

Serial System Disposal plan stalls, unexciting prospects

Our recent visit to Serial System (SERL) indicated that the component distribution operating environment remains challenging. SERL also recently lost a major customer and the potential for capital gains from the sale of Wintech continues to dwindle. Payoff for its efforts to cut cost and target high growth markets like China to raise revenue will not be immediate as the landscape remains competitive. Hence margins could continue to be under pressure. To reflect slower 1H05 semiconductor demand and 3Q04 losses, we downgraded our FY04-05 net profit estimates by 96% and 52% respectively. Despite earnings turnaround in 2005, PE of 18x is expensive. A better alternative is Willas-Array, which is trading at 7x PE with ROE of 13% (SERL: 4%) and dividend yield of 6-7% (SERL: 1%).

- **Divestment stalls.** The planned divestment of its 21% stake in Wintech has stalled as the share price has fallen 40% (from NT\$35 in Apr04) in the past 9 months. At the current price of NT\$21, selling its stake in Wintech would be meaningless as SERL will register an investment loss. Wintech is still profitable and contributes more than 100% to SERL's PBT in 2004. But if its stake is reduced further, it would no longer equity account the earnings.

- **Slowing distribution unit.** With global semiconductor sales expected to be weak, SERL is seeking new opportunities in China. Management expects revenue from China to expand from US\$60m in 2004 to US\$100m in 2005 led by new customers and the proliferation of China's telecommunication sector with the introduction of VOIP, broadband and Bluetooth technologies. However, we believe management may be too optimistic given that the distribution business is already saturated and increases potential threat to its already razor thin pretax margin of 1.5%.

- **Cash call.** SERL will issue 79m warrants at S\$0.045 each, with the exercise price revised down to S\$0.12 (from S\$0.14), implying a 25% premium over the current share price. If fully exercised, SERL will raise S\$13m that could yield S\$0.3m in interest income. This is still insufficient to offset the 26% earnings dilution from the warrant issue. As at end of 3Q04, SERL had net debt of S\$43m or net gearing of 53%, which is cause for concern.

Fully Valued

\$0.18

At a Glance

Price Target:
S\$0.15 (previously S\$0.29)

Stock Code:
Bloomberg: SERL SP
Reuters: SERL.SI

Sector: Electronics
Component Distribution

STI: 2070.15

Reason for Report:
Company update

Implications:
Negative

Earnings Revision:
FY04 -96%
FY05 -52%
FY06 -64%

Consensus EPS:
FY04 0.6 S cts
FY05 1.0 S cts

DBSV vs Consensus EPS (% variance):
FY04 nm
FY05 unch

Principal Business:
Distributes active and passive electronic components

Forecasts and Valuation

| FYE Dec | 2003 | 2004F | 2005F | 2006F |
|------------------|--------|-------|-------|-------|
| Sales (\$m) | 324.8 | 309.5 | 325.0 | 325.2 |
| EBITDA (\$m) | 8.0 | 5.6 | 5.2 | 3.5 |
| Net Profit (\$m) | 3.2 | 0.8 | 3.0 | 1.6 |
| EPS - FD (Sc) | 1.1 | 0.3 | 1.0 | 0.5 |
| EPS Gth (%) | -133.3 | -75.2 | 260.8 | -46.2 |
| BVps (\$) | 0.3 | 0.3 | 0.3 | 0.3 |
| DPS (Sc) | 0.3 | 0.2 | 0.1 | 0.1 |
| P/Sales (x) | 0.3 | 0.2 | 0.2 | 0.2 |
| EV/EBITDA (x) | 12.2 | 13.8 | 15.0 | 22.7 |
| P/E (x) | 25.5 | 65.9 | 18.3 | 34.0 |
| PBV (x) | 1.1 | 0.7 | 0.7 | 0.6 |
| P/CF (x) | 20.1 | 21.6 | 11.2 | 15.2 |
| Div Yield (%) | 1.1 | 0.9 | 0.7 | 0.4 |
| ROE (%) | 5.4 | 1.4 | 4.0 | 2.3 |
| Net Gearing (%) | 11.4 | 23.3 | 23.2 | 23.0 |

General Data

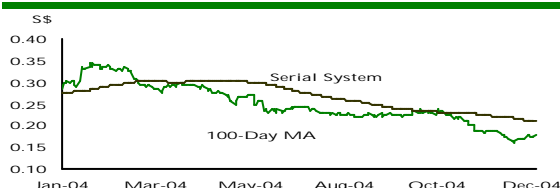
| | |
|-------------------------|---------|
| Issued Capital (m shrs) | 303 |
| Mkt Cap (\$m/US\$m) | 55 / 33 |
| Major Shareholders | |
| Derek Goh (%) | 18.3 |
| Sam Goi (%) | 11.2 |
| Free Float (%) | 70.5 |
| Avg Vol/Day ('000) | 229.0 |

Consensus Analyst Poll

| | Avg Rating | Buy | Hold | Sell |
|--------|------------|-----|------|------|
| 3 Mth | 2.00 | - | - | 1 |
| 6 Mth | 2.00 | - | - | - |
| 12 Mth | 2.00 | - | - | 1 |
| Market | 3.57 | | | |
| Sector | 3.97 | | | |

Source: Bloomberg
Avg Rating: 1 = Sell, 3 = Hold, 5 = Buy

Share Price Chart



Share Price Performance

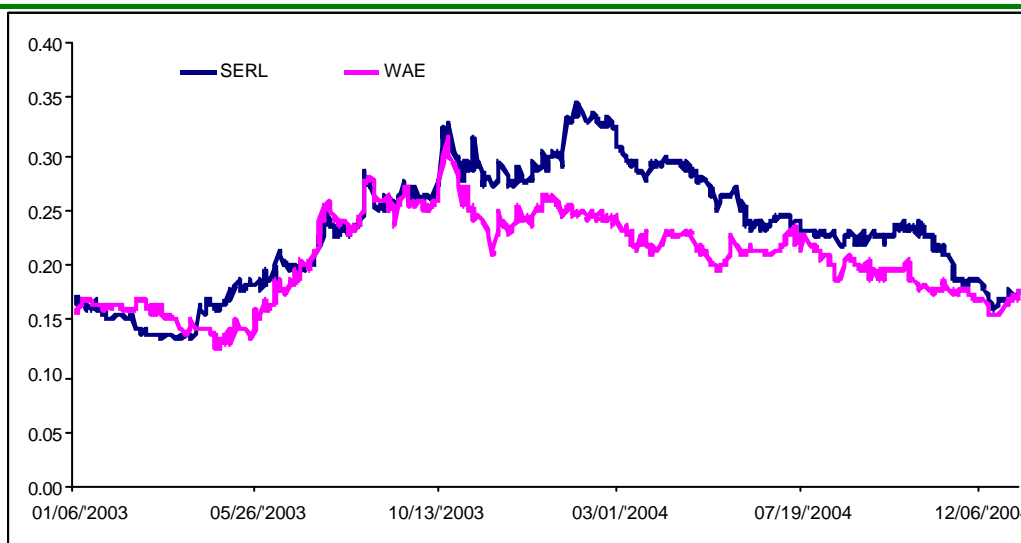
| | Share Price | Rel STI | Rel Sector |
|--------------|-------------|---------|------------|
| Past 1 mth | -5% | 6% | -7% |
| Past 3 mths | -23% | -28% | -23% |
| Past 6 mths | -27% | -39% | -20% |
| Past 12 mths | -41% | -57% | -13% |

Quarterly Earnings Summary

| FY Sep (\$m) | 1Q03 | 2Q03 | 3Q03 | 4Q03 | 1Q04 | 2Q04 | 3Q04 | 4Q04F |
|---------------------------------------|------------|------------|------------|------------|------------|------------|--------------|--------------|
| Segmental | | | | | | | | |
| Semiconductors/Component Distribution | 79 | 73 | 82 | 75 | 76.2 | 92.2 | 66.6 | 70 |
| Other operations | 1 | 4 | 5 | 5 | 0.9 | 1.7 | 0.9 | 1 |
| Sales | 81 | 77 | 87 | 80 | 77 | 94 | 68 | 71 |
| Profit & Loss | | | | | | | | |
| Sales | 80.8 | 77.1 | 87.2 | 79.8 | 77.1 | 93.9 | 67.5 | 71.0 |
| Gross profit | 8.1 | 6.6 | 8.3 | 7.4 | 8.0 | 8.6 | 6.9 | 7.4 |
| S, G & A | (6.7) | (6.0) | (7.3) | (7.1) | (6.7) | (7.1) | (8.8) | (8.8) |
| Opg Pft | 1.4 | 0.6 | 1.0 | 0.2 | 1.3 | 1.5 | (1.9) | (1.4) |
| Interest expense | (0.1) | (0.1) | (0.0) | (0.1) | (0.2) | (0.4) | (0.5) | 0.3 |
| Associates | 1.2 | 0.8 | 0.8 | 1.6 | 1.8 | 0.7 | 1.6 | 2.0 |
| Pretax profit | 2.5 | 1.4 | 1.7 | 1.7 | 2.9 | 1.8 | (0.9) | 0.8 |
| Tax | (1.0) | (0.7) | (0.7) | (0.6) | (0.9) | (0.7) | (0.7) | (1.1) |
| Minority interest | (0.5) | (0.3) | (0.0) | (0.4) | (0.2) | (0.1) | 0.1 | (0.1) |
| Net profit | 1.1 | 0.4 | 1.0 | 0.6 | 1.8 | 1.0 | (1.6) | (0.4) |
| MARGINS | | | | | | | | |
| Gross margin (%) | 10.0 | 8.6 | 9.5 | 9.2 | 10.4 | 9.2 | 10.3 | 10.4 |
| SGA % Sales | (8.2) | (7.8) | (8.4) | (8.9) | (8.7) | (7.6) | (13.1) | (12.5) |
| Opg Mgn (%) | 1.8 | 0.8 | 1.1 | 0.3 | 1.6 | 1.6 | (2.8) | (2.0) |
| EBITDA margin (%) | NA | 2.4 | 15.6 | 17.3 | NA | 3.4 | NA | NA |
| Tax rate (%) | 38.5 | 48.5 | 38.6 | 36.4 | 31.3 | 40.5 | (80.9) | 135.5 |
| QOQ CHANGE (%) | | | | | | | | |
| Sales | na | (4) | 13 | (8) | (3) | 22 | (28) | 5 |
| Gross profit | na | (18) | 25 | (11) | 9 | 8 | (19) | 7 |
| SG&A | na | (10) | 21 | (2) | (6) | 6 | 24 | (0) |
| Opg profit | na | (58) | 59 | (78) | 483 | 16 | (231) | (25) |

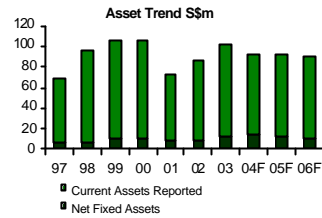
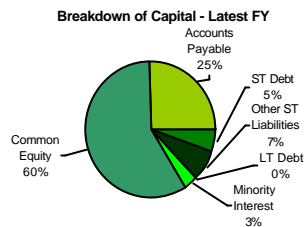
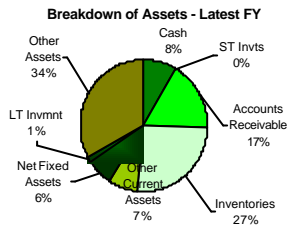
Source: Company; DBS Vickers

Price chart



Source: Bloomberg

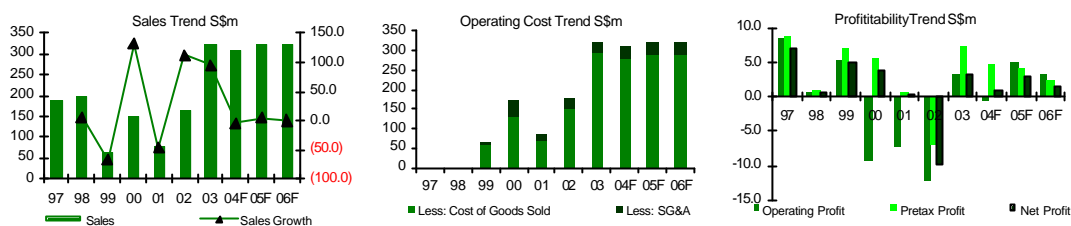
Balance Sheet



| FYE Dec | 97 | 98 | 99 | 00 | 01 | 02 | 03 | 04F | 05F | 06F |
|-------------------------------------|-----------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| Cash | 8 | 29 | 57 | 28 | 20 | 11 | 12 | 3 | 2 | 2 |
| ST Invt | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Accounts Receivable | 35 | 30 | 21 | 19 | 9 | 23 | 24 | 26 | 27 | 27 |
| Inventories | 18 | 29 | 13 | 38 | 27 | 35 | 41 | 39 | 41 | 41 |
| Other Current Assets | 2 | 2 | 4 | 11 | 7 | 9 | 10 | 10 | 10 | 10 |
| Current Assets Reported | 63 | 90 | 95 | 96 | 63 | 78 | 88 | 77 | 80 | 80 |
| Gross Fixed Assets | 7 | 8 | 12 | 12 | 12 | 13 | 19 | 21 | 22 | 22 |
| Accumulated Depreciation | 1 | 2 | 2 | 2 | 3 | 5 | 6 | 8 | 9 | 11 |
| Net Fixed Assets | 6 | 6 | 10 | 10 | 9 | 9 | 13 | 14 | 12 | 11 |
| LT Invmnt | 0 | 1 | 0 | 0 | 2 | 2 | 0 | 28 | 31 | 34 |
| Other Assets | 0 | 5 | 17 | 21 | 33 | 44 | 44 | 25 | 26 | 26 |
| Total Assets | 69 | 101 | 122 | 127 | 106 | 133 | 146 | 145 | 150 | 151 |
| Accounts Payable | 20 | 28 | 17 | 27 | 10 | 33 | 38 | 36 | 38 | 38 |
| ST Debt | 8 | 24 | 6 | 0 | 0 | 7 | 20 | 20 | 20 | 20 |
| Other ST Liabilities | 4 | 0 | 3 | 8 | 3 | 10 | 2 | 2 | 2 | 2 |
| Current Liabilities | 32 | 53 | 27 | 35 | 13 | 50 | 59 | 57 | 59 | 59 |
| LT Debt | 0 | 0 | 0 | 0 | 0 | 0 | 2 | 2 | 2 | 2 |
| Other LT Liabilities | 0 | 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Total Liabilities | 32 | 53 | 28 | 36 | 13 | 51 | 62 | 60 | 62 | 62 |
| Preferred Equity | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Minority Interest | 2 | 2 | 4 | 1 | 1 | 4 | 3 | 4 | 4 | 5 |
| Common Equity | 35 | 47 | 91 | 90 | 92 | 78 | 81 | 81 | 84 | 85 |
| Total Shareholders' Equity | 37 | 48 | 95 | 91 | 93 | 82 | 84 | 85 | 88 | 90 |
| Total Liabilities and Equity | 69 | 101 | 122 | 127 | 106 | 133 | 146 | 145 | 150 | 151 |
| Shares Outstanding | 250 | 274 | 302 | 300 | 302 | 302 | 302 | 303 | 303 | 303 |
| Accounts Rec DOS | 67 | 54 | 118 | 47 | 42 | 49 | 27 | 30 | 30 | 30 |
| Inventory DOS | 36 | 53 | 74 | 93 | 125 | 77 | 45 | 45 | 45 | 45 |
| Accounts Payable DOS | 38 | 50 | 99 | 65 | 44 | 72 | 42 | 42 | 42 | 42 |
| Working Capital | 31 | 37 | 68 | 61 | 51 | 29 | 29 | 20 | 21 | 21 |
| Non Cash Working Capital | 31 | 33 | 17 | 33 | 31 | 25 | 36 | 37 | 39 | 39 |
| Net Cash (Debt) | 0 | 5 | 51 | 27 | 20 | 4 | (9) | (19) | (19) | (20) |
| Net Gearing (%) | Cash | Cash | Cash | Cash | Cash | Cash | 11 | 23 | 23 | 23 |

Source: Company; Bloomberg; DBS Vickers

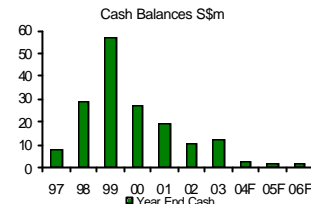
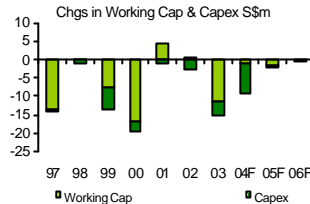
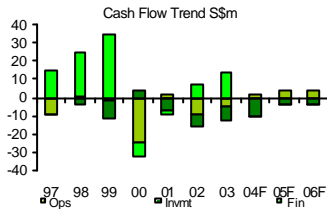
Profit & Loss Statement



| FYE Dec | 97 | 98 | 99 | 00 | 01 | 02 | 03 | 04F | 05F | 06F |
|--------------------------------------|-------|-------|-------|--------|-------|---------|-------|-------|-------|-------|
| Sales | 186.2 | 198.7 | 63.9 | 148.4 | 77.9 | 165.5 | 324.8 | 309.5 | 325.0 | 325.2 |
| Less: Cost of Goods Sold | n.a. | n.a. | 57.5 | 133.8 | 68.5 | 153.2 | 294.5 | 278.6 | 290.9 | 292.7 |
| Gross Profit | n.a. | n.a. | 6.4 | 14.6 | 9.3 | 12.3 | 30.3 | 31.0 | 34.1 | 32.5 |
| Less: SG&A | n.a. | n.a. | 6.1 | 37.9 | 18.5 | 26.9 | 27.1 | 31.6 | 29.2 | 29.3 |
| Operating Profit | 8.5 | 0.7 | 5.2 | (9.3) | (7.2) | (12.2) | 3.2 | (0.6) | 4.9 | 3.3 |
| Less: Net Interest Exp (Inc) | 0.5 | 1.7 | 0.3 | 0.5 | 0.1 | 0.1 | 0.4 | 0.8 | 0.9 | 1.0 |
| Less: Associates Losses (Gains) | (0.6) | (0.9) | (2.1) | (15.7) | (7.3) | (5.5) | (4.4) | (6.1) | (0.2) | (0.2) |
| Pretax Profit | 8.7 | 1.0 | 6.9 | 5.6 | 0.8 | (7.1) | 7.3 | 4.7 | 4.2 | 2.5 |
| Less: Exceptional Losses (Gains) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Less: Tax | 1.0 | 0.2 | 1.8 | 2.7 | 0.6 | 2.0 | 2.9 | 3.5 | 0.8 | 0.5 |
| Inc(Loss) bef X-Ord Items | 7.7 | 0.8 | 5.1 | 2.8 | 0.2 | (9.1) | 4.4 | 1.2 | 3.4 | 2.0 |
| Less: Extraord L(G) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Less: Minority Interests | 0.6 | 0.3 | (0.0) | (0.9) | (0.2) | 0.8 | 1.2 | 0.3 | 0.4 | 0.4 |
| Net Profit | 7.1 | 0.6 | 5.1 | 3.7 | 0.3 | (9.9) | 3.2 | 0.8 | 3.0 | 1.6 |
| Dividends & Cash Earnings | | | | | | | | | | |
| Cash Dividends | 1.6 | 0.4 | 1.5 | 3.0 | 1.5 | 0.3 | 0.7 | 0.4 | 0.3 | 0.2 |
| Reinvested Earnings | 5.4 | 0.2 | 3.6 | 0.7 | (1.2) | (10.2) | 2.5 | 0.4 | 2.7 | 1.4 |
| Div Payout Ratio (%) | 23.2 | 67.9 | 29.6 | 80.9 | 457.6 | (3.0) | 22.4 | 48.3 | 31.0 | 31.0 |
| EBIT | 8.5 | 0.7 | 5.2 | (9.3) | (7.2) | (12.2) | 6.9 | 3.9 | 3.3 | 1.5 |
| Depreciation | 0.2 | 0.4 | 0.3 | 1.4 | 1.3 | 1.4 | 1.0 | 1.7 | 1.9 | 2.0 |
| EBITDA | 8.8 | 1.1 | 5.5 | (7.9) | (5.9) | (10.9) | 8.0 | 5.6 | 5.2 | 3.5 |
| Cash Flow | 7.3 | 1.0 | 5.4 | 5.1 | 1.6 | (8.5) | 4.2 | 2.5 | 4.9 | 3.6 |
| Growth Rates (%) | | | | | | | | | | |
| Sales | | 7 | (68) | 132 | (48) | 113 | 96 | (5) | 5 | 0 |
| COGS | | n.a. | n.a. | 133 | (49) | 124 | 92 | (5) | 4 | 1 |
| SG&A | | n.a. | n.a. | 524 | (51) | 45 | 1 | 16 | (7) | 0 |
| Opg Pft | | (92) | 619 | n.a. | (22) | 70 | (1) | (119) | (888) | (33) |
| Pretax Pft | | (89) | 598 | (20) | (86) | (1,017) | n.a. | (36) | (11) | (41) |
| Net Profit | | (92) | 811 | (27) | (91) | n.a. | n.a. | (74) | 261 | (46) |
| Margins (%) | | | | | | | | | | |
| Gross Margin | n.a. | n.a. | 10.0 | 9.8 | 12.0 | 7.4 | 9.3 | 10.0 | 10.5 | 10.0 |
| SGA % Sales | n.a. | n.a. | 9.5 | 25.6 | 23.8 | 16.2 | 8.3 | 10.2 | 9.0 | 9.0 |
| EBITDA Margin | 4.7 | 0.6 | 8.5 | -5.3 | -7.6 | -6.6 | 2.5 | 1.8 | 1.6 | 1.1 |
| Operating Margin | 4.6 | 0.4 | 8.1 | -6.3 | -9.3 | -7.4 | 1.0 | -0.2 | 1.5 | 1.0 |
| Net Margin | 3.8 | 0.3 | 8.0 | 2.5 | 0.4 | -6.0 | 1.0 | 0.3 | 0.9 | 0.5 |
| Depr % of sales | 0.1 | 0.2 | 0.4 | 0.9 | 1.6 | 0.8 | 0.3 | 0.5 | 0.6 | 0.6 |
| Effective Tax Rate % | 12 | 17 | 26 | 49 | 81 | -28 | 40 | 75 | 20 | 20 |

Source: Company; Bloomberg; DBS Vickers

Cash Flow Statement



| FYE Dec | 97 | 98 | 99 | 00 | 01 | 02 | 03 | 04F | 05F | 06F |
|--------------------------------|--------|-------|--------|--------|-------|--------|--------|--------|-------|-------|
| Cash Flow Net Income | 8.7 | 1.0 | 5.7 | 0.3 | (3.6) | (12.3) | 2.9 | 0.8 | 3.0 | 1.6 |
| Depreciation & Amortization | 0.2 | 0.4 | 0.5 | 1.7 | 1.6 | 2.3 | 2.9 | 1.7 | 1.9 | 2.0 |
| Other Non-Cash Adjustments | (4.0) | (1.5) | 0.3 | (9.9) | (0.6) | 0.5 | 1.0 | 0.0 | 0.0 | 0.0 |
| Changes in Non-Cash Work Cap | (13.8) | 0.3 | (7.9) | (17.0) | 4.5 | 0.5 | (11.4) | (1.3) | (1.4) | (0.0) |
| Cash From Operations | (8.9) | 0.2 | (1.4) | (24.9) | 1.9 | (8.9) | (4.5) | 1.2 | 3.5 | 3.6 |
| Disposal of Fixed Assets | 0.0 | 0.0 | 0.1 | 0.3 | 0.4 | 0.1 | (1.0) | 0.0 | 0.0 | 0.0 |
| Capital Expenditures/Prop Add | (0.4) | (0.9) | (5.9) | (2.8) | (0.9) | (2.5) | (3.9) | (7.8) | (0.6) | (0.5) |
| Decrease in Investments | 0.0 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.9 | 0.0 | 0.0 |
| Increase in Investments | (0.1) | (0.5) | 0.0 | 0.0 | 0.0 | 0.0 | (2.9) | (3.3) | (3.0) | (3.0) |
| Other Investing Activities | 0.0 | (2.4) | (4.9) | 6.0 | (6.3) | (4.0) | (0.5) | 0.0 | 0.0 | 0.0 |
| Cash from Investing Activities | (0.5) | (3.5) | (10.7) | 3.6 | (6.8) | (6.5) | (8.3) | (10.2) | (3.6) | (3.5) |
| Dividends Paid | (1.6) | (1.6) | (3.3) | (1.5) | (3.0) | (1.5) | (0.3) | (0.7) | (0.4) | (0.3) |
| Inc(Dec) in ST Borrowings | 3.1 | 14.2 | (2.5) | (6.0) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Increase in LT Borrowings | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 9.5 | 15.5 | 0.0 | 0.0 | 0.0 |
| Reimbursement of LT Borrowings | (0.0) | (0.0) | 0.0 | 0.0 | (0.0) | (1.3) | (1.1) | 0.0 | 0.0 | 0.0 |
| Increase in Capital Stocks | 13.0 | 12.0 | 37.8 | 0.1 | 0.1 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 |
| Decrease in Capital Stocks | 0.0 | 0.0 | (1.0) | (1.8) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other Financing Activities | (0.1) | (0.4) | 3.5 | 1.3 | (0.0) | 0.0 | (0.5) | 0.0 | 0.0 | 0.0 |
| Cash from Financing Activities | 14.4 | 24.2 | 34.6 | (7.8) | (3.0) | 6.7 | 13.7 | (0.7) | (0.4) | (0.3) |
| Net Changes in Cash / ST Invmt | 5.1 | 20.9 | 22.5 | (29.1) | (7.9) | (8.7) | 0.9 | (9.7) | (0.5) | (0.2) |
| Free Cash Flow | (9.3) | (0.6) | (7.3) | (27.6) | 1.0 | (11.4) | (8.4) | (6.6) | 2.9 | 3.1 |
| Free Cash Flow/Basic Shr | (4.0) | 0.0 | (2.0) | (9.0) | 0.0 | (4.0) | (2.8) | (2.2) | 1.0 | 1.0 |
| Cash Flow per Share | (4.0) | 0.0 | 0.0 | (8.0) | 1.0 | (3.0) | 1.4 | 0.8 | 1.6 | 1.2 |

Source: Company; Bloomberg; DBS Vickers

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