

**Issuer:** Serial System Ltd

**Security:** Serial System Ltd

**Meeting details:**

Date: 28 April 2017

Time: 11:00H

Venue: 8 Ubi View #05-01 Serial System Building Singapore 408554

**Company Description**

Serial System Ltd, an investment holding company, distributes electronic and electrical components, and consumer products. It operates through three segments: Electronic Components Distribution, Consumer Products Distribution, and Other Businesses. The company offers consumer products, including household appliances and lifestyle goods, such as camera accessories, printer accessories, timepieces, motherboards, and hard-disk drives. It is also involved in the trading and rental of investment properties; wholesale and sub-assembly of electrical signals and controls products; assembly and distribution of medical devices and ethylene oxide sterilization; trading and distribution of fast-moving consumer goods, IT, and photographic products; and distribution and marketing of information technology, computer peripherals, parts, software, and related products, as well as electronic component modules focusing on automotive customers. In addition, the company offers hospitality and healthcare, outdoor advertising media, laundry, project financing, and food manufacturer and caterer services, as well as distributes and trades in mobile phone's subscriber identity module cards and top up cards. It serves a range of industries comprising consumer electronics, telecommunication, household appliances, industrial, electronics manufacturing services, automotive, and medical. The company operates in Singapore, Malaysia, Thailand, the Philippines, Indonesia, Vietnam, Cambodia, India, Hong Kong, China, South Korea, Taiwan, Australia, Kazakhstan, the United Arab Emirates, and Bangladesh. Serial System Ltd was founded in 1988 and is based in Singapore.

(Source: [http://www.sgx.com/wps/portal/sgxweb/home/company\\_disclosure/stockfacts?code=S69](http://www.sgx.com/wps/portal/sgxweb/home/company_disclosure/stockfacts?code=S69))

**Q1.** The group's revenue has increased to US\$1.4 billion in 2016, up 15% from 2015 (page 4 of the annual report – Financial Highlights) and more than double the revenue achieved in 2012. Gross profit has increased 6.4% from 2015 and is up more than half since 2012. However, EBITDA and profit attributable to equity holders have lagged. The table below shows the group's performance before and after the new three-pronged strategy that started in 2014.

	FY2012	FY2013	FY2014	FY2015	FY2016
Revenue (US\$' million)	658	817	1,036	1,222	1,403
Gross Profit (US\$' million)	62.6	73.5	90.4	91.5	97.4
EBITDA (US\$' million)	18.9	22.0	30.8	26.0	23.5
Profit Attributable to Equity Holders (US\$' million)	7.9	11.2	16.1	11.0	4.6
Earnings per Share (United States cents)	0.88	1.25	1.80	1.23	0.51
Dividend per Share (Singapore cent)	0.52	0.79	1.05	0.85	0.35
Net Gearing Ratio	0.54	0.89	0.98	1.16	1.12

(Source: Serial System Ltd Annual Reports)

The group's three-pronged strategy, which was first discussed in the FY2013 annual report and shown more clearly in the FY2014 annual report, is shown below.

### Serial System's New Three-Pronged Strategy

Outlines revenue and margin-accretive three-pronged strategy to:

- Increase revenue via expanding product portfolio
- Improve internal efficiencies, with focus on financial, cost, inventory and supply chain management and business intelligence
- Deepen penetration in existing markets and widen geographical reach

(Source: Serial System Ltd Annual Report 2014)

Revenue has grown impressively by over 70% from 2013 to 2016 but EBITDA increased by 7% and profit attributable to equity holders is about 60% lower over the same period. The earnings per share has dropped from 1.25c to 0.51c in 2016 and dividend per share has dropped from 0.79c to 0.35c. The net gearing ratio has increased from 0.89x to 1.12x over the same period.

- a) Can shareholders understand from the board if the decision to boost the group's revenue is a value-accretive strategy?**

In Note 39 (page 151 – Segment information), the group's consumer products distribution shows a segment revenue of US\$173 million and a segment loss of US\$(4.0) million. In the Chairman's Statement, the lower-margin consumer products distribution business was also cited as the reason for the drop in overall gross profit margin (page 6).

- b) Does management intend to scale up the consumer products distribution further?**
- c) How synergistic is the business with the group's core business of Electronic components distribution?**

**d) Does management expect the Consumer products distribution to breakeven in this financial year?**

**Q2.** The group's distribution business is capital intensive as a lot of working capital is required to finance the operations. In FY2016, Trade and other receivables were US\$207.8 million and Inventories accounted for another US\$152.9 million (page 54 – Statements of financial position). The group also had total borrowing of US\$204.4 million. As at 31 December 2016, the group had total equity of US\$124.8 million and a net gearing ratio of 111.6% (page 142 – Capital risk).

Management has also indicated that it is their strategy to maintain a net gearing ratio not exceeding 150%.

- a) Given that the electronics industry can be highly cyclical, can management provide shareholders with more clarity on how it arrived at the net gearing ratio limit of 150%?**
- b) With the current net gearing ratio already at 111.6%, does the group have any limits on what it invests in “Other businesses”?**

**Q3.** In using non-recourse factoring arrangement, the group substantially transferred all the risks and rewards of ownership of the receivables to the financial institutions and the group derecognises the receivables in their entirety (page 65 – Note 2: Significant accounting policies: Financial assets).

Mainly due to the non-recourse factoring arrangement, the group's average turnover days for trade receivables declined to 49 in FY2016 from 53 in FY2015 (page 9). The use of non-recourse could also be one reason for the group's marginally lower net gearing ratio.

- a) What are the typical costs involved in using non-recourse factoring? How extensive is the group's use of non-recourse factoring?**
- b) Compared to the group's other sources of funding, how attractive is non-recourse factoring?**
- c) Given that the distribution business is a low-margin business, has management evaluated the impact of using factoring to fund the business? Does it make the low margin consumer electronics business less attractive?**