

26 September 2006

Microlink Solutions Bhd

Riding the Islamic banking wave

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Trades at 11.6x FY06E P/E based on prospectus forecast (12.8x IBES)

Microlink Solutions Bhd (MSB) is an IT solutions provider to the financial services sector with a niche in Islamic banking. It has been successful in implementing Islamic banking systems in Malaysia and abroad. MSB was listed on MESDAQ in June 2006. Net profit margin improved from 14.6% in FY03 to 25.3% in FY05 (1H06 ann: 24.7%). MSB delivered an ROE of 33.9% in FY05 (1H06 ann: 24.2%). The stock trades at 11.6x FY06E P/E (prospectus est.; 12.8x IBES). It is a net-cash and capex-light company which has been profitable over the last 13 years.

Microlink is an IT solutions provider with a niche in Islamic banking

MSB was established in 1996 and is an end-to-end IT solutions provider that supplies Islamic and Conventional banking solutions to local and foreign financial institutions. Its niche is in providing dedicated Islamic banking solutions. It has offices in Jakarta, Indonesia, Kuwait and the UAE. MSB's key customers include Commerce Tijari, Bank Muamalat, SME Bank, Bank Rakyat, Islamic Bank of Brunei, Capital Bank of Sudan and Standard Chartered Bank Malaysia.

Management forecasts

In its prospectus, management has projected FY06 revenue of RM23.3m (17.5% growth), pre-tax profit of RM6.8m and a net profit of RM6.5m. MSB reported revenue of RM10.5m and net profit of RM2.6m in 1H06, representing 45% and 40% of forecasts, respectively. Management has already secured 71% of the total FY06 forecast and has submitted bids for a further RM16m in local contracts and US\$2.5m in foreign contracts. MSB delivered 33.9% ROE in FY05 and had net cash of RM7.5m as of December 31, 2005.

Banks have a low tendency to switch IT systems

From the company visit, we understand that the time required to plan, implement, test and deploy a system takes approximately two years. There is also significant operational risk in changing a system and the lifecycle of an IT system is about 10 years after which it becomes outdated, and upgrading becomes too expensive.

Figure 1: Financial highlights

| | 2003 | 2004 | 2005 | 2006E |
|------------------------------|------|-------|-------|-------|
| Revenue (RMm) | 8.9 | 18.3 | 19.8 | 23.3 |
| EBITDA (RMm) | 3.0 | 4.8 | 6.3 | na |
| Net profit (RMm) | 1.3 | 3.0 | 5.0 | 6.5 |
| Operating margin (%) | 20.8 | 18.8 | 27.5 | na |
| EPS (RM) | 0.01 | 0.03 | 0.04 | 0.05 |
| Net cash/debt per share (RM) | na | 0.00 | 0.00 | na |
| Net debt/equity (%) | na | -37.5 | -43.5 | na |
| ROA (%) | na | 17.3 | 26.3 | na |
| ROE (%) | na | 49.3 | 33.9 | na |

Source: Company data, Prospectus

Deutsche Bank AG/Hong Kong

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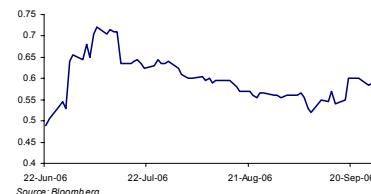
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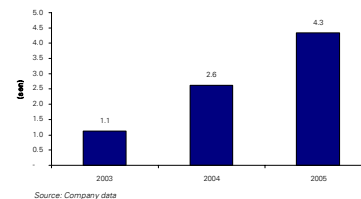
DISCLOSURES AND ANALYST CERTIFICATIONS ARE LOCATED IN APPENDIX 1

Company Visit

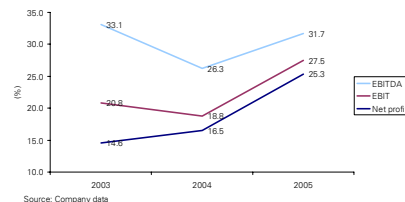
Share price performance



EPS trends



Margin trends



Companies Featured

| | |
|-------------------------------|-----------|
| Microlink Solutions Bhd | Not rated |
| Price at 26 Sept 2006 (RM) | .59 |
| Price target - 12 months (RM) | NA |
| 52-week range (RM) | 0.50/0.75 |
| KLCI | 965.66 |

Stock data

| | |
|------------------------|--------------------|
| Market cap (RMm) | 75.17 |
| Market cap (USDm) | 20.42 |
| Shares outstanding (m) | 127.41 |
| Daily Volume (RMm) | 0.03 |
| Major Shareholders | MiBS Systems 12.4% |

Key indicators

| | |
|-------------------------|-------|
| ROE (%) | 33.9 |
| Net debt/equity (%) | -43.5 |
| Net cash per share (RM) | 0.06 |
| Operating margin (%) | 27.5 |

Company visit

Company background

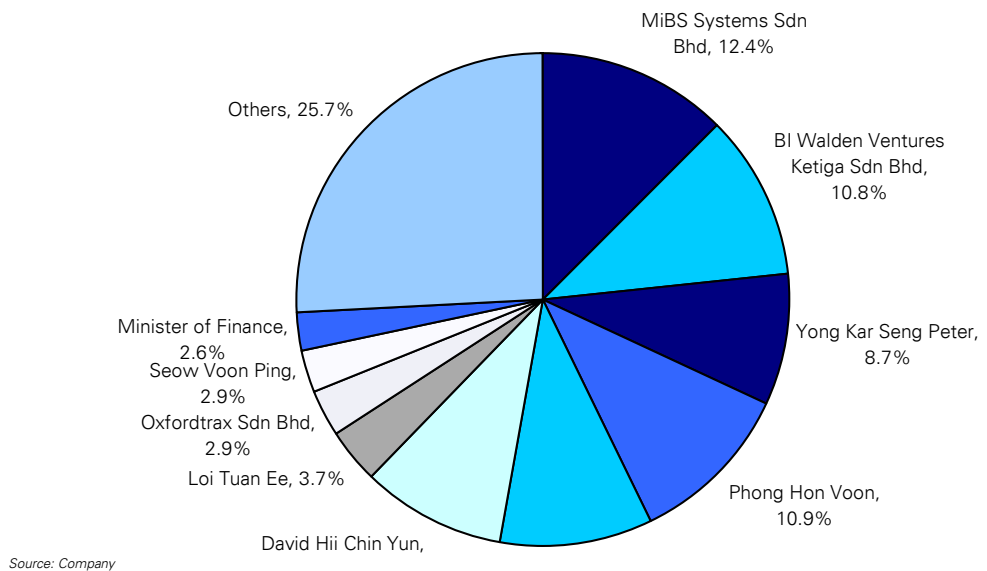
Microlink Solutions Bhd (MSB) started in 1994 as a systems integrator. MSB was listed on the MESDAQ market of Bursa Malaysia on June 23, 2006. It is an end-to-end information technology (IT) solutions provider that supplies Islamic and Conventional banking solutions to local and foreign financial institutions. Its niche is in providing dedicated Islamic banking solutions. In 1996, MSB launched its first IT solutions system with EON Finance as its first client.

On 30 January, 2006, MSB was granted Multimedia Super Corridor (MSC) status for its R&D in Islamic banking software solutions. In addition to current customer sites in Malaysia and other Asean countries, MSB has recently expanded its operations to Indonesia and the Middle East. In 2005, it opened offices in Jakarta and Kuwait. The company also has strategic business partners in Thailand, Brunei, the UAE, Saudi Arabia, Kuwait, Bahrain, Qatar, Oman and North Africa. These partners also offer support services (hardware, servers, printers, ATMs, system software etc.) enabling MSB to offer global one-stop banking solutions. It also has alliances with leading IT companies such as Sun Microsystems, IBM, Oracle, Microsoft and Hewlett Packard.

Microlink was awarded the "Best Application Award" in Islamic Core Banking and the "Best System Integrator" in Malaysia by Sun Microsystems. Also in 2003, it was awarded the "ICT of the Year 2003 Award" by PIKOM Computimes. Most recently, Microlink was awarded the "Best Islamic Financial Service or Product Award" by Halal Journal in May 2005.

MSB has a total staff force of 130, with approximately 30% in R&D, 30% in support, 30% in implementation and 10% in management & operations. Datuk Ali Bin Abdul Kadir, who was previously the Chairman of the Securities Commission, is the Independent Non-Executive Chairman of MSB.

Its founder is Edward Phong, currently CEO of MSB. He began his career in 1988 as a programmer in Taiwan and joined a Japanese electrical manufacturer in Malaysia. He subsequently joined the Lion Group in 1993 as a senior manager in the information systems department. Mr. Phong holds a Masters of Science in Parallel Computers and Computations from the University of Warwick. MSB's Chief Operating Officer is Wong Kim Ming, who is responsible for the development and implementation of MSB's products. He is a Certified Public Accountant in Australia and is also a Chartered Accountant with the Malaysian Institute of Accountants. David Hii is the Chief Technology Officer. He worked in an Australian research institute before joining MSB in 1995, working his way to his current position. David graduated from Monash University with a first class honours in Computer Science.

Figure 2: Top ten shareholders

Products & services/Microlink Banking Solutions (MiBS)

MSB's financial services solutions offering ranges from single application software implementation to complete IT outsourcing. The products and services available include:

- Banking application software
- Technical and operational training
- Software development, customization, maintenance and support
- Network services
- Workflow solutions
- Project management
- Quality management
- Disaster recovery
- Resource management
- Data migration
- Office automation
- Storage area network solution
- Emerging technology services

MSB's flagship application, Microlink Banking Solutions (MiBS) has been developed as an all-in-one banking solution comprising an integrated suite of modules for both conventional and Islamic banking. The first release was in 1995. Subsequent iterations have incorporated technological advances and add-ons. Its customers have a choice between web-browser interfaces or Windows client interfaces.

MiBS is scalable and has been offering 24x7 real-time OLTP (online transaction processing) banking solutions since 1995. It is designed and built from the ground up with multi-currency

and multi-financial institutional capability built in. It offers customers periodic enhancements, on-going maintenance, research and development and round-the-clock support. Some of MiBS' Conventional Banking solutions include deposit services (savings accounts, current account and fixed deposits), financing services (corporate loans, retail loans, hire purchase, leasing and share financing), and Treasury and Trade Finance services (trade finance, remittance, money market, foreign exchange).

MiBS is also a proven Syariah compliant Islamic Core-Banking solution. MiBS Islamic Core Banking Solution has been around since 1996, also designed from the ground up without the encumbrance of conventional interest calculation work-around.

Customer profile

Some of its key Islamic banking customers are Commerce Tijari, Bank Rakyat, Bank Muamalat, Amanah Raya, Bank Pertanian, Bank Pembangunan, SME Bank, Islamic Bank of Brunei, Capital Bank of Sudan and Islamic Bank of Thailand. Commercial banking clients include the Bumiputra-Commerce Group, RHB Bank, Southern Bank and Standard Chartered Bank Malaysia.

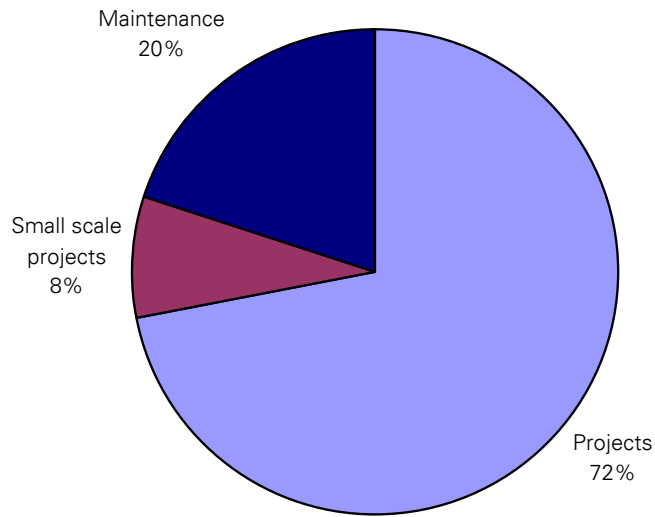
Highlights of the company visit

MSB derives revenue in three forms:

- Projects – one-off roll out projects, non-recurring
- Small scale projects – one-off upgrades, non-recurring
- Maintenance – recurring income

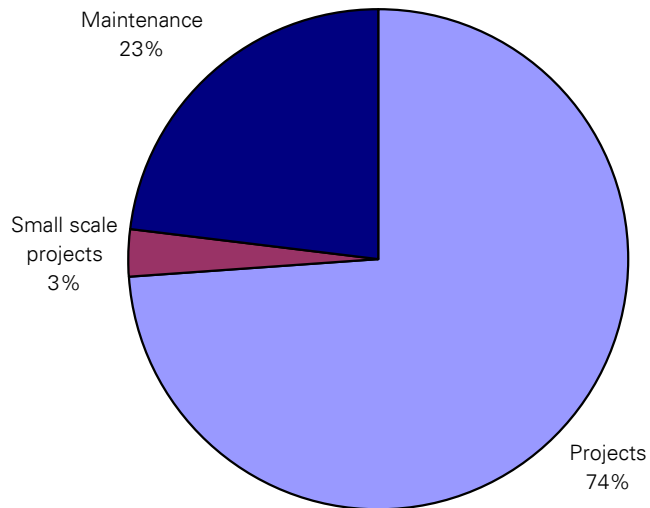
Currently, revenue is heavily dependent on projects, but management is focused on raising the contribution from maintenance income. According to management, current recurring income covers 80% of the total operational cost. The Chief Executive Officer of MSB, Edward Phong, was quoted by the press as saying that MSB is anticipating a major revamp of Malaysia's Islamic core-banking systems, driven mainly by lack of flexibility in the existing legacy systems.

Figure 3: 2005 revenue breakdown



Source: Company

Figure 4: 1H 2006 revenue breakdown



Source: Company

Management highlighted three core strengths of the company:

- End-to-end solutions provider – Unlike other IT solutions companies, MSB is a one-contact solutions provider. It has a track record of fully implementing a system in three months.
- Open standard – MSB also prides itself as being a solutions provider that is platform independent. The systems easily comply with various platforms and allow for core banking systems to adapt to Islamic banking systems.

- Compliant with legacy systems – MSB systems also allow for legacy systems to be converted easily into a new platform.

About 80% of MSB's FY05 revenue was derived from Islamic banks and the remainder from conventional banks.

Management has highlighted some key strategies to grow the business:

- Organic growth – management is focused on R&D, enhancing product solutions, expanding recurring income business, and creating product awareness.
- Geographical expansion – Indonesia, Bahrain, Kuwait, Qatar, the UAE and MENA. Management is targeting a new Islamic banking setup in MENA and is already in talks with several banks with a potential contract value of US\$2.5m in 2006.
- Operational strategy – management intends to keep headcount low, as book orders can be unpredictable at times.

Management does not view the entry of foreign Islamic banks such as the Kuwait Finance House as potential clients. The IT solutions in these banks tend to be outsourced to sister companies. However, it is not worried about the company's market share being taken away because banks are generally sensitive to privacy issues.

From the company visit, we understand that banks have a low tendency to switch IT systems as the time required to plan, implement, test and deploy a system takes approximately two years. There is also significant operational risk in changing a system. The lifecycle of an IT system is about 10 years after which it becomes outdated and upgrading becomes too expensive. Banks will usually open a new bid when they want to change to a new system.

Management projections

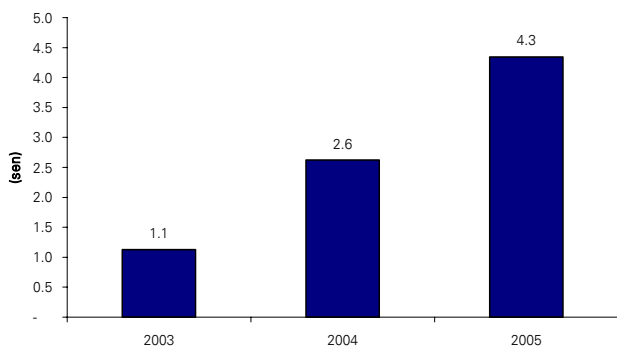
In its prospectus dated 2 June, 2006, management has projected FY06 revenue of RM23.3m, PBT of RM6.8m and a net profit of RM6.5m, translating into an EPS of 5.4 sen and net EPS of 5.1 sen. Microlink reported revenue of RM10.5m and net profit of RM2.6m in 1H06, representing 45.3% and 40.4% of its forecasts, respectively.

| Figure 5: Quarterly performance | | |
|--|---------------|---------------|
| (RM m) | 1QFY06 | 2QFY06 |
| Revenue | 3.678 | 6.865 |
| PBT | 1.349 | 1.438 |
| Net income | 1.291 | 1.32 |
| EPS, reported (sen) | 1.96 | 1.14 |
| FD EPS, reported (sen) | 1.06 | 1.13 |
| Net cash/(debt) (RM m) | 7.372 | 13.755 |
| Net cash/equity (%) | 39.68 | 53.05 |

Source: Company

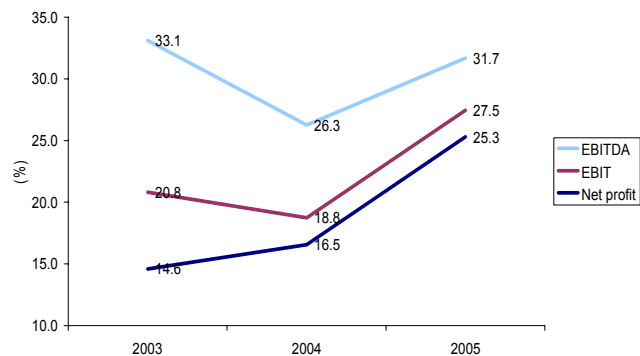
The company announced that management has secured and confirmed contracts worth approximately 71% of the FY06 forecast. Additionally, management has submitted bids amounting to RM16m locally and US\$2.5m overseas. Management expects the contracts to be awarded in the third quarter of 2006 and completed within 6 to 8 months. Hence, with recognition of some revenue from these projects in the current financial year, management is optimistic that the company will achieve its FY06 targets.

Figure 6: EPS trends



Source: Company

Figure 7: Margin trends



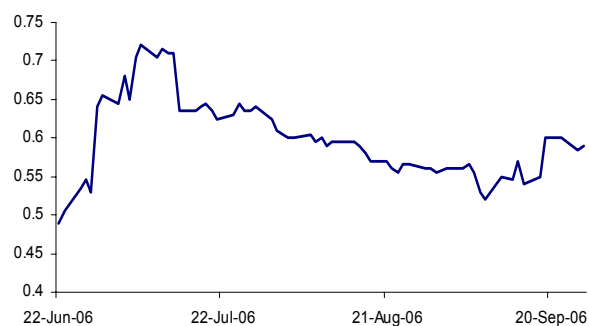
Source: Company

Figure 8: Valuations (based on IBES & Mgmt estimates)

| | 2005 | 2006E (IBES) | 2006E (Mgmt) |
|-------------------------------|-------|--------------|--------------|
| Price @ 26 September 2006 | 0.59 | | |
| Market Capitalisation (US\$m) | 20.8 | | |
| Avg traded daily (US\$m) | 0.008 | | |
| Net profit (RM) | 5.0 | 6.4 | 6.5 |
| EPS (RM) | 0.043 | 0.046 | 0.051 |
| EPS growth (%) | 66% | 7% | 19% |
| PE (x) | 13.7 | 12.8 | 11.6 |
| Dividend Yield (%) | - | - | 1.7% |

Source: Company; IBES

Figure 9: Share price performance



Source: Bloomberg

Comparative valuations

Figure 10: Comparative valuations (based on reported 2005 financials)

| | Price at | Mkt Cap | Avg Daily Vol | EPS | P/E | P/B | Divi Yield | ROE | Net Gearing |
|-------------------------------|-------------|-------------|---------------|-------------|------------|------------|-------------|---------------|-------------|
| | 25-Sep-06 | RMm | RMm | (RM) | x | x | % | % | % |
| Microlink | 0.59 | 75.2 | 0.03 | 0.04 | 13.7 | 3.3 | - | 33.9 | (57.6) |
| Rexit | 1.71 | 323.8 | 0.20 | 0.04 | 38.9 | 35.3 | - | 21.5 | (91.7) |
| Excel Force | 0.39 | 30.8 | 0.00 | 0.02 | 19.3 | 2.1 | 4.6 | 13.3 | (54.2) |
| CBS Tech | 0.30 | 29.4 | 0.02 | 0.04 | 7.3 | 1.3 | - | 19.3 | (11.8) |
| YGL Convergence | 0.81 | 54.1 | 0.86 | 0.04 | 22.5 | 5.5 | 4.0 | 15.5 | (84.5) |
| Global Soft | 0.13 | 16.7 | 0.02 | 0.02 | 7.7 | 0.9 | - | 12.0 | (11.8) |
| Average (ex-Microlink) | 89.2 | 0.22 | 0.03 | 18.5 | 9.0 | 1.7 | 16.3 | (50.8) | |

Source: Bloomberg

- Rexit commenced operations in 1998 and is one of the leading IT solutions providers in Malaysia for the general insurance industry. This includes a one-stop insurance service center to perform insurance transactions online over the Internet via a portal. The portal connects clients, insurance agents, insurance companies, JPJ, banks and telecommunications companies.
- Excel Force specializes in the development of IT solutions for the financial services industry, in particular the stock broking sector. This includes a platform that allows electronic linkage with its customers, remisiers, dealers and employees.
- CBS Technology is involved in the development of radio frequency identification (RFID), e-security solutions and implementation of Enterprise Productivity Solutions.
- YGL Convergence provides consultancy services related to ERP solutions. YGL also resells and implements World Class ERP Solutions. Additionally, it develops proprietary software, which includes a program that automatically calculates income tax payable.
- Global Soft is involved in software R&D, system design, integration and installation and provision of information technology services. The company services a wide array of customers, which range from semiconductor companies, clothing companies and governments.

The Islamic banking sector

Currently, there are seven Islamic banking window arrangements in Malaysia that have been transformed into subsidiaries. Six of these have commenced operations (as at May). Together with two full-fledged Islamic banking institutions and three new foreign Islamic banking players, Malaysia now has 12 Islamic banking institutions operating under the Islamic Banking Act.

With a diversity of players and the larger number of institutions that have been established in the Islamic financial system, it is envisaged that the development of the sector will gain momentum, which implies potential for IT solution providers like MSB. Banks will need to build their capacity to be able to take advantage of potential markets (local and overseas) that are relatively untapped.

The Islamic banking industry grew at an average annual rate of 18.9% in terms of assets from 2001 to 2005. Islamic banking assets accounted to RM113.5bn or 11.3% of the total assets in the banking system in 2005 compared to 6.9% in 2000. Approved Islamic bonds in 2005 exceed RM40bn, while the Islamic money market has recorded sizeable monthly turnovers of RM135.2bn. Similar progress has been achieved on the international front. There has been a

significant increase in the number of Islamic financial institutions in the global financial system, and funds seeking Syariah-compliant investment avenues have also increased dramatically. According to the International Data Corporation, Asia Pacific banks' external IT spending is expected to grow from US\$7.5m in 2004 to US\$12.9m in 2008, representing a 12.5% CAGR.

Figure 11: Financials (December year-end)

| SUMMARY | 2003 | 2004 | 2005 | | | | |
|----------------------------------|-------|-------|-------|---------------------------------|-----------|-----------|------------------|
| EPS, reported (sen) | 1.1 | 2.6 | 4.3 | | | | |
| EPS growth (%) | -67% | 132% | 66% | | | | |
| FCF per share (sen) | na | 0.93 | 2.44 | | | | |
| FCF growth (%) | na | na | 162% | | | | |
| CFO per share (sen) | na | 2.10 | 4.19 | | | | |
| CFO growth (%) | na | na | 100% | | | | |
| Issued shares | 115.4 | 115.4 | 115.4 | | | | |
| INCOME STATEMENT (RM' m) | | | | | | | |
| Revenue | 8.9 | 18.3 | 19.8 | Price (RM) | | | 0.59 |
| EBITDA | 3.0 | 4.8 | 6.3 | 12 month range (RM) | | | 0.75/0.50 |
| Depreciation | -0.3 | -0.2 | -0.2 | Market cap (US\$m/RMm) | | | 75.17 |
| Amortisation | -0.8 | -1.1 | -0.6 | Avg daily volume traded (US\$m) | | | |
| EBIT | 1.9 | 3.4 | 5.4 | | | | |
| Net interest income/ (expense) | 0.0 | 0.0 | 0.0 | Performance (%) | 1m | 3m | 12m |
| PBT | 1.9 | 3.4 | 5.4 | Microlink | 4% | 10% | na |
| Tax | -0.6 | -0.4 | -0.4 | KLCI | 1% | 7% | 4% |
| Net income | 1.3 | 3.0 | 5.0 | | | | |
| CASHFLOW (RM' m) | | | | | | | |
| Cashflow from operations | na | 2.4 | 4.8 | | | | |
| Capex | na | -1.3 | -2.0 | | | | |
| Acquisition of subsidiary | na | -5.5 | 0.0 | | | | |
| Interest received | na | 0.0 | 0.1 | | | | |
| Cashflow from investing | na | -6.8 | -1.9 | | | | |
| Equities raised/ (bought back) | na | 9.0 | 0.0 | | | | |
| Dividends paid | na | 0.0 | 0.0 | | | | |
| Finance costs | na | 0.0 | 0.0 | | | | |
| Repayment of loans | na | 0.0 | 0.0 | | | | |
| Cashflow from financing | na | 9.0 | 0.0 | | | | |
| Net cashflow | na | 4.6 | 2.9 | | | | |
| BALANCE SHEET (RM' m) | | | | | | | |
| Fixed assets, net | na | 0.5 | 0.7 | | | | |
| Software development expenditure | na | 2.2 | 3.3 | | | | |
| Other long term assets | na | 3.0 | 2.8 | | | | |
| Accounts receivables | na | 5.5 | 3.6 | | | | |
| Other current assets | na | 1.8 | 2.6 | | | | |
| Cash & other liquid assets | na | 4.6 | 7.5 | | | | |
| Total assets | na | 17.5 | 20.6 | | | | |
| Short-term loans | na | - | - | | | | |
| Accounts payables | na | 2.5 | 0.5 | | | | |
| Other payables | na | 2.2 | 2.3 | | | | |
| Tax payables | na | 0.0 | 0.0 | | | | |
| Other long term liabilities | na | 0.5 | 0.5 | | | | |
| Long term loan | na | - | - | | | | |
| Total liabilities | na | 5.3 | 3.3 | | | | |
| Share capital | na | 1.1 | 1.1 | | | | |
| Share premium | na | - | - | | | | |
| Reserves | na | 11.2 | 16.2 | | | | |
| Total shareholders' equity | na | 12.3 | 17.3 | | | | |
| RATIO ANALYSIS | | | | | | | |
| Sales growth (%) | -48.5 | 104.8 | 8.3 | | | | |
| EBITDA/sales (%) | 33.1 | 26.3 | 31.7 | | | | |
| EBIT/sales (%) | 20.8 | 18.8 | 27.5 | | | | |
| Net profit/sales (%) | 14.6 | 16.5 | 25.3 | | | | |
| ROA (%) | na | 17.3 | 26.3 | | | | |
| ROE (%) | na | 49.3 | 33.9 | | | | |
| Capex/Sales (%) | na | 7.4 | 10.2 | | | | |
| Capex/depreciation (x) | na | -5.4 | -8.5 | | | | |
| Effective tax rate (x) | 29.8 | 11.6 | 7.9 | | | | |
| Net cash/(debt) (x) | na | 4.6 | 7.5 | | | | |
| Net debt/equity (%) | na | -37.5 | -43.5 | | | | |
| Net interest cover (x) | 310.0 | 428.8 | na | | | | |

Source: Company

Appendix 1

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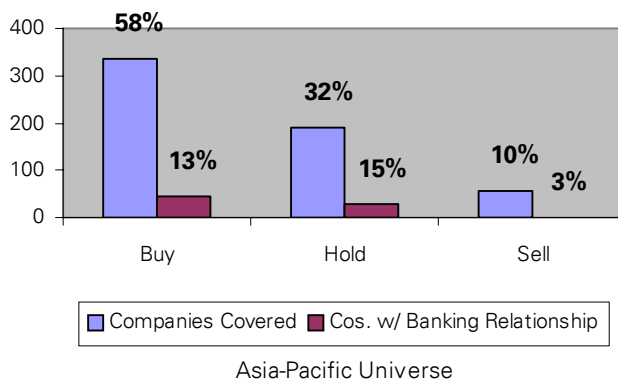
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