

Serial System Ltd

'Target Price' Met, Time for Upgrade

Serial System Ltd's (Serial) results for the first half ended 30 June 2010 exceeded our expectations. 1H FY10 revenue and net attributable profit came in at 58.0% and 60.3% of our prior FY10F forecasts respectively. We now expect 3-year sales and PATMI CAGR of 24.5% and 36.0% respectively from FY10 to FY12. **Upgrade to Increase Exposure with an intrinsic value of S\$0.180 (+38.5% upside).**

Fundamental Drivers:

Sales +62%, PATMI +447.5% YoY. Sales grew by 13.3% sequentially, driven by strong electronics exports growth at Serial's customers in South and South East Asia and by sustained demand growth in China. Net profit, as a percentage of our forecasts, was 2.3% points higher than revenue, as net margin was 0.07% pts higher than expected, driven by product mix improvements.

Growth to continue in 2H 2010. Asia Pacific semiconductor sales (as a proxy to demand for electronic components) grew by 56.7% YoY in 1H 2010 and we anticipate Serial to continue benefiting from strong industry momentum in 2H 2010. Although sequential growth rates will moderate in 2H 2010, we expect full year industry growth to range from 30% to 40%.

Sticking to what it does best. Going forward, Serial intends to a) expand its range of brands carried and cross sell products, and b) increase penetration in key markets such as China and Taiwan, targeting underserved 2nd and 3rd tier OEMs and EMS companies.

Outlook:

Serial's strong results in 1H FY10 are testament of its execution ability. We upped our FY10 and FY11 top-line forecast to S\$779.1m and S\$934.9m respectively. We also extended our forecast horizon to FY12 with sales expected to exceed S\$1bn by then. PATMI is projected to reach S\$13.6m in FY10 and S\$18.8m by FY12.

Increase Exposure

- Intrinsic Value S\$0.180
- Prev Close S\$0.130

Main Activities

Serial System Ltd is principally engaged in the semiconductors and components distribution business. Its geographical presence extends to Singapore, PRC, Hong Kong, Korea, Taiwan, Malaysia and Thailand.

Financial Highlights

(Y/E Dec) S\$m	FY08	FY09	FY10F
Revenue	510.6	556.5	779.1
Gross Profit	46.7	48.6	75.1
Earnings	6.0	7.5	13.6
EPS* (S cts)	1.0	1.1	1.8

Source: Company, SIAS Research

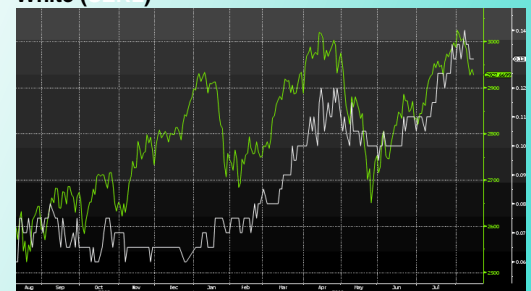
Key ratios (FY10F)

PER	7.4
P/BV	0.94
Return on Equity	13.4%
Gross Debt/ Equity	8.2%
Current ratio	1.5

Source: SIAS Research Estimate

Indexed Price Chart

Green (FSSTI)
White (SERL)



Source: Bloomberg

52wks High-Low 5.5 S cts /14.0 S cts
Number of Shares 727.3m
Market Capitalization S\$98.2m

Analyst:

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Valuation:

38.5% upside. Our updated model now values Serial at S\$0.18, representing an upside of 38.5% from its previous close of S\$0.130. Our prior valuation of Serial System in April at S\$0.14 now seems too conservative. Serial is currently valued at 11.7x FY09 PER, at a 18.3% discount to its peers and 38.7% less than its closer Taiwanese competitors. Our valuation, which already assumes the full conversion of outstanding warrants, is deemed reasonable at 10.2x FY10 PER and 1.3x FY10 P/BV.

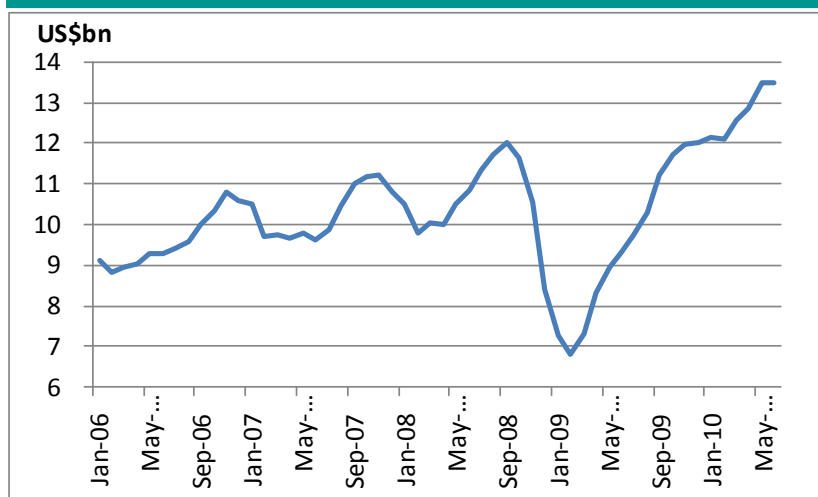
The key risks include its high leverage at 74.8% of common equity and low margin of 1.75%. Serial has 97.4m of outstanding warrants that will provide S\$8.8m of cash flow when exercised. The company also stands to benefit from further economies of scale as it grows its top-line. Serial's strong growth has increased our confidence in the company. We now expect Serial's ROE to grow to 15.1% by FY12, matching that of Taiwanese competitor Yosun Industrial Corp now. **Upgrade to Increase Exposure (Intrinsic value: S\$0.180).**

Figure 1: Results exceeded expectations

	1H FY10	Prior FY10F	%
Revenue	229.1	640.0	58.0%
Gross Profit	20.6	57.0	62.7%
EBIT	2.7	13.0	81.5%
PATMI	1.2	10.8	60.1%
	1H FY09	1H FY10	Growth
Revenue	229.1	371.0	62.0%
Gross Profit	20.6	35.7	73.4%
EBIT	2.7	10.6	297.6%
PATMI	1.2	6.5	447.5%

Source: Company, SIAS Research

Figure 2: Record Semiconductor Sales in Asia Pacific



Source: Semiconductor Industry Association, SIAS Research

Figure 3: Economic Profit Valuation Model

S\$m	FY10F	FY11F	FY12F
Revenue	779.1	934.9	1075.1
EBIT	22.5	27.0	30.7
Tax on EBIT	-6.7	-8.1	-9.2
NOPLAT	15.7	18.9	21.5
Invested Capital	139.9	192.0	210.0
% of Debt	33.2%	40.7%	41.9%
% of Equity	66.8%	59.3%	58.1%
WACC (%)	8.7%	8.0%	7.9%
Capital Charge	12.2	15.4	16.6
Economic Profit	3.5	3.5	4.9
Terminal Value			50.2
Discount Rate	1.0	0.9	0.8
Present Value	3.3	3.1	4.0
Book Value	96.6	Risk Free Rate	2.04%
Explicit Value	10.4	Beta	1.10
Terminal Value	41.5	Market RP	8.94%
Value of Equity	148.5	Cost of Equity	11.9%
Number of Shares (m)	824.7	Cost of Debt	3.50%
Value per share (S\$)	0.180	LT Growth	2.0%

Source: SIAS Research

Figure 4: Peer Comparison

	PER	P/BV	ROE	ROA	Debt/Equity
Arrow Electronics Inc	8.6	0.95	4.4%	1.7%	48.0%
Avnet Inc	8.6	1.20	14.2%	5.8%	42.5%
WPG Holdings Co Ltd	18.8	3.27	20.0%	6.8%	83.9%
Yosun Industrial Corp	19.4	2.95	15.9%	4.4%	139.3%
Excelpoint Technology Ltd	16.3	0.48	-4.2%	-1.5%	48.6%
Average	14.3	1.77	10.0%	3.4%	72.5%
Serial System Ltd	11.7	0.96	8.7%	4.5%	74.8%

Serial's P/BV and Debt/Equity are based on figures as of 1H FY10

Source: Bloomberg, SIAS Research

Figure 5: Financial Forecasts and Estimates

S\$m	FY07	FY08	FY09	FY10F	FY11F	FY12F
Revenue	476.2	510.6	556.5	779.1	934.9	1075.1
Gross Profit	41.5	46.7	48.6	75.1	90.1	103.6
Operating Profit	9.4	8.5	9.0	22.3	26.7	30.7
Net Profit	7.3	6.0	7.5	13.6	16.3	18.8
Attributable to Shareholders						
Total Current Assets	148.5	114.2	161.0	225.5	267.4	298.9
Total Non-Current Assets	32.9	33.0	39.5	51.3	49.7	48.1
Total Current Liabilities	90.7	63.7	99.4	149.3	181.5	201.9
Total Non-Current Liabilities	10.7	2.5	7.5	13.6	13.6	13.6
Total Equity	80.0	81.0	93.5	113.8	122.0	131.4
Cash from Operating Activities	3.5	17.7	(3.7)	(22.1)	2.3	(1.8)
Cash from Investing Activities	18.5	(3.4)	(10.0)	(11.8)	(1.9)	(2.0)
Cash from Financing Activities	(14.1)	(12.4)	18.5	24.8	1.6	5.6
Net change in cash	7.9	1.9	4.8	(9.2)	1.9	1.8
Inventory Days	53	42	40	50	50	50
Receivable Days	48	44	41	45	45	45
Payable Days	48	38	33	40	40	40
Return on Common Equity (%)	9.1	7.6	8.7	13.4	14.1	15.1
ROA (%)	4.1	4.0	4.5	8.2	7.9	8.1
Debt/Equity (%)	47.3	38.2	50.4	70.0	73.4	79.7
Current Ratio	1.6	1.8	1.6	1.5	1.5	1.5
EPS (\$ cents)	1.9	1.0	1.1	1.8	2.0	2.3
BV/Share (\$ cents)	21.0	13.4	12.9	13.8	14.8	15.9
PER	6.7	13.0	11.7	7.4	6.6	5.7
P/BV	0.62	0.97	1.01	0.94	0.88	0.82

Source: Company, SIAS Research

Rating Definition:

Increase Exposure – The current price of the stock is significantly lower than the underlying fundamental value higher level.

Invest – The current price of the stock is sufficiently lower than the underlying fundamental value of the firm. Readers can consider adding this stock to their portfolio.

Fairly Valued – The current price of the stock is reflective of the underlying fundamental value of the firm. Readers may not need to take actions at current price.

Take Profit – The current price of the stock is sufficiently higher than the underlying fundamental value of the firm. Readers can consider rebalancing their portfolio to take advantage of the profits.

Reduce Exposure - The current price of the stock is significantly higher than the underlying fundamental value of the firm. Readers can consider reducing their holdings in their portfolio.

IMPORTANT DISCLOSURE

SIAS Research Pte Ltd received compensation for conducting this valuation research. The estimated fair value of the stock is statement of opinion, and not statement of fact or recommendation on the stock.

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