY08 forecasted earnings to S\$10.8m from previously S\$9.9m, based on a full year gross margin of 27%. A target price of 68 cents is arrived based on the same PE multiple of 12.5x used before.
- Downside risk could come from severe economic slowdown in China. However, we don't see it happening in 2H08. On Aug. 1, Chinese President Hu Jintao said at a news briefing that the government will work to maintain economic growth, shifting from its previous focus on inflation control.
- Recommend **Buy** for this counter, with good support seen at around 50-52 cents. **(JESSY XIA)**

Financial Table and Ratios

(Y/E Dec)	FY05	FY06	FY07	FY08F
Profit & Loss (\$m)				
Turnover	54.9	74.5	102.9	123.4
EBITDA	6.0	8.6	9.1	12.0
Pretax	7.5	8.6	8.9	13.4
Earnings	6.0	6.6	5.7	10.8
EPS (fully diluted - Sts)	3.8	4.2	3.1	5.5
EPS (fully diluted - Scts)	3.8	4.2	3.1	5.5
Balance Sheet (\$m)				
Long Term Assets	7.0	8.5	10.3	25.1
Current Assets	33.3	38.5	56.7	59.5
Current Liabilities	19.6	19.9	26.8	37.2
Long Term Liabilities	1.4	2.4	1.3	3.1
Total Equity	18.9	24.6	39.1	47.9
Cash Flow (\$m)				
Operating Cash Flow	2.2	2.8	2.8	2.1
Investing Cash Flow	4.9	(3.3)	(2.5)	(9.0)
Financing Cash Flow	4.8	(4.1)	7.0	3.1
Financial Ratios				
Revenue Growth (%)	2.6	35.8	38.0	20.0
Operating Profit Growth (%)	(11.9)	43.8	6.0	31.0
Earnings Growth (%)	0.4	10.2	(14.3)	90.6
EPS Growth (%)	(16.7)	10.2	(25.5)	77.6
EBITDA Margin (%)	10.9	11.6	8.9	9.7
Net Margin (%)	10.9	8.9	5.5	8.7
Current Ratio (x)	1.7	1.9	2.1	1.6
Book value per share (\$ cts)	11.9	15.5	21.2	22.8
Net (Debt)/ Cash per share (\$ cts)	4.8	2.8	5.3	0.3
Net Debt / Equity (%)	Cash	Cash	Cash	Cash
Dividend payout ratio (cts)	47.8	48.2	80.8	54.6
Return on Equity (%)	31.7	26.8	14.5	22.5
Return on Asset (%)	14.8	14.0	8.4	12.9
Debtor Days	87.1	73.6	71.4	76.7
Creditor Days	64.1	65.2	61.8	58.7
Inventory Days	72.0	86.4	81.6	81.1
Cash Conversion Cycle	95.0	94.8	91.2	99.1
Valuations				
Price to sales (x)	1.7	1.3	1.1	0.9
PER (x)	15.8	19.2	19.2	10.8
Price to book (x)	5.0	3.8	2.8	2.2
Dividend Yield (%)	3.0	3.4	4.2	5.0

Source: Company, SIAS Research

About the Company

ISDN is a mechatronics engineering group that provides integrated solutions to motion control and industrial computing customers, including design, customisation, assembly installation and after sales support. ISDN strives to be a one-stop services provider of component parts for their motion control and industrial computing customers. ISDN has a customer base of more than 2,000 customers and are not overly dependent on any single customer. ISDN has long-standing relationship with Maxon Motor AG. The tie-ups with Maxon include the exclusive distributorship agreement in the region (Singapore, Hong Kong, Thailand, Malaysia, the Philippines and Indonesia) and the PRC JVs. The company also has set up 52 offices in PRC to facilitate the servicing customers in this region. Dirak Asia was included in the group as an associate in Jan 08.

Price and Volume Chart



Source: Bloomberg

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