

ISDN Holdings Ltd
1H07 results in line, grows by acquisition
06 November 2007

Snapshot		P&L				Key ratios (FY07)		
Recommendation	Hold	(Y/E Dec)	FY05	FY06	FY07	FY08F	PER	12.78x
Current Price	S\$0.47	Sales (S\$m)	54.9	66.6	85.2	110.8	P/BV	2.2x
Target Price	S\$0.50	Gross profit	16.8	19.7	23.1	29.9	Div yield	4.4%
No of Shares	182.8m	Earnings	5.9	6.2	6.4	8.3	ROE	17.3%
Market Cap	S\$85.9m	EPS (Scts)	3.8	3.9	3.52	4.55	Gearing	Cash
Year Hi/Lo	S\$0.60/0.38	EPS growth %	(16.7)	4.7	(10.75)	29.2	Current ratio	1.9x

Source: SIAS Research, Bloomberg
Event Updates

S\$m	FY05	FY06	FY07F	FY08F
Revenue	54.9	66.6	85.2	110.8
Gross profit	16.8	19.7	23.1	29.9
Operating profit	6.7	6.9	7.3	9.2
Net profit	5.9	6.2	6.4	8.3
Revenue growth%	2.6	21.3	28.0	30.0
Gross margin %	30.6	29.6	27.1	27.0
Operating Margin %	12.2	10.4	8.5	8.3
Net margin%	10.7	9.3	7.6	7.5

Source: SIAS Research

- 1H07 Performance reviews:** ISDN's revenue grew 14.8% YoY to S\$43.3m in 1H07. The modest growth was due to a sluggish revenue growth of 5.4% from the motion control segment, which contributed to 76% of its total revenue this half year.

Results by geographical segment were mixed. On the positive side, North Asia sales grew strongly by 61% to S\$25.6m. But sales from South Asia declined 19% to S\$17.6m. Looking forward, we do not foresee serious deterioration in the business environment, thus its 2H07 revenues should be at least at par with 1H07 level. This will represent a 45% revenue increase compared to the same period last year, when ISDN posted abnormally lower revenue because of the weak semiconductor industry in 2H06. Keeping in mind the sanguine picture in China sales and the high volatility of its historical earnings, we maintain our forecast of FY07 revenue at S\$85.2m, up 28% from last year.

- Margins declined:** Gross margin declined slightly from 30.9% in 1H06 to 27.1% in 1H07 due to competition and higher raw material cost. Thus we lower our estimate

for gross margin to 27% for FY07 and FY08.

- Furthermore, the cost in start-ups and consolidation of China manufacturing factories also took their toll on net profit. In our view, the cost saving effect of the consolidation won't be felt soon as the plan is still in its initial stage and we expect net profit margin to stay at around 7-8% level in the next two years. We accordingly adjusted down the net profit for FY07 to S\$6.4m and S\$8.3m for FY08.

Growth drivers

- China overtakes South Asia in revenue:** ISDN's revenue base is fast diversifying into various industries due to the high growth of the general automation business in PRC. The company has increased the number of sales offices in China to 42 currently, up from 35 in 2006.
- We believe ISDN's strategy of focusing in China should bold well for the future. The company will not only benefit from the strength of the Chinese economy and the rapid pace of manufacturing activity, but also be able to diversify from the semiconductor industry.
- The revenue growth in China came mainly from serving niche markets and high-end customers, according Mr Teo, CEO of ISDN. This gives the company significant exposures to the medical and aerospace industries. We believe these industries are less sensitive to government restraint on fixed asset investment and thus should continue to perform strongly in the coming

years. We are encouraged by the continuous efforts to diversify its revenue base, which will strengthen its ability to weather the volatility experienced by the semiconductor industry. The diversification will also enable ISDN to sustain a stable revenue flow in the coming years.

- **Mergers and acquisitions:** In 1H07, the company raised S\$11m through the placement of 24 million new shares. Part of the funds was used to finance mergers and acquisitions in China and India. According to the company, most of the acquisitions are still in the start-up period, so we do not expect these joint ventures to have a material impact on FY07 earnings. We will keep a close eye on the performance of newly acquired associates and subsidiaries to see how significant they will contribute to FY08 results.
- **Proposal to acquire Dirak Asia:** ISDN announced on Oct 29 a proposal to acquire 49% shares of Dirak Asia Pte Ltd, which recorded a net profit of S\$2.8m in FY06. There is a guarantee that Dirak's combined net profit for FY07 and FY08 will be no less than S\$7m. The deal is subject to approval from regulators and shareholders. We expect the acquisition will have a substantial impact on FY08 earnings. (We will assess the full impact of the potential acquisition in later reports.)

Key Risks

- **Volatile semiconductor industry:** The semiconductor industry is cyclical and, at various times, has experienced significant unexpected downturns. Rapid erosion of margins due to oversupply will make downstream semiconductor manufacturing and test services companies to be cautious in upgrading equipments. And this will result in decreased demand for

equipment components and modules from upstream suppliers such as ISDN. Currently, the Group is still relatively dependant on the semiconductor industry although the trend is declining. The Group generated 36% of its total revenue from semiconductor segment in FY06, down from 42% in FY05 and 47% in FY04.

- **Consolidation cost:** As mentioned earlier, the company started an initiative to consolidate all its China operations in one site. We think this may be a double edged sword as the restructuring process could be complicated and prolonged under a foreign country context. Meanwhile, its cost saving benefit remains to be seen.

Valuation/Recommendation

- **Valuation:** We maintain our FY07 revenue growth at 28% to account for accelerated PRC sales growth momentum that is offsetting the sluggish sales in South Asia. Meanwhile we are raising FY08 revenue to grow 30% to hit S\$110.8m largely due to continued acquisition and joint ventures in China and India. Nonetheless, we have trimmed our net profit margin estimate to 7.5% for both FY07 and FY08 to reflect higher start up costs and raw material costs.
- **Recommendation:** Historically, the company has been trading within 9X-11X PER range. We think ISDN's fundamentals remain solid and its business risk remains average given the strength of its services capability and geographical sales coverage. At an PER of 11X, our target price in 12 month forward has been adjusted down to 50 cents based on FY08 earnings.
Recommend Hold. (SIAS Research)

Financial Table and Ratios

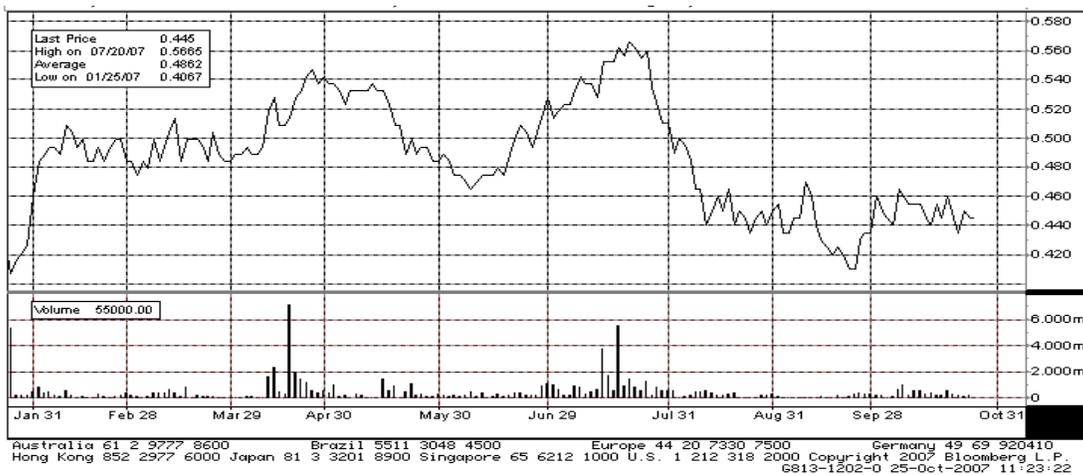
(Y/E Dec)	FY05	FY06	FY07F	FY08F
Profit & Loss (\$m)				
Turnover	54.9	66.6	85.2	110.8
EBITDA	6.0	6.7	7.3	9.3
Pretax	7.5	7.6	8.7	11.2
Earnings	6.0	6.3	6.4	8.3
EPS (fully diluted - Sts)	3.8	3.9	3.5	4.5
EPS (fully diluted - Scts)	3.8	3.9	3.5	4.5
Balance Sheet (\$m)				
Long Term Assets	7.0	10.0	13.3	15.8
Current Assets	33.3	32.6	55.9	54.6
Current Liabilities	19.6	17.3	29.2	25.7
Long Term Liabilities	1.4	2.4	2.6	2.8
Total Equity	18.9	22.4	37.3	41.2
Cash Flow (\$m)				
Operating Cash Flow	2.2	1.7	1.3	5.5
Investing Cash Flow	4.9	(2.7)	(5.5)	1.0
Financing Cash Flow	4.8	(3.4)	7.4	(4.4)
Financial Ratios				
Revenue Growth (%)	2.6	21.4	28.0	30.0
Operating Profit Growth (%)	(11.9)	11.4	9.1	27.9
Earnings Growth (%)	0.4	4.7	2.7	29.2
EPS Growth (%)	(16.7)	4.7	(10.8)	29.2
EBITDA Margin (%)	10.9	10.0	8.6	8.4
Net Margin (%)	10.9	9.4	7.6	7.5
Current Ratio (x)	1.7	1.9	1.9	2.1
Book value per share (S\$ cts)	11.9	14.4	20.5	22.9
Net (Debt)/ Cash per share (S\$ cts)	4.8	1.3	5.7	3.8
Net Debt / Equity (%)	Cash	Cash	Cash	Cash
Dividend payout ratio (cts)	47.8	50.7	71.0	76.9
Return on Equity (%)	31.7	28.0	17.3	20.2
Return on Asset (%)	14.8	14.7	9.3	11.8
Debtor Days	87.1	74.3	77.3	74.5
Creditor Days	64.1	58.7	67.6	58.7
Inventory Days	72.0	81.1	94.0	81.1
Cash Conversion Cycle	95.0	96.7	103.7	96.9
Valuations				
Price to sales (x)	1.3	1.1	0.9	0.7
PER (x)	11.9	12.8	12.8	9.9
Price to book (x)	3.8	3.1	2.2	2.0
Dividend Yield (%)	4.0	4.4	5.6	7.8

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 3,000 customers and is 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 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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