MALAYSIA

D&O Ventures Berhad

Lighting up

Second Board bound D&O Ventures is a contract manufacturer providing assembly, testing and packaging services for semiconductor components. D&O is positioned to ride on growth in optoelectronics – the fastest growing segment within the semiconductor sector. In particular, the company foresees robust demand for LED products going forward. At its IPO offer price of RM0.38/share, the stock is valued at a forward P/E multiple of 12.0x on its prospectus 2005 forecast.

- **A one-stop chip maker.** D&O provides assembly, testing and packaging of optoelectronic and discrete semiconductor components. It positions itself as a "One-Stop" service provider, offering complete product packaging services and solutions. Its products are sold to multi national companies (MNCs) and licensed manufacturing warehouses (LMWs), for applications in a wide variety of end-uses from home appliances to traffic and rear automotive lighting to avionics systems. Whilst most of D&O's customers are located at free trade zones in Malaysia, these companies in turn export their finished products to end customers overseas.

- **Shine from optoelectronics.** After riding on an uptrend since 2003, the semiconductor industry is undergoing an inventory adjustment phase, and the US-based Semiconductor Industry Association (SIA) is forecasting flat sales growth for the semiconductor industry in 2005. However, the optoelectronics segment is expected to shine with a projected 12.8% growth next year, outperforming the other segments. This should benefit optoelectronics-related players like D&O ahead, who are anticipating growth in LED product applications. To prepare for an anticipated increase in demand for its products, the Group has already embarked on expanding its capacity.

- **IPO price implies a P/E of 12.0x 2005 earnings.** At its IPO price of RM0.38, D&O shares will be valued at a P/E of 12.0x on its prospectus FY05 earnings. Whilst not directly comparable, MPI and Unisem (two semiconductor companies in our coverage) are now trading at an average P/E ratio of 16.8x, above our average implied target P/E multiple of 15.1x. We have not put a fair value on D&O shares, as HDBS is an adviser to the IPO deal.

Forecasts and Valuation

FY Dec (RM m)	2002A	2003A	2004E	2005F
Turnover	40.3	69.2	109.1	153.3
EBITDA	9.2	13.0	n.a.	n.a.
Pre-tax Profit	7.0	9.7	16.0	25.2
Net Profit	6.4	9.2	15.7	23.1
EPS (sen) *	0.9	1.3	2.1	3.2
EPS Growth (%)	80.0	44.4	61.5	52.4
P / E Ratio (x) ^	43.6	30.0	17.7	12.0
DPS (sen)	n.a.	n.a.	0.1	0.3
Div Yield (%) ^	n.a.	n.a.	0.3	0.8
ROE (%)	n.a.	n.a.	n.a.	n.a.
Book Value (RM)	n.a.	n.a.	0.2	n.a.
P / Book Value (x)^	n.a.	n.a.	2.5	n.a.

** - based on enlarged share capital of 730m*
^ - based on the IPO price of RM0.38
E – based on the prospectus estimate, includes a pre-acquisition profit of RM10.9m
F - based on prospectus forecast

Historical Financial Analysis

FY Dec (%)	2001A	2002A	2003A
EBITDA Margin	22.9	22.9	18.8
Pre-tax Margin	15.6	17.3	14.1
Net Profit Margin	12.0	15.8	13.4
Tax rate	22.8	9.1	5.1

Key Growth Drivers

- Increasing demand for LED products
- New manufacturing contracts from existing and new customers
- Introduction of new products
- Increasing capacity for LED lamps and other OEM products

Listed Peers

	Market Cap (RM m)
M'sia Pacific Ind	3,085.3
Unisem	1,080.0

Issue Price: RM0.38
Tentative closing: 16 Dec
Tentative listing: 28 Dec

At a Glance

Sector: Industrial products

Issue Statistics:

LISTING DETAILS	
Issue Manager:	HDBS
Funds Raised (RMm):	39.0
Shares on offer (m):	102.6
New Shares (m):	102.6
Vendor Shares (m):	-
Placement Shares (m):	66.1
Public Offer (m):	36.5
POST LISTING	
Ord Share Cap (m):	730.0
Par value (sen):	10
Mkt Cap (RMm) * :	277.4
Est Free Float %:	34.8

* *Based on the issue price of RM0.38*

USE OF PROCEEDS (RM m)	
Capital expenditure	7.8
Equipment & tooling	21.8
New MIS infrastructure	0.8
Working capital	3.6
R&D expenditure	3.0
Est listing expenses	2.0

Management:

Dato Md Azlan Hashim	Chairman
Tay Kheng Chiong	MD
Cheam Dau Peng	ED

Ownership:

PRT Capital Pte Ltd	16.5%
Magna Reserve S/B	14.5%
Omega Riang S/B	11.6%
Dato Md Azlan Hashim	11.0%
Datin Nonadiah Abdullah	4.5%
Dr Lim Thian Soo	3.25%
Lim Thiam Cheok	3.24%
Lim Yam Poh	0.3%
Lim Yam Chiew	0.3%
Goh Nan Yang	<0.1%

Business Description:

Key Activities & Products: Contract manufacturing services for semiconductor components.

Customers: MNCs involved in the E&E industry.

Suppliers: Suppliers of leadframes, headers, silver preform, metal caps, solder bars, mould compound, resin, hardener, silver epoxy, aluminium wire and gold wire.

ATTENTION: HWANG-DBS SECURITIES BHD, A PARENT COMPANY OF HWANG-DBS VICKERS RESEARCH SDN BHD, IS THE ADVISER, MANAGING UNDERWRITER, UNDERWRITER AND PLACEMENT AGENT OF THIS IPO ISSUE.

Malaysia Research Team· 603-2711 2222· general@hwangdbsvickers.com.my

Refer to important disclosures at the end of this report

Background

• **A one-stop, export-oriented chips manufacturer.** Since commencing operations in 1993, D&O has grown from a subcontractor of metal-can semiconductor products with 60 employees to an established contract manufacturer of optoelectronics and discrete semiconductor components, with a total workforce of 1,235 (as at Oct 2004). The Group provides a full range of contract manufacturing services – covering assembly, testing and packaging services – for the manufacturing of semiconductor components. It specialises in hermetic sealed metal-cans (for lasers, sensors, transistors and diodes), resin filled encapsulation packages (for LEDs) and thermoset epoxy moulded packages (for transistors and diodes), which are used in a wide range of applications, ranging from traffic lights to industrial machinery. A list of D&O's products and their applications and end-uses is provided below:

D&O Ventures: Product range

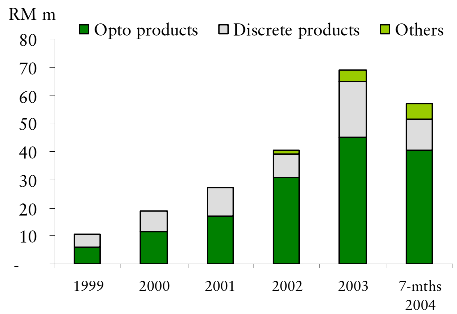
Product type	Application	End-applications
a) Transistor Metal-Can	Transistor, power transistor, voltage regulator, IC	– Avionics systems – Automotive, electronic and military hardware – Industrial equipment – Power generating and medical equipment
b) Opto Metal-Can	Infrared emitter and infrared detector	– Home appliances – Data transmission and telecommunication equipment
c) Photonics Metal-Can – VCSEL – Infra Red – UV – Radio frequency	Emitter and detector, media using light wavelength or radio frequency or pressure	– Wireless communication hardware – Weather station monitor – Sport watches – Welding helmets – Sun bed dosimeter – Purification of air, water and waste water systems – Automotive engine management system – Medical equipment – Industrial equipment
d) Small outline transistor/diode/ radio frequency mixer	Voltage regulator, diode transistor and radio frequency mixer	– Cellular phones – Computers – Audio-visual equipment – Traffic signals – Advertising billboards – Car lights and industrial equipment
e) Discrete transistor	Transistor and voltage regulator	– Cellular phones – Computers – Audio-visual equipment – Traffic signals – Advertising billboards – Car lights and industrial equipment
f) LED lamps	Outdoor display lighting, equipment indicator lighting and infrared light emitter	– Audio visual equipment – Household electronic equipment – Traffic signals – Automobile cockpit and back lighting

Source: Company prospectus

Positioning itself as a "one-stop shop", providing complete product packaging services and solutions, D&O supplies most of its products to MNCs who are engaged in the manufacture of semiconductor products. Although the Group derives its sales from MNCs and LMWs located in Malaysia's free trade and industrial zones, these MNCs and LMWs will ultimately export 100% of the final products worldwide.

• **Optoelectronics the main income contributor.** In terms of revenue contribution, optoelectronics (which includes LED lamps) makes up the bulk of D&O's revenue (see chart below), contributing 65% and 71% to the Group's revenue in 2003 and for the 7-months ended Jul 04, respectively.

D&O: Revenue breakdown



Source: Company prospectus

• **Lopsided customer risk.** The D&O Group is highly dependent on a handful of key customers. In 2003, 90% of its revenue was generated by two MNC customers, namely Agilent Technologies (62%) and STMicroelectronics (28%). Three other key customers, namely Fairchild Semiconductor, Central Semiconductor Corporation and Matsushita Precision Capacitor, made up another 8.3% of the Group's revenue in 2003. This raises concerns of an over-dependence on key customers. Further, as the semiconductor business is a globally competitive industry, there is also the risk of MNCs relocating or terminating contracts (to switch suppliers). Nonetheless, the Group's lopsided risk is somewhat mitigated by the long-standing business relationships with its key customers (ranging between 2 years to 7 years).

In addition, the Group's main business contracts are mainly on a "captive line" arrangement, whereby its customers consign their production equipment to D&O for the purpose of producing the scheduled orders. This will discourage its customers from terminating their business relationships with D&O, considering the high relocation cost factor and the lengthy process to seek their end-customers approval for a change in upstream suppliers.

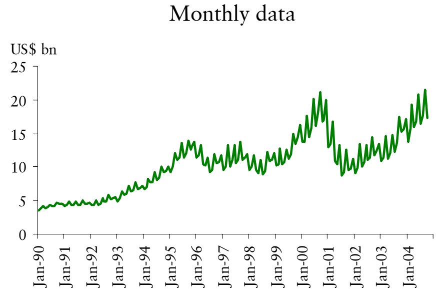
• **No potential conflict of interest.** 7 Directors / substantial shareholders of D&O own a controlling stake in a private company – Dominant Semiconductors Sdn Bhd – which is also involved in the semiconductor business. However, strictly speaking, Dominant is engaged in the manufacturing of surface-mount-technique LEDs for end-user applications such as hand phones and automotive interior lightings, whilst D&O focuses more on LEDs with end-applications in traffic lights and outdoor display signboards. As both target different segments of the semiconductor industry, according to the prospectus, there is no direct competition between D&O and Dominant that can give rise to potential conflicts of interest. Also, a 100%-owned subsidiary of D&O holds an investment in Dominant, in the form of 22.0m 5% redeemable convertible preference shares at an issue price of RM1.00 each (with RM0.55 already called and paid-up to-date).

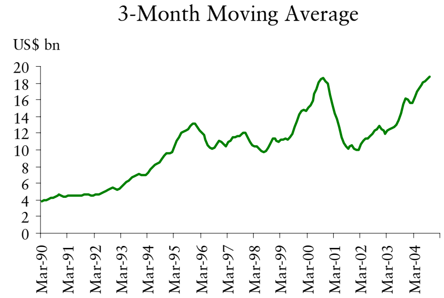
Prospects

• **A highly competitive industry.** The electrical, electronics and machinery group is the leading manufacturing sector in Malaysia. The semiconductor sector is a major part of Malaysia's electronics industry, accounting for 42.8% of the country's total electronics exports in 2003. Whilst the trend towards outsourcing of product manufacturing amongst MNCs remains intact (since sub contractors and full turnkey contract manufacturers are able to lower costs through specialisation and economies of scale), the semiconductor industry is very competitive in Malaysia. In addition to local competition, Malaysian semiconductor manufacturers also compete with regional and global players, due to the export-oriented nature of the semiconductor industry.

• **Optoelectronics to outperform.** Demand and supply within the global semiconductor industry is typically cyclical in nature, with each cycle having two years of strong growth, one year of slow growth and one year of flat or declining growth. The global semiconductor industry experienced its worst ever downturn in 2001, but global billings have since been on an uptrend (see chart overleaf), reaching US$166.4bn in 2003.

Semiconductor industry – Global billings:





Source: Semiconductor Industry Association (www.sia-online.org)

After riding on an uptrend since 2003, the US-based Semiconductor Industry Association (SIA) predicts the global market growing 28.5% to US$213.8bn in 2004. Beyond that, it anticipates the overall industry growth to come in flat in 2005 before resuming its uptrend, growing by 6.3% in 2006 and 14.2% in 2007 (see table below).

Still, amid the flattish semiconductor demand outlook for 2005, the optoelectronics segment – which accounted for 65% and 71% of D&O's revenue in 2003 and 7-months ended Jul 04 – is expected to outperform the overall industry, growing by 12.8% in 2005, 10.2% in 2006 and 15.4% in 2007, respectively.

Global semiconductor market: SIA forecasts

	2004F	2005F	2006F	2007F
Total semiconductors	28.5%	0.0%	6.3%	14.2%
Discrete components	19.4%	-0.2%	2.9%	7.7%
Optoelectronics	45.9%	12.8%	10.2%	15.4%

Source: Semiconductor Industry Association (www.sia-online.org)

• **Future plans.** The Group is looking to consolidate its position by establishing itself as a full turnkey contract manufacturer within three years. The future plans include:

1) *Providing more capacity space* –The Group is looking to provide more capacity space to absorb excess production volume, as well as expand orders of new products from its existing customers, and has already begun capacity expansion for 2 of its new OEM packages to meet customer requirements.

2) *Upgrading existing technology platform* - The Group plans to upgrade its existing technology platform to enable the Group to assemble and test OEM metal-can packages for niche markets. This will involve more collaboration with existing and new customers for new semiconductor products particularly in the assembly and packaging processes;

3) *Intensifying marketing efforts and widening its customer base* - The key objective of these efforts will be to broaden the Group's customer base, and to explore potential opportunities with customers in the US, Europe and Japanese markets; and

4) *Rolling out new products* – The Group plans to expand its OEM product portfolio, particularly for Discrete Surface Mount products. It expects to introduce four new packages in 2005 and 2006.

   The Group also plans to develop high technology packaging designs and solutions for wireless semiconductor and UV sensor devices (R&D for which commenced in 2003) as well as to develop packaging process technology of VCSEL for Photonics Technology applications (R&D commenced in 2004). To keep pace with technological advances, management established an R&D team in 2002, and invested RM0.6m and RM0.9m in R&D in 2002 and 2003, and expects to incur c.RM3.0m in 2004, including investment in machinery and equipment.

- **Capacity expansion on the horizon.** The Group currently operates out of two factories located in the Batu Berendam Free Trade Zone in Melaka. Its average plant utilization rate stands at c.84%-86% of its installed capacity (see table below).

D&O Ventures: Capacity & utilisation

Products	Annual production capacity* (m units)	Annual production output * (m units)	Utilisation rate
Discrete products	211	182	86%
Opto products	1,070	894	84%

**Based on the existing installed production capacity (which may fluctuate from time to time)*
Source: Company prospectus

To prepare for an increase in production of OEM products, the Group is in the midst of extending one of its factories (should have been completed by Nov 04) for capacity expansion. Further, the Group has also constructed a new factory building, which will increase its built-up area by 69,539 sq ft when completed in end-2004, catering for the production of LED products.

- **Aggressive earnings projections.** Historically, the Group's revenue has risen at a compounded annual growth rate of 60% from RM10.6m in 1999 to RM69.2m in 2003. This came on the back of greater demand for its products, new contracts secured, higher selling prices as well as the commencement of 'full turnkey' operations. On the back of the growth in revenue and an improvement in operating margins, the Group's net profit grew at a CAGR of 71% to RM9.2m in 2003.

Going forward, the Group expects revenue to grow at 58% and 41% y-o-y in 2004 and 2005 respectively, driven by higher revenue from LED lamps (attributable to the planned transfer of a major customer's remaining in-house manufacturing activities in LED lamps to the Group during year) and discrete metal-can (after securing a new manufacturing contract with an existing customer). Management also believes that worldwide demand for LED lamps will be driven by increasing applications of LED lamps in traffic signal lights, automotive rear lighting and billboard display screens.

In the prospectus forecast, the Group has assumed a turnover contribution of RM12m (or 8% of the projected revenue in 2005) from a new LED product in 2005. Further, the Group also projects a turnover contribution of RM9m (or 6% of projected revenue in 2005) coming from the introduction of a new high-end laser diode.

After factoring in higher sales and an improvement in pre-tax margins – from 14.1% in 2003 to 14.7% in 2004 and 16.4% in 2005 – D&O estimates net profit will jump to RM15.7m (+70%) in 2004 and RM23.1m (+48%) in 2005.

Over the longer term, there is a potential dilution effect at the EPS level coming from the conversion of Employees' Share Option Scheme (ESOS), as the Company has allocated a total of 109.5m shares (or 15% of existing share base) for its employees spread over 10 years.

Meanwhile, based on the Group's consolidated balance sheets as at 31 Jul 04, the Group's NTA (on a proforma basis) would stand at RM0.15 per share, with total borrowings of RM17.0m.

Valuation

- **IPO is priced at 12.0x 2005 earnings.** The IPO offer price of RM0.38 implies a P/E ratio of 12.0x on the Group's 2005 earnings projections. Whilst not directly comparable (as each caters to a different segment of the wide market spectrum with varying product mix), MPI and Unisem (two semiconductor companies in our coverage) are currently trading at an average P/E ratio of 16.8x, above our average target P/E multiple of 15.1x. In addition, D&O is much smaller in size when compared to MPI and Unisem in terms of market capitalisation, sales and net profit.

At the IPO offer price of RM0.38, D&O shares are valued at a P/NTA of 2.5x on its proforma balance sheet as at 31 Jul 04, versus our implied target P/NTA of 3.9x for MPI and 1.7x for Unisem (see comparisons in the table overleaf).

Stock comparison (annualised)

	FYE	Price @ 14-Dec (RM)	Target price (RM)	CY04 EPS (sen)	CY05 EPS (sen)	Current P/E 04 (x)	Current P/E 05 (x)	Target P/E 05 (x)	Latest NTAPS (RM)	Current P/NTA (x)	Market Cap (RM m)
D&O Ventures	Dec	0.38	n.a.	2.1	3.2	17.7	12.0	n.a.	0.15	2.53	277.4
M'sia Pacific Ind	Jun	14.70	13.50	69.4	87.3	21.2	16.8	15.5	3.46	4.25	3,085.3
Unisem	Dec	7.25	6.40	28.2	43.3	25.7	16.7	14.8	3.87	1.87	1,080.0
			Average (ex-D&O Ventures)				*16.8*	*15.1*		*3.1*	

Source: Company prospectus, HDBSV

We have not pegged a fair value on D&O shares (since HDBS is an adviser to the listing exercise). Instead, we have presented below a valuation matrix (based on different assumptions of earnings forecasts, P/E and P/NTA multiples) for illustrative purposes.

Valuation matrix: Implied fair value (based on different earnings and P/E multiple assumptions)

Scenario:	EPS (sen)	Price (in sen) at P/E multiples of: 8x	10x	12x	14x	16x	18x
-20%	2.5	20.3	25.4	30.4	35.5	40.6	45.6
-10%	2.9	22.8	28.5	34.2	39.9	45.6	51.3
Base case EPS 2005	3.2	25.4	31.7	38.0	44.4	50.7	57.1
10%	3.5	27.9	34.9	41.8	48.8	55.8	62.8
20%	3.8	30.4	38.0	45.6	53.3	60.9	68.5

Source: Company prospectus, HDBSV

Valuation matrix: Implied fair value (based on different P/NTA multiple assumptions)

	NTAPS (sen)	Price (in sen) at P/NTA multiples of: 1.5x	2.5x	3.5x	4.5x	5.5x
Proforma NTAPS (as at 31 Jul 04)	15.0	22.5	38.0	52.5	67.5	82.5

Source: Company prospectus, HDBSV

Vincent Khoo, CFA, Director

Hwang-DBS Vickers Research Sdn Bhd (128540 U)
Suite 13.01, Kompleks Antarabangsa, Jalan Sultan Ismail, 50250 Kuala Lumpur, Malaysia.
Tel.: +603 2711-2222 Fax: +603 2711-2333 email : general@hwangdbsvickers.com.my