

Analyse this...

Retail Research

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Serial System Ltd

Proxy to North Asian electronics demand

 SERL SP
 BUY: TP: S\$0.16

 Price @11/3/10: S\$0.08
 52-week range (SGD): 0.055 – 0.085
 Market cap – S\$57.9m

BUY - Below book, attractive dividend yield

- **BUY**, target price of **S\$0.16** (previously S\$0.12 based on parity to CY10 NTA/share). Target price is derived using 8.1x P/E (20% discount to peer CY11 average P/E of 10.1x).
- Given the improved CY10 outlook and that peers are trading above book, we switch to P/E valuation based on CY11 forecast.
- We believe the Company will continue to pay dividends and this could translate into a more than 6% dividend yield, limiting downside for the share price.

Management optimistic

- We visited Serial System last Friday, 12th March. In line with its FY09 results commentary that the Group was more confident of the outlook in CY10, we sensed that management was optimistic that CY10 could well be a good year (barring further global shocks).
- We have raised earnings forecast post our Company visit as we believe that we may have been looking too much at the rear view mirror. We now believe that it may not be unreasonable to set a double digit revenue growth target for Serial System's sales team given economic growth prospects in North Asia and growth expectations at peers.
- This is likely to be driven by: 1) expansion of geographical presence in North Asia and staff strength despite the down turn in FY09, setting the stage for future growth; 2) effective marketing strategy to increase market penetration in North Asia, widen product range and addition of new principals; 3) strong partnership with a leading component supplier (Serial System's major principal) and 4) inorganic growth via potential M&As.

Limited downside

- **Improved balance sheet.** With the successful completion of a rights issue, the Company has shored up its working capital, making it easier for Serial System to manage its growth. At end FY09, net gearing was a manageable at 0.27x and could fall further to 0.16x in FY10.
- **M&As can be both ways.** Management stressed that any acquisitions will not be taken hastily nor just to grow revenue. Serial System will remain focused on the bottom line in any potential acquisitions. We also note that there has been a return of M&A activities by American distributors in Asia. Given Serial System's North Asian presence, its strong product lines and below book valuation, this might invite attention from industry peers. However, our assessment is that management is more concerned on scaling up the Company further and might not be interested in any offers unless it is one that is extremely attractive.
- **Mean while, collect dividends and enjoy the safety of below book valuation.** Based on FY08 and FY09 track record, the average dividend payout ratio is 54%. However, a simple assumption that DPS over the next three years will be similar to FY09's DPS of 0.51cts, already translates into an attractive 6.4% yield. In addition, Serial System pays dividends twice a year (interim and final).

Financial analysis

	2008	2009	2010F	2011F	2012F
FYE Dec					
Revenue (S\$ m)	510.6	556.5	640.0	720.0	792.0
EBITDA (S\$ m)	11.5	11.8	18.4	21.3	23.7
EBITDA margins (%)	2.3	2.1	2.9	3.0	3.0
Pretax profit (S\$ m)	8.0	9.1	15.0	17.9	20.3
Net profit (S\$ m)	6.0	7.5	11.9	14.3	16.2
EPS (cts)	1.0	1.1	1.6	2.0	2.2
EPS growth (%)	-49%	+13%	+51%	+20%	+13%
P/E (x)	8.3	7.3	4.9	4.1	3.6
FD EPS (cts)	1.0	0.9	1.4	1.7	1.9
FD P/E (x)	8.3	8.9	5.6	4.7	4.1
Gross DPS (cts)	0.6	0.5	0.5	0.5	0.5
Dividend yield (%)	7.0	6.3	6.4	6.4	6.4
P/NTA (x)	0.7	0.7	0.6	0.6	0.5
ROE (%)	7.5	8.6	12.2	13.3	13.5
Net gearing (%)	18.4	27.4	16.3	12.5	7.6
P/CF (x)	6.6	6.5	4.3	3.6	3.2
EV/EBITDA (x)	6.9	6.7	4.3	3.7	3.4

Source: Bloomberg, CIMB-GK Research

Peer valuation

	Mkt cap (US\$ m)	Core P/E (x)		P/BV (x)	ROE (%)
		CY2010	CY2011	CY2010	CY2010
Arrow Electronics Inc	3,505	11.4	9.9	1.1	10.3
Avnet Inc	4,389.6	12.3	10.6	1.3	11.8
US peer average		11.8	10.2	1.2	11.1
WPG Holdings Co Ltd	1,472	13.4	11.4	2.8	20.5
Yosun Industrial Corp	416.7	10.3	8.6	1.4	15.4
Taiwanese peer average		11.8	10.0	2.1	17.9
Sector average		11.8	10.1	1.6	14.5

Source: Bloomberg, CIMB-GK Research

Technical BUY

- The stock appears to be continuing its climb after completing its reverse head and shoulders pattern back in Oct 2009. Prices, which have been in a sideways trend for the past 8 months, broke out in early March.
- With the breakout, prices are expected to edge higher towards S\$0.10-0.11 and possibly even S\$0.125. There are no bearish divergences on its indicators, which mean fewer obstacles ahead.
- Aggressive traders could buy on the breakout with a stop placed below S\$0.07. If key support at S\$0.07 is not breached, the share price is likely to head upwards further.

Corporate profile

- Serial System was established in Singapore in 1988 as a distributor of semiconductors and electronic components in the Asia Pacific region, offering design support, materials planning, inventory management, programming and assembly services.
- Serial System has an established presence in key Asian markets such as China, Hong Kong, Malaysia, Korea, Taiwan, Thailand, Philippines, India and Vietnam.