

D&O VENTURES BHD

Initiating Coverage

BUY

MONDAY, SEPTEMBER 5, 2005

FAIR VALUE : RM 0.56

Analyst

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Price : RM0.47
 Share Capital : 730.00mil
 Market Cap. : RM343.10mil
 Board : Second
 Sector : Technology
 Free Float (est) : 40%

52 Week Price:
 Hi: RM0.65 Low: RM0.38

Major Shareholders

PRT Capital Pte Ltd 16.46%
 Magna Reserve Sdn Bhd 14.51%
 Omega Riang Sdn Bhd 11.59%
 Dato' Mohanned Azlan bin Hashim 11.02%

Key Stock Statistics

	2004	2005F
EPS (RM) (est)	0.022	0.039
P/E (x) (est)	21.87	12.09
Dividend/Share	0.00	0.01
NTA/Share (RM)	0.16	0.18
Book Value/Share (RM)	0.16	0.18

Price Chart



P&L Analysis (RMmil)					
FYE June 30	2002	2003	2004	2005F	2006F
Revenue	40.33	69.19	101.63	154.48	194.65
EBITDA	9.22	13.02	22.23	31.67	40.88
Depreciation	(1.80)	(2.71)	(4.98)	(6.18)	(8.18)
Interest Expenses	(0.62)	(0.77)	(1.08)	(1.62)	(1.95)
Profit from associates	0.00	0.00	0.00	5.64	9.87
Pre-tax Profit	6.99	9.74	16.17	29.53	40.65
Tax	(0.64)	(0.50)	(0.48)	(1.16)	(1.65)
Net Profit	6.36	9.24	15.69	28.38	39.00
Operating Margin	18.41%	14.90%	16.97%	16.50%	16.80%
Pre-Tax Margin	17.34%	14.08%	15.91%	19.12%	20.88%
Net Margin	15.76%	13.36%	15.44%	18.37%	20.03%

Highlights

- D&O is an up and coming player in Malaysia's semiconductor industry with its own niche for packaging, assembly and testing of semiconductors.
- 4 year CAGR for revenue and EBIT are impressive at 40% and 70% respectively.
- D&O's key product, Light Emitting Diodes (LEDs) is set to be the key earnings driver going forward.
- Associate company Dominant Semiconductors Sdn Bhd (Dominant) to provide a further boost to margins.
- We fairly value D&O at RM0.56 which represents a 19.1% upside.

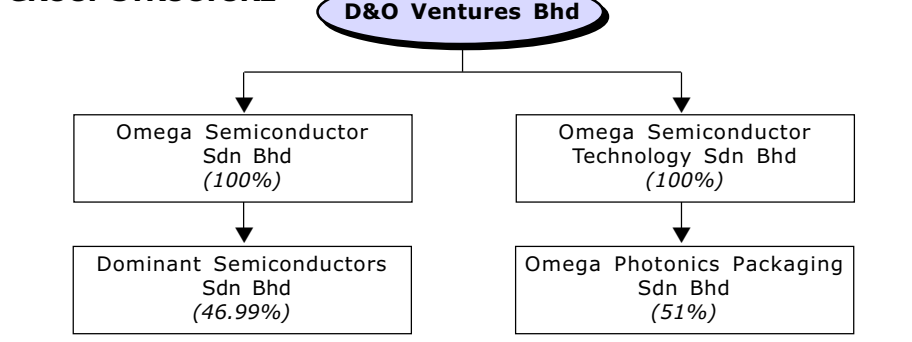
Background

Corporate Profile

Listed in December 2004, D&O Ventures (D&O) is ultimately owned by a Malacca-based team, whom has interest in several entities in Hong Kong and Singapore. The group via its wholly owned subsidiary Omega Semiconductor Sdn Bhd (Omega) is a contract manufacturer for semiconductor components.

Chart 1

GROUP STRUCTURE



Source : Company Data

Operating from 2 factories in Batu Berendam, Malacca, major customers of the Group include Aligent Technologies (M) Sdn Bhd (which contributed to 62% of revenue in FY03), STMicroelectronics Sdn Bhd (28%), and Matsushita Precision Capacitor (M) Sdn Bhd (5.7%).

Business

The captive line agreement. This is where D&O is provided the full consignment of manufacturing equipment for the packaging, assembly and testing of semiconductor products. Much of D&O's growth can be attributed to the inflow of these contracts from its main customers Aligent and STMicroelectronics. We like this aspect of the Group's business as it is recurring in nature. D&O is evidently leveraging well on these contracts as it has maintained steady growth and healthy EBITDA and net margins of roughly 22% and 16%.

D&O's business can be segmented predominantly into two areas, Discrete and Opto products that are further sub-divided into three main manufacturing processes namely: - i) Hermetically Sealed Metal Cans, ii) Resin Filled Encapsulation Packages for LEDs and iii) Thermoset Epoxy Moulded Packages (see Appendix 1 & 2).

Table 1

Estimated Production Capacity and Utilisation Rate			
Product	Annual Production Capacity (mil Units)	Annual Production Output (mil Units)	Utilisation Rate
Discrete	211	182	86%
Opto	1,070	894	84%

Source : Prospectus

Table 2

Revenue Breakdown					
	2000	2001	2002	2003	2004
Discrete	39%	36%	21%	29%	23%
Opto	61%	63%	76%	65%	66%
Others	0%	1%	3%	6%	11%
Revenue (RMmil)	18.89	27.33	40.33	69.19	101.63

Source : Prospectus, EONCAP Securities Sdn Bhd

LED's – lighting the way. Packaging and assembly of Light emitting diodes (LEDs) make up a significant part of D&O's business and have contributed greatly to growth. LEDs have evolved significantly in the past 5 years with demand growth reaching up to 50% per year. The market size is envisaged to exceed US\$3bil by 2006. Taiwan is currently the largest producer of LEDs in the world contributing to half of the world's demand via its 30 LED manufacturers.

Dominant to "dominate" margins. Unlike Omega, Dominant is an ODM (Original Design Manufacturer) that focuses on surface mount LEDs (see Appendix 3). Dominant currently operates at a smaller scale than Omega but is experiencing very rapid growth. Its manufacturing facilities boast full automation and all machinery is proudly in house designed. 2Q05 results showed a 1-month contribution of RM0.99mil for the month of June. We expect similar monthly contributions to boost D&O's bottom line for the rest of FY05 and an increase in FY06.

Earnings Outlook.

Chart 2

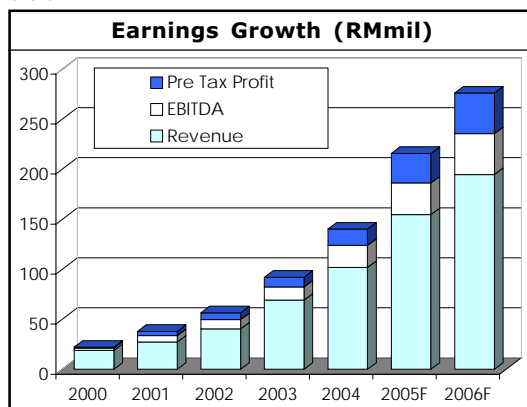
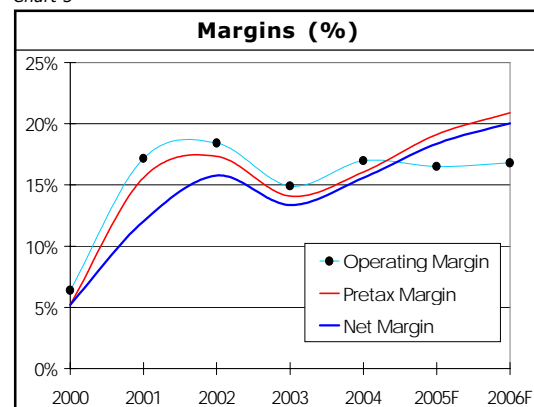


Chart 3



Source : Company Data & EONCAP Securities

Superior track record. D&O Ventures has an impressive 4 year revenue and EBIT CAGR of 40% and 70% respectively. Growth has been largely driven by the increase in demand for LEDs, inflow of "captive line" agreements and OEM contract manufacturing. As shown in the chart above, D&O has been able to maintain healthy EBIT and net margins of 14-18% since FY01. The Group sits comfortably in a net cash position of RM13.2mil. Maintenance capex for all its machinery is roughly at RM4mil pa which we believe can be met by D&O's existing cashflow.

Confident of growth. We are quite bullish on our earnings projections going forward. We project revenue growth at roughly 50% for FY05 and 26% for FY06 as well as net margins escalating to 18-20% from 15.6% in FY04. Our confidence stems from the increasing worldwide demand for D&O's select group of products, it's to be released new range, as well as the improving performance of Dominant.

Having recently listed in December last year, the status of proceeds from listing is as follows:-

Table 3

Description RMmil	Proposed Utilisation	Actual Utilisation as of 20th Aug 05	Balance
Capex on factory expansion	7.850	7.850	0
Purchase of production equipment and tooling	21.782	18.713	3.069
Purchase of new mngt information system infrastructure	0.763	0.227	0.536
R&D Expenditure	3.000	2.830	0.170
Working Capital	3.591	3.000	0.591
Listing Expenses	2.000	1.777	0.223
TOTAL	38.914	34.397	4.517

Investment risks

Overdependence on Aligent Technologies. Having been a customer for more than 6 years, Aligent has contributed significantly to D&O's growth. We are not overly concern with this as chances of Aligent outsourcing elsewhere are slim. Due to the "captive line" agreement, it would not be cost efficient to switch manufacturers.

Competition. Osram Technologies manufacturing arm in Penang poses a big threat to Dominant as it also an ODM for surface mount LEDs. The key advantage they have is a global brand and capital for capacity expansion. Besides that, Taiwan is well known as an LED manufacturer.

Product Lifecycle. As with everything, specialised metal-cans and LEDs will one day become as common as a light bulb. However, these products are in a growing industry and thus surely have more than 5-7 years to expiry. Nonetheless, we believe that the Group is consistently innovating for new manufacturing opportunities and will thus hedge itself from this risk.

Recent Developments

Increasing OEM manufacturing. D&O has set its sights on increasing its OEM product range and getting more OEM manufacturing agreements. D&O is already pending the release of a few new OEM product lines this year. We believe that more OEM customers will strengthen D&O's standing in the industry as well as allow for more customer diversification.

Comparative Valuation

Table 3

Comparative Valuation				
	D&O	Globetronics	Kesm	Mems
Share price @ 02/09/2005	0.470	0.360	1.89	0.73
Mkt Cap (RMmil)	343.1	471.68	81.27	469.36
P/E FY03 (x)	n/a	26.19	13.78	0.00
P/E FY04 (x)	21.87	20.87	8.33	43.14
Price/NTA (x)	2.58	2.25	0.76	6.75
Price/Sales (x)	2.22	1.38	0.53	10.26
Operating Margin (FY04)	16.97%	8.09%	12.42%	23.62%
Dividend Yield	1.45%	2.34%	0.83%	0.00%
Payout Ratio	15.05%	54.51%	0.00%	0.00%

Recommendation

Going forward, we foresee a transfer to main board as D&O's paid up capital and track record qualifies. In terms of valuation, the Group stands in a slightly undervalued position as it has just recently listed. Recent quarterly results show that the Group is set to outperform its target as in the prospectus.

D&O currently trades at a PER of 12.1x based on a prospective EPS of 3.9sen for FY05. Using an eclectic approach from various methodologies, we arrive at a fair value of **56sen** which represents a 19.1% upside. Recommend **BUY**.

Per Share Data			Balance Sheet & other financial data (RMmil)	
	2004	2005F	2004	
Book Value (RM)	0.16	0.18	Total Assets	150.93
Cash Flow (RM)	0.05	0.05	Fixed Assets	79.92
Earnings (RM)	0.02	0.039	Current Assets	71.01
Dividends (sen)	0.00	0.01	Current Liabilities	30.52
Payout Ratio	0%	2.6%	LT Liabilities	6.70
PER (x)	21.87	12.09	Share Capital	73.00
P/Cash Flow	9.9	8.9	Shareholders Funds	113.70
P/Book Value	3.02	2.58		
Dividend Yield (%)	n/a	1.45%		
ROE (%)	13.9%	21.4%		

Fair Value (RM)	
PER	0.61
Price/NTA	0.59
EV/EBITDA	0.47
Simple Average	0.56

Appendix 1

Below is a brief description Omega's production processes.

- 1. Hermetically Sealed Metal Cans.** Any semiconductor device that requires extremely high voltage, current inputs and robust package must be assembled with a metal can. This semiconductor component is used in a electronic circuit and functions as a voltage or power regulator, switching device, amplifier device, UV sensor device, and an infra-red or light emitting device.
- 2. Resin Filled Encapsulation Packages.** This is essentially the plastic housing for an LED (discussed in Appendix 2). The resin allows light of various colour spectrums or infrared light to emit through the package.
- 3. Thermoset Epoxy Moulded Packages.** Epoxy is a plastic bonding agent which can withstand a low to medium voltage or current supply. Typical devices that use this are diode transistors, power transistors, and radio frequency mixers. These devices are in turn assembled in mobile phones, personal computers, automotive electronics and audio visual equipment.

Appendix 2

Light Emitting Diodes.

Having come a long way from barely visible dim lights in our old household appliances and toys, LEDs are a whole new ball game in current times. These little lights have evolved into powerful, durable and, multifunctional items.

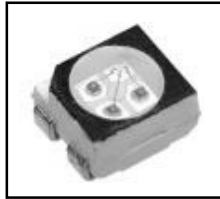
Modern day LEDs boast these benefits:-

- Low power consumption as opposed to conventional lighting
- No Ultraviolet output. UV damages fabric.
- Long lifespan of up to 100,000 hours. An incandescent light bulb will only take you as far as 1000 hours.
- Ecologically friendly
- Light weight
- Emits very little heat output
- Small size allows for various applications
- Coloured light can be produced by controlling the power to each primary colour, eliminating power wastage.

The possibilities are endless. Already actively used in traffic lights, outdoor displays and automobiles, these high quality LEDs have the potential to replace our widely used neon lighting and other indoor lights.

Appendix 3

Surface Mount LEDs. Unlike its two-legged predecessors, surface mount LED's are flat backed and emit light from tiny semiconductor chips housed within them. With chips becoming exceedingly advanced, a single surface mount LED is able to emit different colours as well as white light (previously impossible without chip technology). We find it important to stress the difference between what Dominant and Omega are doing. These LED are more suited to electronic items like mobile phones, laptops and PDA's. Another potential use is for LCD televisions.



BUY (generally >10% upside over the next 12 months)
HOLD (generally \pm 10% over the next 12 months)
SELL (generally >10% downside over the next 12 months)



Kenny Yee
Head of Research

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