

ISDN Holdings Ltd

07 Dec 2007

Acquisition to boost FY08 Results

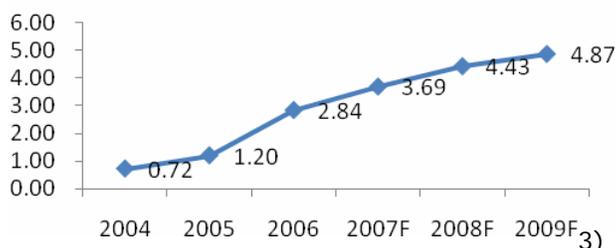
Snapshot		P&L				Key ratios (FY08F)		
Recommendation	Buy	(Y/E Dec)	FY05	FY06	FY07F	FY08F	PER	10.13x
Current Price	S\$0.495	Sales (S\$m)	54.9	66.6	90.9	111.8	P/BV	1.80x
Target Price	S\$0.59	Gross profit	16.8	19.7	24.2	29.6	Div yield	3.7%
No of Shares	182.8m	Earnings	5.9	6.2	6.2	9.7	ROE	20.6%
Market Cap	S\$90..5m	EPS (Scts)	3.8	3.9	3.41	4.94	Gearing	Cash
Year Hi/Lo	S\$0.60/0.38	EPS growth %	(16.7)	4.7	(13.65)	44.87	Current ratio	1.7x

Source: SIAS Research, Bloomberg

Event Updates-Acquisition of Dirak Asia

- As a follow up to our previous report, we had a conference call with ISDN management recently. During the meeting, the management elaborated on several possible synergies regarding the acquisition of Dirak, which is pending SGX and shareholders' approval.

Dirak Asia Pte Ltd
 Net Profit After Tax (SGD m)



- Background of Dirak:** Dirak is jointly founded in 1991 by Mr. Teo, also MD & President of ISDN, and a German partner, with its main products (hinges and locks) serving the high-end industrial enclosure market. Its manufacturing facility is in China and serves mainly the China market. Since 2004, the company has seen faster earnings growth with CAGR above 50%. According to the management, Dirak is well positioned to continue to grow at 30-50% in the next few years. ISDN intends to acquire 49% of the equity stake in Dirak. Once approved, the deal will have a significant impact on ISDN's book in FY08.

Possible Synergies

- Compatible Organization Structure:** With Mr. Teo heading both companies, implementation of the deal should be a smooth process and operational synergy should be easier to realize.
- Overlap of Industry and Customers:** There is great potential for cross-selling, as the two companies enjoy certain degree of overlapping customers. Dirak's popularity with its Chinese customers in the automobile industry should benefit ISDN, as motion control products are used in the automobile industry. This suits ISDN's strategy of diversifying its industry base. At the same time, Dirak can tap on ISDN's extensive distribution network to boost its industrial lock sales.
- Diversification of Industry and customer Base:** Following this acquisition, ISDN's income base will be further diversified, with FY08 earnings contribution from semiconductor industry declining from 40% to 22%. The risk of over-dependence on the semiconductor industry will be greatly mitigated.
- Contribution to the Bottom-line:** Management is upbeat about the future of Dirak. As proof of his confidence, Mr. Teo has given a personal profit guarantee that the combined FY07/08 profit of Dirak will not be less than S\$7m. We expect Dirak to play a big role in lifting profitability and forecast its net profit after tax to be S\$4.43m in FY08.

Key Risks

- **Possible Global Economic Slowdown in FY08:** The Chinese economy will grow 10.8% in 2008 even on the back of a slowdown in US economy, as forecasted by Asian Development Bank. However, if the US slowdown turns out to be a recession, then it could be a turning point for the Chinese economy. We are cautiously optimistic about ISDN in FY08, given the uncertain global economic outlook which will affect revenue visibility.
- **Competitive Pressure:** As an industrial service provider, ISDN's gross margin in recent years has gradually edged down from 30% to 26%, which translated into a reduction of ROE from 30% to only 15% in 1H07. The acquisition came just in time to lift up the depressed ROE and we believe the high-tech advantage in its product solutions will make the gross margin somewhat resilient to further deterioration. We expect the core business to maintain its gross margin at FY07 level. However, there is a risk that margins may deteriorate further due to an escalation in competition and higher business costs.
- The picture may not seem rosier in the top-line either. Sales in China have been growing in double digit numbers. But the growth rate could normalize in a couple of years in reflection of a more competitive environment. The company may face challenges from both top-line and bottom-line when Chinese players catch up with the technology gap.

Valuation & Recommendation

- **Valuation:** We have revised upwards our revenue forecasts for FY08 to S\$111.8m to reflect the synergy brought by Dirak in FY08. We have also lifted up FY08 earnings from S\$8.3m to S\$9.7m to factor in Dirak's contribution. Hence, EPS forecast rises from 3.41 cents to 4.94 cents, which shows the dilution due to the issue of new shares for the acquisition is more than offset by Dirak's earnings contribution.
- **Recommendation:** To capture the value of synergy from the acquisition of Dirak, we raise base PER from 11 to 12. Accordingly our one-year target price climbs to 59 cents from 50 cents. Upgrade from Hold to **Trading Buy**. (SIAS Research)

Financial Table and Ratios

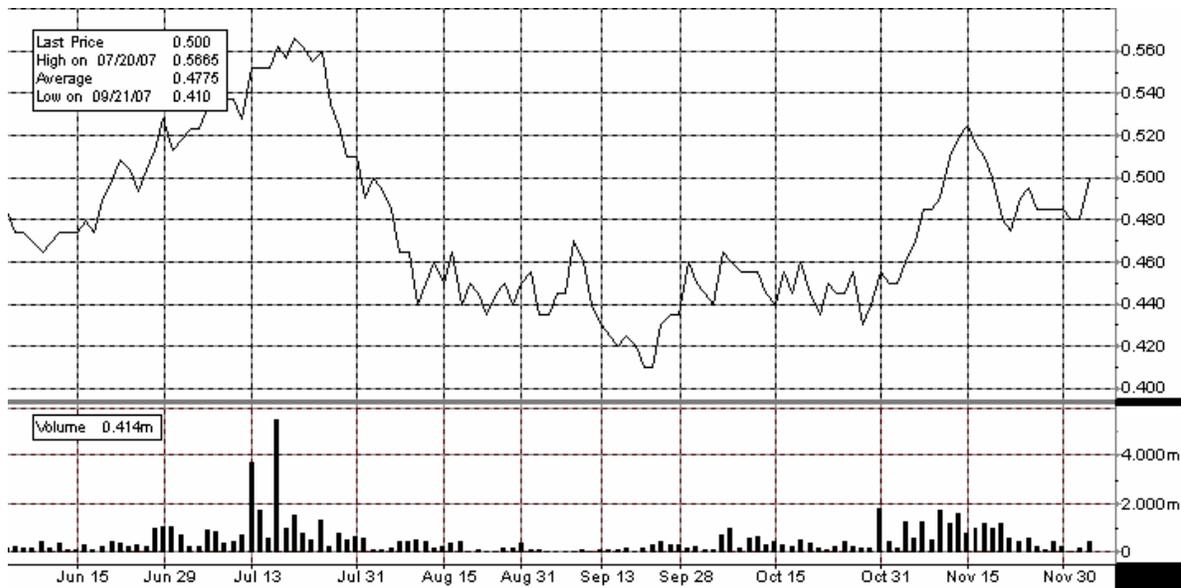
(Y/E Dec)	FY05	FY06	FY07F	FY08F
Profit & Loss (\$m)				
Turnover	54.9	66.6	90.9	111.8
EBITDA	6.0	6.7	7.8	9.3
Pretax	7.5	7.6	8.5	10.7
Earnings	6.0	6.3	6.2	9.7
EPS (fully diluted - Sts)	3.8	3.9	3.4	4.9
EPS (fully diluted - Scts)	3.8	3.9	3.4	4.9
Balance Sheet (\$m)				
Long Term Assets	7.0	10.0	22.0	36.8
Current Assets	33.3	32.6	48.4	53.9
Current Liabilities	19.6	17.3	26.9	33.1
Long Term Liabilities	1.4	2.4	2.6	3.1
Total Equity	18.9	22.9	41.0	52.3
Cash Flow (\$m)				
Operating Cash Flow	2.2	1.8	0.7	3.3
Investing Cash Flow	4.9	(2.7)	(8.5)	(9.0)
Financing Cash Flow	4.8	(3.4)	12.7	2.5
Financial Ratios				
Revenue Growth (%)	2.6	21.4	36.5	23.0
Operating Profit Growth (%)	(11.9)	12.0	16.1	18.9
Earnings Growth (%)	0.4	4.7	(0.6)	55.5
EPS Growth (%)	(16.7)	4.7	(13.6)	44.9
EBITDA Margin (%)	10.9	10.1	8.6	8.3
Net Margin (%)	10.9	9.4	6.9	8.7
Current Ratio (x)	1.7	1.9	1.8	1.6
Book value per share (S\$ cts)	11.9	14.4	22.4	27.8
Net (Debt)/ Cash per share (S\$ cts)	4.8	1.3	2.0	(0.4)
Net Debt / Equity (%)	Cash	Cash	Cash	1.5
Dividend payout ratio (cts)	47.8	46.4	53.7	37.1
Return on Equity (%)	31.7	27.4	15.2	18.5
Return on Asset (%)	14.8	14.7	8.8	10.7
Debtor Days	87.1	74.3	72.5	76.7
Creditor Days	64.1	58.7	62.9	58.7
Inventory Days	72.0	81.1	87.5	81.1
Cash Conversion Cycle	95.0	96.7	97.1	99.1
Valuations				
Price to sales (x)	1.4	1.2	1.0	0.9
PER (x)	13.3	14.7	14.7	10.1
Price to book (x)	4.2	3.5	2.2	1.8
Dividend Yield (%)	3.6	3.7	3.7	3.7

Source: Company, SIAS Research

About the Company

ISDN is an engineering group that provides integrated solutions in motion control and industrial computing. Activities include 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 3,000 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 and Taiwan JVs. The company also has set up office coverage in the region and PRC to facilitate the servicing of customers in a wide geography.

Price and Volume Chart



Source: Bloomberg

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