

6 April 2005

Initiate Coverage

LANKOM ELECTRONICS

Niche In Electromagnetic Components

HOLD | S\$0.185

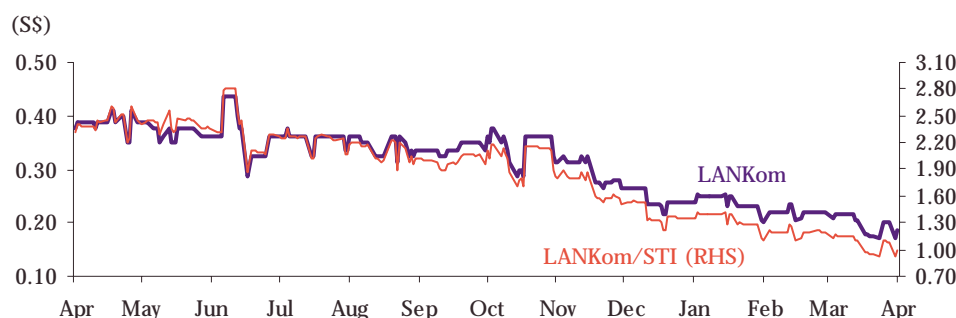
LANKom Electronics designs, develops, manufactures and distributes electromagnetic (EM) components (mainly passive components) to OEMs of electronic products from Taiwan, China and the US. Its products comprise mainly pulse transformers, filters and connectors. While industry prospects are positive, the company faces margin erosion in a competitive market. Initiate coverage with HOLD.

China-driven growth. The strategic decision to shift its focus to China should be commended as it follows its Taiwanese customers there and continues to be their reliable supplier-partner. Customers like Accton, D-Link and Foxconn are now operating on a large scale in China to tap a lower cost base for production as well as to address the huge appetite of the domestic China market. LANKom has also gone ahead to service customers like Cisco Systems, Motorola, Nortel and 3Com in China.

Supported by economic growth. The positive economic outlook for 2005 should provide the underlying support for electronic product sales. The unwinding of excess inventory is fully underway although surpluses still remain for components that are heavily used in wireless telecom and consumer products. According to iSuppli Corp, the outlook for 2Q05 is flat to slightly down for component manufacturers but modestly better for end-product manufacturers.

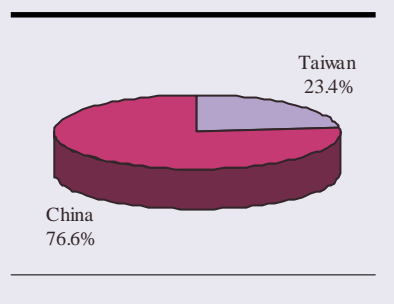
Margin pressures. Given the influx of foreign and local EM component suppliers and manufacturers into China, price competition is likely even when demand picks up. Niche players like LANKom must continually upgraded their technical expertise. The consolidation of its various research and test facilities into a central laboratory is a positive move to streamline its research and development efforts.

Valuation. We forecast net profit to decline 8.3% in FY05, which assumes no tax writebacks and a nominal tax rate of 5%. There was a NT\$7m tax writeback which had distorted the FY04 net profit numbers. Pre-tax profit is projected to grow 11.2% in FY05. LANKom's FY05 PE of 6.4x appears fair given the modest growth projected and is in line with its peers'. Projected dividend yield is 2-4%. Entry price is S\$0.18.



Sector	Technology
Bloomberg	LANK SP
Website	www.lankom.com.tw
Exchange Rate	S\$1.6609/US\$
52-Wk Range (S\$)	0.44/0.16
52-Wk Avg. Daily Vol. ('000)	12
No. of Shares (m)	90.8
Market Cap (S\$m)	16.8
(US\$m)	10.1
Book NTA per Share (NT\$)	6.19
ROE (%)	10.0
Net Cash per Share (NT\$)	0.94
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2005F Revenue Mix



Year to 31 Dec	Turnover (NT\$m)	EBITDA (NT\$m)	Net Profit (NT\$m)	EPS (NT¢)	EPS Growth (%)	PE (x)	EV/EBITDA (x)	DPS (S¢)
2003	449.7	36.3	24.2	26.6	(24.6)	13.2	6.5	0.375
2004	486.5	67.5	55.1	60.7	127.9	5.8	3.5	0.48
2005F	541.6	70.9	50.5	55.6	(8.4)	6.3	3.3	0.40
2006F	618.3	76.4	55.1	60.7	9.1	5.8	3.1	0.45
2007F	717.9	85.3	63.3	69.7	14.9	5.0	2.7	0.50

Consensus net profit -- n.a.

Investment Summary

Tapping on the China potential. While the global passive component industry struggled in the last few years, small Asian suppliers used the electronics boom in China to increase their market share, with some even emerging as legitimate challengers to the market's top players. Because of China's strength, many Asian suppliers have managed to rapidly increase their revenues, while the traditional heavy-hitters based in North America and Japan saw their sales declined. The Asian suppliers made gains in every segment of the passives market, including capacitors and resistors.

The strategic decision by LANKom management to shift its focus to China should be commended as it follows its Taiwanese customers into China, and continues to be a reliable supplier-partner to these customers. Customers like Accton, D-Link and Foxconn are now operating on a large scale in China to tap a lower cost base for production as well as to address the huge appetite of the domestic China market for these end products. LANKom has also gone ahead to service customers like Cisco Systems, Motorola, Nortel and 3Com in these markets.

According to the World Semiconductor Trade Statistics (WSTS) in its Nov 04 update and outlook for the industry, Asia Pacific continues to be the fastest-growing region, due not only to a continuing shift in equipment production but also to rising internal demand in those countries. The growth of equipment production in China will help sustain faster-than-average growth in Asia throughout WSTS's forecast period from 2004 to 2006.

Economic growth should support demand. With each monthly report since mid-04, the electronics market outlook had slipped marginally lower. Component buyers and distributors are still working off the surplus inventory purchased almost a year earlier when there were fears of component shortages. Unwinding of the excess inventory is already underway but surpluses still remain for components that are heavily used in wireless telecom and consumer products.

Back in 2001, there had been continuous weak demand and the then underlying economic support for electronic product sales had been plunging following the end of the Y2K demand surge, the bursting of the Internet bubble in mid-00 followed the terrorist attacks of 11 Sep 01. There is no risk that this period of stock cutting will become a period of sustained reductions in final demand as happened in 2001. In fact, the outlook is positive, especially for component suppliers operating in China, such as LANKom.

Figure 1: GDP Growth

(yoy % change)	2003	2004	2005F	2006F
NAFTA	2.8	4.2	3.7	3.5
Europe	1.2	2.4	2.3	2.5
Asia Pacific	5.8	6.5	5.5	6.1

Source: World Semiconductor Trade Statistics, US Department of Commerce, International Monetary Fund, Electronic Business

According to iSuppli Corp, the outlook for 2Q05 is flat to slightly down for components manufacturers but modestly better for end-product manufacturers. The quarter is expected to see marginal gains in component sales with end-product sales continuing to expand more quickly. Component sales will rise more quickly in the summer and continue expanding at a 10%-plus pace into 2006. On an optimistic note, there could be another period of component sales outpacing consumption in about 12 months' time. Inevitably, it will be followed by a period of inventory cutting as in past cycles. The WSTS's forecasts for global semiconductor shipments indicate a similar view.

Figure 2: Shipments

(yoy % change)	2003	2004	2005F	2006F
Telecom	(4.3)	9.1	10.5	9.3
Computer	13.9	12.3	9.9	2.2
Components (ex-semicon)	(9.8)	11.7	9.4	5.3
Semiconductors (worldwide)	18.3	27.5	4.8	10.1

Source: World Semiconductor Trade Statistics

Margin pressures could emerge. Despite the optimistic outlook for LANKom as a passive component supplier with a significant exposure to China, margin pressures could emerge as in 2003 when its gross margin slipped from 25.8% to 22.7% due to intense competition. Given the influx of both foreign and local EM component suppliers and manufacturers into China, price competition is likely even when demand picks up.

Demand growth for passive components within China has been outpacing supply growth. Typically, Chinese buyers view foreign products as having higher quality than domestically-produced parts. This is giving foreign companies opportunities to serve the market. While falling component prices are necessary to enable component and equipment suppliers as well as operators to maintain market growth, there must be a continuous introduction of new and more sophisticated products. Passive components must integrate new functions and improve their performance.

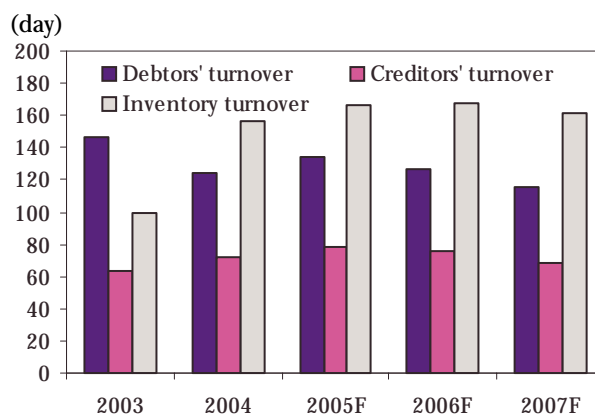
It is imperative that for a small and niche player like LANKom that its technical expertise is continually upgraded. Its consolidation in 2004 of its various research and test facilities into a central laboratory is a positive move to streamline its research and development efforts. The central laboratory now comprises expertise from its materials, applications, environment, reliability, Smart-Bit and electromagnetic interference laboratories.

Financials and Valuation

The company has been experiencing steady growth despite the broad technology industry slowdown following the end of the Internet bubble. Over the last few years, LANKom's customers have moved their operations from Taiwan to China to capitalise on the lower operating costs. This has had an adverse impact on LANKom's Taiwan operations, which posted operating losses over the last three years while its China operations have been a clear beneficiary.

Balance sheet position is solid and the company is in a net cash position. Operating cash flow is strong, projected to generate S\$11m in FY05. Accounts payable is 80 days, while accounts receivable is 130 days. Inventory turnover stands at 160 days. It is supported by a net asset backing of 32.3 cts/share as at 31 Dec 04.

Figure 3: Cashflow and Inventory Management



Source: LANKom, UOB Kay Hian

LANKom's FY05 PE of 6.4x appears fair given the modest growth projected and is in line with its peers'. Projected dividend yield is 2-4%.

Figure 4: Peer Comparables

Company	Market Cap (\$m)	Price @ 5 Apr 05 (\$)	Price to Sales (x)	Price to Book (x)	PE (x)
ASJ Holdings Ltd	82.7	0.47	1.59	1.43	8.96
C20 Holdings Ltd	9.3	0.10	0.13	1.54	4.37
Flextech Holdings Ltd	84.7	0.40	0.10	4.04	6.11
Nucleus Electronics Ltd	39.7	0.20	0.18	1.11	7.83
Willas-Array Electronics	46.3	0.15	0.11	0.71	5.69
Excelpoint Technology Ltd	77.8	0.16	0.08	2.19	6.35
Lankom	16.8	0.185	0.03	0.55	6.38
Average			0.32	1.65	6.53

Source: Bloomberg, UOB Kay Hian

Company Background

LANKom Electronics Ltd was listed on the SGX-ST in Feb 01 and had its beginnings in May 96 when its founder, Chairman and Chief Executive Officer, Mr Albert Liu incorporated LANKom Taiwan with a few business associates. Its main activity then was to distribute electromagnetic (EM) components (mainly passive components) to capitalise on the growing market for EM components in the datacommunications, telecommunications and PC segments.

The company has since grown its business and expertise to include design and development, manufacturing and distribution of EM components

to OEM of electronic products from Taiwan, China and the US. Its products are marketed under its "LANKom" trademark. In addition, the company also manufactures under OEM arrangements for certain customers. Its major customers are approved suppliers to leading manufacturers of electrical and electronic devices in the datacommunications, telecommunications and PC industries, such as Accton, D-Link, Foxconn, 3Com and Cisco.

LANKom's product range of passive components is mainly in pulse transformers, filters and connectors. Its products can be classified into five categories:

Figure 5: Product Range

Product Category	Description
SMD - surface mount device (type transfer mold series)	Application: switch hub, WLAN router, motherboards and notebook PCs Function: noise filter and matching resistance during transmission
Epoxy potting case series	Application: switch hub, WLAN router, motherboards and notebook PCs Function: noise filter and matching resistance during transmission
SMD inductor series	Application: XDSL/WLAN router and notebook PCs Function: power and choke inductors
Telecommunications product series	Application: XDSL and T1/E1 telecommunication products Safety: UL and CE certifications
Connector module series (integrated RJ45 connectors)	Application: switch hub, WLAN router, motherboards and notebook PCs Function: noise filter and matching resistance during transmission

Source: LANKom

The company has a production base in Qinshi Industry District, SanZao Town, Zhuhai City, Guangdong, China with a floor area of 35,000 sqm and about 7,000 workers. The facility has been certified ISO-9002:1994 in 1998 and ISO-9001:2000 in 2001.

MANAGEMENT

Mr Albert Liu is the founder, Chairman and Chief Executive Officer. He oversees the entire operations, product development, strategic planning, corporate business development and policy decision making. Prior to founding LANKom in 1996, Mr Liu has held positions in companies responsible for the manufacture and sales of electromagnetic components as well as product development. Mr Liu holds a degree in English Literature from the TamKang University, Taiwan.

CHALLENGES

As a niche electronics component supplier, LANKom must continue to introduce new and innovative products, and to stave off margin erosion. While it may have a well-equipped laboratory with strong expertise, it will have to constantly contend with the competition from much larger and global players who have vast resources. Even though long-term relationships have been established with customers, the reality is that when companies are fighting to survive, all suppliers will be squeezed on price.

Figure 6: Profit & Loss

Year to 31 Dec (NT\$m)	2003	2004	2005F	2006F	2007F
Turnover	449.8	486.5	541.6	618.3	717.9
Taiwan	182.2	140.6	126.5	120.2	120.2
China	267.5	345.9	415.1	498.1	597.7
Cost of sales	(347.6)	(367.6)	(406.2)	(461.9)	(532.7)
Distribution costs	(4.6)	(9.7)	(10.5)	(13.0)	(15.8)
Administrative costs	(70.1)	(65.2)	(70.4)	(83.5)	(100.5)
Other operating expenses	(2.5)	4.7	(2.7)	(3.1)	(3.6)
EBITDA	36.3	67.5	70.9	76.4	85.3
Depreciation & amortisation	(11.3)	(18.8)	(19.1)	(19.5)	(19.9)
Operating profit	25.1	48.7	51.8	56.9	65.3
Interest income	0.2	0.1	2.8	2.5	2.7
Interest expense	(1.0)	(1.0)	(1.4)	(1.4)	(1.4)
Exceptional items	0.0	0.0	0.0	0.0	0.0
Gains from disposals	0.0	0.0	0.0	0.0	0.0
Forex gain/(loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax profit	24.3	47.8	53.2	58.0	66.7
Taxation	(0.0)	7.3	(2.7)	(2.9)	(3.3)
Minorities	0.0	0.0	0.0	0.0	0.0
Net profit	24.3	55.1	50.5	55.1	63.3
EPS (S cts)	1.4	3.2	2.9	3.2	3.6
DPS (S cts)	0.2	0.5	0.4	0.5	0.5

Source: LANKom, UOB Kay Hian

Figure 7: Balance Sheet

As at 31 Dec (NT\$m)	2003	2004	2005F	2006F	2007F
Current assets					
Prepayments, deposits, other receivables	15.6	8.6	8.9	9.9	11.9
Inventories	122.4	209.0	246.6	283.6	317.6
Trade receivables	180.8	165.3	198.4	214.3	227.1
Cash & equivalents	161.0	110.6	100.3	107.2	127.5
Non-current assets					
Fixed assets	226.7	234.9	227.7	219.4	210.2
Intangible assets	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0
Current liabilities					
Interest bearing loans	2.1	2.1	2.1	2.1	2.1
Trade payables	78.1	96.8	116.2	127.8	134.2
Other payables and accruals	32.7	21.8	30.4	28.3	26.8
Due to related companies	0.0	0.0	0.0	0.0	0.0
Tax payables	30.9	21.9	26.6	29.0	33.3
Non-current liabilities					
Interest bearing bank loans	25.6	23.6	25.0	25.0	25.0
Others	0.0	0.0	0.0	0.0	0.0
Minority interests	0.0	0.0	0.0	0.0	0.0
Shareholders' funds	537.1	562.2	581.7	622.2	672.9
Total equity & liabilities	706.4	728.3	781.9	834.4	894.4

Source: LANKom, UOB Kay Hian

Figure 8: Cash Flow

As at 31 Dec (NT\$M)	2003	2004	2005F	2006F	2007F
Operating	(32.0)	(10.4)	10.8	28.0	41.8
Pretax Profit	24.3	47.8	53.2	58.0	66.7
Depreciation	11.3	18.8	19.1	19.5	19.9
Working capital changes	(67.4)	(76.9)	(61.3)	(49.2)	(44.5)
Income tax paid	(0.1)	(0.1)	(0.3)	(0.3)	(0.3)
Investing	(82.3)	(30.8)	(12.0)	(11.2)	(10.7)
Capex	(98.5)	(32.1)	(12.0)	(11.2)	(10.7)
Proceeds from fixed asset disposals	0.0	0.0	0.0	0.0	0.0
Others	16.3	1.2	0.0	0.0	0.0
Financing	(2.1)	(9.3)	(9.0)	(9.9)	(10.8)
Share issue	0.0	(0.6)	0.0	0.0	0.0
Borrowings	0.0	0.0	0.0	0.0	0.0
Loan repayment	(2.1)	(2.1)	(2.1)	(2.1)	(2.1)
Dividends paid	0.0	(6.6)	(8.6)	(7.0)	(7.8)
Others	0.0	0.0	0.0	0.0	0.0
Net Cash Inflow/(Outflow)	(116.3)	(50.5)	(11.9)	7.8	21.1
Cash & cash equivalent at start of year	277.3	161.0	110.6	100.3	107.2
Cash & cash equivalent at end of year	161.0	110.6	98.6	106.4	127.6

Source: LANKom, UOB Kay Hian

Figure 9: Ratios

Year to 31 Dec (%)	2003	2004	2005F	2006F	2007F
Growth					
Sales	24.7	8.2	11.3	14.2	16.1
EBITDA	(17.7)	95.1	7.0	9.8	15.6
Pretax profit	(20.6)	97.2	11.2	9.1	14.9
Net profit	(18.3)	127.3	(8.3)	9.1	14.9
EPS	(18.3)	127.3	(8.3)	9.1	14.9
Profitability					
EBITDA margin	22.7	24.4	25.0	25.3	25.8
Pretax margin	5.4	9.8	9.8	9.4	9.3
Net margin	5.4	11.3	9.3	8.9	8.8
ROA	3.4	7.6	6.5	6.6	7.1
ROE	4.5	9.8	8.7	8.9	9.4
Leverage					
Total Debt/Total Assets	3.9	3.5	3.5	3.2	3.0
Total Debt/Equity	5.2	4.6	4.7	4.3	4.0
Net (Cash) Debt/Equity	(24.8)	(15.1)	(12.6)	(12.9)	(14.9)
Interest Cover (x)	24.1	47.7	39.3	42.9	49.3
Working Capital Management (Days)					
Debtors' turnover	147	124	134	126	115
Creditors' turnover	63	73	78	75	68
Inventory turnover	99	157	166	167	161

Source: LANKom, UOB Kay Hian

Appendix - Introduction to Passive Components

Passive components are present in virtually all electric and electronic equipment associated with semiconductors, but also as standalone components. Basically, all passive components offer resistance to an electric current.

Resistors adjust the passage of the current, part of which they convert into heat. They use a number of technologies such as wound wire, carbon, carbon film, metal film and oxide film to create fixed and variable resistors. Thermistors and varistors are based on ceramic compound materials. They vary their resistance according to the values of ambient temperature or applied voltage.

Capacitors consist essentially of two electrically charged surfaces called electrodes separated by an insulating material called dielectric. They can be used to store electrical energy and modify the frequency or phase of electrical signals. Dielectric materials used range from aluminium or tantalum oxide for electrolytic capacitors, paper or metallised paper, plastic film, ceramic. The most common ones are ceramic or tantalum.

Ferrites are used as magnetic cores for inductors. Inductors are coils of wire wrapped round a core, which may be hollow or made of a metal or ferrite or another synthetic material. They can function as electromagnets, or couple parts of circuits to each other, or transform the voltage of alternating current. They are often used together with capacitors, in particular, as a filter for noise suppression applications.

Chokes are basically wire-wound components. However, a new technology consists in printing them directly onto a circuit.

Filters may be made as discrete devices, or by combining one or more capacitors and inductors. EMC filters are generally used to enhance the performance of electronic equipment and to reduce electromagnetic interference (electromagnetic compatibility). They combine inductors and capacitors. The use of filters originated from safety requirements and is now governed by EU Standards.

Integrated filters include devices to filter radio frequency signals, such as microwave ceramic components, based on ceramic material, and SAW (surface acoustic wave) components which use crystals.

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