

Serial System Ltd

Reuters: SERL.SI
Bloomberg: SERL SP

Sector: Technology
Price S\$0.19

Rating:

Maintain **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>	-40	+62
Consensus EPS	-	-	0.6	1.0
PER (x) @ S\$0.19	-	18.1	30.2	18.6
NTA (\$)	0.26	0.27	0.29	0.29

Performance (%)	1mth	3mth	12mth	Market Capitalisation :	S\$	56m
Absolute	-14	-16	-32	Issued Shares :		304m
Relative against STI	-17	-22	-54	30-day avg daily vol ('000) :		120

Lowering exercise price of warrants

- **Company lowering exercise price of warrants from 14 cents to 12 cents**
- **This is to reflect decline in share price**
- **Provides additional details to its recent 9M results, highlighting 3Q loss of S\$1.6m.**
- **Retain UNDERPERFORM rating**

Summary: In our earlier report dated 16 Nov 2004, we highlighted that, based on Serial System's 9M04 earnings of S\$1.2m, this implied 3Q loss of S\$1.6m. Management has issued a statement on Friday (3 Dec 2004) providing further details confirming the 3Q loss of S\$1.6m. Serial's share price has already reacted to this, as the price has moved down subsequent to the results announcement, from 20 cents to 19 cents currently, and hitting a recent 52-week low of 18.5 cents. Meanwhile, in a separate announcement, the group is lowering the exercise price of the proposed warrant issue, from 14 cents to 12 cents, citing the recent decline in its share price. We have earlier cut our FY04 earnings to a profit of S\$1.9m, largely due to 3Q loss of S\$1.6m. There are no positive near-term price drivers and sentiment is likely to stay weak in view of the loss-making 3Q. We have an **UNDERPERFORM** rating on the stock.

Management highlighted 3Q loss of S\$1.6m. On Friday (3 Dec 2004), Serial Systems provided additional details to its earlier announced 9MFY04 results (Serial is not required to provide quarterly results, but the company provides a regular quarterly summary of key financial information). More importantly, in Friday's announcement, the company confirmed that it sustained net losses of S\$1.6m in 3Q04. This was already highlighted in our last report dated 16 Nov 2004. Management attributed this loss to lower margins in its semiconductors/components distribution business and higher interest costs from financing of working capital and acquisitions of companies. With the 3Q04 loss, this dragged down its overall performance and the group reported a net profit of S\$1.2m in 9M04 compared to S\$2.5m for the same nine-month period ended 2003. The semiconductors/components distribution business, the key division, reported profit of S\$0.5m in 9M04 versus S\$3.0m in 9M03, down S\$2.5m or 83%.

Revising exercise price from S\$0.14 to S\$0.12. With regards to its proposed warrants issue, the company also announced that it is bringing the exercise price down from S\$0.14 to S\$0.12, mainly to reflect the recent decline in its share price.

To recap, the Group proposed in Sep 2004 a renounceable rights issue of warrants at an issue price of S\$0.045 for each warrant. Each warrant carries the right to subscribe to one Serial share at an exercise price of S\$0.14. Existing shareholders will be allocated warrants on the basis of one warrant for every four existing ordinary shares held.

Meanwhile, the minimum number of warrants has been increased to 75,943,779 from the previously announced minimum of 75,912,529 warrants and the maximum number of warrants under the warrant issue has been reduced to 78,948,529 from the previously announced maximum of 78,994,279 warrants. This is to reflect some minor changes to its share capital during this period.

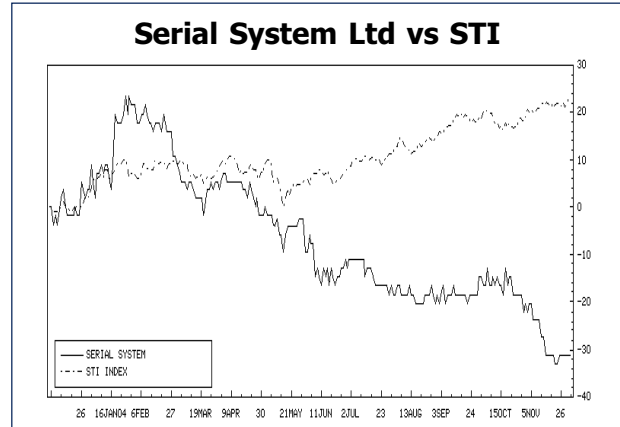
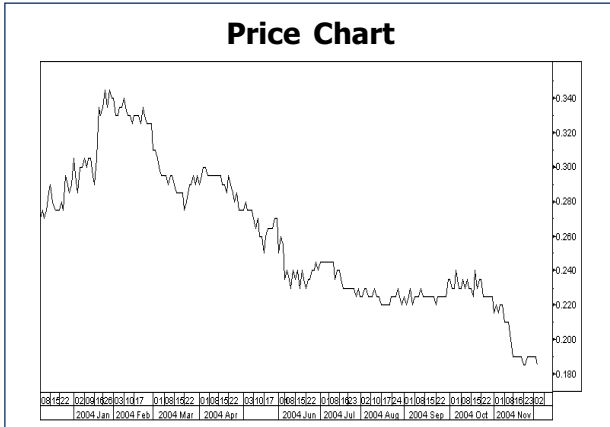
A disappointing 9M performance. To recap, Serial reported a 3% YoY decline in revenue to S\$238.5m for 9M2004. Its core operation in semiconductors and component distribution saw only a slight 0.3% rise in revenue to S\$235m, while the consumer digital appliances and other business reported a 66% decline 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 fare badly and posted losses of S\$2.2m compared to losses of S\$3.4m. While gross margin improved slightly from 9.9% to 9.4% in 9M04, operating margin fell sharply from 1.2% to 0.3%. NAV per share as at end-Sep 2004 stood at 28.2 cents.

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%, and was better than 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 profits.

Valuation. Sentiment for the stock is likely to stay weak following the loss-making 3Q. There is also a lack of near term price drivers. Earlier on, we cut FY04 earnings to a profit of S\$1.9m, largely to capture the 3Q loss of S\$1.6m. We retain our **UNDERPERFORM** rating on the stock.



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