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D&O Ventures

Shin Kao Jack
(603) 2162 4388 ext 432
Shin.kaojack@osk.com.my

A Good Business Model

Recommendation

Offer Price
RM0.38

Fair Value
RM0.42

Share cap / Par Value
730.0m / RM0.10

Listing
Second Board

Major shareholders
PRTC (16.5%)
MRSB (14.5%)
ORSB (11.6%)

Offer Details
Private : 61.1m shrs
Public : 36.5 shrs
Directors & employees :
5.0m shrs

- A semiconductor PAT company which carries out OEM contract manufacturing arrangement and “captive line” arrangement. Products include transistor metal-can, opto metal-can, photonics metal-can, small outline transistor and LED lamps
- Major customers are MNCs which include Agilent Technologies, STMicroelectronics, Matsushita Precision Capacitor and Fairchild Semiconductor. All of D&O Ventures’s products are catered for the export market
- Despite D&O Ventures’s strong fundamental, prospect for the worldwide semiconductor industry is not encouraging. SIA expects the worldwide chip sales growth to slow to 4.2% in 2005, decline by 0.6% in 2006 before rebounding by 11.7% in 2007
- A quality IPO. The only issue is the timing of the IPO. Using Pentamaster as a benchmark, and pegging a fair FY05 PER of 15x, we envisage that D&O Ventures is worth 42 sen per share

Earnings Table

Year to 31 Dec	01A	02A	03A	04E	05F
Turnover (RMm)	27.3	40.3	69.2	97.5	117.5
YoY change (%)	n.m	47.6	71.6	40.9	20.5
EBITDA (RMm)	6.3	9.2	13.0	22.0	29.5
Pretax (RMm)	4.3	7.0	9.7	16.0	22.0
YoY change (%)	332.4	64.2	39.4	64.2	37.5
Net Earnings	3.3	6.4	9.2	15.7	20.2
EPS (sen)	1.1	1.8	2.3	3.2	2.8
YoY change (%)	n.m	65.0	25.7	64.2	37.5
Gross Div (sen)	n.a	n.a	n.a	0.1	0.3
ROE (%)	n.a	n.a	n.a	n.a	16.5
NTA PS (RM)	n.a	n.a	n.a	0.15	0.18
PER (x)	34.3	20.8	16.6	11.7	13.7

EPS for FY01-04 is based on 297.3m, 348.1m, 402.8m and 481.7m shrs in issue respectively
FY05 is based on 730m shrs in issue
PER is based on D&O Ventures’s offer price of RM0.38/ share

A semiconductor PAT company

D&O Ventures’s is a semiconductor packaging, assembly and testing (PAT) company. Products manufactured by D&O Ventures include transistor metal-can, opto metal-can, photonics metal-can, small outline transistor and LED lamps. All of its products are exported through MNCs located at various free trade or industrial zones in Malaysia and direct shipments to U.S, Germany and Singapore. The company secures contracts on OEM manufacturing and “captive line” contract basis. Under a “captive line” agreement, the company’s customers consign their production equipment to them for the purpose of manufacturing the scheduled orders. Such arrangement substantially reduces the likelihood of its customers terminating business relationship with the company due to high relocation costs and possible disruptions of supply

chain. D&O Ventures's major customers are Agilent Technologies, STMicroelectronics and Fairchild Semiconductor, which have been doing business with the company for more than 5 years. Over the years, more than 90% of D&O Ventures's businesses were repeat orders from existing customers.

Figure 1 : D&O Ventures's Products

Product Type	Product Application	Usage / End products application
1. Transistor metal-can	Transistor, power transistor, voltage regulator	Automotive, military hardware, industrial equipment, power generating, medical equipments
2. Opto metal-can	Infrared emitter, infrared detector	Home appliances, data transmission, telecommunications equipment
3. Photonics metal-can	Detector, media using light wavelength or radio frequency or pressure	Wireless communication hardware, weather station monitor, sport watches, medical equipment, industrial equipment, automotive engine management system
4. Small outline transistor	Voltage regulator, radio frequency mixer	Cellular phones, computer, traffic signals, advertising billboard, car lights, audio-visual equipment
5. Discrete Transistor	Transistor and voltage regulator	Cellular phones, computer, traffic signals, advertising billboard, car lights, industrial equipment
6. LED lamps	Outdoor display lighting, equipment indicator lighting, infrared light emitter	Audio-visual equipment, household electronic equipment, traffic signals, automobile cockpit and back lighting

Source: OSK Research

A profitable business

D&O Ventures has been making net profit since FY99. Both revenue and net profit have been increasing since FY01. Not only margins have been maintained relatively stable over the years. From FY01 to FY04, with the exception of FY03, EBITDA margin and PBT margin have been hovering at about 23% as well as between 16% and 17% level respectively. There was a margin squeeze in FY03 as depreciation charge increased during that year due to additional capital expenditure in respect of plant and machinery, and renovation of and extensions to the factory buildings. Management forecasts revenue and net profit will continue to improve in FY04 and FY05. However, we factor in net profit of only RM20.2m against RM23.1m provided in the prospectus as we are cautious towards the prospect of worldwide semiconductor industry in 2005. Based on SIA's assessment, worldwide sales of semiconductors will grow to USD214bn in 2004, surpassing the previous record sales of USD204bn in 2000, but the industry growth is expected to slow to 4.2% in 2005, decline by 0.6% in 2006 before rebounding by 11.7% in 2007.

Pessimistic guidance from major customers

Worldwide semiconductor industry is now undergoing an inventory adjustment period. D&O Ventures's current biggest customer by revenue, Agilent Technologies, said that looking to FY05, the company expects the sharp adjustment in the semiconductor market to continue to impact the performance of its semiconductor products and automated test segments for the next three to six months. Meanwhile, test and measurement growth is moderating because of slowing growth in mobile phone production. In addition, its second largest customer by revenue, ST Microelectronics, earlier also gave a cautious guidance for the 4Q of 2004 and 2005. Management said that the capex for 2004 is expected to be 10% below initial plan and the company is maintaining a conservative approach for 2005's capital spending.

Valuation

A fundamentally strong company

D&O Ventures is a fundamentally sound company. The only drawback is the timing of the IPO as the industry outlook is not encouraging. However, we still believe that the company will be able to meet our net profit estimates of RM20.2m, which is 13% below the management's guidance. Even in FY01 and FY02, the darkest period for the semiconductor industry, the company managed to increase its sales. The company also has a strict cost control policy as the ratio of operating expenses / revenue has been maintained at 77% with the exception of FY03 due to the reason mentioned above. In addition, its "captive line" business strategy will always cushion the company from suffering losses in the slowdown. As for the valuation, we think it is appropriate to compare D&O Ventures with Pentamaster, which is a semiconductor equipment maker listed in the Second Board. Pentamaster, as like D&O Ventures managed to increase revenue in FY01 and FY02 and it also has an excellent cost control policy. Pentamaster's historical average FY00-FY03 PER is equivalent to 14x. Using Pentamaster as a benchmark, and pegging a fair FY05 PER of 15x, D&O Ventures is worth 42 sen per share. We think that D&O Ventures is almost fully valued based on its offer price.

Figure 2 : IPO Proforma balance sheet & Utilisation of proceeds

BALANCE SHEET			UTILISATION OF PROCEEDS		
As at 31 July 2004 (RM'm)			(RMm)		
Current assets	53.4	Share Capital	73.0	Capex	7.9
Current liabilities	(31.1)	Share premium	26.7	Purchase of equipment	21.8
Net current assets	22.3	Reserve on consolidation	7.2	Purchase of management information system infrastructure	0.8
Non current assets	92.0	Accumulated loss	(0.0)	R&D expenditure	3.0
		Shareholders' fund	106.9	Working capital	3.6
		Non current liabilities	7.3	Estimated listing expenses	2.0
	<u>114.3</u>		<u>114.3</u>		<u>39.0</u>

Source: OSK Research

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