STANDARD
&POOR'S

D & O Ventures

Recommendation: **STRONG BUY**

Stock Code: 7204 | Bloomberg: DOV MK | Price: MYR0.535 | 12-Month Target Price: MYR0.67 | Date: November 25, 2005

Board: Second

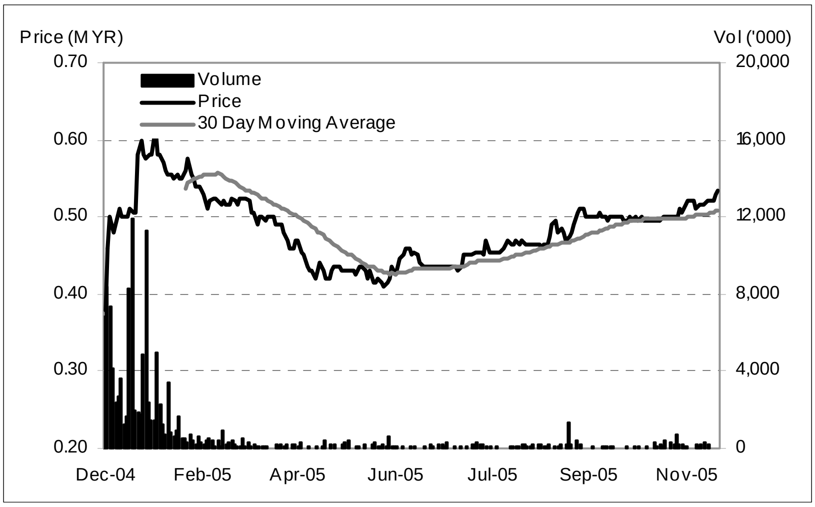
Sector: Technology

GICS: Information Technology / Semiconductors

Market Capitalization: MYR390.6 mln

Summary: D & O Ventures (D&O) provides assembly, testing and packaging services for the manufacturing of semiconductor components. D&O was listed on the Second Board of Bursa Malaysia in Dec. 2004.

Analyst: Vincent Ng



Highlights

- D&O is an established contract manufacturer of semiconductor components and devices for multinational customers. The group is benefiting from increasing outsourcing by MNCs and rapidly growing demand for light emitting diodes (LEDs).
- D&O is aggressively expanding capacity to cater to rising orders from OEM clients and its LED products, and plans to more than double its output by 2006 from 2004.
- We project D&O's net profit to grow by 72% YoY in 2005 and 51% YoY in 2006.

Investment Risks

- Risks to our recommendation and target price include new technologies, which may render D&O's products and services obsolete or uncompetitive.
- In addition, order flow may be disrupted after major customer Agilent completes the sale of its semiconductor products group to private equity investors in Dec. 2005, but customer indications are that it will be business as usual.
- Longer-term growth prospects may be more challenging as competition heats up.

Recommendation

- We initiate coverage on D&O with a Strong Buy recommendation and a 12-month target price of MYR0.67 per share. This is based on 12x projected 2006 EPS, which is within the P/E range of other Malaysian semiconductor assemblers. D&O currently trades at a 20-30% discount to other semiconductor assemblers in Malaysia, which in our view is attractive given its strong earnings outlook.
- Set up more than 10 years ago, D&O is today an established contract manufacturer of discrete semiconductor components, with strong business relationships with well-known MNC customers. It is benefiting from the increasing trend towards outsourcing and also has exposure to the fast growing LED market, which is being driven by expanding applications of LEDs in the automotive and consumer electronics industry. Eventual replacement of the conventional light bulb is expected to be the driver of long-term growth of LEDs.
- D&O's recently acquired associate, Dominant Semiconductors, is growing rapidly, having penetrated the North Asian markets with its own-brand LED products, and the outlook is encouraging as it expands its marketing to Europe and the U.S. amidst buoyant demand for LED products globally. According to market research firm Strategies Unlimited, worldwide sales of LEDS will increase by 84% between 2004 and 2009.

Key Stock Statistics

FY Dec.	2004	2005F
EPS (sen)	2.5	3.7
PER (x)	21.4	14.5
Dividend/Share (sen)	0.1	0.1
NTA/Share (MYR)	0.16	0.19
Book Value/Share (MYR)	0.16	0.19
Issued Capital (mln shares)	730.0	
52-week Share Price Range (MYR)	0.38 - 0.645	
Major Shareholders:	%	
PRT Capital	16.5	
Magna Reserve	14.5	
Omega Riang	11.6	

Per Share Data

FY Dec.	2002	2003	2004	2005F
Book Value (MYR)	NA	NA	0.16	0.19
Cash Flow (sen)	NA	NA	1.6	4.6
Earnings (sen)	NA	NA	2.5	3.7
Dividend (sen)	NA	NA	0.1	0.1
Payout Ratio (%)	NA	NA	15.0	2.7
PER (x)	NA	NA	21.4	14.5
P/Cash Flow (x)	NA	NA	34.2	11.8
P/Book Value (x)	NA	NA	3.4	2.8
Dividend Yield (%)	NA	NA	0.2	0.2
ROE (%)	NA	NA	13.8	19.3
Net Gearing (%)	NA	NA	0.0	1.3

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Background

Corporate Profile

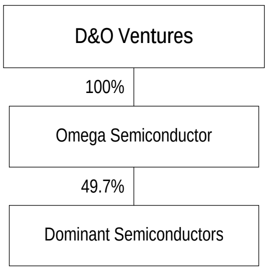
Malacca-based D&O, through wholly-owned Omega Semiconductor (Omega), is a contract manufacturer of semiconductor devices for MNCs, specializing in LEDs. Its 49.7% associate, Dominant Semiconductors (Dominant), designs, develops, assembles and tests opto semiconductor products, mainly surface-mount LEDs.

D&O was listed on the Second Board of Bursa Malaysia in Dec. 2004, following its IPO of 102.6 mln new shares at MYR0.38 each, which raised about MYR37 mln (net of listing expenses).

The board's non-independent and non-executive directors together control about 68% of the company, directly and indirectly. We note that Dato' Mohammed Azlan, formerly Executive Chairman of the Kuala Lumpur Stock Exchange (now known as Bursa Malaysia), is Non-Executive Chairman of D&O. The management team is led by Group Managing Director Tay Kheng Chiong (0.5% stake in D&O) and Executive Director Cheam Dau Peng (1.1%), both of whom have extensive experience in the semiconductor industry.

No significant corporate governance issues were noted. Independent directors are fairly well represented, accounting for three of the eight board members. All three independent directors sit on the audit committee, and two of them on the remuneration committee.

Corporate Structure



Source: Company data

Business

Wholly-owned Omega was established in 1993 and started as a sub-contractor for global semiconductor firm STMicroelectronics (STM FB, Hold). Today, Omega provides full turnkey contract manufacturing services for the manufacture of semiconductor components, specializing in through-hole LEDs (which are used in traffic lights and outdoor display signboards, and account for about 70% of revenue) and discrete components (transistors and diodes). Its major customers include Agilent Technologies (A US, Hold) (79% of sales in 1H05), STMicroelectronics (11.8%), Matsushita (6752 JP, Strong Buy) (3.2%) and Fairchild Semiconductor (FCS US, Hold) (2.1%).

About 80% of Omega's revenue comes from 'captive-line' contracts, where customers consign to the company their production equipment, which is used solely to manufacture for those specific customers. Such arrangements reduce the risk of losing customers due to high switching costs. The other 20% of revenue comes from OEM arrangements, where Omega manufactures for customers with its own equipment and have some design input.

The company's operating margin is significantly higher than other semiconductor assemblers in Malaysia (refer to table below). We believe this is due to the company's focus on a small number of quality customers (top four customers account for 96% of revenue), which allows it to provide superior service and generate greater efficiencies. According to management, the company's ability to fabricate its own, and to modify used equipment and tooling, also helps to lower costs. Omega's exposure to the LED segment, which is growing faster than the overall semiconductor industry, could also be another reason for the superior margin.

EBIT Margin Comparison (%)

	D&O	MPI	Unisem	Globe
Jan-Sep 2005	17.0	5.3	10.4	7.3

Note: MPI = Malaysian Pacific Industries (MPI MK, Not Ranked), Unisem = Unisem (Malaysia) (UNI MK, Not Ranked), Globe =Globetronics Technology (GTB MK, Not Ranked)

Source: Company data

Dominant was set up in 2000 by the same people behind Omega and is principally involved in the manufacture of surface-mount LEDs, which are used in mobile phones (keypad lighting and camera flash) and automotive interior lightings. Unlike Omega, Dominant develops its own products and mainly markets them under its own brand name. Currently, 60-70% of revenues are generated from Korean customers, such as Samsung Electronics (005930 KS, Not Ranked), LG Electronics (066570 KS, Not Ranked) and Hyundai Motor Company (005380 KS, Not Ranked). D&O's 49.7% stake in Dominant was acquired in Jun. 2005 after the company agreed to pay MYR44 mln to convert MYR22 mln worth of redeemable convertible preference shares into ordinary shares. Omega has paid only MYR3.3 mln so far, with the balance of MYR40.7 mln payable as and when Dominant shall call. Dominant's other shareholders include the controlling shareholders of D&O and Group MD Mr. Tay.

D&O acquired its stake in Dominant after the company had received a favorable ruling in a patent infringement case, which could help it enter the U.S. market. Osram GmbH, the lighting unit of German industrial group Siemens AG (SIE GR, Hold), had filed a complaint in May 2004 against Dominant with the United States International Trade Commission (USITC) alleging that Dominant had infringed on several of Osram's LED technology patents – namely three families of product patents and one minor process patent. The main complaint covered the technology that enables LEDs to emit white light from a single semiconductor chip. Such LEDs are typically used for display backlighting for mobile phones and automobile dashboards. The USITC has cleared Dominant of the main complaint, and has made an initial judgement that Dominant did not infringe on Osram's product patents, but did so on the process patent for Dominant's Super SmallDomiLEDs. According to management, the decision has opened the way for Dominant to compete with Osram, which has a near monopoly in the supply of LEDs to the global auto market. The unfavorable ruling on the process patent is expected to have minimal impact on Dominant, as it never commercialized the Super SmallDomiLEDs. Dominant has since filed its own suit against Osram for violating U.S. unfair competition laws.

Omega and Dominant have grown rapidly in the past few years, on the back of increased outsourcing by MNCs, who find it more cost-effective than in-house manufacturing. The rapidly rising demand for LED lamps has also been a contributing factor. Omega's revenue has increased from MYR10.6 mln in 1999 to MYR101.6 mln in 2004, and net profit has surged from MYR1.1 mln to MYR15.7 mln over the same period. From 2002 to

2004, Dominant has seen its revenue rise from MYR12.7 mln to MYR74.3 mln and bottomline improve from a MYR2.5 mln loss to MYR6.0 mln profit.

The market for high-brightness (HB) LEDs has been growing at an annual rate of 46% since 1995 to US$3.7 bln in 2004. In recent years, much of this growth has been driven by the increasing use of HB LEDs in mobile devices, e.g. mobile phones, digital cameras and PDAs (for keypad and LCD backlighting, and flashlights). According to market research firm Strategies Unlimited (SU), the mobile appliance segment accounted for 57% of the HB LED market in 2004. SU expects the HB LED market to grow by 12.9% p.a. on average for the next five years, driven by emerging applications such as general illumination (replacement of conventional lamps), automotive headlamps and backlights for LCD monitors and TV screens.

The increasing popularity of LEDs is due to their advantages over conventional incandescent light bulbs. LEDs can last up to 50 times longer as they don't have a filament that will burn out; their small plastic bulbs make them a lot more durable and they fit more easily into modern electronic circuits; they are also more environmentally friendly, as they do not contain mercury, unlike conventional lightings. But the main advantage is efficiency. LEDs generate very little heat, relative to conventional light bulbs. Hence, a much higher percentage of the electrical power goes directly to generating light, which can lead to as much as 90% energy savings. LEDs were previously too expensive to use for most lighting applications, but the price of semiconductor devices has plummeted over the past decade, making LEDs a more cost-effective lighting option for a wide range of situations. While they may be more expensive than incandescent lights up front (about 50 times), their lower cost in the long run can make them a more attractive option, especially after taking into account the current high cost of energy.

The LED market is fairly competitive. The high-end segment (e.g. LEDs for automotive interior lightings, backlight for LCD displays and handphone keypad lightings and camera flashes) is dominated by big players such as Cree (USA), Nichia (Japan), Osram (Germany) and Lumileds (joint venture between Agilent and Royal Philips Electronics). Hundreds of Taiwanese and Chinese companies fight over the rest of the market (e.g. LEDs for traffic lights, outdoor display signboards, indicator lights on household appliances and illuminated numbers on digital clocks).

We expect Dominant to continue targeting the markets for (1) display and keypad backlighting and camera flashes in handphones, and (2) automotive interior lighting. We believe that Dominant has LED products that can compete in the world market. In our view, Osram's patent infringement complaint is acknowledgement that Dominant's LED products are of a quality that could pose a competitive threat. Dominant's expertise in LED technology comes from Mr. Tay, who was the former director of manufacturing at Osram's opto business unit in Malaysia, and his team.

D&O is aggressively expanding capacity to cater to rising orders, and plans to more than double its output by 2006 from 2004. It has recently completed construction of a new four-storey factory building and an extension to an existing one, increasing production space by about 40%.

The group is also working on a new product for the security control market, to be launched in 2006. The product - a Radio Frequency Identification (RFID) label – has strong potential due to rising security concerns globally. RFID is a technology that uses radio waves to automatically identify people or objects. According to management, the worldwide market size for RFID is set to rise from US$1.2 bln in 2004 to US$3.3 bln in 2008. Recently, Wal-Mart – the U.S. retail giant - has started using RFID technology to track its products for inventory and warehousing, raising the prospects of increasing applications of RFID.

Annual Production Capacity

(mln units)	End-2004	End-2005F	End-2006F
Discrete (Omega)	119	455	591
Opto (Omega)	796	1,278	1,789
SM LEDs (Dominant)	240	720^	1,000
RFID (Omega)*	NA	30	60

^ Capacity expansion in 3Q05

* Production of RFID to start only in Dec. 2005

Note: The installed production capacity may fluctuate from time to time due to changing product requirements.

Source: Company data

Earnings Outlook

We project D&O's net profit to grow by 72% in 2005 and 51% in 2006, driven by increased outsourcing by existing MNC customers and surging contributions from 49.7%-owned Dominant. We believe D&O is well positioned to benefit from increased outsourcing by its existing customers, as it has already proven itself for more than 10 years. The fact that 90% of its revenues are from repeat customers attests to the satisfaction of its customers. D&O's close proximity to its Malaysia-based MNC customers also places it ahead of competitors from China and Taiwan.

We see revenues growing 32% in 2005 and 37% in 2006, based on its capacity expansion plans. To cater for increased outsourcing by existing captive-line customers and expanding orders for its OEM business that it has been developing since 2002, D&O has built additional factory space and installed new production equipment, with the intention of more than doubling capacity by 2006. Management has expressed optimism over the prospects of the RFID product it is currently developing, but we feel it is early days yet as global standards do not yet exist, and we do not expect significant contributions in the near term.

Having successfully penetrated the Korean electronics makers, we expect Dominant to achieve strong growth as it is increasing its capacity by more than four-fold to cope with rising demand for LEDs that go into mobile phones, e.g. camera flashes and keypad backlights. The company has also been developing customers in Europe and China, and expects its efforts to bear fruit. Dominant has also set its sights on the U.S. market, having successfully dealt with Osram's patent infringement allegations.

Following its IPO, D&O's had net cash of MYR19.4 mln at end-2004, which we expect to be fully utilized by end-2005 due to projected investments in factory, production equipment and R&D. Based on our forecast of rising profits, we expect D&O to lift its net cash to MYR9 mln by end-2006. Our estimates have taken into account a recurring 0.1 sen dividend per share, the same as that paid for 2004.

New technologies may render D&O's products and services obsolete or uncompetitive. For example, IBM recently claimed to have developed a transistor that glows 1,000 times brighter than a LED. If this product is successfully commercialized, D&O's prospects could be severely dented if the group cannot adjust its assembly and packaging processes accordingly.

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Order flow may be disrupted after major customer Agilent completes the sale of its semiconductor products group to private equity investors in Dec. 2005. According to management, feedback from Agilent, a 'captive-line' customer, so far indicates that it will be business as usual.

D&O's OEM and LED businesses are expected to grow rapidly from a small base, but after the group reaches a certain size, longer-term growth prospects may be more challenging as competition heats up.

Valuation

D&O is trading at 9.6x projected 2006 earnings vs. other listed semiconductor assemblers in Malaysia at 12x-14x forward earnings. We believe D&O does not deserve to trade at the same forward P/E as MPI (14x), given the latter's significantly larger size and longer track record. However, we believe D&O should trade at least on par with Globetronics (12x), given its strong earnings outlook. A possible transfer to the Main Board next year may generate a sentiment boost for D&O shares in our view. D&O will qualify for admission to the Main Board if it reports 2005 results in line with our forecast.

Comparative Valuation

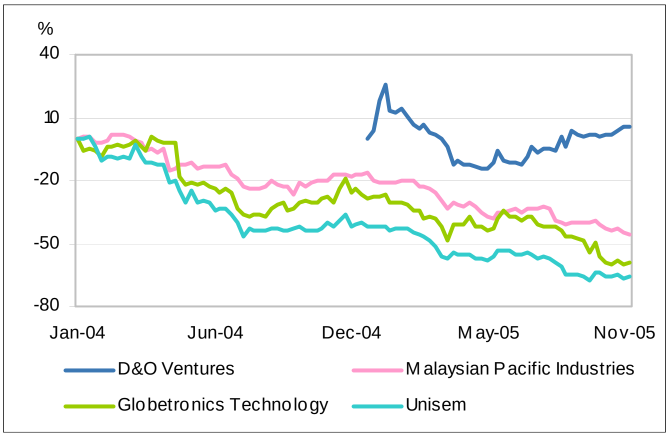
	D&O	MPI*	Unisem	Globe
Share Price (MYR) @ Nov 22, 05	0.535	9.60	1.35	0.29
Mkt. Cap (MYR mln)	390.6	2,015.0	603.3	380.0
Ave. Daily Vol. ('000)	124	133	676	1,411
PER FY03 (x)	NA	14.6	NM	12.4
PER FY04 (x)	21.4	40.2	5.8	12.4
P/NTA	3.4	3.0	0.4	1.8
Yield (%)	0.2	3.9	5.7	2.1^

* MPI: FY04 (Jun.) and FY05 (Jun.)

^ If special dividend of 0.7 sen is included, 4.5%.

Source: Bloomberg, Company data

Relative Share Price Performance of Comparables



Source: Bloomberg, S&P Equity Research

Recent Developments

Nov. 2005: Announced net profit of MYR17.3 mln for Jan.-Sep. 2005, vs. pro-forma net profit of MYR12.0 mln in the year ago period.

Jun. 2005: Wholly-owned subsidiary, Omega, converts its entire investment of 22 mln Redeemable Convertible Preference Shares (RCPS) in Dominant into 22 mln new ordinary shares of MYR 1 each in Dominant. Upon completion of the conversion, Omega is the single largest shareholder in Dominant with a 49.7% equity interest.

May 2005: Initial Determination by the United States International Trade Commission (USITC) cleared Dominant of allegations that it had infringed on certain of Osram's product patents.

May 2005: Shareholders approve a first and final tax-exempt dividend of 1% per share for FY04 at the company's first Annual General Meeting (AGM).

Profit & Loss

FY Dec. / MYR mln	2003	2004	2005F	2006F
Revenue	69.2	101.6	133.9	183.6
Operating Profit (EBIT)	7.9	17.3	22.2	30.1
Depreciation	-2.6	-5.0	-6.3	-8.9
Net Interest Income / (Expense)	-0.9	-1.1	-0.2	-0.5
Pretax Profit	7.0	16.2	28.8	43.6
Effective Tax Rate (%)	7.1	3.0	6.5	6.8
Net Profit	6.5	15.7	26.9	40.7
Operating Margin (%)	11.4	17.0	16.6	16.4
Pretax Margin (%)	10.2	15.9	21.5	23.8
Net Margin (%)	9.5	15.4	20.1	22.2

Source: Company data, S&P Equity Research

Balance Sheet

FY Dec. / MYR mln	2002	2003	2004
Total Assets	44.6	70.8	150.9
Fixed Assets	25.3	39.8	60.0
Current Assets	19.1	20.7	71.0
Other LT Assets	0.1	10.3	19.9
Current Liabilities	10.4	33.0	30.5
LT Liabilities	5.6	5.3	6.7
Share Capital	2.9	4.2	73.0
Shareholders' Funds	28.5	32.5	113.7

Source: Company data, S&P Equity Research

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Glossary

Strong Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, by a wide margin over the coming 12 months, with shares rising in price on an absolute basis.
Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months, with shares rising in price on an absolute basis.
Hold: Total return is expected to closely approximate the total return of the KLCI or KL Emas Index respectively, over the coming 12 months with shares generally rising in price on an absolute basis.
Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months and share price is not anticipated to show a gain.
Strong Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months by a wide margin, with shares falling in price on an absolute basis.

S&P 12 Month Target Price – The S&P equity analyst's projection of the market price a given security will command 12 months hence, based on a combination of intrinsic, relative, and private market valuation metrics.

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Alexander Chia, ACA
Hoe Lee Leng, CPA