

# Serial System

Reuters: SERL.SI  
Bloomberg: SERL SP

Sector: Technology

Rating:

Price S\$0.18

Maintain **Underperform**

Y/E 31-Dec	2002A	2003A	2004F	2005F
Net Profit (S\$m)	-9.9	3.2	-0.4	1.1
EPS (S cent)	-3.3	1.1	-0.1	0.4
EPS Growth (%)	-	<i>n.m.</i>	<i>n.m.</i>	<i>n.m.</i>
Consensus EPS	-	-	0.5	1.0
PER (x) @ S\$0.18	-	17.1	-	51.4
NTA (S\$)	0.26	0.27	0.28	0.28

Performance (%)	1mth	3mth	12mth	Market Capitalisation :	S\$	55m
Absolute	+6	-22	-40	Issued Shares :		304m
Relative against STI	+2	-28	-57	30-day avg daily vol ('000) :		143

## Warns of losses in 4Q and FY04

- Issues profit warning for 4Q and FY04
- Expecting losses for both periods
- **UNDERPERFORM** rating stays, but slashing FY04 estimate to loss of S\$0.4m

**Summary:** Serial System has released a very short statement stating that it expects losses for 4Q and FY04. This is a further disappointment and adds to losses already sustained in 3Q04. To recap, the group released its 9M results in Nov 2004 where net profit fell 51% YoY to S\$1.2m for 9M04. This translated into 3Q net loss of S\$1.6m on a sharp 28% QoQ or 23% YoY decline in 3Q revenue to S\$67.5m. With the decline in 3Q revenue and with distribution and administrative expenses maintained at roughly the same level, this brought the group into the red in 3Q04. In terms of profits, the core semiconductor division saw a drop in contribution from S\$3.0m in 9M03 to S\$0.5m for 9M04, down a staggering S\$2.5m. We were not able to reach the company for further details on this latest profit warning. Pending further clarification from the management, we have cut FY04 estimate, from previous estimates of a profit of S\$1.9m to a loss of S\$0.4m. The **UNDERPERFORM** rating on the stock stays.

**Warning of losses in 4Q and FY04.** Serial System has released a very brief statement that it expects to sustain losses in 4Q04 and FY04. This adds to the disappointing 3Q losses of S\$1.6m.

To recap, Serial turned in a very disappointing 9-month report card in November 2004. It reported a 3% YoY decline in revenue to S\$238.5m for 9M2004. However, stripping off the stronger 1Q and 2Q revenues (1Q of S\$77.1m and 2Q of S\$93.9m), this marked a sharp 28% QoQ or 23% YoY decline in 3Q revenue to S\$67.5m. As a result of this, its core operation in semiconductors and component distribution saw only a slight 0.3% rise in revenue to S\$235m, while the consumer digital appliances and other business reported a 66% decline in revenue to S\$3.5m. Management attributed this to weak demand and the loss of a major client for its logistics business.

Net profit also fell 51% YoY to S\$1.2m in 9M2004. This was largely due to the disappointing performance of its semiconductor division which reported a profit of only S\$0.5m compared to S\$3.0m in the previous period. Associates turned in a flat performance of S\$2.9m, while the consumer digital appliances and other businesses continued to bleed and posted losses of S\$2.2m compared to losses of S\$3.4m. NAV per share as at end-Sep 2004 stood at 28.2 cents.

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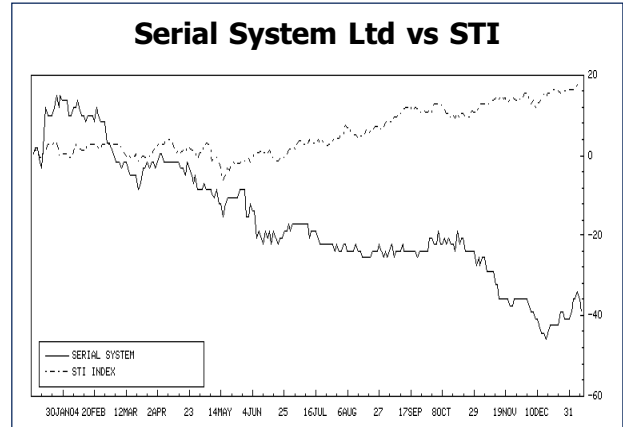
With a sharp decline in 3Q revenue and with cost of sales staying at the same percentage level as the first two quarters, this led to a significant decline in gross profit to S\$7.0m compared to S\$8m or more for 1Q04 and 2Q04. After deducting total distribution and administration expenses of S\$5.6m and other expenses of S\$4.1m, this brought total expenses to S\$9.7m, far exceeding gross profit of S\$7.0m, plunging the group into the red in 3Q04.

**Some recent negative developments.** The latest profit warning came shortly after the 3Q losses in Nov 2004 - the first quarterly loss in eight quarters. As share prices corrected to this news, the group had to lower the exercise price for its warrants recently from 14 cents to 12 cents. The warrants were proposed in September 2004.

**Valuation.** Sentiment for the stock has stayed frail for a while, and this latest profit warning is likely to

take a further toll on the stock. We have not been able to reach the company to get further details on the latest profit warning. Pending further clarification from management, we have assumed a similar quantum of losses for 4Q. As conjecture, in order to bring the group into red for FY04, 4Q losses must have exceeded S\$1.23m. We are now projecting losses of S\$1.63m for 4Q04 and slashing our FY04 estimate from a profit of S\$1.9m to a loss of S\$0.4m. Meanwhile, the Semiconductor Industry Association (SIA) is expecting sales of US\$214 billion in 2004, up 28.6% from US\$166.4 billion in 2003. Going forward, SIA expects sales to be flat in 2005 with growth resuming only in 2006. Against this backdrop, there are limited drivers for growth and the latest profit warning is a definite dampener on sentiment.

Serial's share price has already reacted to this, hitting a recent low of 16 cents. At the current price, valuations are expensive. We retain our **UNDERPERFORM** rating on the stock.



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