



Arhnu Tan
+60 (3) 2162 4388 (638)
arhnu.tan@osk.com.my

D&O Ventures Bhd

BUY
Price **RM0.52**
Target **RM0.64**

Share Profile/Statistics	
Bloomberg Ticker	DOV MK
KLCI	896.8
Issued share capital (m)	730.0
Market Capitalisation (RMm)	376.0
52 week High (RM)	0.65
52 week Low (RM)	0.38
Average Volume (3m) '000	139.6
YTD Returns (%)	0.0
5 yr Average ROE (%)	#N/A
5 yr Average ROA (%)	#N/A
Net gearing (x)	-0.2
Altman Z-Score	7.26
ROCE/WACC	0.37
Beta (x)	#N/A
Cash Ratio (x)	1.3
FCF/share (x)	0.0
P/FCF/share (x)	-47.7
Book Value/share (RM)	0.16

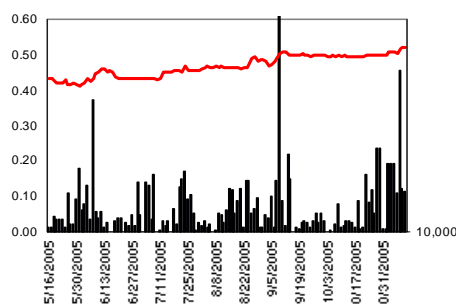
Major Shareholders (%)	
PRT Capital Pte Ltd	16.46%
Magna Reserve SB	14.51%
Omega Riang SB	11.59%

Share Performance				
(%)	1m	3m	6m	12m
Absolute	4.0	10.8	18.7	N/A
Relative	7.2	14.4	17.7	N/A

Growth Profile (%)				
	03a	04a	05f	06f
Revenue	-	46.9	20.0	26.0
EBITDA	-	41.4	18.9	25.7
PBT	-	67.3	61.0	47.0
NP	-	401	46.9	21.5

Margin (%)				
	03a	04a	05f	06f
EBITDA	-	21.9	22.6	22.6
PBT	-	15.9	21.3	24.9
NP	-	4.71	19.7	22.9

Historical Price Ratio				
(x)	01a	02a	03a	04a
P/Sales	-	-	-	1.22
P/Earnings	-	-	-	26
P/Book	-	-	-	3.34



And then there was light...

Little lights with big potential. Having carved out niche in the packaging assembly and testing of Light Emitting Diodes (LEDs), D&O is now a one stop outsourcing centre with contracted sales of LEDs making up 66% of its revenue.

A track record to prove. Exhibiting an albeit short but impressive earnings track record (40% and 37% 4 year revenue and net income CAGR), D&O is evidently leveraging well from the increasing worldwide demand for LEDs.

Margins set to escalate. 49.66% owned associate, Dominant Semiconductor SB is set to push up net margins by a whopping 10% starting from this year. Its expertise lies in the original design manufacture of surface mount LEDs, which are far superior in terms of technology compared to conventional LEDs.

Sustainable earnings growth. Going forward we expect top line growth at roughly 20-26% yearly as the group continues to develop better products and more efficient processes.

Diversification ahead. Acknowledging its shortcomings, D&O has embarked to increase its OEM manufacturing lines and contracts to hedge against potential risk that its main customer, Aligent Technologies leaving. Also there have been whispers of a new venture into manufacture of RFID tags.

A decent small cap BUY. Since listing in Dec04, share price has gained 39% to 52sen, which we reckon is decent considering the thin trading on the stock. We believe that D&O has all the makings to become a prominent semiconductor player in Malaysia. By way of DDM coupled with basic PE valuation, we have arrived at a **fair value of 64sen** citing a potential upside of 24%.

FYE Dec (RMm)	FY02	FY03	FY04	FY05f	FY06f
Total Revenue	-	-	101.63	121.96	153.67
Net Profit	-	-	15.69	23.97	35.21
% chg YoY	-	-	-	-	-
Consensus EPS (sen)	-	-	-	-	-
EPS (sen)	-	-	2.2	3.3	4.5
Gross DPS (sen)	-	-	0.73	1.6	1.6
Gross Div. Yield (%)	-	-	0.19	3	3
PER (x)	-	-	26.0	15.8	10.8
P/BV (x)	-	-	3.34	2.98	2.35
CFO per share (sen)	-	-	1.0	3.1	3.2
ROE (%)	-	-	3.17%	9.57%	12.30%
ROA (%)	-	-	5.99%	24.07%	29.24%
Net Gearing	-	-	Net Cash	Net Cash	Net Cash
Current Ratio	-	-	2.33	1.92	2.22

Hails from Malacca. D&O Ventures Bhd (D&O) is ultimately owned by a group of local investors. Since inception of its main subsidiary Omega Semiconductor SB in 1993, the Group has grown into a flourishing semiconductor manufacturer. With bulk (estimated at 75%) of its contracts secured by 'captive line agreements' (where the customer provides the full consignment of machinery and raw materials) with various MNCs, D&O financials has shown some impressive figures.

The Group's forte, under Omega as well as through its associate Dominant Semiconductors SB (Dominant) is the manufacturer, packaging, testing and assembly of LEDs (Light Emitting Diodes). (See Appendix 1)

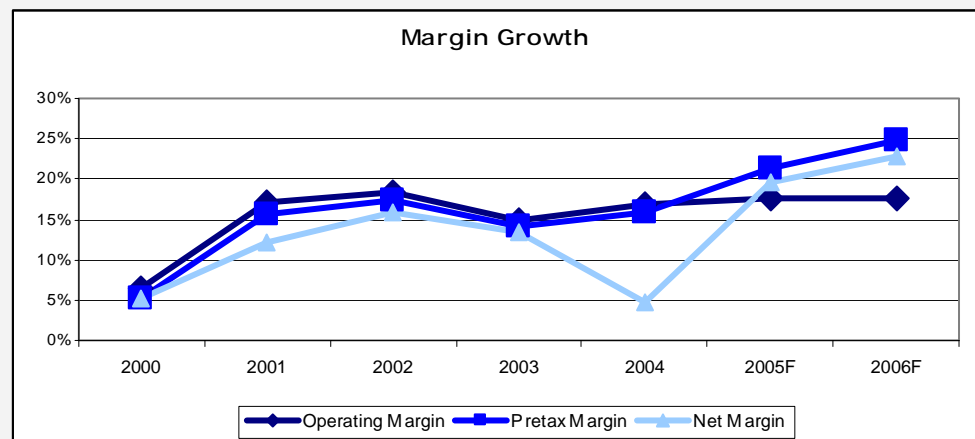
Revenue Breakdown	2003	2004	2005F	2006F
Discrete	29%	23%	22%	20%
Opto^	65%	66%	68%	70%
Others	6%	11%	10%	10%
Revenue	69.2	101.6	154.5	194.6

^LEDs are classified under Opto products

*Source: Prospectus, OSK Research

The Dominant factor. Dominant (49.66% owned associate to Omega) is distinctly different from Omega as it is an Original Design Manufacturer (ODM). Its manufacturing expertise is in Surface Mount LEDs (SMD). All machinery is cost effectively obtained from expired captive line agreements and remodeled into new production lines. We estimate that Dominant is able to churn up at least RM10-15m in sales pa.

Providing a much-needed boost to margins. Q204 results showed a 1-month debut contribution to bottom line from Dominant amounting to RM1m pretax. Going forward, we expect equal monthly contributions and possibly more by mid FY06 as contract flow increases in tandem with the growing demand for SMDs.



Note: Consolidated results are from FY04 onwards.

*Source: Company, OSK estimate

Surface Mount LED Vs Conventional LED.

	Surface Mount LED (SMD)	Conventional LED
To illustrate		
Brief Description	An SMD consists of red, green, and blue diodes mounted on a chipset, which is then mounted on the driver PC board. The individual diodes are smaller than a pin and are set very close together.	Is a special type of semiconductor diode. Like a normal diode, it consists of a chip of semiconducting material impregnated, with impurities to create a structure that emits light with electricity flow.
Function	Providing illumination for Handphones, PDA's, PC's, laptops and possibly replacing neon lights.	Outdoor electronic display boards, household appliances, traffic lights, automobiles break lights.

Source: Company, OSK Research

Demand for LEDs has been growing at a 50% rate for the past 5 years and the industry is envisaged to exceed US\$3bn by FY06.

RFID (Radio Frequency Identification Device) – jumping in the bandwagon?

The group has expressed some interest in venturing into the manufacture of RFID tags on an OEM basis either through Dominant or Omega. As plans have not been finalized, we have not imputed any earnings from this new segment.

Earnings review and outlook.

P&L Summary (FYE Dec 31)	2002	2003	2004	2005F	2006F
Revenue	40.33	69.19	101.63	121.96	153.67
EBITDA	9.22	13.02	22.23	27.56	34.65
Depreciation	-1.80	-2.71	-4.98	-6.22	-7.61
EBIT	7.43	10.31	17.25	21.34	27.05
Interest Expense	-0.62	-0.77	-1.08	-1.34	-2.31
Pre-Tax Profit	6.99	9.74	16.17	26.03	38.27
Tax	-0.64	-0.50	-0.48	-2.06	-3.06
Pre acquisition profits	0.00	0.00	-10.90	0.00	0.00
Net Income/Net Profit (Losses)	6.36	9.24	4.79	23.97	35.21

Source: Company, OSK estimate

Abundant in potential. Omega's revenue and net profit CAGR prior to listing was high at 40% and 37% respectively. Forecasts stated in the prospectus are bullish (net income growth of 401% to RM23m) as the group is banking on decent bottom line contributions from Dominant. We estimate a 19% boost to net income amounting to RM5.9m for FY05 and possibly double that amount in FY06. Q1 and Q2 results hold plenty of promise and are inline to achieving the forecast. Net margins are set to double in the coming years averaging at between 18-20%.

D&O currently sits comfortably in a net cash position but we expect to see some increase in short or long term borrowings in the next 2 years. Yearly maintenance capex lies in the RM4-5m region and on top of that we expect another RM3-5m for expansion purposes going forward as D&O attempts to increase its OEM product lines.

Areas for concern.

1. *Over-dependence on Aligent Technologies.* Undeniably, considering that almost 60% of revenue are derived from Aligent. D&O is taking initiatives to ease dependence by increasing its OEM product lines. A possible new venture into RFID would diversify its customer base. For FY05 a total of 3 product lines have been introduced and the group is steadily gaining customer base. Note however that due to captive line agreements it is unlikely for Aligent to move elsewhere as it would be cost inefficient to move and reinstall machinery.

2. *Overshadowed by own associate.* Many may argue that competition between Omega and Dominant is prevalent however we must reiterate that both are very different in many aspects i.e from customer base to manufacturing process to products.
3. *Competitors galore.* Taiwan is currently the world's largest manufacturer of LEDs and contributes to roughly half the worlds supply via its 30 known established manufacturers. On the surface mount forefront, Dominant has to put up with the likes of established lighting experts like Osram Technologies.
4. *It's a numbers game.* Making a decent margin depends on successful achievement of economies of scale. With consistent growing demand for LEDs and a secured relationship with Aligent – we see no issue here.

Valuation

A usual suspect - Liquidity. After it's listing in Dec04, more that 70% of D&O is held by internal parties (largely via top management). With only RM73m worth of shares in issue, free float is limited. We see any further issuance of equity unlikely in the near future, even in the event if D&O considers a main board transfer. On the flipside, a consistent dividend payout should be in tow due to the shareholding profiles. According to its prospectus, a 3% GDPS is envisaged for FY05.

Unique. With no listed peers exposed largely to LED manufacturing and other semiconductor players being too large and established (i.e MPI and Unisem), we have benchmarked D&O to the 2nd Board. Our eclectic mix of valuation methodologies proves D&O to be one of the better performers in our lacklustre 2nd Board index despite being a new entry.

Dividend Discount Model. Although we do not portray D&O to be a dividend play, we believe usage of the DDM model is fair given the Group's expressed interest in paying out consistent dividends. Note that **expected gross yield for FY05 is 3% and 2.2% on a net basis.** This supersedes the 2nd Board average gross dividend yield of 1.74%.

Dividend Discounted Model	
Sustainable Dividend- Gross (sen)	1.642
Sustainable Dividend- Net (sen)	1.182
Required Return on Equity	5.30%
Terminal Growth Rate	2.00%
DDM - Gross (RM)	0.50
DDM- Net (RM)	0.36

Price/Earnings. D&O currently trades at a PE of 15.8x based on a prospective EPS of 3.3sen for FY05. **Pegging the average 2nd board PE of 32.7x, we thereby derive a fair value of RM1.06.**

Fair Valuation	RM
DDM methodology (gross)	0.50
DDM methodology (net)	0.36
Price/Earnings	1.06
Simple Average	0.64

The combination of both valuations resulted in a reasonable fair value of **64sen** representing a **24% upside to current price.** We recommend **BUY.**

Appendix 1

Such a lot of hype over such a small light. Why?

- LEDs are capable of emitting light of an intended colour without the use of colour filters that traditional lightings require.
- The shape of the LED package allows light to be focused. Incandescent and fluorescent sources often require an external reflector to collect light and direct it in a useable manner.
- LEDs are insensitive to vibration and shocks, unlike incandescent and discharge sources.
- LEDs are built inside solid cases that protect them, making them hard to break and extremely durable.
- LEDs have an extremely long life span: typically ten years, twice as long as the best fluorescent bulbs and twenty times longer than the best incandescent bulbs.
- Further, LEDs fail by dimming over time, rather than the abrupt burn-out of incandescent bulbs.
- LEDs give off less heat than incandescent light bulbs with similar light output.

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OSK RESEARCH SDN. BHD. (206591-V)

(A wholly-owned subsidiary of OSK Holdings Berhad)

Level 6, Plaza OSK, Jalan Ampang, 50450 Kuala Lumpur

Tel : +60 (3) 2162 4388 Fax : +60 (3) 2162 4729

E-mail : research2@osk.com.my



Hilmi Mokhtar
Senior Vice- President, Advisor