

Analyst: Anita Hwang

Main Board Listing – Research

Delta Networks, Inc. [Stock Code: 0722] 達創科技股份有限公司

Sole global coordinator, bookrunner, lead manager and sponsor : Goldman Sachs

Sector : Technology Hardware & Equipment
 Business : Design and manufacture of networking products

<p>Total share offer: <u>313,600,000</u> shares (26.2% of the enlarged share capital)</p> <p>Public Offer: 31,360,000 shares (10%)</p> <p>Placing: *282,240,000 shares (90%)</p> <p>Greenshoe: 47,040,000 shares</p> <p><i>*Comprising 203,840,000 New Shares and 78,400,000 Sale Shares</i></p>	<p><u>Business of Delta Networks (Delta)</u></p> <p>Delta is an original design manufacturer of networking products. It designs and manufactures a wide range of networking products, including Ethernet switches, broadband access products, wireless adaptors and routers. Delta also provides contract manufacturing and ancillary services, including product design, manufacturing design and test engineering services.</p> <p>Key customers include leading telecommunication equipment providers, major enterprise solution providers and brand name vendors of small and home office networking products. In 2006, the top 5 customers consisted of Alcatel-Lucent, Dell, H3C, NETGEAR and Nortel Networks. Delta's manufacturing facilities are located in Taoyuan in Taiwan and Dongguan in the PRC.</p> <p>Delta's goal is to provide customers with high performance and cost-effective products and services by optimizing design, engineering and manufacturing facilities, as well as utilizing research and development expertise.</p> <p>Delta gives a profit forecast for the 6 months ending 30 June 2007 to be no less than US\$8.2 million, which translates into an unaudited pro forma fully diluted forecast EPS of US 0.71 cents.</p>
<p>Price: HK\$3.25 – HK\$4.50 per share</p> <p>Market Cap: HK\$3,487 – HK\$4,828 million</p> <p>Pro-forma fully diluted FY06 PER: N/A</p> <p>Estimated P/E (EAS) : 17.5x – 24.2x</p> <p>Adjusted NTA per share: US\$0.1789 – US\$0.2129</p> <p>Staffing: 2,406</p>	
<p>HK Public Offer period: 22nd June 07 – 27th June 07 noon</p> <p>Receiving bank: Standard Chartered Bank (HK) Bank of China (HK)</p> <p>Share registrar: Tricor Investor Services Limited</p> <p>Listing date: 6th July 2007</p>	

Major Shareholders after Listing (Assuming the over-allotment option is not exercised)

Delta Electronics Inc. through Delta Networks Holding Ltd.	63.4%
HSBC International Trustee (Hong Kong) Limited * - upon trust for Employee Incentive Scheme of Delta	10.4%
Public Shareholders	<u>26.2%</u>
	<u>100.0%</u>

Use of Proceeds

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Net proceeds from the offer are estimated to be HK\$826 million. *(Being the mid-point of the offer price range [HK\$3.875 per share] and assuming the over-allotment option is not exercised)*

	HK\$ million
For the acquisition and development of new manufacturing sites	350
For future strategic acquisitions (specific targets have not been identified)	393
For working capital and other general corporate purposes	83

Financial Highlights

US\$ million	Year ended 31 st December		
	2004	2005	2006
Revenue	199.8	289.4	357.4
Gross profit	29.6	44.8	57.3
Operating profit	3.3	15.7	22.1
Profit for the year	3.0	15.5	25.6
Gross Margin	14.8%	15.5%	16.0%
Operating Margin	1.7%	5.4%	6.2%
Net Margin	1.5%	5.4%	7.2%

Breakdown of turnover by business segments

US\$ million	2004	%	2005	%	2006	%
Ethernet switch products and services	148.2	74.1	235.2	81.3	280.5	78.5
Broadband and wireless products and services	39.9	20.0	44.0	15.2	59.7	16.7
Others	11.7	5.9	10.2	3.5	17.2	4.8
Total	199.8	100.0	289.4	100.0	357.4	100.0

Strengths/Opportunities

- ✓ **Vertically-integrated** Delta offers customized end-to-end solutions covering the entire value chain, from strong in-house product design, development and customization, engineering, manufacturing, quality management and testing, to after-sales support.
- ✓ **Reasonable valuation** There is no direct peer listed in HK; several closest peers are listed in Taiwan, namely D-Link (2332.TW), Alpha Network (3380.TW) and Gemtek (4906.TW). The average FY06A and FY07E PER for these companies are 19.0X and 15.7X, respectively. Based on the expected market capitalization range and FY06 net profit, Delta's FY06A PER would have been about 17.5X – 24.2X. It is considered that valuation of the counter is reasonable.

Weaknesses/Threats

- × Despite the long-term growth in demand for networking products (at some 16% CAGR to 2010 for Ethernet switches and routers), the rapid technological change and increasingly short product life-cycles make the industry increasingly competitive.
- × Delta has a number of share-based compensation schemes. For the years ended 31 Dec 2004, 2005 and 2006, the share-based compensation expenses recognized were US\$4.07 million, US\$6.74 million and US\$11.2 million, respectively. Delta estimates those expenses to be recognized in FY07E and FY08E to be US\$12.4 million and US\$1.6 million, respectively. Such expenses may be a drag on the accounting profit for Delta.

Recommendation: Hit & Run

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