

## Singapore

5 January 2006

Share Price	S\$0.30
Target Price	S\$0.41
Upside Potential	36.7%
Recommendation	BUY

### Report type

Initiating Coverage

### Company ticker

Bloomberg: ISDN SP

### Sector

Mechatronics

### Company website

[www.isdnholdings.com](http://www.isdnholdings.com)

### Major shareholders

Teo Cher Koon 68.7%

### Share data

SGX Mainboard	
Share Cap :	158.8m shares
Market Cap:	S\$47.6m
Free Float	30%

### Analyst

Westcomb Research Team

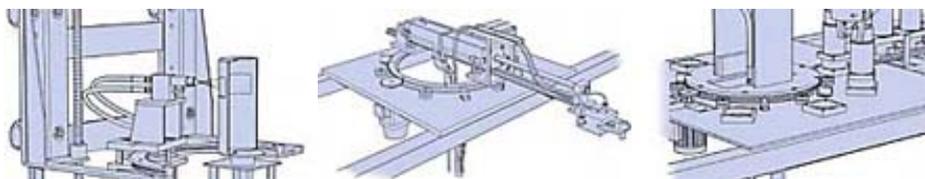
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## Upward motion in good control



- **Recovery of semiconductor industry**

The semiconductor industry experienced a trough that commenced from the second half of 2004. Recent industry data and optimism of industry participants signal that the semiconductor industry is currently in its recovery phase. The industry is expected to be boosted by the increasing digitisation and memory needs of the consumer electronics products, and also by the increasing domestic demand of electronics by fast growing populous economies such as the PRC, India, etc. From FY02 to FY04, the semiconductor industry contributed 42.2%, 51.0% and 46.6% to ISDN's total revenue respectively.

- **Extensive geographical sales network**

ISDN (subsidiaries, JVs, associates) have sales offices that extend to most of PRC's major cities, such as Shanghai, Beijing, Suzhou, Chongqing, Shenzhen, Mianyang, Shenyang, Xi'an, Harbin, Fuzhou, Chengdu, Guangzhou and Wuhan. ISDN also has sales exposure in Singapore, Hong Kong, Thailand, Malaysia and the Philippines. ISDN's wide business network enables them to be in close proximity to their customers, thereby enabling ISDN to provide timely and cost-effective services to their customers

- **Increased outsourcing of manufacturing to low-cost countries**

There is an increasing trend towards re-location of manufacturing to low-cost countries such as the PRC. This is even more so for the electronics industry with many OEMs moving their manufacturing facilities to such countries to capitalise on the low cost of labour, and also to cater to the rapidly growing domestic markets. These new manufacturing facilities require manufacturing equipment, many of which require motion control functions.

- **Fast diversifying income base**

ISDN's income base is fast diversifying due to the high growth of the general automation business in PRC. In FY03, the general automation segment accounted for 19.8% of total revenue. This increased to 31.3% of total revenue in FY04. The contribution from general automation is expected to continue its increase with the explosive growth of ISDN's sales in the PRC market. The general automation segment is very diverse and includes the medical, automotive, security, aviation, power tools, robotics, printing, oil & gas, and food & beverage sectors.

- **Ability to service both the mass market and the high-end niche market**  
ISDN's engineering expertise and close relationships with suppliers (in particular, Maxon Motor Ag) provides ISDN with a wide repertoire of technical abilities and motion control products that service both the mass market and the more valuable high-end niche market
- **Expand upstream into components manufacturing**  
ISDN recently announced the establishment of the Eisele JV, with German firm Eisele Antriebstechnik GmbH, for the manufacture of gearboxes in the PRC. This will enable ISDN to move up the value chain and improve its margins. ISDN is constantly on the lookout for more JVs to further improve their technical and manufacturing capabilities.

#### **Recommendation.**

- We are of the view that prospects for the Group will improve from FY06 onwards: net profit should remain flat in FY05, but we see double-digit growth in FY06 and FY07.
- Key risks include cyclical nature of the semiconductor industry, intense competition, and over-dependence on suppliers.
- We have valued ISDN at S\$0.41, equivalent to an undemanding 9x FY06 PER.

#### **Valuation & Forecast**

##### **Comparison to Peers**

There is no direct comparable listed on the SGX. Our valuation will be benchmarked against other service providers to the semiconductor industry. These companies trade at an average historical PER of 9x, current PER of 8.3x and P/B of 1.6x. We have valued ISDN at the target price of 41 cts, which is at an undemanding 9x FY06 PER. Assuming 50% of FY05 net profit is given out as dividends, the dividend yield for ISDN at the current market price of 30 cts could be at the very attractive rate of approximately 6.1%.

Company	Business	FY	Market Cap (\$M)	Hist. PER (x)	Est. PER (x)	P/B (x)	ROE (%)
<b>ISDN</b>	<i>Motion Control</i>	12/04	47.6	6.8	6.9	2.8	40.6
<b>Micro Mechanics</b>	Provide precision tools, assemblies and consumable products for semiconductor industry	06/05	58.2	10.7	8.4	2.1	18.6
<b>Ellipsiz</b>	Services foundry for wafer fabs	06/05	84.4	7.3	8.1	1.0	14.4

Source: Bloomberg and Westcomb estimates

### Forecasts

Revenue and net profit are expected to remain relatively flat in FY05 but grow in double digits in FY06 and FY07. FY05 was characterised by a slow semiconductor sector that is expected to affect the sales of the Group. We expect the slower sales to the semiconductor industry in FY05 to be mostly offset by strong growth in sales to other industries in the PRC.

The IPO proceeds and cash generated from operations should be more than sufficient for the Group's expansion in the near term. Notwithstanding any major investments or acquisitions, we expect the Group to be net cash as at end FY05 and FY06.

### Financial Ratios

Financial Ratios						
Year end: 31 Dec	2002A	2003A	2004A	2005F	2006F	2007F
<b>Per Share Data</b>						
Revenue/share (Sing cts)	16.2	29.6	40.6	40.2	41.5	50.2
EPS (Sing cts)	1.1	2.4	4.4	4.3	4.6	5.3
EPS (growth)	nm	104.8%	86.6%	-1.5%	5.5%	17.2%
NTA/share (Sing cts)	na	na	10.0	15.5	17.5	20.9
<b>Valuation</b>						
P/revenue (x)	1.9	1.0	0.7	0.7	0.7	0.6
PER(x)	26.1	12.8	6.8	6.9	6.6	5.6
P/NTA (x)	na	na	3.0	1.9	1.7	1.4
PEG (x)	na	0.1	0.1	-4.8	1.2	0.3
Net gearing (x)	na	na	net cash	net cash	net cash	net cash
Return on Equity (%)	na	na	40.6%	28.5%	25.2%	24.9%
Return on Assets (%)	na	na	27.8%	23.1%	22.9%	23.4%
<b>Growth Rates (%)</b>						
Revenue	na	83.1%	37.1%	1.2%	21.9%	20.8%
Gross profit	na	59.3%	44.4%	4.3%	20.4%	17.8%
Operating profit	na	109.5%	91.7%	-7.8%	24.9%	17.6%
Pre-tax profit	na	110.4%	90.7%	1.5%	25.8%	18.2%
Net profit	na	104.8%	86.6%	0.6%	24.6%	17.2%
<b>Margins (%)</b>						
Gross margin	30.3%	26.3%	27.7%	28.6%	28.3%	27.5%
Operating margin	8.2%	9.4%	13.1%	11.9%	12.2%	11.9%
Pre-tax margin	8.4%	9.6%	13.4%	13.4%	13.8%	13.5%
Net margin	7.1%	7.9%	10.8%	10.7%	11.0%	10.7%

## Earnings Forecast

Profit & Loss (\$\$ m)						
Year end: 31 Dec	2002A	2003A	2004A	2005F	2006F	2007F
<b>Revenue</b>	21.30	39.00	53.46	54.10	65.95	79.67
<b>Cost of sales</b>	14.85	28.73	38.62	38.62	47.31	57.72
<b>Gross profit</b>	6.45	10.27	14.83	15.48	18.63	21.94
<b>Operating expenses</b>	5.13	6.97	8.34	9.47	11.07	13.01
Selling & dist	0.82	1.11	1.29	1.41	1.84	2.39
Admin expense	3.97	5.39	6.04	7.45	8.56	9.85
Other operating expenses	0.34	0.47	1.01	0.61	0.67	0.77
Other operating income	0.42	0.35	0.51	0.45	0.50	0.55
<b>Operating profit</b>	1.74	3.65	7.01	6.46	8.07	9.48
Net interest	(0.07)	(0.09)	(0.09)	(0.03)	0.02	0.06
Associate income	0.11	0.18	0.22	0.87	1.11	1.33
<b>Pre-tax profit</b>	1.78	3.74	7.14	7.24	9.11	10.77
Income tax	0.26	0.69	1.27	1.34	1.73	2.10
MI	(0.01)	0.04	(0.09)	(0.09)	(0.14)	(0.18)
<b>Net Profit</b>	1.51	3.10	5.78	5.81	7.24	8.49
<b>EPS (Sing cts)</b>	1.15	2.35	4.39	4.32	4.56	5.35
<b>EPS growth (%)</b>	0.0%	104.8%	86.6%	-1.5%	5.5%	17.2%

## Balance Sheet

Balance Sheet (\$\$ m)				
Year End: 31 Dec	2004A	2005F	2006F	2007F
<b>Total non-current assets</b>	5.8	6.6	8.2	9.1
Plant and Equipment	4.1	3.9	4.3	4.3
Investment in associates	1.1	2.0	3.1	4.0
Investment property	0.7	0.7	0.7	0.7
Goodwill	0.0	0.1	0.1	0.1
<b>Current assets</b>				
Inventories	5.6	12.7	15.6	19.0
Trade receivables	8.2	8.9	10.8	13.1
Other receivables	0.6	0.6	0.7	0.9
Cash and cash equivalents	5.7	8.7	7.3	7.8
<b>Total current assets</b>	20.2	30.9	34.5	40.8
<b>Total assets</b>	26.0	37.6	42.7	49.9
<b>Current liabilities</b>				
Trade payables	4.9	4.9	6.0	7.3
Other payables	1.6	1.6	1.9	2.4
Income tax payable	1.8	1.8	1.8	1.8
Interest bearing loans	1.2	1.2	0.8	0.5
Trust Receipts	0.8	0.0	0.0	0.0
<b>Current liabilities</b>	10.3	9.4	10.5	12.0
<b>Non-current liabilities</b>				
Deferred tax liabilities	0.0	0.0	0.0	0.0
Finance leases	0.0	0.0	0.0	0.0
Loans	1.2	1.2	0.8	0.5
<b>Total non-current liabilities</b>	1.3	1.3	0.8	0.5
Minority Interest	0.2	0.3	0.4	0.6
<b>Shareholders funds</b>	14.2	26.6	30.9	37.2

## Cash Flow

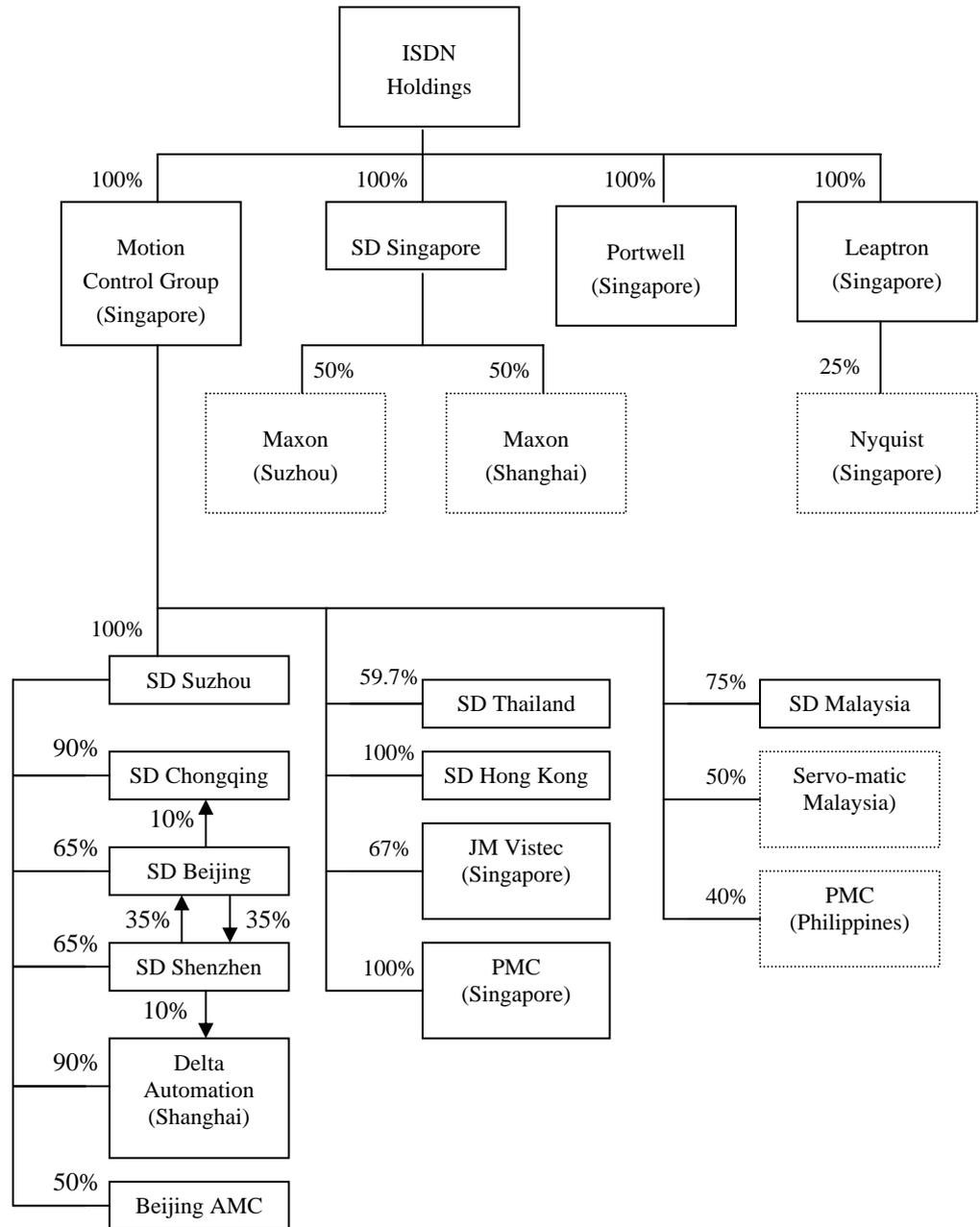
Cash flow Statement (S\$ m)				
Year End: 31 Dec	2004A	2005F	2006F	2007F
<b>Cash flow from Operating Activities</b>	2.39	(2.03)	3.61	4.13
Pretax profit	7.14	7.24	9.11	10.77
Adjustments for:				
Depreciation	0.32	0.38	0.46	0.46
Interest expense	0.09	0.08	0.06	0.05
Interest income	(0.00)	(0.06)	(0.08)	(0.10)
Associate income	(0.22)	(0.87)	(1.11)	(1.33)
<b>Operating cash flow bef working cap change</b>	7.32	6.78	8.44	9.84
<b>Changes in working capital</b>	(4.63)	(7.77)	(3.48)	(4.09)
Trade & other receivables(prioryr-curr yr)	4.37	(0.63)	(2.08)	(2.41)
Inventories	(1.54)	(7.09)	(2.86)	(3.42)
Trade & other Payables(curr yr- prior yr)	(7.46)	(0.04)	1.45	1.74
<b>Cash generated from operations</b>	2.69	(0.99)	4.96	5.75
Dividend from associate	0.12	0.38	0.45	0.53
Income tax paid	(0.32)	(1.34)	(1.73)	(2.10)
Interest Expense	(0.09)	(0.08)	(0.06)	(0.05)
<b>Net cash generated fr operations</b>	2.39	(2.03)	3.61	4.13
<b>Cash flow from Investing Activities</b>	(0.20)	(0.64)	(1.28)	(0.86)
Investment in associate		(0.41)	(0.50)	(0.50)
Investment in subsidiary		(0.10)		
Capex-purchase fixed assets	(0.20)	(0.19)	(0.86)	(0.46)
Interest received	0.00	0.06	0.08	0.10
<b>Cash flow from Financing Activities</b>	1.57	5.66	(3.70)	(2.77)
Investments by Minority Shareholders	0.05			
Finance lease	(0.03)	(0.05)		
Bank loan	0.65		(0.80)	(0.60)
Trust receipts	0.79			
Net proceeds from issuance of capital		6.50		
Proceeds from issue of paid-up capital of companies of the Pro-forma Group	0.11			
Dividends paid			(2.91)	(2.17)
<b>Net effect of exchange rate changes in consolidating subsidiaries</b>	(0.09)			
<b>Net increase in cash and cash equivalent</b>	3.67	2.99	(1.37)	0.50
<b>Cash and cash generated at beginning of year</b>	2.06	5.73	8.72	7.35
<b>Cash and cash equivalent at end of year</b>	5.73	8.72	7.35	7.85

## What it does

### *ISDN - Chronology*

- Servo Dynamics commenced business in 1987 with the distribution of servo motors from Baldor Electric Company (a USA based company) and selling them to universities and polytechnics in Singapore for use as teaching aids. The Company started with 3 employees with Teo Cher Koon helming as the Managing Director.
- In 1989, the Company established relationships with various international suppliers of motion control components, distributing their products to the domestic market, and subsequently to the regional markets. At that time, the semiconductor industry was booming in the region.
- In 1990, SD Malaysia was incorporated to cater to the Malaysian market. The same year also saw the signing of an exclusive distribution agreement with Swiss Company, Maxon Motor.
- In 1992, the Company expanded business operations to assemble and provide industrial computers to various industries.
- SD Hong Kong and Maxon Suzhou were incorporated in 1995 to cater to the Greater China markets. In the following year, Interelectric AG (parent Company of Maxon Motor) invested in Maxon Suzhou, which became an assembly facility for the supply of motion control systems containing "Maxon Motor" motion control components.
- In 1997, Portwell was incorporated to provide system integration solutions for industrial computing solutions. A distribution agreement was also signed with the Wonderware Corporation to distribute the "Wonderware" software.
- In 1998, SD Thailand was incorporated to cater to the Thailand market.
- In 2001, SD Suzhou was incorporated to cater to the China market. SD Suzhou focused on the supply of motion control systems to the growing China Market.
- Leaptron was incorporated in Singapore in 2002 to distribute and integrate machine vision control systems. In the following year, Leaptron entered into an agreement with Dutch Company, Nyquist B.V. to form the associate company Nyquist to market, distribute and provide technical support for Nyquist B.V.'s robot control system products.
- To facilitate operations in China, SD Shenzhen (2002), SD Beijing (2002), SD Chongqing (2003), Maxon Shanghai (2004), Delta Automation (2004) and Beijing AMC (2005) were set up simultaneously in the space of four years.
- In 2005, SD Shenzhen, SD Beijing, SD Chongqing and Delta Automation became wholly-owned subsidiaries of the Group. In 2005, the Group invested in PMC Philippines (trading of goods, such as electro-mechanical equipment and accessories installation on wholesale basis) and JM Vistec (supply of vision related products and industrial automation solutions).

*Group Structure*



\* Companies enclosed in dotted boxes are treated as associate companies

### **Business Profile**

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.

#### Motion Control

ISDN designs and assembles major electro-mechanical functional modules for motion control (control of object movement) in a wide range of industries including, semiconductor, general automation, manufacturing and hard disk drive industries. These functional modules are used in the manufacture of equipment such as SMT machines, wafer processing machines, X-ray machines, industrial robots and hard disk drive testing machines, etc.

Components used in these functional modules include positioning systems (various motors and drives, gears, ballscrew systems, couplers, pulley systems, actuators, linear motion guides, etc), machine-man interfaces (PLCs, touch screen monitors, industrial computing systems), and motion controllers.

#### Industrial computing

ISDN customises, assembles and installs integrated hardware and software solutions to meet the industrial computing needs of a wide range of industries including, semiconductor, general automation, manufacturing and hard disk drive industries. These solutions are sold mostly to manufacturers of factory automation systems that cater to these various industries.

Products and services offered include customisation and assembly of the industrial computers (hardware), distribution of the "Wonderware" software programme (fully integrated suite of software for industrial automation); and system integration services.

### **Major Customers**

ISDN has a customer base of more than 2,000 customers and are not overly dependent on any single customer. Listed below are the few customers that accounted for more than 5% of ISDN's total annual revenue in the past three years.

Major Customers	Percentage of Group's revenue (%)		
	FY2002	FY2003	FY2004
ASM Asia Ltd <sup>1</sup>	2.2	6.1	7.7
ASM Technology Singapore Pte Ltd <sup>1</sup>	5.0	7.1	4.1
Ever Technologies Pte Ltd <sup>2</sup>	3.2	8.6	7.2
Norelco Centreline Pte Ltd <sup>3</sup>	3.7	7.0	5.8

<sup>1</sup> ASM Asia Ltd and ASM Technology Singapore Pte Ltd are wholly-owned by ASM Pacific Technologies Ltd (listed on the Hong Kong Stock Exchange), which in turn is majority held by ASM International N.V. (listed on NASDAQ and Euronext Stock Exchange). ASM International N.V. is a supplier of semiconductor process equipment.

<sup>2</sup> Ever Technologies Pte Ltd is a subsidiary of AEM-Evertch Holdings Ltd (listed on SGX) which is engaged in the design and manufacture of automated equipment and parts used in the semiconductor manufacturing process.

<sup>3</sup> Norelco Centreline Pte Ltd is a subsidiary of Norelco UMS Holdings Ltd (listed on SGX) and is a contract equipment manufacturer engaged mainly in the manufacture of precision machining component, assembly and integration of equipment and automated assembly lines mainly for hard disk drive manufacturers and semiconductor equipment manufacturers.

**Major Suppliers**

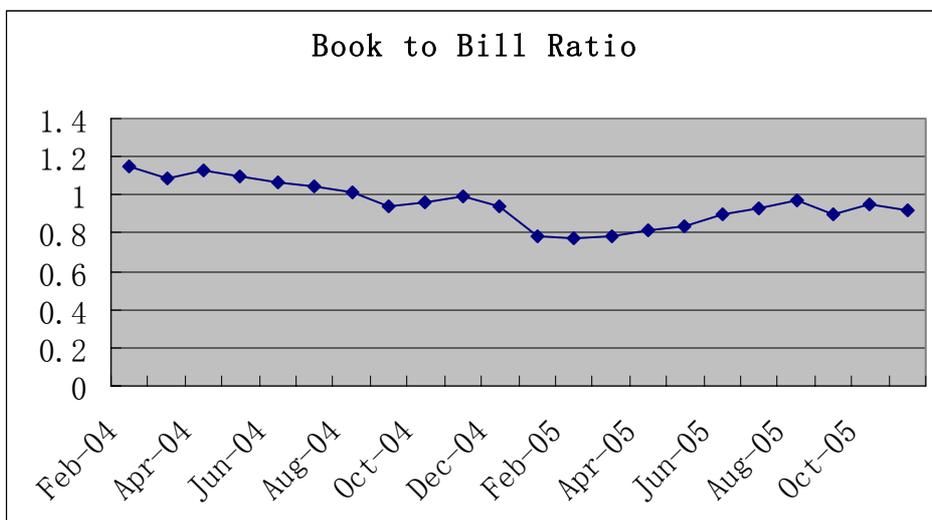
Major Suppliers	Supplies	Percentage of Group's purchases (%)		
		FY2002	FY2003	FY2004
Maxon Motor Ag	Motors, drives	11.2	11.8	11.1
Copley Controls Corporation	Power amplifiers, high performance motion control components	3.9	7.8	7.4
Pacific Scientific	Motors, drives	6.2	5.8	4.4
W. Schneeberger Ag	Linear technology products	8.3	7.8	2.1
Yaskawa Electric (Singapore) Pte Ltd	Motors, drives, controllers	5.8	5.6	7.2

**Seasonality**

ISDN generally experience higher sales in the second half of the FY as customers in North Asia tend to place orders during this period. Revenue in the second half as compared to the first half was 23.1% higher and 53.1% higher in FY02 and FY03 respectively. FY04 was an anomaly due to the slow down of the semiconductor industry in the second half of the FY which resulted in the first half revenue being 13.5% higher than the corresponding second half revenue.

**Industry**

Semiconductor Equipment



Source: Semi Press Releases

The semiconductor industry is characterised by short cycles. In the second half of 2003 and first half of 2004, the industry was booming and this led to increased capital expenditure by industry participants. In the second half of 2004, the industry started to slow and for the first time in many months, the book-to-bill ratio went below one in September 2004. The book-to-bill ratio has stayed below one since then but appears to be improving in recent months. Our checks with semiconductor equipment makers also give indications that the industry is slowly picking up, but the improvement is gradual.

### *Outsourcing of manufacturing to low cost countries*

The trend towards re-location of manufacturing to low-cost countries (such as the PRC) remains rampant. This is even more so for the electronics industry with many OEMs moving their manufacturing facilities to such countries to capitalise on the low cost of labour, and also to cater to the rapidly growing domestic markets. These new manufacturing facilities require manufacturing equipment, many of which require motion control functions.

According to the 2005 World Population Data Sheet<sup>1</sup>, the total population of World's more developed countries stood at 1.2 billion in mid-2005. This compares to the combined PRC and India population of 2.4 billion at that time. One can imagine the extent of growth if the output/person in these less developed countries eventually reach or better that of today's more developed nations. Domestic demand for goods in these countries is expected to rise with rising income levels.

## **Competitive Strengths**

### ***Strong design and development capabilities***

The strong team of 46 technical engineers (as at the latest practicable date) enables ISDN to develop customised solutions (often with a high degree of sophistication) to satisfy their customers' special needs.

### ***Tie-ups with Maxon Motor Ag***

Maxon Motor Ag is one of the leading global suppliers of high-tech drive components and systems. Maxon Motor Ag manufactures customised and high precision motors. Its credentials include providing NASA with the motor systems used on the NASA Mars Exploration Rover, and which successfully landed on Mars in January 2004. ISDN has a long-standing relationship with Maxon Motor Ag. The tie-ups with Maxon Motor Ag, which include the exclusive distributorship agreement in the region (Singapore, Hong Kong, Thailand, Malaysia, the Philippines and Indonesia) and the PRC JVs, are testament of this relationship.

The benefits drawn from the exclusive Contract and JVs with Maxon Motor are not solely derived from sales of Maxon Motor's motors to ISDN's customers but also from the sales of supplementary items (e.g. other motion control components from other suppliers) that complement the motor in the controls sub-assembly.

### ***Wide geographical sales coverage***

ISDN has established subsidiaries, joint ventures and associated companies in the region (Singapore, Malaysia, Thailand, Philippines and Hong Kong) and PRC cities like Suzhou, Chongqing, Shenzhen, Shanghai and Beijing. The company also has set up business operations in major cities in the PRC such as Mianyang, Shenyang, Xi'an, Harbin, Fuzhou, Chengdu, Guangzhou and Wuhan. ISDN's extensive sales office coverage in the region and PRC facilitates the servicing of customers in a wide geography and allows ISDN to ride on the fast growing manufacturing sector in the PRC.

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<sup>1</sup> Data provided by the Population Reference Bureau.

**Diverse customer base**

As at the Latest Practicable Date, ISDN has a large customer base of more than 2,000 customers from various industries, such as the semiconductor, general automation, manufacturing and hard disk industries. Some of these customers are SMEs, MNCs or government bodies. The diverse customer base which spreads across various industries reduces the risk of exposure to any downturns in any particular industries.

**Competition**

The business per se does not appear to have high barriers to entry as there are many similar players in the market. However, the tie-ups with Maxon Motor Ag do give ISDN access to a more niche, high-end market where there are fewer competitors.

Some of ISDN's competitors include the following:

**Motion Control Division**

Flexible Automation System Ltd.	Hong Kong
Go-well Technology Trading Co.	Hong Kong
Aims Industrial Supply Sdn Bhd	Malaysia
FA Controls Sdn Bhd	Malaysia
Factory Automation Co., Ltd	Thailand
Beijing E-Motion Control Equipment Co. Ltd	PRC
E-Drive System Co. Ltd	PRC
Shanghai Power Automation Device Co. Ltd	PRC
Step Servo (Shenzhen) Ltd	PRC
Elshin International Pte Ltd	Singapore
Plant & Mill Supplies Pte Ltd	Singapore
Ultra Automation Pte Ltd	Singapore

**Industrial Computing Division**

Advantech Co. Singapore Pte Ltd	Singapore
Allied Solutions Pte Ltd	Singapore
Emerson Process Management Asia Pacific Pte Ltd	Singapore

**Results****FY04 Revenue growth of 37.1% and net profit growth of 86.6%****Revenue**

From FY03 to FY04, the Group posted YoY revenue growth of 37.1%, up from S\$39.0 million to S\$53.5 million. Revenue increased in both the motion control segment (up S\$12.4 million) and industrial computing segment (up S\$2 million). The increase in revenue in the motion control segment was mainly due to increased demand in the general automation industry and the strong semiconductor industry in 1H04. The increase in revenue in the industrial computing segment was mainly due to strength in the semiconductor and hard disk drive industries. Sales to North Asia (Hong Kong, PRC), grew by 68.5% (S\$7.65 million), faster as compared to sales growth of 24.0% (S\$6.66 million) in

South Asia.

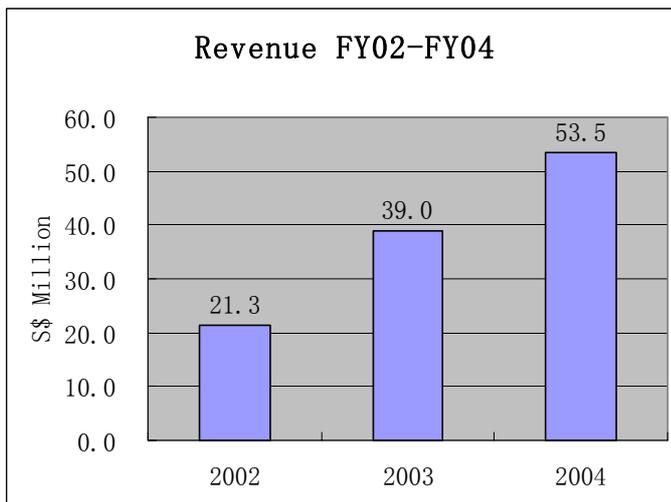
**Gross Profit Margin**

From FY03 to FY04, gross profit margin improved slightly YoY from 26.3% to 27.8%. The improvement was mainly due to better margins from the increased business in North Asia.

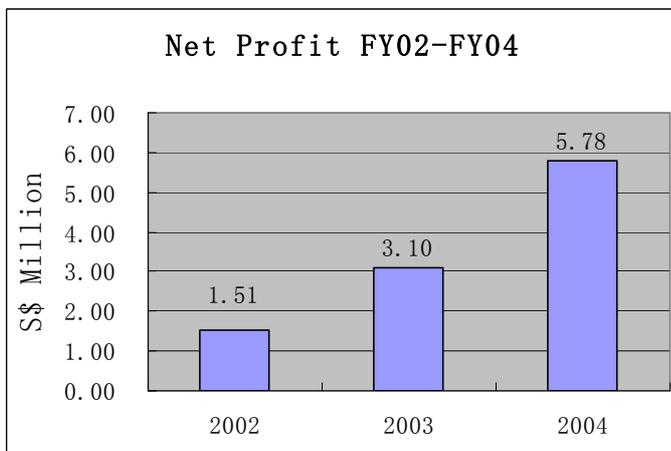
**Pre-tax Profit and Net Profit**

From FY03 to FY04, net profit increased 86.6% YoY from S\$3.10 million to S\$5.78 million. The increase in net profit was in line with the increase in revenue and slight improvement in gross profit margin. From FY03 to FY04, the less than proportionate increase in distribution expenses from S\$1.11 million to S\$1.29 million, and administrative expenses, from S\$5.39 million to S\$6.04 million, also contributed to the considerable net profit growth.

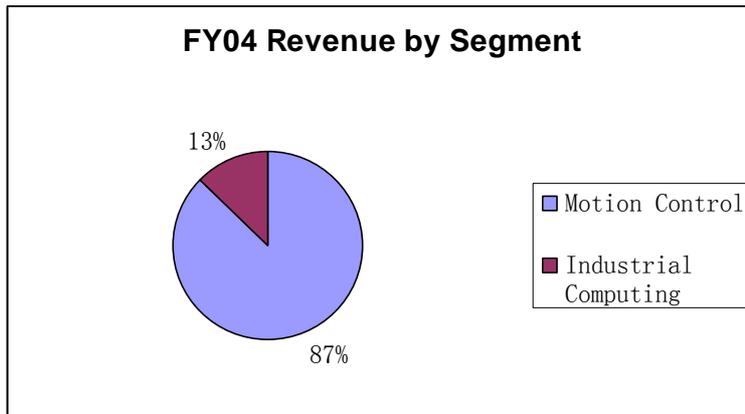
**Revenue, FY02-FY04**



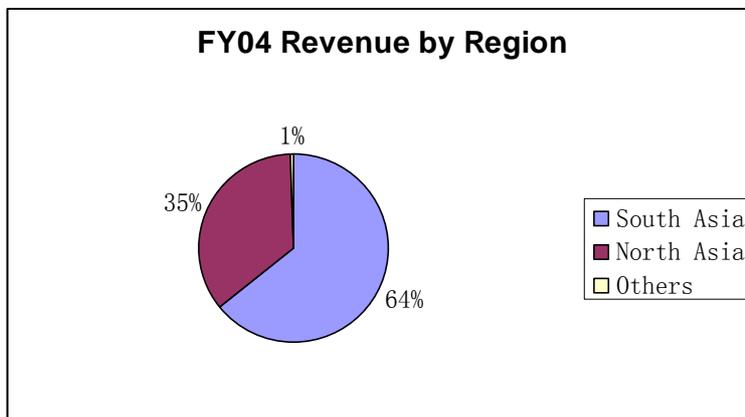
**Net Profit, FY02-FY04**



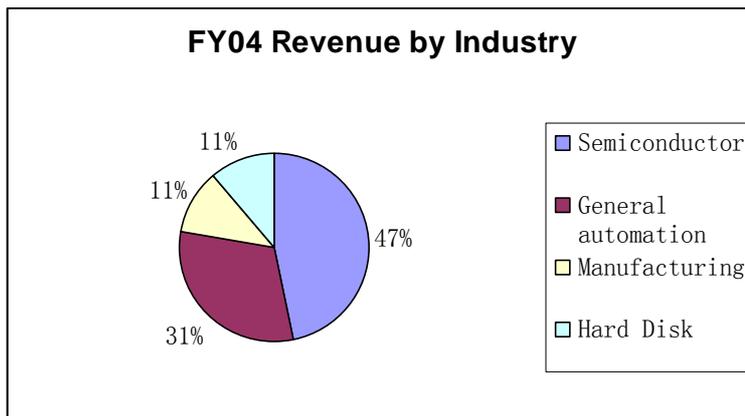
**Revenue By Segment, FY04**



**Revenue By Region, FY04**



**Revenue By Industry, FY04**



**Financial Position**

ISDN was net cash as at 31 December 2004. Cash and bank balances amounted to S\$5.7 million, while loans amounted to S\$2.4 million.

**Risk Factors*****Cyclical nature of the semiconductor industry***

The semiconductor industry is cyclical and, at various times, has experienced significant downturns, which at times is aggravated by production over-capacity as well as reduced unit demand. This, in turn, may cause rapid erosion of average selling prices and low capacity utilisation. When this happens, downstream semiconductor manufacturing and package/test services companies become more prudent in purchasing new equipment, resulting in decreased demand for equipment components and modules from upstream suppliers such as ISDN. From FY02 to FY04, contributions to total revenue from the semiconductor industry were 42.2%, 51.0% and 46.6% respectively.

***Over-dependence on Maxon Motor Ag***

Much of ISDN's business involves the selling of Maxon Motor's motors. From FY02 to FY04, purchases from Maxon Motor amounted to 11.2%, 11.8% and 11.1% of total purchases respectively. On 1 October 2004, ISDN renewed (for three years) the agreement with Maxon Motor, for exclusive rights to distribute Maxon Motor's products in Singapore, Hong Kong, Thailand, Malaysia, the Philippines and Indonesia. JVs have also been set up between ISDN and Interelectric AG (parent company of Maxon Motors) to sell motors and related motion control products in the PRC. The benefits drawn from the exclusive Contract and JVs with Maxon Motor are not solely derived from sales of Maxon Motor's motors to ISDN's customers but also from the sales of supplementary items (e.g. other motion control components from other suppliers) that complement the motor in the controls sub-assembly.

***Highly competitive industry***

The value-add that ISDN offers is in the advice and selection of motors and other motion control components that suit the particular purposes as required by their customers. Product differentiation comes in the form of engineering expertise/experience. The business per se does not appear to have high barriers to entry as there are many similar players in the market.

More important to ISDN is the exclusive tie-up with Maxon Motor Ag. ISDN's exclusive tie-up with Maxon Motor gives them exclusive regional access to Maxon Motor's customised, high precision motors and customers who prefer Maxon Motor's solutions will approach ISDN for their solutions.

**Dividend Policy**

For FY05, assuming that before the end of that year there are no material adverse developments in respect of the Group, the intention is to recommend and distribute a target dividend payout of up to 50% of net distributable profits (the "Proposed Dividend"). However, investors should not treat the Proposed Dividend as an

indication of the Group's future dividend policy. Future Dividends will be paid as and when approved by Shareholders and Directors.

## **Plans**

### ***Growth through acquisitions, Joint Ventures and Strategic Alliances***

ISDN is investing an initial investment sum of S\$257,000 in the Eisele JV; this investment is expected to increase to a total of S\$1 million within a period of two years. ISDN's JV partner, Eisele Antriebstechnik GmbH will hold 25% of the registered capital of the JV and has an option to acquire a further 25% within two years from the date of establishment. This JV will ride on Eisele's manufacturing capabilities and ISDN's sales network to manufacture and sell gearboxes in the PRC as a standalone item or as part of ISDN's motion control solutions.

ISDN is also investing an initial sum of approximately S\$150,000 for a 19% stake in a small Taiwanese Company that engages in R&D and manufacture of motion control components such as controllers, drives, etc. This is a strategic investment as ISDN intends to capitalise on the technical expertise of the said Taiwanese Company and leverage on ISDN's own sales network to grow the business of the Taiwanese Company.

ISDN is investing S\$300,000 for a 67% stake in JM Vistec System Pte Ltd, which engages in the supply of vision related products. At the moment, JM Vistec is a distribution outfit that distributes hardware components for the image processing market. ISDN intends to nurture it into an outfit with manufacturing capabilities.

The aim of the above acquisitions and JVs are for ISDN to move up the value-chain and improve its cost competitiveness and technical capabilities.

### ***Expand and develop existing operations***

ISDN plans to expand and develop existing operations and sales network in countries such as the PRC, Thailand and the Philippines. In addition, ISDN intends to increase assembly capabilities in the PRC and Thailand through the acquisition of more equipment.

### ***Expand into new markets***

Currently, principal markets are Singapore and the Greater China. ISDN intends to expand into new markets in Asia, including Indonesia, India and Vietnam.

### ***Establish an integrated computerized system for operations***

ISDN intends to establish an integrated computerised system, namely Enterprise Resource Planning ("ERP"), for their operations. The establishment of the ERP will facilitate operations, including the accounting functions of the Group and the ordering of stocks, resulting in better management and better internal control. The ERP will allow ISDN to have access to real-time inventory information, thereby improving efficiency over the control of inventory.

**Prospects**

The recovery of the semiconductor industry and the increasing demand for motion control devices and components in the PRC, are the twin factors that bode well for ISDN in the next few years. ISDN can leverage on their increasing exposure to PRC, strong technical expertise and continued close relationships with key suppliers to ride on the growth in these areas.

Key risks include cyclical nature of the semiconductor industry, intense competition, and over-dependence on principal suppliers.

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During the previous 12 months from the report date, Westcomb Capital Pte Ltd was the issue manager for the IPO of the Company, and Westcomb Securities Pte Ltd acted as the underwriter and placement agent of the Company's said IPO.

#### Westcomb Securities Pte Ltd Rating System

Buy : >15% upside over the next 12 months

Trading Buy : + 10% to + 15% range over the next 3 months

Hold : +/- 10% range over the next 12 months

Trading Sell : - 10% to - 15% range over the next 3 months

Sell : >15% downside over the next 12 months

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