

Dated: 6th May 2002



D-Link (India) Limited

Company visit report: Initial Opinion

Person Met: Mr. Prabodh Vyas

Designation: Director - Sales

Person Met: Mr. CM Gaonkar

Designation: Director - Finance

Person Met: Mr. Anand Mehta

Designation: Marketing Manager

Analyst: Amol Dhariya

We met up with D-Link (India) (DLI) to ascertain its growth prospects. We believe that D-Link's profile of a one-stop-shop for networking needs of the enterprise market & the retail segment would see it benefit from 1) Increased PC penetration and 2) Aggressive rollout of telecom networks by private operators.

D-Link (India): Background

The company is owned 34.5% by the \$500 million D-Link Corporation (Taiwan), a manufacturer of networking, broadband and computer peripherals. Indian promoters of DLI led by KR Naik (also the chairman) own 28.8% of the company's equity capital of Rs6 cr (FV of Rs2). The company made a public issue in March 2001.

For FY02, DLI clocked Rs164.5 cr in gross revenues and Rs18.7 cr on net profit. The company operates in what is known as the networking industry. In IT parlance, networking is referred to as the construction of networks. Networks are nothing but a series of points interconnected by a communication path (such as a local area network or a wide area network).

DLI sells equipment that goes in establishing such networks and making them accessible. Equipment that DLI sells includes network interface cards (NIC), hubs, switches, routers, modems and remote access servers. DLI has also broadened its profile to include peripheral equipment such as structured cabling (both fiber and copper), motherboards and digital home products (digital cameras and MP3 players). It has also enhanced its profile to now include VoIP products and software development. DLI also distributes high-end products from Cisco, has a tie-up with Clarent for VoIP products, and has a technical tie-up with Gigabyte for motherboards and a joint venture with Lanner Inc. for its products in the industrial PC market. The JV with Lanner also has investment from D-Link Taiwan.

Exhibit 1: Turnover break-up

Category	FY01	FY02
Networking Products	40.9%	31%
Internetworking Products	40.2%	31%
Structured Cabling	9.5%	15%
Cisco Range of Products	8.8%	17%
Software	0.1%	5%
Digital Home Products	0.5%	1%

Source: Company

Highlights of our meet:

- The size of the domestic networking market is around Rs1400 cr (depending on what products are included) if measured in terms of end-user pricing. The growth rates would vary from one segment to another and would also depend on what stage of its life cycle is a product or technology. The key to growth in this market is to add new product lines or introduce new technologies.

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- DLI only manufactures products with monthly consumption in excess of 1000-2000 units at its plant in Goa. These would include NIC's, hubs, dial-up modems, motherboards and some other products. Otherwise, goods are imported from either D-Link Taiwan or companies with whom it has a marketing tie-up such as Cisco. For FY01, traded goods accounted for 27% of DLI's turnover. This has not changed significantly in FY02.
- DLI's marketing tie-up is not aimed at making high profit, but to enable DLI emerge as a one-stop-shop for all networking and related needs in the enterprise segment. Since the sales channels are also common it make sense for DLI to keep products that complete its range. For Cisco, it mainly sells its high-end routers and WAN switches. The company is one of the top three distributors for Cisco in India along with Ingram and Tech Pacific.
- Distributors account for 65% of DLI's sales, followed by 25% to OEM's and the balance through system integrators (SI) & tenders. Debtor days for FY02 stood at 48 days. Distributors take up 30 days to make payments to DLI. OEM's take 75 to 90 days while SI's take 90 about days.
- DLI is adding to product profile for growth. With structured cabling products and PC motherboards, DLI has used its low-cost manufacturing and technology skills to enter into sub-segments of the market that will grow along with the need for networking equipment even though D-Link Taiwan may not make these products. Structured cabling products were a result of DLI's own in-house efforts, while the technology for PC motherboards was sourced by DLI from Gigabyte, one of the world's largest makers of the product.
- The company has a software & R&D team of about 25 professionals and these are working on projects based on digital signal processing, networking protocols and embedded systems. The team is to be ramped to 75 professional in FY03. The idea of the software team is 1) Develop products for DLI and D-Link Taiwan, and 2) In the long run, act as an export unit for D-Link Taiwan and other clients. Revenues from software contributed 5% to DLI's revenues in FY02.

Financials

From Rs77.3 cr in gross revenues in FY00, DLI's revenues in FY01 stood at Rs152.5 cr. Net profit in the same period grew from Rs6.8 cr to Rs18.8 cr. DLI's aggressive growth has come from mass market segments such as NIC's, hubs and dial-up modems. For FY02, both turnover and net profit are expected to be only slightly better than FY01 figures given the tough economic conditions. However, in FY03, the company is looking at growing in new product lines -- leased lines (where MRO-TeK is a significant player), PC motherboards, D-Link brand switches and in structured cabling.

Exhibit 1: Financial Performance

(Rs in crore)

Year ending March 31 st	FY00	FY01	FY02
Months	12	12	9
Net revenues	77.34	152.57	121.37
Total expenditure	71.16	130.27	106.94
Operating Profit	6.18	22.30	14.43
<i>OPM (%)</i>	<i>7.99</i>	<i>14.62</i>	<i>11.89</i>
EBIT	5.66	21.36	12.62
Interest	0.31	0.12	0.48
Other Income	3.74	1.34	15.49
PBT	9.09	21.48	13.69
Taxes	2.22	2.70	1.25
PAT	6.87	18.78	12.44
Equity Capital	4.13	4.57	6.00

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Valuation

The current market price of 110.7 discounts DLI's FY02 earnings at 17.5x (assuming net profit for FY02 is similar to what it recorded in FY01). Price-to-sales ratio is roughly 2x revenues. Comparative valuation of Tata Telecom, in similar type of business, is a PE of 16x on expected earnings of FY02 and a PSR of 1.2x on expected revenues of FY02. DLI's relative valuations thus seem on the higher side. However, we believe that DLI still offers a great investment opportunity for the following reasons:

1. Networking market would annually grow by 12 to 15%. For the time being, however, continuing sluggishness in the economy remains a worry.
2. DLI strength lies in being a strong player in the mass-market product segments as well as its ability to enter new product segments. As a result, we expect the company to grow faster than the networking market, at around 20 to 25% per annum over the next two years.
3. DLI initiatives in expanding its product offerings and entering new market segments such as VoIP and software would ensure growth for the company beyond FY04.
4. It is focused on leading the market from the point of view of price/performance, and makes no qualms about the fact that it is not in the forefront of new technologies, where companies like Cisco clearly dominate. We believe this strategy would work in a price-conscious India market.
5. The company's broad product range and tie-ups with companies for products not manufactured by D-Link Taiwan lower DLI business risk.
6. Volume growth & new product launches would compensate for price erosion.

We rate DLI a **"Market Outperformer"**.

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