

GICS: Information Technology/Semiconductors

Business Summary: Recently listed in the Singapore Exchange in July 2010, Smartflex provides IC assembly and test services for contact smart cards and dual interface smart cards. Its customer base mainly comprises smart card solution providers which cater to the telecommunications and financial services sectors.

Country of Incorporation: Singapore

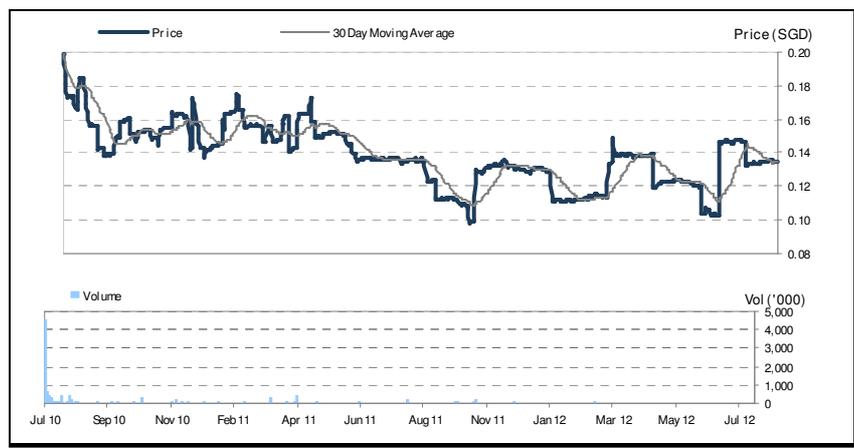
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Results Review

- 1H12 results were within our expectations, as both topline and net profit accounted for 49% of our full year forecast.
- Revenue was down 4.1% YoY to USD14.0 mln, on the back of weakening sentiment in Europe, coupled with aggressive price competition, particularly from China. We understand that sales to Europe accounted for around 20% of Smartflex's revenue in 1H12.
- Slower demand, coupled with higher gold prices and margin pressure, led to a 34.0% YoY decline in EBITDA. Margin was also notably softer at 5.0% vs. 11.1% in 1H11. In spite of this, Smartflex remained in the black with USDD0.7 mln in net profit (1H11: USD1.6 mln).
- According to management, the new production capacity is on track to come on stream in 2H12, with management pinning on demand uplift outside of Europe. We understand that funding for the new capacity has already been secured, and it is unlikely to take on further debt in the near term. As of end-June 2012, net gearing remains manageable at 0.11x vs. 0.17x last year.
- Smartflex recently announced a joint venture (JV) with SANsystems Sarl, a smartcard engineering company. The SGD1.6-mln investment represented a 70% stake in the JV, enabling it to tap into its in-house patented technology and expand into high volume manufacturing.

Earnings Outlook / Estimates Revision

- Management remains cautiously optimistic of the near-term outlook, citing high gold prices and slowing global demand amid the macroeconomic uncertainties. Yet, Smartflex expects to stay profitable for 2012. To improve its profitability, management is looking into three key areas, namely operational improvements, diversification of product applications outside of the telecoms market, and solutions innovation.
- We leave our projections unchanged, which does not factor in potential contribution from its new JV. We think that it is still early days before we see meaningful improvements to its bottom line. Overall, we see a relatively flat net profit in 2012, before rising to USD2.4 mln in 2013.

Investment Risks

- Investment risks include high customer concentration, volatile raw material prices and foreign exchange fluctuations. Rampant payment fraud and identity theft also increase the susceptibility of embedded smart card chips to hack attacks, requiring smart card solutions providers to stay tuned to rapid technological changes.

Key Stock Statistics

52-week Share Price Range (SGD)	0.10 - 0.15
Avg Vol - 12 months ('000 shares)	2.7
Price Performance (%)	
- 1 month	0.0
- 3 month	9.8
- 12 month	12.5
No. of Outstanding Shares (mln)	82.4
Free Float (%)	20.1
Market Cap (SGD mln)	11.1
Enterprise Value (SGD mln)	12.7
Major Shareholders (%)	
Tan Gee Beng Pte Ltd	62.1
Smarrtron Technology Pte Ltd	17.2

Per Share Data

FY Dec.	2010	2011	2012E	2013E
Book Value (US cents)	12.82	13.63	14.64	16.86
Cash Flow (US cents)	5.4	3.5	3.5	4.8
Reported Earnings (US cents)	2.7	1.6	1.7	2.9
Dividend (US cents)	0.8	0.7	0.7	0.7
Payout Ratio (%)	24.9	39.0	39.2	22.7
PER (x)	4.0	6.6	6.5	3.8
P/Cash Flow (x)	2.0	3.1	3.1	2.3
P/Book Value (x)	0.8	0.8	0.7	0.6
Dividend Yield (%)	7.5	6.0	6.0	6.0
ROE (%)	30.3	12.6	11.7	18.2
Net Gearing (%)	0.0	0.0	0.0	0.0

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Earnings Performance

FY Dec. / USD mln	1H12	1H11	% Change
Reported Revenue	14.0	14.6	-4.1
Reported Operating Profit	0.7	1.6	-56.7
Depreciation & Amortization	-0.9	-0.7	16.1
Net Interest Income / (Expense)	NA	NA	NA
Reported Pre-tax Profit	0.7	1.6	-58.3
Reported Net Profit	0.7	1.6	-59.4
Reported Operating Margin (%)	5.0	11.1	-
Reported Pre-tax Margin (%)	4.8	11.0	-
Reported Net Margin (%)	4.7	11.2	-

Source: Company data

Profit & Loss

FY Dec. / USD mln	2010	2011	2012E	2013E
Reported Revenue	26.8	25.3	28.6	32.0
Reported Operating Profit	2.7	1.5	1.7	2.9
Depreciation & Amortization	-1.4	-1.5	-1.5	-1.6
Net Interest Income / (Expense)	-0.1	0.0	0.0	0.0
Reported Pre-tax Profit	2.6	1.5	1.7	2.9
Effective Tax Rate (%)	21.9	10.0	18.0	18.0
Reported Net Profit	2.1	1.3	1.4	2.4
Reported Operating Margin (%)	10.0	6.0	6.0	9.1
Reported Pre-tax Margin (%)	9.8	5.9	5.8	9.0
Reported Net Margin (%)	7.7	5.3	4.8	7.4

Source: Company data, S&P Equity Research

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