

# Serial System Ltd

**Reuters:** SERL.SI  
**Bloomberg:** SERL.SP

**Sector:** Technology

**Rating:**
**Price** S\$0.225

 Maintain **Market Perform**

Y/E 31-Dec	2002A	2003A	2004F	2005F
Net Profit (\$m)	-9.9	3.2	4.6	6.5
EPS (cents)	-3.3	1.1	1.5	2.2
EPS Growth (%)	-	<i>n.m.</i>	+45	+41
Consensus EPS	-	-	-	-
PER (x) @ S\$0.225	-	21.4	14.8	10.5
NTA (\$)	0.26	0.27	0.30	0.31

Performance (%)	1mth	3mth	12mth	Market Capitalisation :	S\$	70m
Absolute	-8	-13	-4	Issued Shares :		303m
Relative against STI	-10	-21	-29	30-day avg daily vol ('000) :		49

## New acquisitions buoyed 1H results

- 1H earnings of \$2.8m, slightly better than expectation
- Performance aided by recent acquisitions
- Maintain MARKET PERFORM rating

Year Ended 31 Dec	1H04 (\$m)	1H03 (\$m)	Chg (%)
Turnover	171.0	157.9	8.3
Cost of sales	-154.5	-143.2	7.9
Gross profit/loss	16.6	14.7	12.6
Other operating income	4.3	2.2	96.9
Distribution & admin expenses	-11.6	-9.9	18.0
Other operating expenses	-6.6	-5.0	31.0
Profits from operation	2.7	2.1	31.6
Finance cost	-0.5	-0.2	195.5
Associates	2.5	2.0	26.4
Pre-tax Profit	4.7	3.9	21.5
Net Profit	2.8	1.5	86.7
EPS (cts) - Basic	0.9	0.5	87.8%
EPS (cts) - Diluted	0.9	0.5	83.7%
Operating margin (%)	1.6	1.3	
Pretax margin (%)	2.8	2.5	
Net profit margin (%)	1.6	0.9	

Serial System reported an 87% YoY rise in net earnings to \$2.8m for the first six months of the year. This is slightly better than our expectation. Revenue grew 8% YoY to \$171.0m. Gross margin improved from 9.3% in 1H03 to 9.7% in 1H04. Operating margin rose from 1.3% in 1H03 to 1.6% in 1H04. With the improvement in margins and higher contribution from associates, the group reported a 21.5% rise in pre-tax profit to \$4.7m. While the overall 1H04 performance is better than the previous half year and is slightly above our projections, we are retaining our estimates for now. At 22.5 cents, the stock is trading at 14.8x FY04 earnings and 10.4x on FY05 earnings. We are retaining our MARKET PERFORM rating on the stock.

**1H04 results were slightly above expectation.** Serial Systems posted a strong 87% YoY increase in net earnings to \$2.8m. This was partly due to an 8.3% increase in revenue. Together with higher margins on most fronts, this led to stronger bottomline performance. Semiconductor/component distribution remained the key contributor, with a 10% increase in revenue to \$168.4m, and accounted for 98.5% of group revenue. This came from the growth in the North Asian markets, especially Greater China and Korea and

benefited from the recent expansion in its operations following a series of acquisitions in semiconductor-related businesses in North Asia.

Reflective of the growing importance of its new market segments and the North Asian contribution from recent acquisitions, Other Income rose 97% to \$2.1m due to commission income from two wholly-owned subsidiaries which were acquired in 1Q 2004. Associates reported a sharp 26% YoY rise in contribution to \$2.6m in 1H04.

**Growth by acquisition strategy has bore fruit.** As shown from the above set of results, its recent acquisition trail, where it brought several companies into its fold, has started to show results and has enabled the group to further its presence in the growing North Asian region. While segmental breakdown was not given, revenue contribution from China surged from

\$9.7m in FY02 to \$25.6m by FY03, up 164% YoY. Similarly, revenue contribution from Korea rose sharply from \$63.2m in FY02 to \$195.1m by FY03, up 209%.

With the higher growth in the North Asian region, management intends to continue to focus its growth in China and Korea.

**Prospects and valuation.** We have fine-tuned our estimates, resulting in slight changes to our FY04 projections. We are expecting net earnings of \$4.4m in FY04, up 44% YoY. Based on our projections and the share price of 22.5 cents, the stock is trading at 14.8x FY04 earnings and 10.4x FY05 earnings. We are expecting semiconductor and component distribution to remain its core activity and accounts for more than 96% of revenue in FY04-05. It is currently trading at less than 1x book. We are maintaining our **MARKET PERFORM** rating and fair value of 27 cents.

**EARNINGS FORECAST**

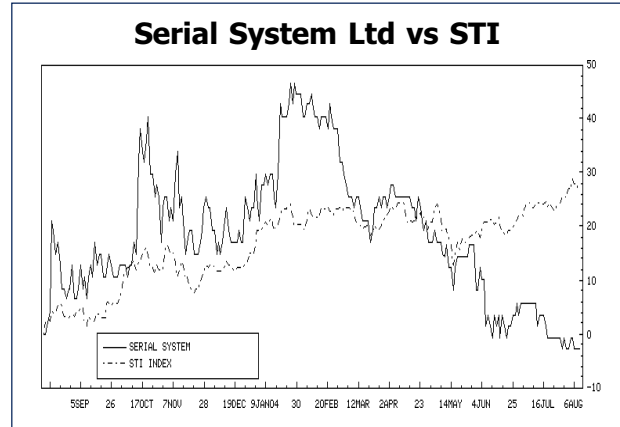
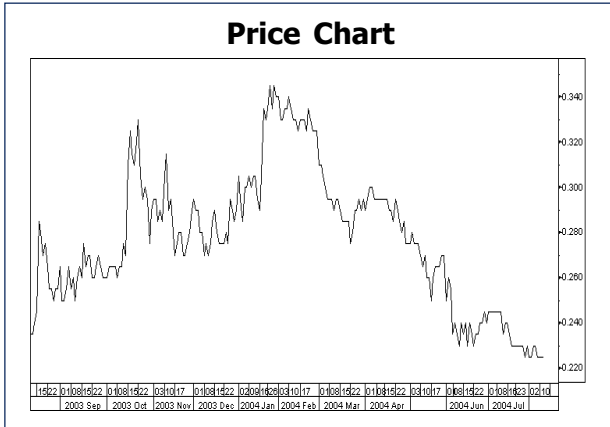
Year Ended 31 Dec (S\$m)	FY02A	FY03A	FY04F	FY05F
Semiconductor & component distribution	153.1	309.7	350	429.3
Others	12.4	15.1	6.8	7.1
<b>Revenue</b>	<b>165.5</b>	<b>324.8</b>	<b>356.8</b>	<b>436.4</b>
Pre-tax profits	-7.1	7.3	8.4	11.6
Net Profits	-9.9	3.2	4.6	6.5
EPS (cents)	-3.3	1.1	1.5	2.2
DPS (cents)	0.1	0.4	0.4	0.4
NAV (cents)	25.9	26.6	29.6	31.4
<b>KEY RATIOS</b>				
Revenue growth (%)	112.6%	96.3%	9.8%	22.3%
Pre-tax growth (%)	nm	nm	14.7%	39.1%
Net Profit growth (%)	nm	nm	44.5%	41.9%
Pre-tax profit margin (%)	nm	2.2%	2.3%	2.7%
Net profit margin (%)	nm	1.0%	1.3%	1.5%

**SUMMARY BALANCE SHEET**

As at 31 Dec (S\$m)	FY02A	FY03A	FY04F	FY05F
Share capital	30.2	30.3	30.3	30.3
Reserves	51.7	53.8	59.0	64.3
<b>Shareholders' Funds</b>	<b>81.8</b>	<b>84.1</b>	<b>89.3</b>	<b>94.6</b>
Fixed assets	54.3	58.1	74.1	83.5
Current assets	78.2	87.5	124.6	117.5
Current liabilities	49.6	58.9	102.5	103.4
Long-term liabilities	1.0	2.7	6.9	3.0
<b>Assets less Liabilities</b>	<b>81.8</b>	<b>84.0</b>	<b>89.3</b>	<b>94.6</b>

**SUMMARY CASH FLOW**

Year Ended 31 Dec (S\$m)	FY02A	FY03A	FY04F	FY05F
Pretax profits	-12.3	2.9	3.9	6.6
Depreciation	1.4	1.0	1.2	1.2
Others	2.5	1.7	3.2	3.5
Changes in working capital	-0.8	-7.5	-30.7	0.8
<b>Operating cash flow</b>	<b>-9.2</b>	<b>-2.0</b>	<b>-22.5</b>	<b>12.2</b>
Net cash from operating activities	-10.1	-3.8	-25.5	7.9
Net cash used in investing activities	-5.1	-8.7	-9.0	-6.3
Cash flow from financing activities	6.6	13.7	26.4	6.2
Change in cash/(debt)	-8.7	1.2	-8.2	7.8
End cash/(debt)	11.0	12.2	4.0	11.8



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