

ISDN Holdings Limited

Overweight

Current Price	S\$0.183
Fair Value	S\$0.300
Up / (downside)	63.9%

Stock Statistics

Market cap	S\$64.9m
52-low	S\$0.171
52-high	S\$0.235
Avg daily vol	460,106
No of share	354.7m
Free float	49%

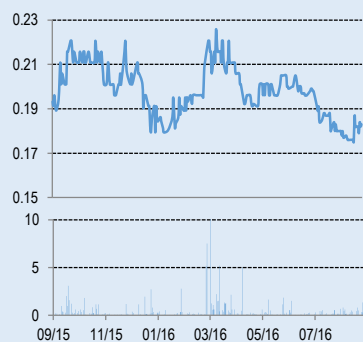
Key Indicators

ROE 17F	5.5%
ROA 17F	4.7%
P/NAV	0.5x
Net gearing	Net cash

Major Shareholders

Teo Cher Koon	37.0%
Tan Thiam Chye	8.0%
Karl Walter Braun	5.6%

Historical Chart



Source: Bloomberg

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Attractive Risk-Reward Profile Deserves Attention

- Low share price and potential dual listing creates attractive risk reward profile.** Since the submission of its application proof to the Hong Kong stock exchange (HKSE) on 13 September, ISDN's share price has recovered by just 1.2 cents to S\$0.183 last Friday. We highlight that ISDN trades at an attractive 50% discount from its NAV per share as of 30 June, and that its current share price may not have fully factored a) any earnings recovery in 2017 and b) any successful dual listing in 4Q 2016 or 2017. Excluding 5.5 cents of net cash, ISDN trades at just 6.7x estimated FY17 EPS. Assuming a bear case valuation of S\$0.157 versus our base case valuation of S\$0.300, we are looking at downside risk of 2.6 cents versus upside of 11.7 cents. Maintain Overweight (high-average return / moderate risk).
- Weak 2016 has been highly factored into share price.** ISDN's 1H16 PATMI fell by 68.9% or S\$3.4m to S\$1.5m due to lower cost pass-through to clients, which eroded gross margin, and S\$0.9m of foreign exchange loss. We estimate that the company may make full year PATMI of S\$3.6m or 1.02 cent EPS in 2016, translating to a FY16 P/E of 12.5 (ex. net cash). Adjusting for ISDN's current cost structure, we lowered our FY17 forecast PATMI from S\$11.0m to S\$6.8m or 1.92 cents EPS, thus deriving a P/E multiple of 6.7x against FY17 earnings based on an adjusted share price of S\$0.128 after deducting net cash per share. Over the last five years, ISDN's PATMI has ranged from S\$4.8m in 2013 to S\$8.7m in 2015. Hence, our FY17 forecast can be said to be reasonable.
- Bear case scenario shows moderate downside risk.** Assuming that ISDN fails to stage a recovery and earns a flat PATMI of S\$3.6m in 2017, we estimate that ISDN's share price may touch S\$0.157 based on 10x P/E and 5.5 cents net cash. On the other hand, our valuation of S\$0.300 (as per last report) implies 12.8x base case FY17 EPS of 1.92 cents, after adding back the net cash. Our basis for earnings growth stems from 1) higher orders from smartphone clients as they prepare for their next series of new products, 2) initial contribution from mini hydropower projects, 3) lower financing costs following the repayment of debt post-dual listing and 4) lower FX losses which amounted to S\$0.9m in 1H16.
- Application submission is a positive signal.** The submission of the application proof means that the company has likely already entered into pre-consultation with exchange officials via its HK "sponsor" and indicates a higher chance of success. The upside is that shareholders can increase their gains by transferring any SGX listed shares for sale on the HKSE, if prices in HK are higher. However, we also caution that ISDN's results in FY16 are expected to just barely meet the HKSE listing criteria and may be taken into consideration if the listing drags into 2017.

Key Financial Data (S\$ m, FYE Dec)	2014	2015	2016F	2017F	2018F
Sales	230.5	236.0	247.7	272.4	299.6
Gross Profit	61.5	65.6	61.9	68.1	74.9
Net Profit	7.5	8.7	3.6	6.8	8.0
EPS (cents)	2.1	2.5	1.0	1.9	2.3
EPS growth (%)	59.2	17.0	(58.5)	88.3	17.8
PER (x)	8.7	7.4	17.9	9.5	8.1
NTA/share (cents)	23.3	25.0	23.7	24.2	24.9
DPS (cents)	0.4	0.4	0.4	0.4	0.4
Div Yield (%)	2.2	2.2	2.2	2.2	2.2

Source: Company, NRA Capital forecasts

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Will the dual listing succeed? The submission of the application proof to the HKSE on 13 September is actually a major milestone, as the company's advisers would have most likely entered into pre-consultation or other forms of talks with the HKSE officials in advance to address any initial concerns or questions. Secondly, the application proof means that a significant portion of the financial and legal due diligence have already been completed in the process of the preparation of the document.

We also noted that the company has reviewed its operations to ensure full compliance with the relevant laws and regulations in the jurisdictions in which it operates. Some of the measures implemented have included additional social security contributions in Indonesia and Vietnam and environment assessments of subsidiaries in China.

Profit test is key. We compared the HKSE's main board listing requirements against ISDN's current conditions. If the review period of 2013 to 2015 (three years) is selected, ISDN will likely meet the Profit test of the financial requirements for a listing on the HKSE main board. The company cumulatively made approximately HK\$119.5m from 2013 to 2015, as opposed to a required minimum of HK\$50m.

There are also several other key requirements, e.g. shareholding spread and public float. We are not sure if the minimum public float of 15% to 25% includes ISDN's shares listed on the SGX. Based on the application proof, ISDN will likely issue new shares to list on the HKSE. In any case, the public float requirements should not pose a major challenge based on our analysis in Figure 1.

Figure 1: HKSE Main Board Listing Requirements

	Requirements	Remarks – in relation to ISDN
1)	Financial Requirements (one of I, II or III)	
	I) Profit test - A) HK\$50m in cumulative PATMI over last three financial years, PATMI of at least HK\$20m in the most recent financial year, and aggregate profits of at least HK\$30m recorded in the 2 years before that. B) Market capitalisation of at least HK\$200m at the time of listing II) Market Cap / Revenue Test Market Cap of at least HK\$4 billion at time of listing Revenue of at least HK\$500m for most recent audited financial year III) Market Cap / Revenue / Cashflow Test Market Cap of at least HK\$2 billion at time of listing Revenue of at least HK\$500m for most recent audited financial year Positive operating cash flow of at least HK\$100m in total for the last three financial years	PATMI: 2013 - S\$4.8m (HK\$27.1m) 2014 - S\$7.5m (HK\$42.6m) 2015 - S\$8.7m (HK\$49.8m) 2016F - S\$3.6m (HK\$20.7m) @ S\$1 = HK\$5.71 Mkt Cap: S\$64.9m (HK\$370.6m) as of 23 Sep Not applicable to ISDN. 2015 Revenue: S\$2326m (HK\$1.3 billion) Not applicable to ISDN. Net operating cashflows 2013 - S\$7.5m (HK\$42.7m) 2014 - (S\$0.9m) (negative HK\$5.0m) 2015 - S\$6.6m (HK\$37.9m)
2)	Acceptable Jurisdiction	NA - ISDN is already listed in Singapore
3)	Accounting Standards	NA - historical financials in Application Proof are presented in HK FRS
4)	Suitability for Listing	NA - ISDN is already listed in Singapore
5)	Operating History and Management	NA - no major management changes over last 3 yrs
6)	Minimum Market Capitalisation of HK\$200m (S\$35m)	NA - Mkt Cap - S\$64.9m
7)	Market Capitalisation of Public Float of HK\$50m	NA - Equivalent to about 13.5% of current number of shares at S\$0.183 each.
8)	Public Float of at least 15% to 25%	SGX public float of 49.16% as of 9 March
9)	Shareholding Spread of at least 300 shareholders	1,589 public shareholders on SGX as of 9 March
10)	Offering Mechanism	NA
11)	New Issue Price - no discount below nominal value	NA

Our remarks do not mean that ISDN is definitely compliant or not compliant with any of the above requirements. These requirements are also subject to change and interpretation with other requirements that we may have omitted.

Source: https://www.hkex.com.hk/eng/listing/listreq_pro/listreq/equities.htm

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What happened in 2016? During 1H 2016, ISDN's PATMI fell due to lower gross margin of 25.8% compared to 27.7% a year ago. Cash operating expenses were kept tightly controlled at around S\$23.6m year-on-year (see Figure 2). Of the S\$3.4m decrease in PATMI, about S\$2.3m can be attributed to the variance in gross margin. Foreign exchange loss also increased by about S\$0.7m year-on-year in 1H 2016. Other operating expenses such as higher allowance for impairment of trade receivables and allowances for inventories obsolescence also affected profitability. The cost of these two items increased by S\$0.35m year-on-year in 1H 2016.

Gross margin fell as some of ISDN's customers were not willing to accept higher product prices in the midst of the depreciation of the RMB and some of the engineering solutions business in 2016 are of lower margin.

Expect recovery in 2017. We see the lower gross margin as a structural issue, where the adjustment in gross margin is one-off in nature. The company will probably attempt to maintain its gross margin in 2017, or even raise prices marginally and take on higher margin projects to gradually claw back its historical gross margin of around 26% to 30%.

Based on our estimated PATMI of S\$3.6m for FY16, we are assuming PATMI of S\$2.1m in 2H16, versus S\$1.5m in 1H16. Higher foreign exchange loss and allowances dragged PATMI lower by about S\$1.05m in 1H16. In the absence of these losses, we can expect 2H16 PATMI to be higher.

Secondly, we estimate that ISDN will only need about S\$9m to S\$10m of revenue to recover the "lost" profit from lower gross margin. This is equivalent to unchallenging revenue growth of about 4% over 2015's revenue of S\$235.96m.

To some extent, we felt that the lower performance of 2016 is also due to product cycle of certain major customers. Within the smartphone industry, major brands such as Apple and Samsung have been launching new models lately. Typically, ISDN will be selling its motion control and other engineering solutions to the contract manufacturers one to two years prior to any product launch. Hence, we can expect demand to be stronger in 2017.

Figure 2: Results Review

FYE Dec (\$\$ m)	1H16	1H15	yoy % chg	2Q16	1Q16	qoq % chg
Revenue	120.5	119.3	1	59.8	60.7	-1
Gross profit	31.1	33.1	-6	15.3	15.8	-3
Gross margin (%)	25.8	27.7		25.6	26.0	
Operating expenses	(23.6)	(23.7)	-0	(12.2)	(11.4)	7
EBITDA	7.5	9.4	-20	3.1	4.4	-29
EBITDA margin (%)	6.2	7.9		5.2	7.2	
Depn & amort.	(1.0)	(1.1)	-13	(0.5)	(0.5)	0
EBIT	6.5	8.3	-21	2.6	3.9	-33
Interest expense	(0.4)	(0.4)	7	(0.2)	(0.2)	-23
Interest & invt inc	(0.7)	0.8	nm	0.1	(0.7)	nm
Associates' contrib	(0.5)	0.7	nm	(0.3)	(0.2)	39
Exceptionals	0.0	0.0		0.0	0.0	
Pretax profit	4.9	9.4	-48	2.2	2.7	-19
Tax	(1.7)	(2.8)	-39	(0.7)	(1.0)	-22
Tax rate (%)	34.4	29.6		33.7	35.0	
Minority interests	(1.7)	(1.7)	0	(0.6)	(1.1)	-48
Net profit	1.5	4.9	-69	0.9	0.7	34
EPS (cts)	0.43	1.39		0.25	0.18	39

Source: Company, NRA Capital

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Should ISDN be re-rated higher? We filtered a list of 14 companies of market capitalization of less than S\$500m that are currently listed on the HKSE and classified as “Industrial Services” under the ICB classification method. Most of these companies supply industrial equipment such as machine tools to manufacturers and users. We found that the median company trades at about 15.3x P/E and 0.9x P/B. Due to certain companies having very high P/E, we decided not to use the average for benchmarking purpose.

Comparing ISDN against this basket of peers, we noted that ISDN’s annual revenue is similar to these companies. Earnings growth is slower, but ISDN’s balance sheet is relatively healthy being in net cash position, with comparable ROE. In a nutshell, there is a reasonable basis for ISDN to trade at a higher P/E or P/B multiple, translating to a trading range of 25.6 cents to 32.8 cents. For simplicity, we maintain our valuation of ISDN at S\$0.300 per share.

Figure 3: Peer Comparison

Company Name	Mkt Cap (\$m)*	Sales (\$m)*	3-yr Avg EPS Growth	Ret. On Com. Equity	Net debt to com. Equity	Current P/E	Current P/B
China Metal International Holdings Inc	478.1	53.0	10.2%	13.3%	7.4%	8.0	1.1
Shanghai Prime Machinery Co Ltd	423.2	1,289.5	40.7%	6.3%	66.2%	10.1	0.6
CHTC Fong's Industries Co Ltd	367.0	525.1	13.4%	14.0%	47.3%	15.7	1.6
Tiangong International Co Ltd	334.4	549.9	-30.5%	1.0%	60.5%	41.4	0.4
EVA Precision Industrial Holdings Ltd	316.0	587.2	116.1%	4.2%	9.6%	16.1	0.7
IPE Group Ltd	304.1	145.3	NM	6.1%	net cash	17.4	1.1
CW Group Holdings Ltd	224.2	420.0	75.0%	15.4%	40.5%	5.8	0.8
Zhejiang Tengy Environmental Technology Co Ltd	188.7	161.1	67.5%	22.6%	9.8%	7.6	1.5
Yusei Holdings Ltd	126.9	197.3	NM	16.0%	49.7%	10.3	1.5
Good Friend International Holdings Inc	120.1	177.1	37.3%	5.2%	41.3%	15.0	0.8
Austar Lifesciences Ltd	112.2	109.9	NA	1.2%	net cash	107.5	1.0
LK Technology Holdings Ltd	103.2	494.4	19.1%	0.0%	69.9%	750.4	0.3
Asia Tele-Net & Technology Corp Ltd	71.0	95.3	NA	2.2%	net cash	57.9	1.3
Leepport Holdings Ltd	56.8	127.8	61.6%	6.5%	15.2%	13.6	0.9
Median	206.4	187.2	39.0%	6.2%	41.3%	15.3	0.9
ISDN Holdings Limited	64.9	237.2	16.4%	5.5%**	net cash	9.5**	0.5

*Mkt Cap as of 23 Sep, Sales is on a trailing 12-month basis. ** Based on FY17 EPS and ROE Source: Bloomberg, NRA Capital

Figure 4: Prospective Issue Price

	P/E	P/B
Median	15.3	0.9
FY17 EPS - Adjusted for 15% new shares	0.017	
Current NAV		0.3642
Potential price	0.256	0.328

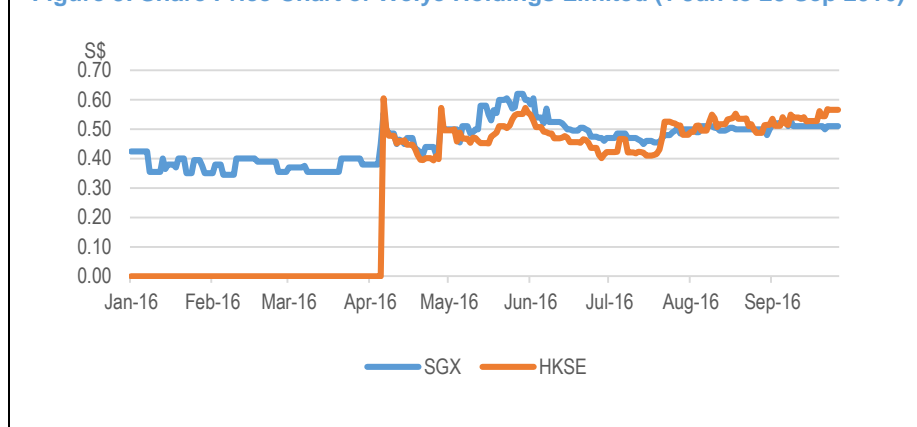
Source: See Figure 3, NRA Capital

As a case study, we have also referred to the listing by way of introduction of Weiye Holdings Limited on the HKSE on 6 April 2016. While Weiye’s share price fell below the initial first-day close in HK, its share price in Singapore has climbed from a range of about 40 cents to a peak of 60 cents. Therefore, we can infer ISDN may enjoy similar share price appreciation on successful dual listing.

However, any pure arbitrage opportunity will depend on whether traders can borrow shares in Hong Kong to sell short while waiting for the transfer of their share scripts from Singapore.

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Figure 5: Share Price Chart of Weiye Holdings Limited (1 Jan to 23 Sep 2016)



Source: Bloomberg, NRA Capital

What can go wrong?

- 1) Our earnings forecasts do not include any one-off listing expenses which may drag on the reported full year profitability of either 2016 or 2017. Nonetheless, we argue that the analysis and valuation of ISDN should be based on recurring operating profits.
- 2) We also have not factored in the issue of new shares to our earnings model. The number of new shares to be issued and the issue price are still pending confirmation. Depending on the issue price, the new shares may not be dilutive.
- 3) The dual listing can still fail. Our FY16 PATMI forecast of S\$3.6m is equivalent to about HK\$20.7m. Under the Profit test, the issuer's latest financial year PATMI has to be at least HK\$20m. There is the risk that the listing process drags into 2017 and the HKSE request for the review period to be based on 2014 to 2016 results. In this scenario, ISDN's 2H 2016 performance will be crucial to provide a buffer of safety to meet listing requirements.

Recommendation. On balance, we see ISDN as undervalued, regardless of the potential dual primary listing. We reiterate that ISDN has net cash of about 5.5 cents per share as of 30 June. Excluding this cash balance from its share price, ISDN actually trades at just 6.7x FY17 P/E. Even if ISDN ends FY17 flat compared to FY16, it still trades at about 12.5x P/E. Therefore, we argue that downside risk is low, barring any sharp drop in operating performance after 1H 2016. However, we do not anticipate a deterioration in performance given that some of the higher costs e.g. foreign exchange loss and allowances are relatively lumpy in nature.

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Profit & Loss (S\$ m, FYE Dec)	2014	2015	2016F	2017F	2018F
Revenue	230.5	236.0	247.7	272.4	299.6
Operating expenses	(214.3)	(218.0)	(233.8)	(256.0)	(281.6)
EBITDA	16.3	18.0	13.9	16.4	18.1
Depreciation & amortisation	(2.2)	(2.2)	(2.3)	(2.3)	(2.3)
EBIT	14.1	15.8	11.7	14.1	15.7
Net interest & invt income	0.1	0.6	(1.8)	0.8	1.5
Associates' contribution	1.1	0.8	0.0	0.0	0.0
Exceptional items	0.0	0.0	0.0	0.0	0.0
Pretax profit	15.2	17.2	9.9	15.0	17.2
Tax	(4.6)	(5.3)	(3.0)	(4.5)	(5.2)
Minority interests	(3.1)	(3.2)	(3.3)	(3.7)	(4.0)
Net profit	7.5	8.7	3.6	6.8	8.0
Shares at year-end (m)	354.7	354.7	354.7	354.7	354.7
Balance Sheet (S\$ m, as at Dec)	2014	2015	2016F	2017F	2018F
Fixed assets	31.4	35.6	39.3	43.0	40.7
Intangible assets	11.7	11.7	11.7	11.7	11.7
Other long-term assets	6.8	7.2	7.4	7.6	7.8
Total non-current assets	49.9	54.4	58.4	62.3	60.2
Cash and equivalents	37.5	39.1	34.2	32.9	40.2
Stocks	34.6	40.9	44.6	49.0	53.9
Trade debtors	68.0	73.1	76.8	84.4	92.9
Other current assets	0.0	0.0	0.0	0.0	0.0
Total current assets	140.1	153.1	155.5	166.3	187.0
Trade creditors	45.1	51.9	56.6	62.3	68.5
Short-term borrowings	13.1	14.1	12.4	10.9	12.0
Other current liabilities	1.5	1.5	3.0	4.5	5.2
Total current liabilities	59.7	67.5	72.0	77.6	85.6
Long-term borrowings	0.6	0.7	0.5	0.5	0.5
Other long-term liabilities	0.0	0.0	0.0	0.0	0.0
Total long-term liabilities	0.6	0.7	0.5	0.5	0.5
Shareholders' funds	112.1	119.7	118.5	123.9	130.6
Minority interests	17.7	19.5	22.9	26.5	30.5
NTA/share (S\$)	0.23	0.25	0.24	0.24	0.25
Total Assets	190.0	207.5	213.9	228.6	247.2
Total Liabilities + S'holders' funds	190.0	207.5	213.9	228.6	247.2
Cash Flow (S\$ m, FYE Dec)	2014	2015	2016F	2017F	2018F
Pretax profit	15.2	17.2	9.9	15.0	17.2
Depreciation & non-cash adjustments	3.4	4.7	(1.8)	1.5	6.9
Working capital changes	(15.7)	(10.0)	(3.2)	(6.9)	(6.8)
Cash tax paid	(3.8)	(5.3)	(1.5)	(3.0)	(4.5)
Cash flow from operations	(0.9)	6.6	3.4	6.7	12.8
Capex	(4.1)	(6.0)	(6.0)	(6.0)	(6.0)
Net investments & sale of FA	(0.4)	(0.5)	0.0	0.0	0.0
Others	0.1	0.4	0.0	0.0	0.0
Cash flow from investing	(4.4)	(6.1)	(6.0)	(6.0)	(6.0)
Debt raised/(repaid)	0.0	1.5	(1.9)	(1.5)	1.1
Equity raised/(repaid)	(1.4)	0.0	0.0	0.0	0.0
Dividends paid	(1.4)	(1.4)	(1.4)	(1.4)	(1.4)
Cash interest & others	4.0	1.3	1.0	1.0	1.0
Cash flow from financing	1.2	1.5	(2.3)	(2.0)	0.6
Change in cash	(4.1)	2.0	(4.9)	(1.3)	7.4
Change in net cash/(debt)	(4.1)	0.5	(3.0)	0.2	6.3
Ending net cash/(debt)	23.8	24.3	21.3	21.5	27.8
KEY RATIOS (FYE Dec)	2014	2015	2016F	2017F	2018F
Revenue growth (%)	32.7	2.4	5.0	10.0	10.0
EBITDA growth (%)	46.5	10.8	(22.6)	17.8	10.0
Pretax margins (%)	6.6	7.3	4.0	5.5	5.7
Net profit margins (%)	3.2	3.7	1.5	2.5	2.7
Effective tax rates (%)	30.4	31.0	30.0	30.0	30.0
Net dividend payout (%)	19.0	16.3	39.2	20.8	17.7
ROE (%)	6.7	7.3	3.1	5.5	6.1
Free cash flow yield (%)	(7.7)	1.0	(3.9)	1.0	10.4

Source: Company, NRA Capital forecasts

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