

# Serial System Ltd

Reuters: SERL.SI  
Bloomberg: SERL.SP

Sector: Technology

Rating:

Price S\$0.20

Downgrade to **Underperform**

Y/E 31-Dec	2002A	2003A	2004F	2005F
Net Profit (\$m)	-9.9	3.2	1.9	3.1
EPS (S cent)	-3.3	1.1	0.6	1.0
EPS Growth (%)	<i>n.m.</i>	<i>n.m.</i>	-40	+62
Consensus EPS	-	-	1.5	2.2
PER (x) @ S\$0.20	-	19.0	31.7	19.6
NTA (\$)	0.26	0.27	0.29	0.29

Performance (%)	1mth	3mth	12mth	Market Capitalisation :	S\$	59m
Absolute	-13	-11	-32	Issued Shares :		304m
Relative against STI	-17	-21	-52	30-day avg daily vol ('000) :		155

## 3Q slipped into losses

- **Weak 9-mth performance, net profit fell 51% YoY to S\$1.2m**
- **This implied 3Q loss of S\$1.6m, its first loss in 8 quarters.**
- **Sentiment likely to be hit by the drastic drop in 3Q revenue and 3Q losses**
- **Downgrade to UNDERPERFORM**

**Summary:** While Serial System is not required to report quarterly results, the group has provided a short financial update for its performance for the 9-month period ended Sep 2004. Net profit fell 51% YoY to S\$1.2m for 9M04. The core semiconductor division saw a sharp drop in contributions from S\$3.0m in the previous period to S\$0.5m for this period, down S\$2.5m. The main reason for the weak performance was a sharp drop in 3Q revenue, which fell 28% QoQ and 23% YoY to S\$67.5m. With distribution and administrative expenses staying the same, this led to a net 3Q loss of S\$1.6m. Since we initiated coverage of the stock in May 2004 with a MARKET PERFORM rating, the stock has been on a downtrend. While the share price is currently at the low of 20 cents, there are still no near term price drivers. In fact, sentiment is likely to be hit as the group sustained its first quarterly loss in eight quarters. Recall Serial sustained

losses of close to S\$10m in FY02 and that also caused the stock to languish during that period. We are cutting our FY04 earnings drastically from a profit of S\$4.6m to a profit of S\$1.9m, largely to capture the 3Q loss of S\$1.6m. We are also downgrading the stock to an **UNDERPERFORM**.

**Disappointing 9M report card.** While Serial System is not required to report quarterly results, the group has provided a short financial update for its performance for the 9-month period ended Sep 2004. It reported a 3% YoY decline in revenue to S\$238.5m for 9M2004. Its core operation in semiconductors and component distribution saw only a slight 0.3% rise in revenue to S\$235m, while the consumer digital appliances and other business reported a 66% decline in revenue to S\$3.5m. Management attributed this to weak demand and the loss of a major client for its logistics business.

Net profit fell 51% YoY to S\$1.2m in 9M2004. This was largely due to the disappointing performance of its semiconductor division which reported a profit of only S\$0.5m compared to S\$3.0m in the previous period. Associates turned in a flat performance of S\$2.9m, while loss-making consumer digital appliances and other businesses continued to drag

and posted losses of S\$2.2m compared to losses of S\$3.4m. While gross margin improved slightly from 9.4% to 9.9% for the 9M04, operating margin fell sharply from 1.2% to 0.3%. NAV per share as at end-Sep 2004 stood at 28.2 cents.

**Sharp drop in 3Q revenue.** On a 3Q04 basis, revenue fell sharply both YoY and QoQ. Revenue of S\$67.5m was down 28% QoQ and down 23% YoY. This led to lower gross profit of S\$6.9m compared to more than S\$8m for 1Q04 and 2Q04. While gross margin stayed at 10.3%, which were better than the margins of 9.2% in 2Q04 and 9.5% in 3Q03, this was not able to mitigate its operating costs, which remained at about the same level despite the drastic drop in revenue. With total distribution and administration expenses of S\$5.6m and other expenses of S\$4.1m, this brought total expenses to S\$9.7m, far exceeding gross profit.

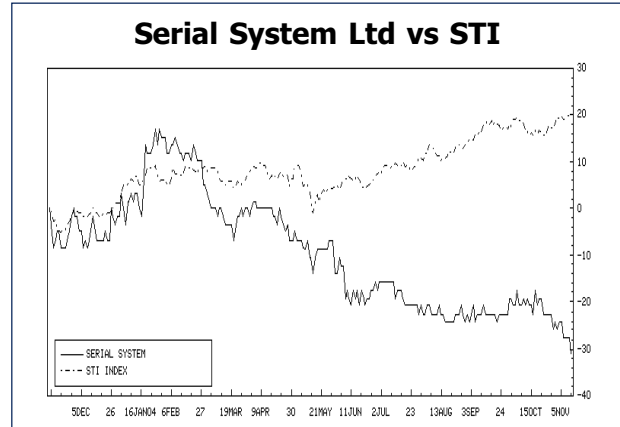
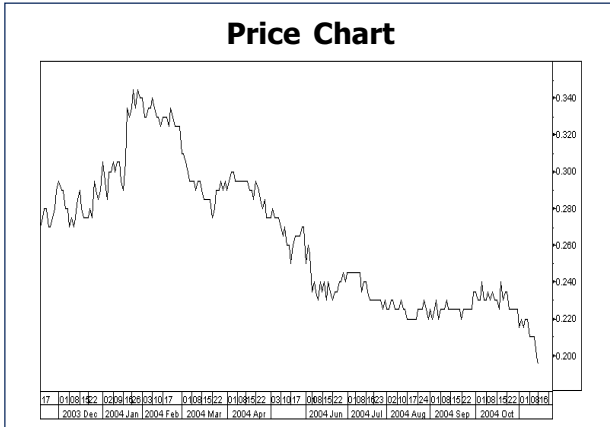
**Warrant issue has secured in-principle approval.** To recap, the group recently secured the Singapore Exchange's in-principle approval for its application for the listing and quotation of up to a maximum of 78.99m

warrants at an issue price of S\$0.045 for each warrant. Each warrant will carry the right to one share at an exercise price of S\$0.14. One warrant will be given for every four existing ordinary shares held at a date to be determined later. If fully exercised, this will result in 78.99m new shares or about 26% of its existing issued and paid-up share capital.

**Outlook and valuation.** Since we initiated coverage on Serial with a MARKET PERFORM rating, the stock has been on a downtrend. While the share price is currently at the low of 20 cents, there are still no near term price drivers. In fact, sentiment is likely to be hit as the group sustained its first quarterly loss in eight quarters. Recall Serial sustained losses of close to S\$10m in FY02 and that also caused the stock to languish during that period.

We are cutting our FY04 earnings drastically from a profit of S\$4.6m to a profit of S\$1.9m, largely to capture the 3Q loss of S\$1.6m. We are also downgrading the stock to an **UNDERPERFORM**.

<b>Serial System Year Ended 31 Dec</b>	<b>3Q03 (S\$m)</b>	<b>3Q04 (S\$m)</b>	<b>Chg (%)</b>	<b>9M03 (S\$m)</b>	<b>9M04 (S\$m)</b>	<b>Chg (%)</b>
Turnover	87.2	67.5	-22.6	245.1	238.5	-2.7
Cost of sales	-78.9	-60.5	-23.3	-222.1	-215.0	-3.2
Gross profit/loss	8.3	6.9	-15.9	23.0	23.5	2.4
Other operating income	1.2	0.9	-25.4	3.4	5.2	54.5
Distribution & admin expenses	-5.0	-5.6	12.4	-14.9	-17.3	16.1
Other operating expenses	-3.4	-4.1	18.4	-8.4	-10.6	25.9
Profits from operation	1.0	-1.9	n.m.	3.0	0.8	-73.1
Finance cost	0.0	-0.5	n.m.	-0.2	-1.1	379.7
Associates	0.8	1.6	91.3	2.8	4.1	45.0
Pre-tax profit	1.7	-0.9	n.m.	5.6	3.9	-31.6
Net profit	1.0	-1.6	n.m.	2.5	1.2	-51.4
Operating margin (%)	1.1	-2.8		1.2	0.3	
Pretax margin (%)	2.0	-1.3		2.3	1.6	
Net profit margin (%)	1.2	-2.3		1.0	0.5	



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