

Visdynamics Holdings

Recommendation: **STRONG BUY**

Stock Code: 0120

Bloomberg: VHB MK

Price: MYR0.335

12-Month Target Price: MYR0.42

Date: January 4, 2008

Board: Mesdaq

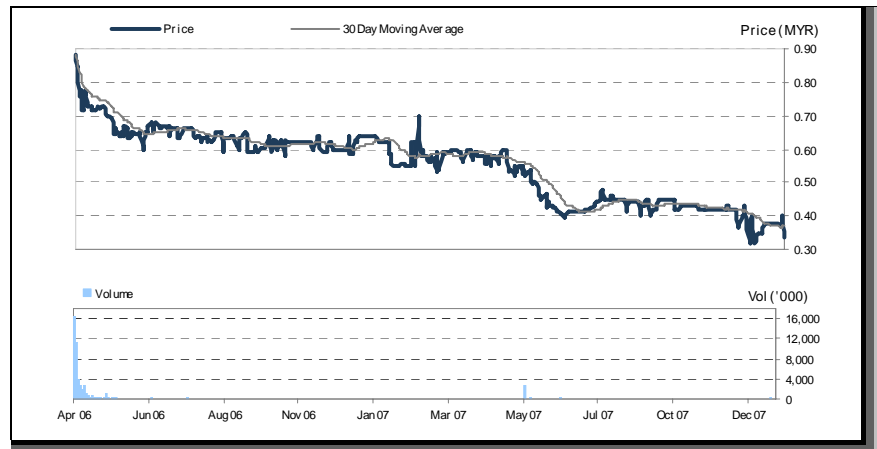
Sector: Technology

GICS: Information Technology / Semiconductor Equipment

Market Value - Total: MYR22.4 mln

Summary: VisDynamics Holdings (VHB) is engaged in the research & development (R&D), design, assembly and final set-up / tuning of test / backend equipment for the Automated Test Equipment (ATE) industry for semiconductors. The group was listed on Mesdaq market of Bursa Malaysia on Apr. 13, 2006.

Analyst: Su Peng Ng



Highlights

- VHB provides systems to the backend processing segment of the semiconductor industry. Its products, gravity- and tray-based systems, are targeted towards inspection of medium- and larger-sized integrated circuits.
- The group launched a new tray-based model in 3Q07 that is expected to be well received and bring in significant sales contribution for FY08 (Oct). We are projecting the tray-based system to contribute up to 15% of group-wide sales as oppose to about 11% presently.
- We are forecasting strong net earnings growth for VHB over the next two years (3-year CAGR of 82%) led by: (i) sales of its new tray-based model recently introduced in Sep. 2007, (ii) improving sales of its increasingly popular gravity-based systems after it has been proven to perform well thus far and (iii) launch of new models such as the laser-based inspection system expected in FY08.

Investment Risks

- Risks to our recommendation and target price include a slower-than-expected global economic growth, a slowdown in the semiconductor sector which would have a negative impact on earnings and faster-than-expected appreciating MYR, which would negatively impact VHB's revenue.

Recommendation

- We initiate coverage on VHB with a Strong Buy recommendation and a 12-month target price of MYR0.42.
- Our valuation methodology utilizes a blend of PER and P/B. We arrive at VHB's target price by ascribing target multiples of 10x PER and 2x P/B against our estimated FY08 EPS and BVPS respectively.
- Our target multiples for VHB are benchmarked to local peers forward PER average and are at a 20% discount to ICOS's forward PER and P/BV. The discount is in place to cater for VHB's smaller market capitalization and limited listing track record.
- We believe that VHB's growth prospects for FY08 is bright, despite potentially muted sentiment on the global semiconductor industry over the medium-term given increasing expectations of a global economic slowdown. We expect VHB to benefit from its' new and competitively-priced models from existing and new customers. As such, we believe that VHB's share price could gain ground, reflecting anticipated earnings growth and margin recovery.

Key Stock Statistics

FY Oct.	2007	2008E
Reported EPS (sen)	0.4	2.7
PER (x)	76.1	12.6
Dividend/Share (sen)	0.0	0.0
NTA/Share (MYR)	0.26	0.29
Book Value/Share (MYR)	0.26	0.29
No. of Outstanding Shares (mln)	67.0	
52-week Share Price Range (MYR)	0.32 - 0.70	
Major Shareholders:	%	
Choy Ngee Hoe	30.4	
Lembaga Tabung Haji	5.0	

Per Share Data

FY Oct.	2005	2006	2007	2008E
Book Value (MYR)	0.14	0.26	0.26	0.29
Cash Flow (sen)	6.8	0.8	1.1	3.5
Reported Earnings (sen)	6.6	0.5	0.4	2.7
Dividend (sen)	0.0	0.0	0.0	0.0
Payout Ratio (%)	0.0	0.0	0.0	0.0
PER (x)	5.1	65.8	76.1	12.6
P/Cash Flow (x)	4.9	41.5	30.1	9.7
P/Book Value (x)	2.3	1.3	1.3	1.2
Dividend Yield (%)	0.0	0.0	0.0	0.0
ROE (%)	NA	2.8	1.7	9.6
Net Gearing (%)	0.0	0.0	0.0	0.0

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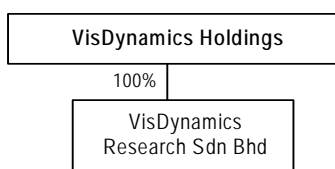
Background

Corporate Profile

VHB was established as a public limited company in 2005 and is the holding company of VisDynamics Research Sdn Bhd (VRSB). The group was listed on Bursa Malaysia's Mesdaq market on Apr. 13, 2006. VRSB was founded by a group of nine individuals who are experienced technologists in the backend Automated Test Equipment (ATE) market for the semiconductor industry. Mr Choy Ngee Hoe is in charge of business strategy and operations and is the group's Executive Director and Chief Executive Officer and also its major shareholder with a 30.4% stake.

VHB's board of directors has six members comprising two Independent Non-Executive Directors, three Executive Directors and a Non-Executive, Non-Independent Chairman. The board composition meets the listing requirement which requires at least two or one third of the board to be independent directors.

Corporate Structure



Source: Company data

Business

VHB is a solutions provider in the backend processing segment of the semiconductor industry. It is principally engaged in R&D, design, assembly and final set-up / tuning of backend equipment to semiconductor manufacturers. The group was awarded Pioneer Status in Jun., 2003 which exempts it from paying corporate tax for up to 10 years. It has also a Licensed Manufacturing Warehouse (LMW) status where it is exempted from custom duties and sales tax related to import of raw materials.

The semiconductor industry consists mainly of the design and fabrication of chips which are integrated circuits (ICs) required in electrical and electronic devices. The process of creating these chips involves a multiple-step process during which circuits are created on a silicon wafer.

These steps can be loosely grouped into three segments namely

- i. Front end processing – formation of transistors onto the silicon wafer
- ii. Back end processing and testing – testing of semiconductor devices to determine if they function properly (VHB falls into this category by providing the machines utilised to test these ICs)
- iii. Packaging

The Automated Test Equipment (ATE) market, valued at approximately US\$4 bln, is grouped into the backend processing segment of the semiconductor industry and is a competitive and fragmented market. While there are no direct local competitors, VHB faces competition from international companies such as ASTI (Singapore) and ICOS (Belgium). Companies compete on factors such as product performance (i.e. speed, accuracy and reliability), pricing, quality and adaptability to customers' requirements. Management believes VHB is capable of at least matching its international peers on these competitive factors as its products have higher processing speed, occupies less floor space and offers more operational flexibilities. VHB's products also offer customers the flexibility

to modify their machines according to individual needs at a fraction of the costs. Management attributes this flexibility to the design of its machines to incorporate "change kits" where customers can purchase "change kits" in order to modify their machines to match their changing needs. These "change kits" are priced at between 10%-15% of the cost of a new machine. Competitors do not offer this flexibility in their machines and a customer would have to purchase an entirely new machine to match a new requirement.

Currently, VHB derives a significant proportion of its revenue from North Asia (+60% in 2007) followed by the Asean region with a 28% share of sales. The balance is derived from USA. Length of customer relationships averages only between 2 to 3 years but this is due to the relatively recent establishment of VHB in the market. VHB's management however has been involved in this industry since the late 1980s and early 1990s. Its customer list include Stats-Chippac (STATS SP, SGD1.65, Not Ranked) and Amkor (AMKR US, US\$8.49, Hold) who are both in the top 5 global semiconductor contract manufacturers (SCM), RF Micro Devices (a leader in radio frequency technology) (RFMD US, US\$5.71, Hold) and Unisem (a local SCM) (UNI MK, MYR1.72, Not Ranked).

VHB presently offers its customers six varieties of backend testing equipment comprising of gravity-based and tray-based products as well as de-taping and inspection systems. Prices for its main products (gravity and tray-based systems), ranges between US\$150,000 to US\$230,000 per machine. The gravity-based system is tailored to the medium-sized ICs while the tray-based system is aimed at the large-sized ICs. Management has no immediate plans to enter into the small-sized IC market because it is a market that is based on volume and is extremely fragmented. Unless VHB develops a system that adds value to the machine, management will not move into a market to compete solely on pricing.

The group's current bestseller is the gravity-based equipment which contributes 82% to the group's total revenue followed by tape-based equipment with 11%. The group recently launched a new tray-based model in 3Q07 and have been marketing this model to potential customers so far. Management expects to reap the full benefits of this new model in 2008. In addition, VHB is currently in the process of developing one to two more models and hopes to launch these by 2008/2009.

On top of the backend processing equipment, VHB also offers customers equipment upgrading services, supplementary equipment as well as maintenance and repair services. However, these additional services make up only 7% of group revenue.

Cost wise, VHB's raw materials can be broken down into two segments namely (i) standard parts and (ii) fabricated precision parts which are made of both metallic and non-metallic materials. All of its raw materials with the exception of camera components are sourced from local suppliers. Camera components are sourced from Singapore. The group receives its revenue quotation almost entirely in US\$ but 30% of its costs are based in MYR and hence the strengthening of the MYR against the US\$ will have a negative impact on group's profit margins.

VHB's management have identified several strategies to further build upon its past success. Management is planning to:-

1. introduce new models such as laser-based inspection system by 2008 to capture new markets and customers within the ATE industry;

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2. build up anchor customer bases in major sub-sectors of the semiconductor industry (i.e. power, automotive);
3. develop a common platform design to help reduce R&D costs, eases maintenance and reduces overall complexity; and
4. set up new sales and marketing offices globally which will also include equipment demonstration and storage centres in major locations.

VHB is in the midst of setting up a new office and plant which will be ready for occupation by end-1QFY08. We expect the new plant will provide the group with the physical capabilities to expand its production should it be required.

Earnings Outlook

VHB's revenue is heavily tied to the performance of the semiconductor industry and ultimately the electrical and electronics industries. Gartner, which is an independent researcher in the semiconductor industry, is forecasting a CAGR (2005-2011) of 4.6% pa for the ATE market while S&P Equity Research currently has a Marketweight view on both the semiconductor and semiconductor equipment industries. One of management's strategies to even out the cyclical nature of the industry is to have strong customer bases over various sub-sectors within the semiconductor industry. This would also ensure that VHB is not overly reliant on one customer or a sub-sector in particular.

VHB recently released its FY07 results, registering a revenue growth of 52% YoY. This surge in sales came mainly during 4QFY07 after the launch of its new tray-based system in Sep. 2006 which has seen increase of orders acceptance over the last quarter of FY07 after much marketing and testing efforts. Despite the strong revenue growth, profit before tax grew a marginal 2.6% as the group suffered from lower gross margins during the year as a result of escalating costs for product enhancement exercises (for the tray-based system), a weak US\$ against the MYR and to a small extent, higher raw material costs (due to higher commodity prices).

While bearing in mind the potential economic slowdown in the US in the near- to medium-term, we are forecasting a revenue growth of between 30%-40% in FY08 and FY09 for VHB, driven by the following:-

1. increased orders on its tray-based systems, in particular, from a new model that was launched in 3Q07;
2. increased orders from existing and new customers for its gravity-based systems after its proven performance so far;
3. new inspection models expected to be launched in 2008/2009 such as the laser-based inspection system.

However on the cost side, we expect the US\$ to continue to weaken against the MYR and for commodity prices to remain high. As such, we expect these risks to crimp VHB's margins and reported revenues (in MYR) over the near- to medium-term. In view of this, we expect gross margins of about 55% in FY08 and FY09 compared to normal levels of above 60%.

The group's balance sheet as at Oct. 31, 2007 shows unusually high inventory levels accounting for around 200 days of sales in FY07. Management explains that this as a common occurrence when new models are developed and marketed. When new models are launched, such as the recent tray-based model, VHB has to manufacture a demo model to for use when marketing to its potential clients which spikes up its inventory base. This ratio would then reduce as sales of the new model picks up.

Valuations

We base our valuation of VHB on a combination of PER and P/B benchmarked to its international and listed local competitors. We have identified ICOS (IVIS BB, EUR30.90, Not Ranked) a Belgium-based listed peer as a direct competitor. In terms of local peers, there is no one that is directly comparable but we highlight several which are either comparable in parts of the business or will bring in the local market characteristics in valuing VHB.

Local peers comprise of Vitrox (Vitro MK, MYR0.90, Not Ranked), Pentamaster (PENT MK, MYR0.64, Not Ranked) and LKT Industrial (LIB MK, MYR3.38, Not Ranked). Our target multiples for VHB are benchmarked to local peer average and are at a 20% discount to ICOS. The discount reflects VHB's smaller market capitalization and limited listing track record.

We value VHB using a combination of 10x PER and 2x P/B against our estimated 2008 EPS and BVPS to arrive at our fair value of MYR0.42 per VHB share.

Comparative Valuation

FY Oct. / MYR mln	IVIS (EUR mln)	VITRO (MYR mln)	PENT (MYR mln)	LIB (MYR mln)
Price @ Jan 3, 08	30.90	0.90	0.64	3.38
Mkt. Cap (mln)	326.2	139.5	85.3	239.6
Ave. Daily Vol. ('000)	24.7	130.3	72.8	394.3
PER FY05 (x)	24.1	7.6	5.3	9.0
PER FY06 (x)	47.5	14.8	8.1	NA
P/NTA	3.5	4.2	0.7	1.7

Source: Company data, S&P Equity Research

Profit & Loss

FY Oct. / MYR mln	2006	2007	2008E	2009E
Reporting Revenue	6.3	9.6	13.5	17.5
Reported Operating Profit	0.2	0.1	1.6	1.9
Depreciation & Amortization	-0.2	-0.5	-0.5	-0.7
Net Interest Income / (Expense)	0.1	0.2	0.2	0.2
Reported Pre-tax Profit	0.3	0.3	1.8	2.0
Effective Tax Rate (%)	0.0	0.0	0.0	0.0
Reported Net Profit	0.3	0.3	1.8	2.0
Reported Operating Margin (%)	2.9	1.0	12.1	10.8
Reported Pre-tax Margin (%)	5.0	2.6	13.2	11.6
Reported Net Margin (%)	5.4	3.1	13.2	11.6

Source: Company data, S&P Equity Research

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Recommendation: **STRONG BUY**

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Bloomberg: VHB MK

Price: MYR0.335

12-Month Target Price: MYR0.42

Date: January 4, 2008

Balance Sheet

FY Oct. / MYR mln	2006	2007
Total Assets	20.9	20.7
Fixed Assets	1.8	3.3
Current Assets	15.8	13.8
Other LT Assets	3.3	3.6
Current Liabilities	3.3	2.7
LT Liabilities	0.3	0.3
Share Capital	6.7	6.7
Shareholders' Funds	17.3	17.7

Source: Company data, S&P Equity Research

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Glossary

Strong Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, by a wide margin over the coming 12 months, with shares rising in price on an absolute basis.

Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months, with shares rising in price on an absolute basis.

Hold: Total return is expected to closely approximate the total return of the KLCI or KL Emas Index respectively, over the coming 12 months with shares generally rising in price on an absolute basis.

Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months and share price is not anticipated to show a gain.

Strong Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months by a wide margin, with shares falling in price on an absolute basis.

S&P 12 Month Target Price – The S&P equity analyst's projection of the market price a given security will command 12 months hence, based on a combination of intrinsic, relative, and private market valuation metrics.

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Recommendation and Target Price History

Date	Recommendation	Target Price
New	Strong Buy	0.42

