

Rexford Darko,
Lucia Lu, John Langley, CFA
(212) 784-6185
research@griffenrose.com

Infosmart Group, Inc.

Infosmart bids to become Brazil's No. 1 Writable DVD
Manufacturer by December 2007

At a Glance

Price & Valuation

Price	\$0.30
52-Week High	\$1.25
52-Week Low	\$0.22
Market Value (MV)	\$39.0M
Enterprise Value (EV)*	\$62.0M
Book Value/Share	\$0.11
P/Adjusted E 2006e	13.2x
P/Adj. E 2006e/Growth	0.1x
P/E 2007e	7.5x
Price/Book	2.6x

Trading Information

Shares Out.	134.4M
Adjusted Shares Out.	191.7M
Avg. Daily Vol., 90-day	0.0M
Float (M shares)	125.5
Institutional (%)	2.3%
Insider (%)	67.9%

Financial (TTM)

Revenue	\$26.2M
EBITDA Margin	16.4%
EBIT Margin	9.3%
Net Income Margin	3.8%
Assets	\$31.6M
Total Debt/Equity	31.0%
No. of Employees	105

*Based on 191.7 million shares.

Profile

Founded in August of 2002, Infosmart Technology Limited was Hong Kong's first manufacturer of writable digital versatile disks ("DVDRs"). Now a combination of three companies, Infosmart Group, Inc. ("Infosmart") was the world's 10th largest producer of DVDRs in 2005 and has been one of the most consistently profitable firms in its peer group. Infosmart operates writable DVDR factories in Hong Kong at maximum capacity and is building another facility in Brazil. Infosmart manufactures mainly 8x and 16x discs, and expects to launch production of high density DVDRs later this year.

Summary

- In Infosmart's third fiscal quarter of 2006 (3Q06), ending September 30, 2006, net sales increased 89.5% year over year (YOY) from \$4.0 million in the prior year quarter to \$7.6 million. In geographical terms, new revenues came from Brazil (\$2.3 million) and Australia (\$0.9 million) as the Company shifted focus away from lower margin sales to European customers.
- Revenue growth and cost control combined to drive the Company's core operating profit up 129.6% from \$670,000 (17.9% of revenue) in 3Q05 to \$1.5 million (20.5% of revenue) in 3Q06, a result that clearly shows that money can be made in this sector.
- We estimate that Infosmart's net income would have been about \$1.2 million - \$1.3 million (17.0% of revenues) but for \$2.8 million in one-time professional expenses and about \$50,000 higher administrative expenses associated with its recapitalization and transformation into a publicly-held U.S.-listed company. All but approximately \$600,000 of the professional expense was paid in stock rather than cash. In GAAP terms, the one-off items pushed Infosmart to a \$1.4 million net loss.
- Infosmart offers investors the potential growth and value prospects of one of the best managed DVDR manufacturers in its peer group. The Company is bidding for a leading manufacturing presence in Brazil, which imports up to 90% of its DVDRs and is one of the world's fastest growing optical disc markets. In addition, Infosmart is preparing to meet accelerating U.S. and European demand for high density DVDRs suitable for recording high definition films, television programs and music.

Projected Infosmart EPS (cents), 2007-2008

	Q1	Q2	Q3	Q4	Full
	Mar	Jun	Sep	Dec	Year
2006 EPS	0.8a	1.0a	(3.2)a	0.5e	(0.9)e
2006 Adjusted EPS*	0.8a	1.0a	0.2a	0.5e	2.5e
2006 Shares Out.**	110.2a	112.4a	120.0a	132.3e	118.7e
2007e EPS	0.3	0.5	1.1	1.4	3.4
2007e Shares Out.	138.5	146.7	154.9	163.1	150.8
2008e EPS	0.8	1.2	1.6	1.6	5.2
2008e Shares Out.	171.2	179.4	187.6	191.7	182.5

a = actual e = expected *Excludes stock payments to advisors and deemed preferred dividends. **Millions of shares outstanding.

Source: Griffen-Rose.

Valuation Perspective: IFSG (OTC BB)

(DJII: 12,577.15 S&P 600 SC: 401.01 SIC: 3695)

Current Price	\$0.30
Recommended Base Case Value	\$0.54⁽¹⁾
Recommended Conservative Value	\$0.42⁽²⁾
Recommended Aggressive Value	\$0.65⁽³⁾

DCF/FCFE, using 191.7 million shares, assumes full dilution of convertible stock, options and warrants, and: (1) 16.6% cost of equity and 16.4x FCFE terminal multiple; (2) 18.6% cost of equity and terminal value 20.0% below base case projections; (3) 15.6% cost of equity and terminal value 20.0% above base case projections.

Source: Griffen-Rose.

Summary (cont.)

- **Thesis.** Infosmart is attractive for three key reasons. Firstly, it makes CD-Rs and DVDRs profitably and is mounting a serious bid to become Brazil's leading DVDR manufacturer by the end of this year. DVDRs are bought by content replicators in order to make DVD copies of movies and software, and by consumers for recording entertainment content and data backup. DVDRs are in ever greater demand because cheaply replicated digital content is driving the adoption of CD and DVD players and PCs in developing countries, where most people in the world live. The world's biggest DVDR manufacturers, which are located in Taiwan and India, supply large domestic replication industries. In Brazil, however, DVDR manufacturers meet only about 10% of local demand; the country's large replication industry depends heavily on supplies of DVDRs that are expensively imported or hazardedly smuggled, rather than locally made. A substantial, well-run Brazilian DVDR manufacturing business should therefore prove successful. Secondly, Infosmart will soon be producing high density DVDRs (HD DVDRs) for its customers in several of the countries rapidly taking up high definition DVD movies and TV programs, such as the U.S., parts of Western Europe and Australia. High definition technologies will eventually replace standard definition technologies because they provide significantly better visual and aural experiences and are supported by key stakeholders in the home entertainment industry. Demand for HD DVDRs will grow as the installed base of HD DVD players and drives grows. Thirdly, Infosmart is able to minimize the investment required for HD DVDR production by upgrading its existing equipment rather than buying new equipment.
- **2007 outlook.** We expect revenue and profits to be depressed in 4Q06 and 1Q07 by lower output volume as the Company temporarily takes offline and transfers some production lines to Brazil, but to recover strongly thereafter. The Brazilian strategy gives Infosmart's operations more options for expansion and profitability. Infosmart stands a good chance of making a success of its geographical diversification strategy and the addition of HD DVDRs to its product mix. The Company is thoroughly experienced in manufacturing writable CDs ("CD-R") and DVDRs planned for its Brazilian plant and, in the past, has successfully switched production from one generation of optical media discs (CD-Rs) to the next (DVDRs). From the second half of this year we expect that the profitability of the Company's Hong Kong operations will rise when Infosmart begins to make writable high density DVDR discs ("HD DVDRs") there.
- **Brazilian opportunity.** Brazil's 185 million people and \$1.6 trillion GDP, measured on purchasing power parity basis, account for half of South America's population and

GDP. Brazil's DVD home video market is growing at a rate of over 20% per year, and the country meets about 90% of its DVDR demand from imports. With only one cinema screen per 95,000 residents (compared with one screen per 7,600 residents in the U.S.) and low video-on-demand penetration, DVD discs are comparatively a more important entertainment medium in Brazil than in many other developed or emerging economies. Half of a growing continent, Brazil offers Infosmart the prospect of strong and steady optical disc sales for many years to come.

- **Strong DVDR demand growth in emerging markets will continue.** Developing countries have hitherto lagged behind advanced economies in replacing VHS cassettes with DVDs but are now doing so rapidly, largely because content replicators have made cheap discs widely available. DVDs are a key part of the world's continuing digital expansion. Strong Brazilian demand for DVDRs is in line with a global trend in the DVDR industry, which has shifted from early adopting, now saturated markets, like Japan, the U.S. and western Europe, to the world's largest developing markets in South America, Africa, India and the Asia/Pacific region. Through its manufacturing presence in Brazil, Infosmart will be connected with this trend more than ever before. Understanding & Solutions ("U&S"), an international research firm focused on digital imaging and storage media markets, estimates that annual global DVDR output will need to rise by 4.3 billion over 2006 levels to meet 2009 projected demand (see Table 1). Furthermore, Infosmart's manufacturing presence in Brazil may expose the firm to demand from other South American countries.

Table 1: Projected Worldwide Supply of DVDRs (millions of units)

	2005	2006	2007	2008	2009
Discs	5,054	6,396	8,451	9,783	10,674
Growth	104%	27%	32%	16%	9%

Source: Understanding & Solutions.

- **Brazilian competition.** Infosmart needs to build its Brazilian presence quickly and scale its business to bear the higher administrative expenses associated with its new publicly-held status. Although smaller and less experienced than Infosmart, Brazilian DVDR manufacturers are expanding output in response to the same opportunity the Company has recognized. Infosmart's current planned DVDR capacity in Brazil, which could account for up to 15% of the volume Brazil currently imports, is arguably too small.
- **Greater options.** The existence of its Brazilian operation widens the range of options available to Infosmart on when, where, and how to grow its revenues most profitably. Hitherto, Infosmart has sold its output mainly

to distributors. The Company intends to sell its output in Brazil in three ways: directly, to the largest retailers and bulk customers, cutting out middlemen; semi-directly, through a network of agents, to retailers and mid-size commercial customers; and indirectly, through distributors, to retailers and end users. By bringing Infosmart closer to the market, this distribution system will be an asset in itself. By providing Infosmart early intelligence on local market needs in optical disc and related markets, it may also provide the Company a relatively low-risk path to broadening its product portfolio.

- **High Density DVDs and High Definition Television.** Research from Leichtman Research Group, Inc. suggests that as of the fourth quarter of calendar 2006 one in six households in the U.S. had at least one high definition-capable TV (HDTV) – a rapid increase from about one in fourteen households two years ago. We expect manufacturers to accelerate U.S. sales of HDTV sets by exploiting the February 2009 FCC-mandated deadline for the switch from analogue to digital transmission. This in turn will spur sales of electronic hardware incorporating disc drives that play and burn high definition content to writable high density discs.
- **Infosmart's HD DVDR Bias.** The rising demand for writable HD DVDs should support Infosmart's planned production of this medium, beginning in mid-2007, for sale to its established U.S., European and Australian customers. Infosmart's larger competitors, CMC and Ritek, have already started volume production of 15 gigabyte (GB) and 30 GB dual layer HD DVDRs. The smaller optical disc manufacturers in Taiwan, including Prodisc Technology, Lead Data and Gigastorage are expected to follow suit early in 2007. Nearly three quarters of Infosmart's production lines are upgradeable to HD DVD production at a fraction of the cost of purchasing new HD DVD manufacturing equipment; therefore, other factors being equal, we expect the Company's ratio of incremental returns to investment in HD DVD production to be high in the early years.
- **Combo drives will make the BDR versus HD DVDR format war less important.** Infosmart is better positioned to take advantage of future growth prospects in the writable HD DVD (HD DVDR) market than the writable Blu-ray disc (BDR) market. The Company may have to invest in costly BD manufacturing lines if the success of Blu-ray threatens the profitability of HD DVDR production. It is too early to say which format is likely to triumph. The BD platform has been boosted by backing from the majority of Hollywood majors; the launch of the PlayStation 3; and similar retail pricing between 15 GB HD DVDR and 25 GB BDR discs despite the latter's 67% greater capacity. The HD DVD format benefits from: better name recognition (consumers can more easily associate HD DVD, than Blu-ray, with HDTV and high definition film); and lower retail prices of HD DVD drives and players compared with BD ones. HD DVD should benefit in the near term from the installed base of 8-10 million Microsoft X-box 360 owners, who can now purchase the new X-box HD DVD add-on player for less than \$200. The importance of the Blu-ray/HD DVD format war is likely to be reduced by combo drives, newly being marketed by companies such as LG, which can be expected to decline in price in tandem with rising demand for high density disc players.
- **Demand impact of VOD.** It is unclear whether HD video on demand (VOD) or low-cost HD movie rental services - such as are offered by Netflix, a disc rental service, and MovieBeam, a rental service that uses the broadcast spectrum to deliver movies to customer set top boxes - would lower consumers' desire to buy replicated HD content or store movies on writable HD discs. Such services could actually end up boosting demand for writable HD discs in net terms by enlarging the volume of readily available content consumers want to have copies of. Disc demand may be further spurred by consumer desire to circumvent the managed copy restrictions of original-content HD discs and the limited storage capacity of affordable hard disc drives.
- **Infosmart needs to broaden its product portfolio.** Infosmart is a pure play optical disc manufacturer. Disc makers typically enjoy high gross profit margins and sales volume growth rates as a product takes off in the mass-market. They suffer slow sales growth and falling unit gross margins as the product matures, and their operating profitability increasingly depends on being able to add new higher margin products to the product mix or generate economies of scale over fixed costs. Infosmart has successfully adopted both of these strategies; however, the optical disc industry is prone to sharp product-specific capacity swings, and with average blank media prices continuing to fall across Asia, encouraged by the move to multi-disk spindle packaging and the rising market share of aggressively priced, local, 'no name' brands, it can be stressful for a manufacturer to surf the wavelike form of the industry's profitability. For example, in 2005 Infosmart's sales volume grew 75.1%, but revenues grew only 9.6%. In the long-term, Infosmart needs to complement its strategy of geographical diversification with one of greater product variety in order to improve the stability of its profit margins and lower overall product and operating risks.
- **Relative performance.** Infosmart has hitherto been well managed. Its production lines have been run consistently at full capacity. In our estimate, the Company's compounded annual sales growth over the fiscal years fully reported so far (2003-2005) was 40.5%, the second

highest of nine firms in its peer group (see Table 5). Over the same period, Infosmart's average return on equity was 73.1%, the best in its peer group, although this was partly due to high leverage resulting from negative working capital. Restructuring made some of Infosmart's performance metrics decline during 2Q06 and 3Q06. The Company's average trade receivables collection period nearly doubled from 48 days during 2005 to 85 days as of 3Q06 due to the knock-on effects of a Brazilian customs strike. Although management expects the collection period to fall sharply, in the future the Company may need to accept an average payment period longer than 48 days in order to close new deals with Brazil's largest retailers or retain the loyalty of its European and Australian customers purchasing mature DVD products.

- **Share overhang.** The Company's common share count is likely to rise from today's 134.4 million shares to 191.7 million shares on a fully diluted basis over the next 18 months if all warrants are exercised and convertible preferred stock converted. Infosmart's will be a thinly-traded stock for some time and therefore not suitable for short-term investors.
- **Share price.** Our 54 cents per share recommended price for Infosmart's common stock, derived from a discounted cash flow model, assumes 191.7 million shares outstanding. This price is equivalent to 77 cents per share at the current 134.4 million share count. Key operating assumptions include: rapid revenue growth from 3Q07 to 4Q08 resulting from the successful launch of Infosmart's Brazilian operations and the start of HD DVDR production at the firm's Hong Kong factory from 3Q07; steady operating margins as a result of a richer product mix until 2008/9; and revenue growth and operating margins beginning to decline from 2009. On the basis of these factors, we think the stock is currently undervalued. Barring unwelcome surprises, we expect that the validity of our outlook will be demonstrated over the six months; by the end of this period Infosmart's Brazilian operations should be running on an even keel, its Hong Kong plant should have initiated HD DVDR production, and the share count will probably have risen above the current level.
- **Catalysts.** Key catalysts for altered value prospects are:
 - The speed with which Infosmart can expand production and sales in Brazil beyond our current expectations.
 - Infosmart's ability to secure greater tax concessions from the State of Bahia, Brazil, than currently projected.
 - Significant changes in the direction or speed of the Company's high definition disc production plans,

which will in turn depend on the speed with which HD DVDR is accepted by consumers. Management may decide to accelerate or expand HD DVDR production beyond our current forecasts, or switch to writable Blu-ray disc production, or produce both types of disc.

- Significant declines in optical disc market prices beyond our current forecasts.
- Indications that Infosmart can exploit its Brazilian distribution system to broaden its product line.

1.0. Recent Results

1.1. Fiscal 2006 Third Quarter Results

In Infosmart's third fiscal quarter of 2006 (3Q06), ending September 30, 2006, net sales increased 89.5% year over year (YOY) from \$4.0 million in the prior year quarter to \$7.6 million. In geographical terms, new revenues came from Brazil (\$2.3 million) and Australia (\$0.9 million) as the Company shifted focus away from lower margin sales to European customers.

Table 2: Infosmart: Selected Operating Metrics, 2004-2006

	2004	2005	1Q06	2Q06	3Q06
Output Growth	257.0%	75.1%	na	na	na
Revenue	\$22.4	\$24.6	\$6.2	\$6.3	\$7.6
Revenue Growth	80.2%	9.6%	6.7%	(26.8%)	89.5%
Core EBIT	\$3.4	\$5.0	\$1.2	\$1.3	\$1.5
Net Profit	\$3.0	\$4.2	\$0.9	\$1.1	(\$1.4)
Gross Profit Margin	22.9%	26.6%	25.5%	29.9%	28.5%
EBIT Margin	15.2%	20.3%	19.4%	21.2%	20.5%
Net Profit Margin	13.5%	17.1%	14.8%	17.3%	19.0%
Assets	\$22.6	\$24.9	\$25.8	\$28.2	\$31.6
Liabilities	\$16.9	\$15.9	\$15.8	\$17.1	\$13.1
Equity	\$5.7	\$9.0	\$10.0	\$11.0	\$18.6
Debt/Equity	129.5%	91.4%	85.6%	76.1%	31.0%
ROA	17.7%	16.8%	15.0%	10.6%	3.7%
ROIC	72.5%	52.9%	49.6%	40.6%	28.1%
ROE ⁽¹⁾	62.8%	48.6%	40.7%	28.2%	24.0%

Source: Company, Griffen-Rose.

(1) Calculation excludes non-cash financing expenses and deemed preferred dividends).

Though not traditionally a CD-R manufacturer, market scarcity of writable CD-Rs prompted Infosmart to produce them in 3Q06. CD-R sales contributed \$0.8 million in net sales for the quarter, probably at higher margins than the foregone DVDR production. Given the ease with which the Company can switch from CD-R to DVDR manufacture, it can be presumed that Infosmart's product mix and geographical sales focus in any particular fiscal quarter will reflect management's opportunistic attempt to maximize profit.

Cost of sales as a proportion of revenue was 71.5% in 3Q06 versus 72.7% in 3Q05 primarily because of higher margin Brazilian sales. The combination of rising sales and falling costs of goods sold (COGS) as a percentage of revenue lifted gross profits 98.2% YOY, from \$1.1 million in the prior year quarter to \$2.2 million. Selling and distribution costs, more fixed in nature and tightly controlled by management, fell 21.2% from about \$130,000 (1.4% of sales) in 3Q05 to about \$158,000 (0.8% of sales) in 3Q06. The Company particularly benefited from changing to a more competitive freight forwarder.

Administrative expenses rose 69.1% in absolute terms, but fell 0.6% relative to sales, from about \$227,000 (5.7% of sales) in the prior year quarter to about \$385,000 (5.1% of sales). The dollar increase was due to a combination of one-off items (overseas traveling expenses incurred for the Company's recent share exchange transaction and financing) and new permanent factors (higher costs of financial reporting and the hiring of new administrative personnel as a result of becoming a public company).

Revenue growth and cost control combined to drive the Company's core operating profit up 129.6% from \$670,000 (17.9% of revenue) in 3Q05 to \$1.5 million (20.5% of revenue) in 3Q06. However, this core profit was turned into loss before interest and tax by \$2.8 million in one-time professional expenses related to Infosmart's restructuring, financing and share exchange. All but approximately \$200,000 of this sum was a non-cash expense paid in stock, as the Company sought to preserve cash for operations and strategic expansion.

Infosmart's net loss after tax for the quarter was about \$1.4 million (19% of sales) versus earnings of about \$343,000 in the prior year quarter (8.6% of sales). Our estimate of the Company's core earnings, on a pro forma normalized basis using the statutory tax rate, is \$1.2 million (15.5% earnings margin) and \$450,000 (11.2% earnings margin) in 3Q06 and 3Q05, respectively.

1.2. Nine Month Results

On a nine-month-to-nine-month basis (January – September 2006 versus the same period in 2005):

- Revenue was up 8.9% and gross profit up by 10.4%, aided primarily by a softening in polycarbonate pricing.
- The Company's gross margin widened 40 basis points from 27.6% to 28.0%.
- Core operating and net profits fell 66.0% and 18.0%, respectively, because of higher administrative expenses.

Revenue for the three quarters reported in fiscal 2006 was \$20.1 million compared with \$18.5 million in the prior year period, which represents an 8.9% YOY increase. The

Company achieved this revenue growth primarily by expanding output and generating 8x DVDR sales to Brazil at prices substantially higher than Infosmart's sales of the same product into the more competitive European market. As of 3Q06 Infosmart's revenue run rate and trailing twelve month revenue were \$30.2 million and \$26.2 million, respectively, compared with \$24.6 million for the whole of fiscal 2005.

Infosmart's operating profit in the nine months to 3Q06 was \$4.1 million (20.4% of revenue), which was slightly below the \$4.2 million (22.5% of revenue) achieved in the prior year period. This was despite the modest improvement in the Company's COGS as a percentage of revenue, which fell to 72.0% of revenue during 1Q06-3Q06, compared with 72.4% during 1Q05-3Q05. The drop in Infosmart's operating profit margin was primarily due to higher sales, general and administrative expenses. SG&A has been \$1.5 million (7.6% of revenue) during the 1Q06-3Q06 period, compared with \$0.95 million (5.1% of revenue) during the 1Q05-3Q05 period for the reasons discussed above.

The impact of extraordinary transaction costs in 3Q06 caused reported net income to fall 84.8% to about \$600,000 for the nine months ending September 30, 2006, compared with \$3.8 million for the nine months ending September 30, 2005. Our estimate of the Company's core earnings on a pro forma normalized basis using the statutory tax rate is \$3.0 million (15.2% earnings margin) and \$3.7 million (20.1% earnings margin) for 1Q06-3Q06 and 1Q05-3Q05, respectively, primarily because of the higher SG&A expense level.

1.3. Liquidity and Capital Resources

Reported net cash flow from operations was about \$312,000 for the nine months ending September 30, 2006 compared with \$450,000 for the nine months ending September 30, 2005. The reported numbers include loan payments made to or received from related parties in the context of product manufacturing. We estimate that cash from operations excluding these transactions was approximately \$2 million, and \$2.2 million, in the nine months to 3Q06 and 3Q05, respectively. Cash flow from operations so far during fiscal 2006 has been negatively affected by an 87% (\$2.8 million) rise in trade receivables to \$6.1 million, partly offset by a \$635,000 rise in payables. This deterioration in core working capital occurred because of late payment from some of the Company's Brazilian customers, who were hit by a Brazilian customs strike and were unable to discharge and sell consignments dispatched to them in a timely manner so as to meet terms agreed to with Infosmart.

Of the approximately \$1.9 million used for investment, Infosmart spent about \$930,000 on construction of its Brazilian plant in the nine months to 3Q06, leaving about \$1.8 million to be paid during the next two fiscal quarters as the plant is completed. The rest was spent mainly on the acquisition of equipment. Of the approximately \$7.7 million

raised by the Company in August 2006, it appears the Company: spent about \$800,000 on advisory fees, \$500,000 on reducing long-term debt and \$2.1 million on reducing its short-term bank debt and overdraft; repaid \$1.2 million in loans from a related party; invested \$500,000 in property, plant and equipment; reserved \$400,000 for after-market financial marketing support efforts; extended \$640,000 in credit to a third party; and holds the rest in cash. As of September 30, 2006, cash on hand was about \$2.8 million (26.3 days of sales); the current ratio was 1.42x, positive for the first time in Infosmart's history. The Company's interest burden as of the end of 3Q06 was 11.7x.

2.0. How Well is Infosmart Run?

Falling market prices on sales to Europe, which had accounted for about 75% of its revenue in 2005, has prompted Infosmart to diversify its revenue base rapidly during 2006; this in turn has generated higher margin sales from customers in some developing countries. The Company's very high returns in its early years have been falling but have still been excellent by comparison with its peer group (see Table 5). 2Q06 and especially 3Q06 can be viewed as exceptions to the pattern of high returns because of unusual expense items. These two quarters are also transitional, firstly because they mark Infosmart's transformation into a public company, and secondly because the Company has begun to increase its exposure to Brazil in sales and manufacturing terms. We expect that the next two quarters will be similar because the Company has entered a period of reduced capacity while transferring 45% of its production lines from Hong Kong to Brazil.

2.1. Competitive Conditions

Table 3. Number of Significant Producers Worldwide

Year	2003	2004	2005
Significant DVD+ or -R Producers ⁽¹⁾	47	89	101
Total DVDR Output (million discs/year)	713	2,482	5,054
Output to Significant Producer Ratio (million discs/year)	15.2	27.9	50.0

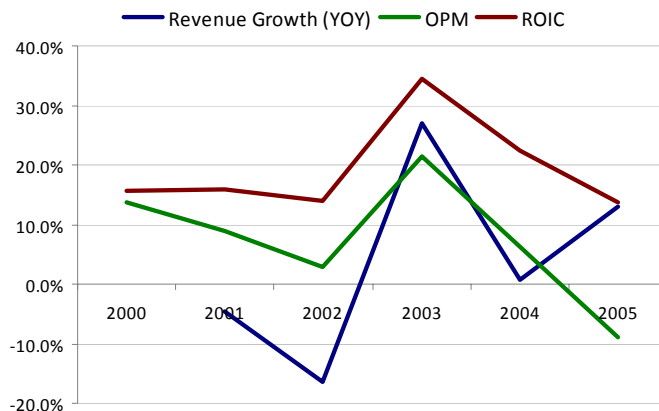
Source: Understanding & Solutions.
(1) Estimated by taking the higher of the number of DVD+R producers and DVD-R producers in any year, since most manufacturers produce both types.

According to U&S, the total number of significant producers of once-writable discs increased by 114% between 2003 and 2005; however, production volumes have been rising even faster, up 609% during the same period. The ratio of total market output per year to significant producers has risen from 15.2 to 50.0 million discs. This suggests that although competition has intensified, producers have been able to grow with the market.

Figure 1 illustrates the volatility of revenue growth and operating margins among firms in the industry during 2001-

2005. The industry group's return on invested capital (ROIC), calculated as EBITDA divided by the sum of long-term debt and equity, has been less volatile because the metric is unaffected by the variability of local depreciation rules; the ROIC ranged between 13% and 34% over the period.

Figure 1: Infosmart's Industry Group - Key Performance Metrics, 2000-2005



Source: Bloomberg, Griffen-Rose.
Data selected from Infosmart's industry group companies as defined by Griffen-Rose. OPM = operating profit margin; ROIC = return on average invested capital, calculated as EBITDA divided by the average of the opening and closing balances of long-term debt and stockholder's equity for the relevant year.

Table 4: The World's Top Write-Once DVD Manufacturers

Company	Plant Loc.	Rank	Output	Share	Cum. Share
CMC	Taiwan, Japan, China	1	831	16.9%	16.9%
Ritek	Taiwan, U.K., China	2	636	13.0%	29.9%
Taiyo Yuden	Japan	3	410	8.3%	38.2%
Daxon Tech.	Taiwan	4	363	7.4%	45.6%
Prodisc ⁽¹⁾	Taiwan	5	340	6.9%	52.5%
Moser Baer ⁽²⁾	India	6	312	6.4%	58.9%
Optodisc ⁽¹⁾	Taiwan	7	275	5.6%	64.5%
Princo	Taiwan	8	270	5.5%	70.0%
TDK	Lux.	9	150	3.1%	73.0%
IFSG	H.K.	10	122	2.5%	75.5%
Hitachi Maxell	Japan	11	120	2.4%	78.0%
Lead Data	Taiwan	12	88	1.8%	79.8%
AnyanFeiyong Optical Disc	China	13	69	1.4%	81.2%
Umedisc	H.K.	14	60	1.2%	82.4%
Gigastorage	Taiwan	15	50	1.0%	83.4%
Other			815	16.6%	100.0%
World			4,911	100.0%	

Source: Understanding & Solutions (Dec. 2005), Griffen-Rose.
Output measured in millions of discs. (1) Prodisc and Optodisc announced plans to merge in October 2005 but the merger has since been on hold. (2) Moser Baer has moved to third position since this table was compiled.

Although Infosmart's traditional products are 8x and 6x discs, in recent months the Company has opportunistically manufactured quantities of CD-Rs in response to their market scarcity. Once the scarcity disappears, it is likely Infosmart will reallocate all Hong Kong capacity to DVDR production. It is also likely, however, that Infosmart's unit profit margins on CD-Rs and DVDRs output will contract in 2007 and beyond, particularly that portion not produced for Brazilian or other developing country markets. As that happens, Infosmart will, like its peers, shift to blue laser media production targeted at developed country markets.

Table 5: Infosmart Versus Peer Group, Fiscal 2005

	Group Median incl. IFSG	Group Median excl. IFSG	IFSG Rank	IFSG FY05
As% Sales				
Cost of Goods Sold	99.9%	104.8%	1	73.4%
SG&A	14.5%	17.3%	1	6.3%
Operating Profit (Loss)	(8.8%)	(13.3%)	1	20.3%
Interest Expense	3.2%	3.3%	2	2.1%
Net Profit (Loss)	(8.7%)	(13.1%)	1	17.1%
Reinvested Earnings	(8.1%)	(8.7%)	1	11.0%
Depreciation	19.0%	20.6%	1	6.9%
R & D	1.9%	2.4%	1	0.0%
2003-2005 Revenue CAGR	4.6%	2.3%	2	40.5%
Sales/Employee ⁽¹⁾	\$138.2	\$126.4	4	\$234.1
Net Profit/Employee ⁽¹⁾	\$(19.4)	\$(27.8)	1	\$40.1
Current Ratio	1.0	1.1	9	0.7
Total Debt/Equity	83.2%	78.3%	6	91.4%
Inventory Turnover	5.5x	4.5x	2	10.4x
Net Fixed Asset Turn.	0.7x	0.6x	2	1.3x
Asset Turnover	0.4x	0.4x	1	1.0x
Receivables Period ⁽²⁾	75	76	4	48
Payables Period ⁽²⁾	23	22	-	40
Return on Inv. Capital ⁽³⁾	6.9%	6.7%	1	52.9%
2003-2005 Avg. Return on Common Equity ⁽⁴⁾	(1.6%)	(2.9%)	1	73.1%

Source: Griffen-Rose.

(1) In thousands of U.S. dollars. (2) In days (3) Mean value was 13.0% (4) Mean value was 11.4%.

For optical disc manufacturers, size and profitability do not necessarily coincide. Distribution in many emerging markets is fragmented compared with North American patterns. Order sizes tend to be smaller, befitting manufacturers with the ability to handle heterogeneous or small to midsize orders (500,000 – 5 million discs). Smaller companies may be outgunned by the world's top five or six manufacturers in a pitched battle for multimillion disc orders from top tier U.S. distributors and retailers, but not necessarily in street fights for smaller orders especially in developing countries such as Brazil.

2.2. Peer Comparison

In Table 5 we compare Infosmart's output and market share with the reported performance in fiscal 2005 of eight other firms, nearly all from among the top 15 DVD manufacturers. The group comprises: Infosmart, Gigastorage Corp., Optodisc Technology Corp., Lead Data Inc., Prodisc Technology Inc., Princo Corp., Moser Baer India Ltd., Ritek Corp., Megan Media Holdings BHD. Other firms were excluded because of size, product mix or lack of information.

Table 6: Infosmart Versus Peer Group, Fiscal 2004

	Group Median incl. IFSG	Group Median excl. IFSG	IFSG Rank	IFSG FY05
As% Sales				
Cost of Goods Sold	82.4%	86.5%	3	77.1%
SG&A	14.0%	14.3%	1	7.8%
Operating Profit (Loss)	7.6%	5.4%	2	15.2%
Interest Expense	2.1%	2.2%	1	1.4%
Net Profit (Loss)	4.7%	3.8%	2	13.5%
Reinvested Earnings	3.4%	3.0%	3	7.8%
Depreciation	19.3%	19.5%	1	8.8%
R & D	2.7%	3.0%		0.0%
Sales/Employee ⁽¹⁾	\$165.4	\$137.3	1	\$373.7
Net Profit/Employee ⁽¹⁾	\$7.9	\$4.2	2	\$50.4
Current Ratio	1.0	1.1	9	0.4
Total Debt/Equity	82.5%	76.2%	7	129.5%
Inventory Turnover	6.3x	5.7x	2	14.6x
Net Fixed Asset Turn.	0.7x	0.7x	2	1.7x
Asset Turnover	0.5x	0.4x	1	1.3x
Receivables Period ⁽²⁾	77	80	1	30
Payables Period ⁽²⁾	23	17	-	93
Return on Inv. Capital ⁽³⁾	12.9%	12.4%	1	72.5%

Source: Griffen-Rose.

(1) In thousands of U.S. dollars. (2) In days. (3) Mean value was 24.6%.

Although other firms in the peer group are inexact matches for Infosmart, the results are instructive. In considering the group, it is important to remember that Infosmart: (1) enjoys no advantages over its competitors in raw materials purchasing or technology - indeed, their greater size arguably gives them greater strength in negotiations with suppliers than Infosmart; (2) has no labor cost advantages over its competitors, because manufacturing wages in Hong Kong and Taiwan are comparable, and probably higher than in India (Moser Baer); (3) has no pricing power in optical disc markets - like other manufacturers, it is a price taker. Yet despite operating in a strongly competitive market, Infosmart was the most profitable and one of the most efficient firms in its peer group in fiscal 2005.

High inventory turnover enable a manufacturer to spread fixed production costs over a greater volume of sales for a

given fixed asset base. This in turn reduces unit fixed production costs, lowers overall unit COGS and boosts gross margins. Accordingly, Infosmart's depreciation as a percentage of revenue was almost one third of the group's median and its COGS as a percentage of revenue were 26.5% below the peer group median. Focused purely on production, Infosmart incurred no R&D expense.

Management held the Company's sales, general and administrative expense (SG&A) as a percentage of revenue at 6.3%, almost 60% below that of the peer group. As a result, Infosmart's 20.3% operating margin and 52.9% ROIC dwarfed the peer group's median 8.8% operating loss margin and 6.9% ROIC. Together with a close match between trade payables and receivables (in Infosmart's case, only eight days in fiscal 2005), this enabled Infosmart to maintain a 91.4% debt to equity ratio, compared with the group's median 72.4% ratio.

Table 7: Infosmart Versus Peer Group, Fiscal 2003

	Group Median incl. IFSG	Group Median excl. IFSG	IFSG Rank	IFSG FY05
As% Sales				
Cost of Goods Sold	71.7%	72.5%	3	57.0%
SG&A	14.6%	15.1%	2	9.2%
Operating Profit (Loss)	20.5%	16.6%	3	33.8%
Interest Expense	2.0%	2.2%	1	0.4%
Net Profit (Loss)	16.3%	14.8%	3	31.4%
Reinvested Earnings	12.8%	11.9%	2	31.4%
Depreciation	14.6%	14.8%	1	8.0%
R & D	2.7%	2.7%		0.0%
Sales/Employee ⁽¹⁾	\$166.0	\$149.0	1	\$732.0
Net Profit/Employee ⁽¹⁾	\$20.8	\$17.5	1	\$230.2
Current Ratio	1.3	1.3	9	0.6
Total Debt/Equity	68.8%	67.5%	7	79.7%
Inventory Turnover	7.7x	7.5x	2	10.8x
Net Fixed Asset Turn.	1.0x	0.9x	1	1.5x
Asset Turnover	0.6x	0.6x	1	1.1x
Receivables Period ⁽²⁾	70	78	1	42
Payables Period ⁽²⁾	25	17	-	135
Return on Inv. Capital ⁽³⁾	24.6%	21.9%	1	105.8%

Source: Griffen-Rose.

(1) In thousands of U.S. dollars. (2) In days. (3) Mean value was 37.9%.

Tables 6, 7 and 8 show that Infosmart was consistently one of the sector's top three most profitable firms during 2003-2005. Recent months have witnessed deterioration in some of the metrics for reasons discussed in section 1.1 of this report.

3.0. Does Brazil Make Sense?

3.1. Introduction

Infosmart's long-term strategy appears to be to produce DVDRs, and CD-Rs if need be, for developing markets, and DVDRs and writable HD media, preferably HD DVDR over Blu-ray, for consumers in countries which are rapidly adopting HD media. Infosmart has chosen to dedicate 45% of its present capacity to Brazil while holding the remainder in Hong Kong to continue serving global customers. As of September 30, 2006, the Company had about \$2 million in cash, which, together with asset-backed financing, is available to support further capacity expansion in Hong Kong or Brazil according to management's best judgment.

To date, Infosmart's expansion has been held back by limited capital. Until August 2006, it lacked the long-term financing to expand capacity more aggressively than it did. Having successfully closed its first round of financing, liquidity has improved and the Company now faces the strategic choices that, if successful, could propel it toward a more significant presence in the global optical disc manufacturing industry, while maintaining attractive returns to capital.

3.2. Importance of Replication

A key requirement for any volume manufacturer of writable optical media is for a strong relationship with a large, preferably local, replication industry. In 2004, for example, about 1.94 billion writable DVDs were used for replication, equivalent to almost 70% of global output; the overwhelming majority of them were DVDRs. Taiwan's massive replication industry has been the foundation for the enormous size of its top optical media manufacturing companies – five of the world's top ten DVDR producers by output volume (CMC, Ritek, Prodisc/ Optodisc, Daxon Tech, Princo) are Taiwanese and in 2005 they accounted for 55% of global output according to U&S. India's Moser Baer has been propelled to global top 5 status by demand based on Bollywood's output and the switch by Indian consumers from audio and VHS cassettes to CDs and DVDs.

Table 8: Importance of Replication to the DVDR Industry, 2005

Recordable ⁽¹⁾ DVD Production	2,810
Recordable DVD Replication	1,935
Replication as% of Production	69%

Source: Understanding & Solutions.

(1) Includes DVD-RW, DVD+RW, DVD-Ram, DVD-R and DVD+R.

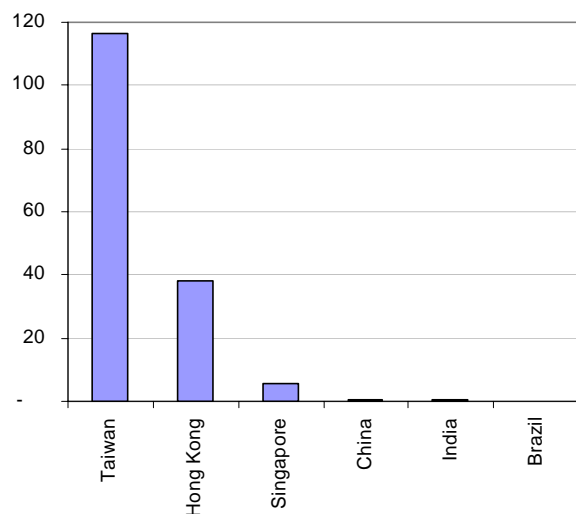
Optical disc manufacturers benefit from being able to dedicate sizeable capacity to stable recurring orders from large replicators ("allocated capacity"), while setting aside additional capacity for spot or one-off orders ("merchant capacity"). The smaller the manufacturer, the higher its merchant capacity is likely to be as a proportion of its output.

Infosmart's strongest relationships, until its entry into Brazil, have been with distributors, rather than replicators, in markets such as Europe where price competition is rising. Expansion to Brazil, one of the fastest growing home entertainment markets in the world, creates for Infosmart the chance to become, effectively, a domestic supplier to that country's large replication industry as well as its wholesale and retail distributors. Infosmart may thereby move to a mix of allocated and merchant capacity rather than wholly merchant capacity as is presently the case.

3.3. Brazilian DVDR Market Opportunity

Infosmart's Brazilian subsidiary, Discobras, will be a Brazilian domestic producer and therefore aligned with Brazil's economic development goal, which is to encourage domestic production rather than imports. Operational advantages of the move include: as part of the State of Bahia's incentive package, VAT benefits and avoidance of the 17-18% import duty usually levied on imports of raw materials; proximity to customers; and the sale price differential that domestically produced discs enjoy over imported discs simply by virtue of the 70%-100% import duty and tax levied on imported discs.

Figure 2. Home Manufactured DVD+/-R Output per Capita, 2005



Source: Understanding & Solutions, Griffen-Rose.

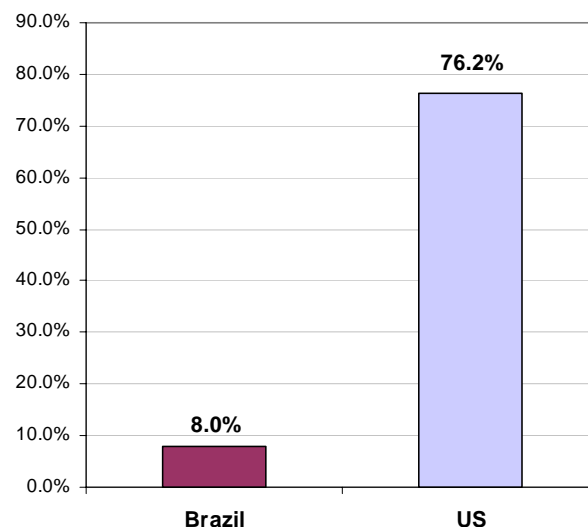
Table 9: DVD+/-R Output per Capita, 2005

Country	Output m	Discs/Person
Taiwan	2,679.0	116.48
Hong Kong	261.5	37.90
Singapore	25.2	5.60
China	498.9	0.38
India	323.8	0.30
Brazil	6.2	0.03
World	5,054.0	1.21

Source: Understanding & Solutions, Griffen-Rose.

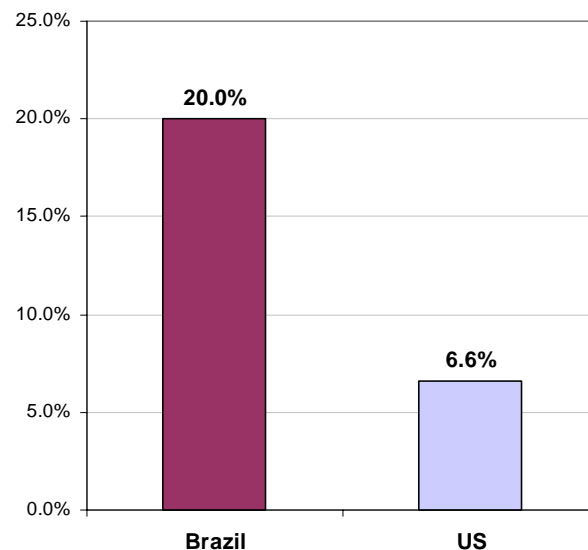
With a population of 185 million, Brazil is without a global top 10 manufacturer of DVDR discs. Compared with Brazil, output of DVDR discs on a per capita basis is about 9x greater in India, 12x greater in China, 170x greater in Singapore and 3,532x greater in Taiwan. Brazil's per capita output is one fortieth of the global average.

Figure 3. DVD Player Penetration per Household, 2005



Source: Source: Motion Picture Association, U.S. Commercial Service, Understanding & Solutions.

Figure 4. Growth in Home Video Market, 2005



Source: Source: Motion Picture Association, Understanding & Solutions.

DVD hardware penetration of Brazilian homes and offices is set to grow, to the potential benefit of DVDR manufacturers like Discobras. There are an estimated 60 million televisions in Brazil, with 1.2 televisions per household, compared to 2.5 per household in developed countries. However, according to the U.S. Commercial Service, there are only 4 million DVD

players for the country's 60 million televisions. The DVD player market possibly has the greatest potential for growth in Brazil's entire entertainment hardware sector.

Brazil has 31 PCs per 1,000 people; the U.S. has 370, Canada 416. As Brazil's televisions per household and pc penetration ratios rise to developed country levels, the potential market for DVD players and thereafter DVD discs will further expand.

According to U&S, DVDs make up 90% of legitimate pre-recorded content media sold in Brazil, Chile, Columbia, Mexico and Venezuela. The DVD home video market is growing at a rate of 20%+ per year; this demand is being met with original DVD-ROM content and replicated content manufactured with DVDRs.

DVDs and DVDRs are comparatively more important to the film industry in Brazil than the U.S. because a far greater proportion of Brazilians watch movies at home than in cinemas. According to the Associated Press, only 7% of Brazilian cities have a movie theater. Mexico, the Latin American country with the most movie theaters, has one for every 30,000 residents while Brazil has one screen for each 95,000 residents. The U.S. has one screen per 7,600 residents. This supports anecdotal evidence that the number of DVDs used per DVD household in Brazil is much greater than in the U.S.

Brazil's is one of the world's largest entertainment markets. It is the tenth largest music market in the world measured by legal sales, despite the fact that it has one of the world's highest music piracy rates (the International Federation of Phonographic Industries (IFPI) estimates that 52% of the music CDs and cassettes sold in Brazil are pirated copies). High piracy rates suggest the presence of a significant replication industry. Whereas U.S. sales of CDs have been falling because of the impact of digital distribution, in Brazil the fall in sales of legitimate CDs has been fuelled by the rise of greater illicit physical distribution.

Digital downloads make up an insignificant proportion of Brazil's music and, by extension, movie purchases – only 1% in 2004 (see Table 24), although this figure is likely to have risen since then. Following recent legal successes by the music industry against Napster (2001), and Kazaa, Grokster and StreamCast Networks (2006), operators of unlicensed media sharing networks face higher risks of fine and closure. This may well impede the further development of such networks in Brazil, to the benefit of the CD-R manufacturers such as Infosmart.

As of 2004, Brazil's 50 million disc/month optical disc capacity consisted largely of CD-ROM manufacturing lines. Yet CD-R demand vastly outstripped supply. According to IFPI estimates, in 2004 about 16.7 million blank CD-Rs, which Discobras will manufacture, were smuggled into Brazil

each month from Paraguay alone.

Of approximately 33 million DVDR discs sold in Brazil each month in 2005 (management's estimates), about 18 million discs are imported, 2 million discs are produced by local manufacturers Novodisc and Videolar, and the rest (13 million) are smuggled into Brazil from other countries such as Panama.

Discobras is located in Camacari, in the State of Bahia (close to Salvador, Bahia). Bahia is close to the southeastern states of Espírito Santo, Minas Gerais, Rio de Janeiro and São Paulo. The southeast is the richest region of the country, responsible for approximately 60% (\$900 billion) of the Brazilian GDP and nearly 40% (72 million) of Brazil's population.

3.4. Infosmart's Competition in Brazil

Infosmart's larger Taiwanese competitors have no Brazilian DVDR factories. As already mentioned, many discs are imported from Taiwan to Paraguay and smuggled into Brazil.

Brazilian DVDR manufacturers Novodisc, Videolar and VTO have based their production lines in the Amazon region's Manaus Free Trade zone; they also maintain sales offices in major cities like Sao Paulo. According to U&S, as of 2005 these three were the only significant producers of DVDRs in Brazil. In that year their aggregate output was estimated at 520,000 discs per month, substantially below Infosmart's current 11 million discs per month capacity. Infosmart believes that they have since increased capacity to approximately 2-2.5 million discs per month in aggregate. Other major optical disc manufacturers in Brazil include MicroService and SonoPress, who make DVD-ROMs, not DVDRs.

Like Infosmart, Novodisc, Videolar and VTO have recognized the promise of DVDR manufacturing in Brazil. Infosmart can therefore expect to face competition in Brazil, which will grow in time. The Company's chances of gaining and holding significant market share in Brazil are reasonably strong. On the one hand, the indigenous Brazilian firms may have greater local knowledge; on the other, Infosmart has greater experience in DVDR production and brings the industriousness of a leading Hong Kong optical disc manufacturer to Brazil. Infosmart has shown its ability to thrive in the fiercely competitive Hong Kong DVDR market, and should be able to withstand the challenge of its smaller Brazilian competitors.

One or more of Infosmart's global competitors could, of course, establish a Brazilian plant, but to date that seems unlikely. For top Taiwanese firms, Brazil's lack of diplomatic relations with Taiwan is a drawback because it denies them Taiwanese government support for major investments in Brazil. Paraguay, which enjoys diplomatic relations with

Taiwan, would arguably be their preferred investment target but, since Paraguay is already the favored destination for substantial Taiwanese disc shipments destined for South America's smuggling routes, the need to establish production there may not be pressing. Furthermore, some Taiwanese firms such as Prodisc and Optodisc have been in serious financial difficulties this year; restructuring their businesses and repairing their balance sheets are likely to take priority over expansion possibilities in South America. Moser Baer is expanding capacity in India and would probably be unable to explore Brazilian opportunities. Nevertheless there is no shortage of second tier Taiwanese manufacturers that may be less sensitive to political risk, or experienced DVDR manufacturers in Hong Kong, Japan or China that could decide to set up manufacturing operations in Brazil. Infosmart will need to try and establish market share leadership in Brazil as rapidly as possible.

4.0. Global Outlook for Optical Discs, 2007-2009

4.1. CD-Rs

The Japan Recording-Media Industries Association (JRMIA) predicts as follows:

Global demand for Data CD-Rs — Global demand for data CD-Rs, which has been declining after peaking in 2005, will fall 7% from 2006 levels to 6.6 billion units in 2007, 7% in 2008 to 6.1 billion units, and a further 8% in 2009 to 5.6 billion units. Demand is shifting from data CD-Rs to write-once DVDs as applications expand and need for higher capacities increases, and demand for write-once DVDs is expected to exceed that for data CD-Rs in 2008.

Global demand for Audio CD-Rs — Global demand for audio CD-Rs, which has declined since peaking in 2004, will fall in 2007 by 6% to 258 million units, by 7% in 2008 to 240 million units, and by 6% in 2009 to 225 million units. Portable digital audio devices that use hard disc drives (HDDs) and the expansion of music download via the Internet are having significant impact on demand.

Global production of CD-Rs — Global production of CD-Rs is forecast to decline by 7% in 2007 from 2006 to 7,495 million units, by 7% in 2008 to 6,972 million units, and by 8% in 2009 to 6,400 million units. In response to inventory adjustments and the increase in demand for writable DVDs, domestic and overseas makers are withdrawing from CD-R production or shifting production from CD-Rs to writable DVDs.

4.2 DVDRs

The JRMIA expects global demand for write-once DVDs to continue growing at a strong pace: up by 21% to 5,727 million units in 2007; by 13% to 6,489 million units in 2008; and by 7% to 6,923 million units in 2009. The projected increase in

the recordable DVD market is expected to be supported by strong shipments of PCs and DVD recorders, with write-once DVDs accounting for 92% of the forecast demand for 2007. Write-once DVDs are the easiest to use for PC and DVD recorder users, and their low prices have enhanced acceptance. However, rewritable DVDs (DVD-RW) that are compatible with content protection for recordable media (CPRM) mechanisms are attracting attention as the suitable media for recording digital television broadcasts, supported by the expansion of digital television broadcasting in Japan, and although demand is currently low, it is expected to grow at a steady pace.

The JRMIA's estimate of the current and future size of the global DVDR industry differs from U&S' estimates. Both however, predict continued strong growth for this sector.

4.3. Blue Laser Disks (BDs and HD DVDs)

The JRMIA forecasts global demand for blue laser disks is forecast to reach 10 million units in 2007, 52 million units in 2008, and 141 million units in 2009. With the increasing penetration of large-screen high definition televisions and PCs with full audio/video capabilities (AV-type PCs) in conjunction with the start of terrestrial digital broadcasts in Japan and the expansion of digital broadcasting in the U.S., demand for large-capacity disks is expected to increase. Various PCs and recorders containing blue laser disk drives are being released and an environment for widespread adoption is being developed, supporting the generally accepted view that demand will take off from 2008.

5.0. Company

5.1. Corporate Structure

Infosmart's operating companies are Info Smart Technology Ltd. ("ISTL"), Info Smart International ("ISIEL") and Infoscience Media ("IML"), which all produce DVDRs in Hong Kong. Infosmart controls Discobras, its Brazilian subsidiary, through IML.

5.2. Control

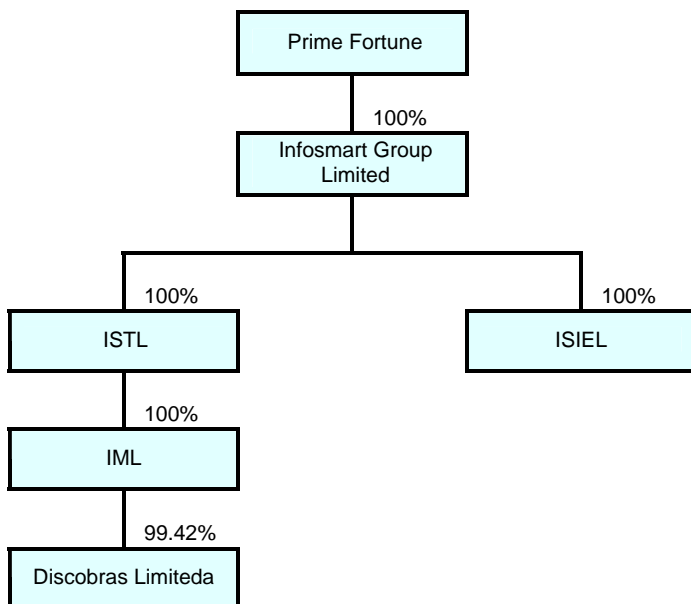
Infosmart raised \$7.65 million in August 2006 and became a publicly owned company in the U.S. via a reverse merger completed on August 16, 2006. Chung Kwok, Chief Executive Officer, Po Nei Sze, Chief Financial Officer, and Andrew Chang, Chairman of the board, control approximately 56% of the outstanding voting shares as of the completion of the financing.

5.3. Shareholding

There are 134.4 million shares outstanding of Infosmart's common stock, none of which are restricted. As of November 3, 2006, a further 29.3 million shares underlie the Company's

convertible Series B Preferred Stock at a conversion price per common share of \$0.261 per common share; and there are outstanding warrants entitling the holders to purchase up to 28.0 million common shares at an exercise price of \$0.326 per share. Assuming full conversion of all outstanding preferred stock and exercise of all warrants, the Company's shares of common stock would be approximately 191.7 million.

Figure 5. Infosmart's Corporate Structure



5.4. Employees

As of September 30, 2006, Infosmart employed 105 full-time employees. No trade union is active in the Company and management can readily scale the workforce to match capacity increases or reductions.

5.5. Legal Proceedings

Management reports that there are currently no claims against the Infosmart Group.

5.6. Research and Development

Infosmart has historically invested insignificant resources in R&D. This is likely to change if management decides to proceed with HD DVDR pre-production, which will require dye and stamper testing, mold modification and process fine-tuning. Our projections for the Company assume that management will proceed with HD DVD production in 2007 and R&D expense will be approximately \$400,000 for fiscal 2007 or 0.9% of projected revenue.

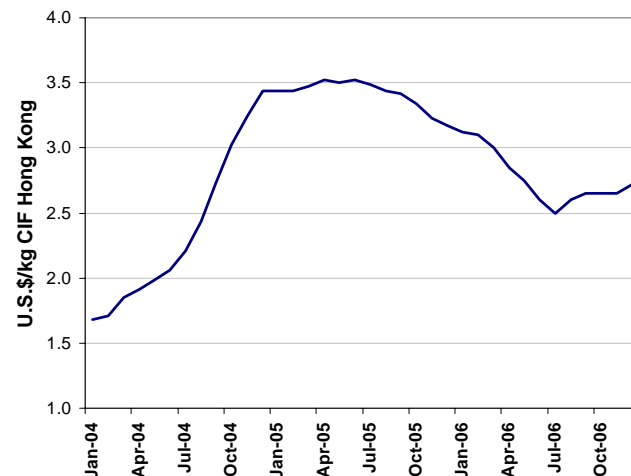
5.7. Production Equipment

Infosmart uses Singulus machines to manufacture optical discs. All the Company's machines are capable of producing 52x CD-Rs and 8x/16x DVDRs. The switch from CD-R to DVDR production requires only about 24 hours' preparation. The Company's 24 Hong Kong production lines can be upgraded for HD DVDR production at a capital expenditure ("capex") cost of approximately \$500,000 - \$700,000 per line. Infosmart's equipment base therefore favors HD DVDR production. Should Sony's Blu-ray format triumph over the HD DVD format, Infosmart would have to purchase new equipment to produce Blu-ray discs.

5.8. Production Costs

Raw material costs constitute approximately 50% of the production costs for DVDR discs. Key materials used in DVDR production are polycarbonate, silver target, organic dye, printing oil and bonding glue. The most important cost item is polycarbonate, which accounts for about half of cost of goods sold.

Figure 6. Polycarbonate Price, CIF Hong Kong, 2004-2006



Source: Company.

The supply market for polycarbonate is competitive. Major polycarbonate suppliers include Teijin Chemicals, Dow Chemical, General Electric, Bayer, and Mitsubishi. Infosmart orders polycarbonate from a variety of sources depending on price and availability. Since polycarbonate is a petroleum byproduct, its price is affected by crude oil prices and can be volatile. Infosmart places three month supply contracts with polycarbonate vendors. These supply contracts guarantee quantity but leave pricing to be market determined.

Polycarbonate prices (PCB) increased from \$1.90 - 2.50/kg in 2004 to around \$2.80/kg - \$3.50/kg in 2005 on the back of surging oil prices and supply constraints, thereby seriously cutting the profit margins of disc manufacturers worldwide.

Capacity was hit in 2004 by the explosion of GE's PCB factory in Spain. At the end of 2005, worldwide PCB capacity rose as a major new factory came online in Shanghai, and two other large factories in Japan and the U.S. expanded output in response higher market prices. PCB prices were approximately \$3.00/kg - \$3.10/kg at the beginning of 2006, and have since dropped into the \$2.70-\$2.80 range. We anticipate that expanded PCB industry production capacity will continue to offset upward price pressures resulting from higher oil prices, leading to price stability or even a modest price decline in PCB prices in the near term.

5.9. Product Mix

Infosmart currently manufactures write-once 8x and 16x DVD discs and CD-Rs. However, the Company is preparing to launch production of HD DVDRs later this year. In order to act as a one-stop-shop for the optical storage media needs of its customers, Infosmart outsources orders for products it does not produce itself, such as DVD±RW, DVD-RAM and other low margin DVDR items. Eighty-nine% of Infosmart's revenue in 2005 was from sales of self-manufactured discs, up from 66% in 2004.

Table 10. Infosmart's Capacity and Product Mix

	Product Mix	Dec 2006 Capacity	Feb 2007E Capacity	Sept 07E Capacity
Hong Kong	16x & 8x DVDR; 52x CD-R; HD DVDR	8MM DVDR/ 12MM CD-R or a mix		12MM DVDR/ 18MM CD-R/ 8.2MM HD DVDR ⁽¹⁾ or a mix
Brazil	8x DVDR; 52x CD-R		5MM DVDR/ 7.5MM CD-R or a mix	

Source: Company.

(1) Assuming all lines were to be converted.

Demand is moderately seasonal; the busiest months for Infosmart tend to be April through November. Infosmart's output is sold in several countries worldwide. In the coming years, the Company believes its major DVDR customers will be from developing countries and its major HD DVDR customers from developed countries.

Hong Kong Production

The Company's Quality Management System complies with ISO9001:2000 requirements and the Company is ISO 9000 certified. Infosmart has hitherto manufactured discs in cooperation with two parties that have licenses for the use of technologies and intellectual properties necessary for the production of its products. Infosmart now has its own Hong Kong production licenses in place and has not needed to renew the co-operation agreements.

By the end of 2007, management expects to have at least

two production lines converted to HD DVDR output and another 46 lines devoted to DVDR and possibly CD-R output. All of the Company's Hong Kong DVDR manufacturing lines are available for conversion to HD DVDR production.

Brazil Production – Discobras S.A.

Infosmart is establishing a production facility and a sales base in Brazil organized under its Discobras subsidiary. Infosmart's joint venture partner in Discobras is Mr. Nassim Cattán, a Brazilian entrepreneur with extensive local business knowledge and strong relationships with Brazilian government officials. Infosmart holds a 99.42% ownership interest in Discobras and Mr. Cattán holds the remainder.

Discobras' factory is located in the city of Camaçari, Bahia, which is 45 kilometers from the port of Salvador, Bahia. Infosmart plans to duplicate its Hong Kong ISO-compliant manufacturing standards at the Brazilian facility and seek ISO certification for the plant. Raw materials can be shipped from Hong Kong or sourced from North America. The facility is expected to be operational in 1Q07; its monthly capacity will be 5 million DVDRs or 0.5 million CD-Rs or a mix of the two formats in varying quantities. Discs can easily be shipped from Bahia to customers in southeastern Brazil located two days' drive away. Discobras' warehouse and sales office are in São Paulo city. The southeastern states of Espírito Santo, Minas Gerais, Rio de Janeiro and São Paulo form the richest region of Brazil, and together are responsible for approximately 60% (\$900 billion) of the Brazilian GDP and nearly 40% (72 million) of Brazil's population.

Under the State of Bahia's investment incentive program, Discobras has been granted a substantial reduction in the Value Added Tax ("VAT") it is required to pay on product sales. Discobras pays 2.28% compared to VAT of 12% in Salvador and 18% in São Paulo. This VAT reduction will be available to the Company until June 2016. Since Discobras' customers will buy products gross of VAT at market prices, Discobras will benefit financially from the VAT differential competitors from other states have to pay. Infosmart also benefits from an incentive program for foreign investment that exempts Discobras from paying Brazil's taxes on raw materials it imports for production. This tax exemption will last through June 2016.

5.10. HD DVD versus Blu-ray

In today's high definition optical media market, a format war is going on between HD DVD and Blu-ray. At present, Infosmart has no option but to monitor trends closely and at an opportune time bet cautiously on HD DVD's success. The individual upgradeability of its production lines for HD DVDR production means that the Company can finely adjust expenditure on HD DVDR capacity as the situation warrants, thereby minimizing investment risk. Upgrading the production lines is expected to cost half as much as buying new

machines. However, if Blu-ray becomes the dominant format, Infosmart would need to purchase totally new equipment for Blu-ray production.

5.11. Marketing

The Company has acquired about 80% of its customers, and increased its exposure in Europe, U.S., South America, the Middle East, Asia and China, through attendance at international trade shows such as CeBIT (Hanover, Germany), Comdex (Las Vegas, U.S.), Computex (Taipei, Taiwan), Gitex (Dubai, UAE), China Sourcing Fairs, IT Brazil, and the Hong Kong Electronics Show. Infosmart has attracted the rest of its customers mainly through print advertising and referrals. Infosmart runs marketing campaigns in Brazil including advertisements in Brazilian newspapers and magazines, and attendance at local Brazilian trade exhibitions.

The Company plans to launch its own branded "Hontek", "Laser Line" and "Top Comp" recordable optical media products in the Brazilian retail market from 2007. Management has earmarked a \$650,000 budget for this marketing effort over the next 18 months.

The Internet is increasingly being used for product sourcing. Infosmart currently invests \$20,000 per year in online exposure in industry portals such as globalsources.com, alibaba.com and the Hong Kong Trade Development Council website. Infosmart plans to increase its online promotional activities. The Company's website, www.infosmart.com.hk, provides general corporate and product information.

5.12. Distribution

Table 11: Infosmart's Sales by Territory, January – June 2006

Territory	% of Sales
U.K.	24%
H.K.	18%
Brazil	19%
Australia	15%
U.S.	5%
Singapore	3%
Others	16%
Total	100%

Source: Company.

Historically, Infosmart has mainly sold to distributors for resale to retailers, and the Company's Hong Kong operations will continue this tradition. Some of Infosmart's Western Europe distributors sell the Company's products to retailers in the Middle East and Eastern Europe. The Company plans a greater direct sales push into major developing markets in the Middle East, Africa, Russia and Eastern Europe by attending

trade shows and advertising on trade websites.

Discobras' planned distribution strategy will depart from Infosmart's norm. In Brazil, the Company will sell directly to a select group of twenty-five large retail chains, including chain stores such as Bompreco (a Wal-Mart subsidiary), and sell the remainder of its output to replicators and wholesalers and through a network of agents. Management believes that creating a distribution system in Brazil will bring immediate financial benefits by capturing the wholesaler's margin, and long-term strategic value by bringing Infosmart into direct contact with end customer needs.

5.13. Customer Concentration

Infosmart has substantially broadened its customer base during 2006. In 2005, 84% of the Company's revenue was derived from three customers, and one customer contributed approximately 69% of revenue. As of 2Q06, Infosmart's top four customers accounted for 62% of revenue, and no single customer accounted for more than 28%. Brazilian customers will dilute the Company's customer concentration further.

Infosmart's customer base has broadened beyond the original U.S., European and Australian core to include customers from countries such as Brazil, Panama, Chile and Thailand. This reflects the evolution of global demand patterns, and the Company expects that sales to its emerging market customers will continue to grow in coming years.

5.14. Inventories

Infosmart holds minimal levels of inventory and produces to order. It does not act like a supermarket. Customer payment terms accommodate and reflect the strength of Infosmart's relationship with individual customers. In Brazil, it is customary to pay cash on delivery (C.O.D.) and Discobras does intend to give payment terms to its Brazilian wholesale customers. Discobras anticipates offering terms of up to 60 days to major supermarkets and retail chains with which it establishes close relationships.

5.15. Key Management and Directors

Management

Andy Kwok, Chief Executive Officer and Director

Mr. Kwok has over 12 years' experience in the optical storage media industry. In 1993, he began his international sales career with a subsidiary of Sonopress AG, one of the world's top three prerecorded CD/DVD manufacturers, and gained solid experience in the dynamics of global storage media markets. In 1997, he co-founded Mega Winner (H.K.), Ltd. ("Mega Winner"), a leading CD manufacturer, before spotting the DVDR market opportunity and co-founding Infosmart in 2002. He served as chairman of the Hong Kong Optical Disc

Manufacturing and Technology Association from 2000 to 2002. He received his Bachelor of Mathematics degree from The Chinese University of Hong Kong, China.

Table 12. Infosmart's Officers and Directors

Name	Age	Position
Andy Kwok	39	Chief Executive Officer and Director
Pauline Sze	33	Chief Financial Officer and Director
Andrew Chang	36	Chairman of the Board of Directors
Tony Wong	37	Director
Godwin Wong	57	Director
Gavin Wong	27	Vice President, Sales and Marketing
Sebastian Tseng	34	Regional Director – South America; Vice President, Production and R&D

Pauline Sze, Chief Financial Officer and Director

Ms. Sze co-founded Infosmart in 2002 and oversees the Company's finance, accounting, human resources, purchasing and shipping departments. From 1996 to 1998 she worked with Wing Shing Cassette Manufacturing Co. Ltd., where she witnessed the shift in media production from cassette to VCD to DVDR. She established her own company, Mega Century, with her spouse, Mr. Tony Wong, in 1998 to produce VCDs. Ms. Sze received her degree in business administration from the British Columbia Institute of Technology in Burnaby, BC, Canada.

Gavin Wong, Vice President, Sales & Marketing

Mr. Wong joined Infosmart's sales division in 2002, shortly after completing his bachelor's degree. He quickly proved his sales and marketing abilities and was promoted to vice president of sales and marketing within two years of joining the Company. He is responsible for sales, channel marketing and international business development. He organizes Infosmart's participation in important trade shows such as the Hong Kong Electronic Show, Gitex Dubai and IT Brazil. Mr. Wong received his Bachelor of Commerce degree, majoring in Marketing Management, from the University of Melbourne, Victoria, Australia. Mr. Wong and Mr. Tony Wong are cousins.

Sebastian Tseng, Regional Director, South America and Vice President, Production and R&D

Mr. Tseng brings over six years' senior management experience and skill in the purchasing and use of raw materials required for DVD production. He was previously vice president of sales and purchasing manager of Evervictory Acuteh Corporation, an optical dye trading company, between 1999 and 2004. He holds a Bachelor of Science degree from the University of California, San Diego, California, and a Master of Science degree from Polytechnic University, Brooklyn, New York, both degrees in chemical engineering.

Directors

Infosmart's executive directors are Andy Kwok and Pauline Sze. The Company's non-executive directors are:

Andrew Chang, Chairman of the Board of Directors

Mr. Chang is a seasoned entrepreneur. In 1995, he founded Hang Tat International (H.K.) Ltd., a telecommunication devices manufacturing business, which has 1,400 workers and generates sales of \$15 million. His company exports output mainly to the U.S.; its major customers include Family Dollar, Best Buy, Circuit City, Southern Telecom and jWIN Electronics. Mr. Chang holds a Master of Economics degree from the Mcquarie University, New South Wales, Australia and a Bachelor of Commerce degree majoring in accounting from the University of New South Wales, Sydney, Australia. Mr. Chang is Mr. Tony Wong's cousin.

Tony Wong, Director

Mr. Wong, a co-founder of Infosmart, is an entrepreneur with over 18 years' experience in manufacturing businesses. In 1997, he founded Giant Peak Co. Ltd., a video compact disc (VCD) manufacturing company, which had factories in Hong Kong and Indonesia and revenue exceeding \$8 million per year from sales to customers largely in China and Indonesia. Before founding Giant Peak, Mr. Wong served with a printing company for 10 years during which he was promoted in several steps from technician to partner. Mr. Wong is the husband of Ms. Pauline Sze, and is also the cousin of both Mr. Andrew Chang and Mr. Gavin Wong.

Godwin Wong, Director

Dr. Wong is an independent member of Infosmart's Board. He has been on the faculty of the Haas School of Business at the University of California, Berkeley, for twenty years. He was raised in Hong Kong and holds a Ph.D. from Harvard University, Master's from U.C.L.A. and baccalaureate from the University of Wisconsin. Dr. Wong serves on the Board of Directors of the United Commercial Bank, a number of NASDAQ companies and certain technology ventures based in the San Francisco area and overseas. He has been advisor to various organizations, corporations, government agencies and business enterprises in the U.S., Canada, Europe and Asia. Dr. Wong has been appointed Chief Expert Advisor to the City Government of Beijing HaiDian located in China's "Silicon Valley". He also serves as director of one of Shanghai's top ten software companies. He is fluent in four dialects of Mandarin.

6.0. Summary of Strengths and Weaknesses/Risks

Strengths

Management. In each year of its life, Infosmart has performed creditably compared with its peer group in generating pretax returns on invested capital, despite having significantly smaller revenues than its peers.

Growing markets. DVDR use will expand rapidly into emerging economies and persist in advanced economies in the medium term. The installed base of DVD write drives in computer and home entertainment hardware worldwide continues to expand, generating demand for writable discs. The Company's DVDR sales in Brazil and other emerging markets can be expected to grow, along with the growth of those markets, if the Company maintains its competitive position with customers.

Output flexibility. The Company's production lines are capable of producing a broad range of optical discs, from 52x CD-Rs to 16x DVDRs. Most of the production lines can also be converted to HD DVDR production quickly and on a cost effective basis. This flexibility enables Infosmart to alter its product mix to maximize gross profits.

No idle capacity and minimal inventory levels. Infosmart has achieved, and continues to achieve, virtually 100% capacity utilization. In the last three full fiscal years, the Company's inventory turnover ratio ranged from 10.4 to 14.6; the median inventory turnover ratio for other firms in its peer group ranged from 4.5 to 7.5 during the same period.

Potential diversification opportunities. Infosmart's Brazilian distribution system opens the way for Infosmart to import/assemble and sell products apart from optical discs into Brazil. This may prove useful should predictions for the Brazilian DVDR market prove optimistic.

Force of habit. Despite the advent of alternative, possibly low cost delivery mechanisms for HDTV, PVRs and other hard disc devices for storing and playing movies, people are accustomed to, and will probably wish to continue, collecting and archiving films in permanent discrete form using low cost, portable media. Furthermore, niche content may be available on disc that is not available via other delivery methods.

Illegal digital distribution channels will become rarer. Illegal downloads and file swapping of entertainment content is likely to become rarer, at least in advanced economies. For example:

- In September 2006, EMI, Universal Music Group, Sony BMG Music Entertainment, and EMI Group successfully sued Kazaa Media Desktop for authorizing the widespread violation of copyright works.
- In June 2006, the U.S. Supreme Court ruled that

Grokster, Ltd, and StreamCast Networks, Inc. could be held liable for copyright infringements committed by users of their peer-to-peer file-sharing software.

- In February 2001, Napster lost its copyright infringement case, consequently filed for bankruptcy, and was liquidated.

These examples show that it will be more difficult in the future for Web-based piracy to flourish. In developing markets, where penetration of the internet, PVRs and handheld flash/hard disc MP3 players and video players is low, the inhibition of the development of free digital distribution will be to the benefit of sales of low cost replicated media produced using DVDRs.

Weaknesses/Risks

Sector dynamics leave little margin for management error. Optical disc companies must consistently be excellent in adjusting capacity and selecting product and territorial markets to enter. Supply and demand for specific products are often mismatched in a given territory. Information flows being imperfect, high prices trigger overproduction and low prices excessive capacity cuts. In the past, Infosmart has been proficient at negotiating such competitive challenges and maximizing revenue and return on capital, but that is no guarantee of future success.

Brazil venture risk. In Hong Kong's business-friendly environment, economic efficiency is encouraged by flexible labor laws, the industriousness of the labor force and the light hand of officialdom. Infosmart may fail to replicate in Brazil the efficiency of its Hong Kong operations if any of these factors in Brazil are appreciably below Hong Kong's standards.

Competing storage and distribution technologies. The development of distribution alternatives could erode Infosmart's sales volume as well as product and services pricing. This risk could be manifest in two ways. Firstly, Infosmart's DVD sales could be at risk from the growth in online distribution of entertainment content and storage on hard drives or flash memory, thereby eroding the demand for optical discs. This risk is strongest in countries with high broadband penetration and low internet subscription costs, and weakest in emerging markets that Infosmart is increasingly targeting for DVD sales. Secondly, Infosmart's hope for the emergence of strong demand for HD DVDR media following the introduction of HD DVD in economically advanced countries could be thwarted by online distribution in areas of very high internet bandwidth/fiber optic capacity or by distributors using other means. In February 2006, for instance, MovieBeam, Inc. launched a VOD service renting standard and high definition movies via over-the-air set-top boxes using portions of the analog NTSC broadcast spectrum of PBS affiliates. HD optical disc formats could be

marginalized were MovieBeam, and other video-on-demand providers, to prove commercially successful in sending HD movies to consumers' homes.

Anti-dumping and anti-subsidy levies. The Company derives a significant part of its revenue from international markets. Sometimes governments within these markets display protectionist attitudes and use anti-dumping measures to provide protection to local businesses. The EU has in the past levied anti-dumping tariffs on CD-R discs from Taiwan's largest manufacturers. The tariff risk to Infosmart's overall output is attenuated by the fact that the Company's Brazilian production for the domestic market will be insulated from such risks.

Competition. Optical disc product markets become increasingly competitive over time. Large, more technologically adept manufacturers respond to thinning profit margins by moving to new products including those that compete against optical discs such as flash memory devices. Infosmart is a pure play optical disc manufacturer and at present fully exposed to the fortunes of a single market sector.

Brazil country risk. Brazil's economic management has improved in recent years. The Brazilian government's actions to control inflation and carry out other policies have in the past involved wage and price controls, currency devaluations, capital controls and limits on imports, among other things. Although at present unlikely, it is possible that future Brazilian governments might revert to such actions that could adversely affect Infosmart's performance. Currently, Infosmart can legally exchange and transfer out of Brazil after-tax profits equal to the Company's total investment in its Brazilian subsidiary Discobras, which will be approximately \$8 million for 2006 and an additional \$6 million for 2007. Transfers beyond that limit would require special authorization. These restrictions could affect Infosmart's ability to collect and use funds effectively.

Table 13. Exchange Rates to the U.S. Dollar

	BRL	HKD
2001	2.38	7.80
2002	2.97	7.80
2003	3.12	7.79
2004	2.93	7.79
2005	2.43	7.78
2006	2.18	7.77

Source: www.oanda.com.

Currency risk. Infosmart does business in Hong Kong and U.S. dollars and soon also the Brazilian real. The Company's U.S. investors will expect U.S. dollar returns, and the value of the Company's common stock will therefore be affected by the foreign exchange rates between U.S. and Hong Kong

dollars and the Brazilian real. The Hong Kong dollar to U.S. dollar exchange rate has been extremely stable in the last five years, averaging H.K.\$7.79 = U.S.\$1 \pm 0.2%. The Brazilian real has been more volatile, averaging BRL 2.67 = U.S.\$1 \pm 16.8% -18.2%.

Closely held stock. As of August 2006, Infosmart's directors and senior executives controlled approximately 56% of the Company's voting stock. This control could adversely affect the rights and interests of minority holders and could depress the share price of the Company's common stock.

Stock overhang. As of December 11, 2006, there were 134.4 million shares outstanding of Infosmart's common stock. Assuming full conversion of all outstanding preferred stock and exercise of all warrants, the Company's shares of common stock would be approximately 191.7 million, which would dilute pre-existing ownership and book value per common share. Early sales of Infosmart stock in thin trading conditions may depress the Company's market value.

7.0 Valuation

The key operating assumptions underlying our discounted free cash flow (DCF) to equity model are set out in Table 20. Our forecasts for 2007-2008 assume that:

- The Company's plans for capacity expansion as outlined in Table 10 will be implemented.
- Infosmart will maintain its historical manufacturing yields or its established CD-R and DVDR product lines. However its HD DVDR production yields will start significantly lower and rise gently thereafter as the Company's production know-how for that product improves.
- A richer product mix will raise Infosmart's average sales price per disc by about 30% and 28% in fiscal 2007 and 2008, respectively. Ex-factory sales prices by specific product type, however, will fall by at least 10% annually; price declines will be more rapid for HD DVDRs although they will offer the greatest unit profitability.
- Infosmart's product mix will be optimized to maximize overall gross profits; in particular the Company will gradually increase the proportion of its DVDR compared with CDR output in Brazil and HD DVDR output versus DVDR output in Hong Kong.
- Infosmart's working capital management will gradually improve. We project that days in trade receivables and trade payables outstanding will gradually decline to about 46 and 36 days, respectively, which are broadly in line with Infosmart's 2005 numbers but bettered by its 2003 numbers. Infosmart has always manufactured to order, never to replenish inventory. Its capacity utilization has always been above 90% and we have assumed that this pattern will continue except in the first six months of

Brazilian production.

Our 2009-2013 forecasts assume that:

- Infosmart will make modest HD DVDR capacity increases in Hong Kong.
- Market prices for HD DVDRs will drop as HDTV gains mass-market acceptance in the U.S. DVDR prices will also drop, more sharply with respect to the Company's Hong Kong than Brazilian production.
- Infosmart's overall revenue will grow, albeit far more slowly than in the 2005-2007, because its Hong Kong plant will overwhelmingly be devoted to HD DVDR production by 2013.
- The Company's operating profit will increase but its operating profit margin will decline.
- Infosmart's working capital management will be in line with the pattern established as of 4Q08.
- Infosmart's operations will be in steady state by the 2012-2013 period, assuming that further industry product innovation is largely within the blue laser generation of disc technologies. Incremental HD DVDR sales volume will be driven by the adoption of high definition content and hardware in more countries across the globe.

Using free-cash-flow-to-equity (FCFE) projections through fiscal 2013, a DCF value was used to determine our base case price of about \$0.54 per share, an 80% improvement on the current \$0.30 share price.

Critical assumptions for the DCF included an unlevered 16.6% cost of equity, 16.2x FCFE terminal multiple, and 191.7 million shares outstanding. In calculating the debt shield, we estimated: an optimal capital debt to equity ratio of 30.4%; 8.5% to 9.3% interest rates over the forecast period; and a blend of Hong Kong and Brazilian statutory tax rates. Conservative leverage is justified by the volatility of Infosmart's historical operating profit margins and the potential vulnerability of its operations in the event of financial distress. Given the conservatism of our leverage assumption, we discounted the tax shield stream at the cost of debt. We added the present value of the tax shield result to the net present value of the equity FCF to arrive at the adjusted net present value of \$0.54 per share. This is equivalent to \$0.77 per share at the current 134.4 million share count. The bond yield plus risk premium approach suggested 15.7% cost of equity but conservatism leads us to prefer the higher cost of equity resulting from the capital asset pricing (CAPM) model. We derived the terminal value multiple by applying a blend of median enterprise value multiples to projected sales, EBITDA, EBIT and capital employed (capital employed being the sum of net working capital and net fixed assets). The implication, that Infosmart will broadly resemble its industry group in the terminal year, is cautious given the Company's

core operating performance to date.

If we flex the critical assumptions underlying the DCF to a more conservative 18.6% cost of equity and a terminal value 20% below the base case projection, we arrive at a valuation of \$0.42 share, which is 40% above the current price. This scenario may appeal to those less sanguine about Infosmart's near-term constraints on valuation, such as the early stage of the Company's Brazilian operations, uncertainties surrounding the HD DVD versus Blu-ray contest and currently high level of insider holdings.

Conversely, if we use more aggressive assumptions of a 15.6% cost of equity and terminal value 20% above the base case, we arrive at a valuation of \$0.65 per share, which is 117% above the current price. This scenario may appeal to those bullish about the prospects of a company, which: (1) is bringing Hong Kong levels of efficiency in the manufacture and marketing of standard products to Brazil, a country that represents half the continent's population and GDP, has a large replication industry, and currently imports about 90% of its DVDR requirement; (2) should be capable of making new generation optical media – HD DVDR preferably, BDR if necessary - that are required for high definition content on the brink of mass adoption in advanced economies; (3) until now, has been one of the best performing firms in its industry.

Table 14. Infosmart Group, Inc. - Income Statement (U.S.\$, '000 except EPS data)

	2003	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06	4Q06E	2006E	2007E	2008E
Total sales	12,444	22,422	5,841	8,648	3,990	6,098	24,577	6,232	6,330	7,561	5,249	25,371	34,081	52,401
Cost of sales	7,095	17,282	4,096	6,374	2,903	4,674	18,046	4,640	4,437	5,405	3,914	18,397	24,116	37,335
Gross profit	5,349	5,140	1,745	2,275	1,088	1,424	6,531	1,591	1,894	2,155	1,334	6,975	9,965	15,066
Gross profit margin	43.0%	22.9%	29.9%	26.3%	27.3%	23.4%	26.6%	25.5%	29.9%	28.5%	25.4%	27.5%	29.2%	28.8%
Expenses														
Depreciation	29	178	49	51	55	59	215	58	63	63	63	247	800	949
Selling & distribution	775	887	85	31	130	337	583	48	150	158	110	467	507	647
R&D	0	0	0	0	0	0	0	0	0	0	0	0	400	200
Administrative	344	674	95	225	227	191	740	274	337	385	332	1,327	1,360	1,395
Operating profit	4,201	3,401	1,515	1,967	675	837	4,993	1,211	1,344	1,550	830	4,935	6,898	11,875
Operating profit margin	33.8%	15.2%	25.9%	22.7%	16.9%	13.7%	20.3%	19.4%	21.2%	20.5%	15.8%	19.5%	20.2%	22.7%
Commission reversal	0	0	0	(717)	0	(2)	(718)	0	0	0	0	0	0	0
Financial raise expenses	0	0	0	0	166	155	321	0	0	2,753	0	2,753	0	0
Other income	507	680	131	69	40	62	303	52	120	160	180	511	553	899
Interest expenses	45	320	68	162	134	157	521	148	127	132	141	549	528	640
Pre-tax income	4,663	3,761	1,578	2,590	415	589	5,173	1,115	1,336	(1,176)	869	2,144	6,924	12,133
Income taxes	750	736	275	454	73	156	958	195	242	261	152	850	1,552	2,437
Net income	3,913	3,024	1,303	2,136	343	433	4,215	920	1,094	(1,437)	717	1,293	5,371	9,696
Net income margin	31.4%	13.5%	22.3%	24.7%	8.6%	7.1%	17.1%	14.8%	17.3%	(19.0%)	13.7%	5.1%	15.8%	18.5%
Preferred dividends	0	0	0	0	0	0	0	0	0	2,364	58	2,422	156	35
Income to common	3,913	3,024	1,303	2,136	343	433	4,215	920	1,094	(3,802)	659	(1,129)	5,215	9,661
EPS (cents)	34,661.8	14,984.4	1.2	1.9	0.3	0.4	3.8	0.8	1.0	(3.2)	0.5	(1.0)	3.5	5.3
Shares outstanding			110.2	110.2	110.2	110.2	110.2	110.2	112.4	120.0	132.3	118.7	150.8	182.5

Source: Company, Griffen-Rose.

Table 15. Infosmart Group, Inc. – Pro Forma Normalized Income Statement

(\$, 000)	2003	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06	4Q06E	2006E	2007E	2008E
Revenue	12,444	22,422	5,841	8,648	3,990	6,098	24,577	6,232	6,330	7,561	5,249	25,371	34,081	52,401
GM	5,349	5,140	1,745	2,275	1,088	1,424	6,531	1,591	1,894	2,155	1,334	6,975	9,965	15,066
Commission reversal	0	0	0	(717)	0	(2)	(718)	0	0	0	0	0	0	0
PF EBIT	4,201	3,401	1,515	2,684	675	838	5,712	1,211	1,344	1,550	830	4,935	6,898	11,875
D&A	993	1,968	349	412	418	517	1,696	442	448	455	400	1,745	2,573	3,257
PF EBITDA	5,194	5,369	1,864	3,096	1,093	1,355	7,407	1,653	1,791	2,005	1,230	6,680	9,471	15,132
CAPEX	4,618	3,646	90	137	122	1,106	1,455	202	1,184	525	3,026	4,937	8,450	7,800
PF EBITDA - CAPEX	576	1,723	1,774	2,959	971	249	5,953	1,451	607	1,480	(1,795)	1,742	1,021	7,332
Interest expense	45	320	68	162	134	157	521	148	127	132	141	549	528	640
Non-recur/other income	507	680	131	69	(126)	(93)	(18)	52	120	(2,594)	180	(2,242)	553	899
PF normalized core EBT	4,156	3,081	1,447	2,521	541	681	5,191	1,063	1,216	1,417	689	4,386	6,370	11,234
PF tax	665	539	253	441	95	119	908	186	213	248	121	768	1,429	2,256
PF NI	3,491	2,542	1,194	2,080	446	562	4,282	877	1,003	1,169	569	3,619	4,941	8,978
Non-cash pref. dividends	0	0	0	0	0	0	0	0	0	2,297	0	2,297	0	0
PF NI to common	3,491	2,542	1,194	2,080	446	562	4,282	877	1,003	1,102	511	3,493	4,786	8,943
PF diluted common shares										191.70	191.70	191.70	191.70	191.70
PF diluted EPS (cents)										0.6	0.3	1.8	2.5	4.7
% revenue change		80.2%					9.6%	6.7%	(26.8%)	89.5%	(13.9%)	3.2%	34.3%	53.8%
% core OPM change		(19.0%)					68.0%	(20.0%)	(49.9%)	129.6%	(1.0%)	(13.6%)	39.8%	72.1%
% PF NPM change		(27.2%)					68.5%	(26.5%)	(51.8%)	162.0%	1.2%	(15.5%)	36.6%	81.7%
% PF EPS change										nc	nc	nc	37.0%	86.9%

Source: Company, Griffen-Rose.

Table 16. Infosmart Group, Inc. - GAAP & Pro Forma Normalized Margin Analysis

	2003	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06	4Q06E	2006E	2007E	2008E
GAAP Margins														
COGS	57.0%	77.1%	70.1%	73.7%	72.7%	76.6%	73.4%	74.5%	70.1%	71.5%	74.6%	72.5%	70.8%	71.2%
GM	43.0%	22.9%	29.9%	26.3%	27.3%	23.4%	26.6%	25.5%	29.9%	28.5%	25.4%	27.5%	29.2%	28.8%
D&A	8.0%	8.8%	6.0%	4.8%	10.5%	8.5%	6.9%	7.1%	7.1%	6.0%	7.6%	6.9%	7.5%	6.2%
S&D	6.2%	4.0%	1.5%	0.4%	3.3%	5.5%	2.4%	0.8%	2.4%	2.1%	2.1%	1.8%	1.5%	1.2%
R&D	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	1.2%	0.4%
Admin	2.8%	3.0%	1.6%	2.6%	5.7%	3.1%	3.0%	4.4%	5.3%	5.1%	6.3%	5.2%	4.0%	2.7%
EBIT	33.8%	15.2%	25.9%	22.7%	16.9%	13.7%	20.3%	19.4%	21.2%	20.5%	15.8%	19.5%	20.2%	22.7%
EBITDA	41.7%	23.9%	31.9%	27.5%	27.4%	22.2%	27.2%	26.5%	28.3%	26.5%	23.4%	26.3%	27.8%	28.9%
EBITDA-capex	4.6%	7.7%	30.4%	25.9%	24.3%	4.1%	21.3%	23.3%	9.6%	19.6%	(34.2%)	6.9%	3.0%	14.0%
NI	31.4%	13.5%	22.3%	24.7%	8.6%	7.1%	17.1%	14.8%	17.3%	(19.0%)	13.7%	5.1%	15.8%	18.5%
NI to common	31.4%	13.5%	22.3%	24.7%	8.6%	7.1%	17.1%	14.8%	17.3%	(50.3%)	12.6%	(4.4%)	15.3%	18.4%
PF Normalized Margins														
EBIT	33.8%	15.2%	25.9%	31.0%	16.9%	13.7%	23.2%	19.4%	21.2%	20.5%	15.8%	19.5%	20.2%	22.7%
EBITDA	41.7%	23.9%	31.9%	35.8%	27.4%	22.2%	30.1%	26.5%	28.3%	26.5%	23.4%	26.3%	27.8%	28.9%
EBITDA-capex	4.6%	7.7%	30.4%	34.2%	24.3%	4.1%	24.2%	23.3%	9.6%	19.6%	(34.2%)	6.9%	3.0%	14.0%
NI	28.1%	11.3%	20.4%	24.1%	11.2%	9.2%	17.4%	14.1%	15.9%	15.5%	10.8%	14.3%	14.5%	17.1%
NI to common	28.1%	11.3%	20.4%	24.1%	11.2%	9.2%	17.4%	14.1%	15.9%	14.6%	9.7%	13.8%	14.0%	17.1%
Multiples														
EV/Sales										6.2x	9.3x	1.8x	1.5x	1.0x
EV/PF EBIT										30.1x	58.7x	9.1x	7.5x	4.4x
EV/PF EBITDA										23.2x	39.6x	6.7x	5.4x	3.4x
EV/PF EBITDA - capex										31.5x	nc	25.8x	50.4x	7.1x
MV/PF NI										33.4x	70.9x	10.1x	9.4x	6.2x
PF tax rate	16.0%	17.5%	17.5%	17.5%	17.5%	17.5%	17.5%	17.5%	17.5%	17.5%	17.5%	17.5%	22.4%	20.1%

Source: Company, Griffen-Rose.

Table 17. Infosmart Group, Inc. - Ratio Analysis

	2003	2004	2005	1Q06	2Q06	3Q06	4Q06	2006E	2007E	2008E
Manufactured disc output growth		257.0%	75.1%	0.0%	0.0%	0.0%	0.0%	7.4%	9.5%	26.6%
Revenue growth		80.2%	9.6%	6.7%	(26.8%)	89.5%	(13.9%)	3.2%	34.3%	53.8%
COGS growth		143.6%	4.4%	13.3%	(30.4%)	86.2%	(16.2%)	1.9%	31.1%	54.8%
Gross profit growth		(3.9%)	27.1%	(8.8%)	(16.7%)	98.2%	(6.3%)	6.8%	42.9%	51.2%
SG&A growth		51.4%	(11.6%)	65.0%	79.0%	46.7%	(14.1%)	32.7%	50.3%	4.1%
Operating profit growth		(19.0%)	46.8%	(20.0%)	(31.7%)	129.6%	(0.8%)	(1.2%)	39.8%	72.1%
Adjusted earnings* growth		(22.7%)	39.4%	(29.4%)	(48.8%)	1.7%	65.7%	(26.9%)	74.4%	80.5%
Adjusted EBITDA* growth		6.1%	22.2%	(14.6%)	(39.6%)	110.5%	11.7%	(4.4%)	42.0%	59.9%
Value Creation*										
Return on assets (ROA)	33.8%	17.7%	17.8%	15.5%	10.5%	9.6%	10.5%	10.5%	14.3%	20.2%
Return on common equity (ROE) ⁽¹⁾	99.2%	62.8%	57.3%	45.3%	27.7%	21.8%	23.1%	23.1%	26.3%	33.7%
Return on capital employed (ROCE) ⁽²⁾	64.4%	34.7%	28.7%	25.8%	19.1%	18.3%	16.6%	16.6%	19.2%	28.1%
Return on invested capital (ROIC) ⁽³⁾	105.8%	72.5%	60.8%	54.6%	39.9%	38.9%	39.9%	39.9%	38.7%	46.3%
Efficiency										
Inventory turnover	10.8	14.6	11.5	10.7	16.1	12.1	13.6	13.6	17.1	20.4
Trade receivables collection (days)	41.7	26.7	38.0	38.1	78.6	59.3	63.5	63.5	61.0	43.4
Trade payables settlement (days)	135.4	73.4	63.5	40.9	66.0	58.5	45.3	45.3	41.4	31.8
Days sales in cash	10.6	1.6	2.3	2.4	2.7	26.3	39.9	33.0	50.5	94.8
Purchase/sales	62.3%	81.8%	72.3%	69.0%	70.5%	69.6%	80.4%	71.9%	71.5%	72.3%
Capital structure										
Total (interest-bearing) debt/assets	27.1%	32.6%	33.2%	33.1%	29.8%	18.2%	16.9%	16.9%	16.5%	18.3%
Long-term debt/equity	74.9%	75.8%	27.8%	24.7%	22.2%	10.5%	16.8%	16.8%	17.7%	22.0%
Total debt/equity	79.7%	129.5%	91.4%	85.6%	76.1%	31.0%	29.9%	29.9%	28.0%	29.4%
Interest-paying debt/total liabilities	41.1%	43.6%	52.0%	54.0%	49.0%	43.9%	38.9%	38.9%	40.4%	48.5%
Liquidity										
Current ratio	0.59	0.42	0.70	0.82	0.90	1.42	1.52	1.52	1.94	2.52
Quick ratio	0.47	0.24	0.55	0.70	0.80	1.31	1.37	1.37	1.73	2.29
Times interest earned	93.9x	10.6x	9.6x	8.2x	10.6x	11.7x	5.9x	9.0x	13.1x	18.5x

Source: Griffen-Rose. *Calculations exclude financing expenses paid for in stock and (1) deemed preferred dividends. (2) The sum of net income plus after tax interest expense, divided by the sum of net working capital plus net fixed assets. (3) Earnings before interest, tax, depreciation & amortization divided by long-term debt and total shareholders' equity.

Table 18. Infosmart Group, Inc. – Summary of Key Metrics

I. EV Calculation (in millions except per share data)		III. Income Statement Summary (in millions)			IV. Working Capital Mgmt & Liquidity		
Analysis price (cents)	54.6	Revenues	2006e	\$25.4	Trade receivables (days)	MRQ	68
Current price (cents)	30.0		2007e	\$34.1	Inventory held (days)	MRQ	14
TTM high	125.0		2008e	\$52.4	Trade payables (days)	MRQ	46
TTM low	22.0	EBIT*	2006e	\$5.3	Current ratio	MRQ	1.4x
Basic shares outstanding (common)	134.4		2007e	\$7.5	Times interest earned	MRQ	11.7x
Market value (common)	\$40.3		2008e	\$12.8	Long-term debt/equity	MRQ	10.5%
Stock equiv. pref. & options out.	57.3	EBITDA*	2006e	\$7.1	NWC/revenue	MRQx4	12.5%
Market value (warrants/options)	\$17.2		2007e	\$10.0			
Adjusted market value	\$57.5		2008e	\$16.0			
Less: cash	\$2.2	EBITDA*-Capex	2006e	\$2.4	V. Value Creation Statistics		
Plus: debt & other loans	\$6.6		2007e	\$2.4	Return on equity:	2005	57.3%
Plus: minority interest	\$(0.0)		2008e	\$8.2		2006e*	23.1%
Enterprise value	\$62.0	Net income*	2006e	\$3.1		2007e	26.3%
			2007e	\$5.4	Return on assets:	2005	17.8%
			2008E	\$9.7		2006e*	10.5%
			3yr High	\$4.2		2007e	14.3%
		Net income (common)*	2006e	\$3.0		2008e	20.2%
			2007e	\$5.2	Return on invested capital:	2005	60.8%
			2008e	\$9.7		2006e*	39.9%
		EPS (cents)*	2006e	2.5		2007e	38.7%
			2007e	3.5		2008e	46.3%
			2008e	5.3			
		EBIT* margin	2006e	21%	VI. Valuation Information		
			2007e	22%	P/E:	P/2005 Earnings	9.6x
			2008e	24%		P/2006e Earnings*	13.7x
		EBITDA* margin	2006e	28%		P/2007e Earnings	11.1x
			2007e	29%		Adj. P/2006e Earnings*	18.7x
			2008e	31%		Adj. P/2007e Earnings	10.7x
		EBITDA*-Capex margin	2006e	-1%	BV:	P/Book	2.6x
			2007e	7%		Adj. P/Book	3.1x
			2008e	16%	EV:	EV/IC	2.5x
		Net income* margin	2006e	12%		EV/Assets	2.0x
			2007e	16%		EV/2006e EBIT*	11.7x
			2008e	19%		EV/2007e EBIT	8.3x
			3yr High	31%		EV/2006e EBITDA*	8.8x
						EV/2007e EBITDA	6.2x
Dividend per common share	-						

Source: Griffen-Rose. *Calculation excludes one-off expenses associated with reverse merger and recapitalization in 2006. Net income to Common and EPS excludes deemed preferred dividends.

Table 19. Infosmart Group, Inc. – Selected Industry Group Performance and Valuation Metrics

	Median	Mean	High	Low	IFSG	IMN	MBI	MMHB	2323	2349	2396	2406	2443	3142	8053
Trailing 12 Month Data															
Revenue*	\$284.2	\$464.3	\$1,584.7	\$26.2	\$26.2	\$1,584.7	\$373.3	\$285.9	\$1,019.6	\$941.8	\$257.7	\$54.5	\$162.0	\$117.3	\$284.2
Revenue growth	10.8%	8.5%	49.1%	(19.1%)	49.1%	26.0%	30.0%	14.4%	10.8%	30.4%	(19.1%)	(13.2%)	(11.3%)	(13.1%)	(10.0%)
Gross margin	4.9%	3.7%	26.9%	(20.0%)	26.9%	21.7%	na	na	12.9%	8.6%	(5.3%)	(11.2%)	4.9%	(20.0%)	(4.8%)
EBITDA margin	10.3%	10.2%	23.1%	(11.4%)	16.4%	10.0%	20.7%	23.1%	21.7%	16.8%	1.7%	(4.0%)	6.7%	(11.4%)	10.3%
EBIT margin	(5.9%)	(9.8%)	11.4%	(40.2%)	9.3%	7.6%	1.6%	11.4%	1.1%	(5.9%)	(31.0%)	(35.5%)	(8.8%)	(40.2%)	(17.7%)
Net profit margin	(7.6%)	(13.3%)	7.2%	(45.8%)	3.8%	4.8%	(0.4%)	7.2%	(1.2%)	(7.6%)	(45.6%)	(35.4%)	(8.7%)	(45.8%)	(17.5%)
3yr avg. net margin	4.8%	2.5%	20.7%	(11.0%)	20.7%	4.8%	8.6%	7.2%	5.6%	(10.4%)	(8.8%)	(11.0%)	(3.5%)	(0.9%)	15.2%
Current ratio	1.2x	1.4x	2.2x	0.8x	1.4x	2.2x	2.0x	2.0x	1.1x	1.2x	1.0x	1.8x	0.9x	1.1x	0.8x
Long term debt/equity	33.3%	61.1%	271.1%	0.0%	10.5%	0.0%	64.4%	116.5%	42.0%	33.3%	63.0%	24.9%	14.9%	271.1%	31.1%
Inventory turnover	6.3x	8.3x	22.3x	2.7x	16.6x	6.3x	na	22.3x	6.3x	4.1x	4.5x	4.2x	6.4x	9.7x	2.7x
Net fixed asset turnover	0.6x	1.5x	8.5x	0.4x		8.5x	0.7x	1.5x	0.5x	0.6x	0.4x	0.6x	1.1x	0.5x	0.7x
Valuation Metrics															
Enterprise value*	\$368.9	\$608.9	\$1,671.3	\$62.0	\$62.0	\$1,268.2	\$1,197.3	\$269.4	\$1,671.3	\$950.9	\$465.2	\$77.7	\$145.8	\$220.5	\$368.9
Market value*	\$142.8	\$417.1	\$1,520.7	\$9.6	\$39.0	\$1,520.7	\$891.0	\$36.5	\$1,006.8	\$588.1	\$142.8	\$59.3	\$95.3	\$9.6	\$199.0
Price/Sales	0.7x	0.9x	2.4x	0.1x	1.5x	1.0x	2.4x	0.1x	1.0x	0.6x	0.5x	1.1x	0.6x	0.1x	0.7x
Price/EBIT	16.1x	54.4x	148.3x	1.1x	16.1x	12.7x	148.3x	1.1x	94.0x	nc	nc	nc	nc	nc	nc
Price/EBITDA	9.0x	11.1x	33.5x	3.7x	9.1x	10.4x	11.6x	na	4.6x	3.7x	33.5x	NC	8.8x	NC	6.8x
P/Earnings	19.9x	20.1x	38.7x	1.8x	38.7x	19.9x	nc	1.8x	nc	nc	nc	nc	nc	nc	nc
Price/Tangible book	0.7x	1.0x	2.6x	0.3x	2.6x	1.5x	1.3x	0.3x	0.7x	0.5x	na	0.5x	0.5x	0.6x	1.0x
EV/Sales	1.4x	1.6x	3.2x	0.8x	2.4x	0.8x	3.2x	0.9x	1.6x	1.0x	1.8x	1.4x	0.9x	1.9x	1.3x
EV/EBITDA	13.1x	23.5x	109.2x	6.0x	14.4x	8.7x	15.5x	na	7.6x	6.0x	109.2x	nc	13.5x	nc	12.7x
EV/EBIT	25.5x	79.9x	199.2x	8.3x	25.5x	10.6x	199.2x	8.3x	156.1x	nc	nc	nc	nc	nc	nc
EV/Invested capital	1.0x	1.2x	2.7x	0.5x	2.7x	1.9x	1.7x	0.9x	0.8x	0.5x	0.8x	0.7x	1.1x	1.0x	1.0x

Ticker	Company	Country	Ticker	Company	Country	Ticker	Company	Country	Ticker	Company	Country
IFSG	Infosmart	U.S.	MMHB	Megan Meida	Malaysia	2396	Prodisc	Taiwan	3142	Optodisc	Taiwan
IMN	Imation	U.S.	2323	CMC Magnetics	Taiwan	2406	Gigastorage	Taiwan	8053	Princo	Taiwan
MBI	Moser Baer	India	2349	Ritek	Taiwan	2443	Lead Data	Taiwan			

Source: Bloomberg, Griffen-Rose *In millions of dollars.

Table 20. Infosmart Group, Inc. – Summary of Discounted Cash Flow Forecast Assumptions

Projections	2003	2004	2005	2006e	2007e	2008e	2009e	2010e	2011e	2012e	2013e
Sales growth	nm	80.2%	9.6%	3.2%	34.3%	53.8%	25.0%	17.5%	10.0%	7.5%	7.5%
Core EBIT margin	33.8%	15.2%	23.2%	19.5%	20.2%	22.7%	22.4%	21.4%	20.4%	19.4%	18.4%
HK contribution to EBIT	100.0%	100.0%	100.0%	100.9%	34.3%	65.5%	50.0%	50.0%	50.0%	50.0%	50.0%
Brazil contribution to EBIT	0.0%	0.0%	0.0%	-0.9%	65.7%	34.5%	50.0%	50.0%	50.0%	50.0%	50.0%
Effective tax rate	16.1%	19.6%	18.5%	39.7%	22.4%	20.1%	20.1%	20.1%	20.1%	20.1%	20.1%
Statutory tax rate	16.0%	17.5%	17.5%	17.5%	22.4%	20.1%	20.1%	20.1%	20.1%	20.1%	20.1%
WC/sales	4.0%	-2.7%	14.9%	35.8%	24.8%	17.5%	17.5%	17.5%	17.5%	17.5%	17.5%
Gross PPE/sales	75.7%	95.9%	93.7%	108.7%	103.4%	82.1%	79.8%	78.7%	78.1%	77.6%	77.1%
Expected cost of borrowing				7.7%	8.5%	9.2%	9.3%	9.3%	9.3%	9.3%	9.3%
Income Statement	2003	2004	2005	2006e	2007e	2008e	2009e	2010e	2011e	2012e	2013e
Net sales	12.4	22.4	24.6	25.4	34.1	52.4	65.5	77.0	84.7	91.0	97.8
Core EBIT	4.2	3.4	5.7	4.9	6.9	11.9	14.7	16.5	17.3	17.7	18.0
Pro forma NOPAT	3.5	2.7	4.7	3.0	5.4	9.5	11.7	13.2	13.8	14.1	14.4
Balance Sheet	2003	2004	2005	2006e	2007e	2008e	2009e	2010e	2011e	2012e	2013e
Net working capital (excl STD)	0.5	-0.6	3.7	9.1	8.5	9.2	11.5	13.5	14.8	15.9	17.1
Gross PPE	9.4	21.5	23.0	27.6	35.2	43.0	52.3	60.6	66.1	70.6	75.4
Cumulative depreciation	1.0	3.0	4.7	6.5	9.1	12.5	16.2	20.8	26.1	31.8	38.0

Source: Company, Griffen-Rose.

Table 21. Infosmart Group, Inc. – Discounted Cash Flows to Equity

FCF (\$, million)	2003	2004	2005	2006e	2007e	2008e	2009e	2010e	2011e	2012e	2013e
NOPAT	3.5	2.7	4.7	3.0	5.4	9.5	11.7	13.2	13.8	14.1	14.4
+Depreciation	1.0	2.0	1.7	1.7	2.6	3.3	3.8	4.6	5.3	5.8	6.2
-Increase in working capital	-0.5	1.1	-4.3	-5.4	0.6	-0.7	-2.3	-2.0	-1.3	-1.1	-1.2
-CapEx	-4.6	-3.7	-1.5	-4.7	-7.7	-7.8	-9.3	-8.3	-5.5	-4.5	-4.8
+Deferred taxes	0.8	0.7	1.0	0.9	1.2	1.2	-1.1	-1.1	-1.1	-1.1	-1.1
-Cash preferred dividends	0.0	0.0	0.0	0.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Free cash flows	0.2	2.8	1.6	-4.8	2.0	5.4	2.8	6.3	11.1	13.1	13.4
2007 Industry median multiples:										Terminal Value	
EV/Sales				1.4x							141.0
EV/EBITDA				12.9x							313.1
EV/EBIT				25.5x							460.0
EV/Capital employed				1.0x							54.1
Average of terminal values											242.0
Minus debt											-29.6
Equity terminal value											212.4
Present values of FCF & TV (million)					1.7	4.0	1.8	3.4	5.1	5.2	77.0
Sum of PVs of FCF & TV (million)					\$98.1						
Cost of Equity Calculation					2007e	2008e	2009e	2010e	2011e	2012e	2013e
Adjusted CAPM approach:											
10-year US Treasury					4.8%	4.8%	4.8%	4.8%	4.8%	4.8%	4.8%
Country risk premium - Hong Kong*				5.8%	2.0%	3.8%	2.9%	2.9%	2.9%	2.9%	2.9%
Country risk premium - Brazil*				8.7%	5.7%	3.0%	4.3%	4.3%	4.3%	4.3%	4.3%
Small stock premium					4.6%	4.6%	4.6%	4.6%	4.6%	4.6%	4.6%
Cost of equity					17.1%	16.2%	16.6%	16.6%	16.6%	16.6%	16.6%
Average cost of equity					16.6%	*Adjusted for contribution to Group EBIT					
Bond yield + risk premium approach:											
10-year US Treasury					4.8%	Industry median unlevered Beta					0.73
Levered beta					0.90	Levered IFSG beta					0.90
Market risk premium					7.0%	Industry median unlevered cost of equity					10.3%
Small stock premium					4.6%	Industry median levered cost equity (@72.5% D/E)					17.0%
Cost of equity (kE)					15.7%						

Source: Bloomberg, Griffen-Rose.

Table 22. Infosmart Group, Inc. – Discount Cash Flows to Debt and Summary

Optimal Capital Structure		2003	2004	2005	2006e						
Sales		12.4	22.4	24.6	25.4						
EBIT		4.2	3.4	5.7	4.9	Average	STDEV	EBITRWC Margin			
EBIT margin		33.8%	15.2%	23.2%	19.5%	22.9%	8.0%	7.0%			
Coverage ratio		2.5									
Interest covered (% of revenues)		2.8%									
Average borrowing costs, 2007-2013		9.1%									
Maximum feasible debt, 2007e (million)		\$10.4									
Optimal Capital Structure											
Debt (million)		\$10.4									
Equity (million)		\$34.3									
Enterprise value (million)		\$44.8		Based on current shares outstanding							
Debt/equity		30.4%									
Tax Shield FCF					2007e	2008e	2009e	2010e	2011e	2012e	2013e
Interest					0.5	0.6	1.8	2.2	2.4	2.5	2.7
Tax shield					0.1	0.1	0.4	0.4	0.5	0.5	0.6
TV of tax shield											5.9
PVs of tax shield (discounted at rD)					0.1	0.1	0.3	0.3	0.3	0.3	3.5
Sum of present values					5.0						
Summary											
Present value of equity FCF		\$98.1			Current	Diluted					
Present value of tax shield FCF		\$5.0		Shares (millions)	134.4	191.7					
Value of equity		\$103.1		Price/share	\$0.77	\$0.54					

Source: Griffen-Rose.

Table 23. Infosmart Group, Inc. – Valuation Stresses

Implied Present Value of Free Cash Flow per Share Stresses

Price/Share (191.7m shares)			Cost of Equity					
		\$0.54	15.1%	15.6%	16.1%	16.6%	18.6%	20.6%
Terminal Value Adjustment	-30%	-30.0%	0.46	0.45	0.44	0.42	0.38	0.35
	-20%	-20.0%	0.50	0.49	0.47	0.46	0.42	0.38
	-10%	-10.0%	0.54	0.53	0.51	0.50	0.45	0.41
	-	0.0%	0.58	0.57	0.55	0.54	0.49	0.44
	+10%	10.0%	0.62	0.61	0.59	0.58	0.52	0.47
	+20%	20.0%	0.66	0.65	0.63	0.61	0.55	0.50
	+30%	30.0%	0.71	0.69	0.67	0.65	0.59	0.53

Price/Share (191.7m shares)			Cost of Equity					
		\$0.54	15.1%	15.6%	16.1%	16.6%	18.6%	20.6%
FCF Adjustment	-30%	-30.0%	0.54	0.52	0.51	0.50	0.45	0.40
	-20%	-20.0%	0.55	0.54	0.52	0.51	0.46	0.42
	-10%	-10.0%	0.57	0.55	0.54	0.52	0.47	0.43
	-	0.0%	0.58	0.57	0.55	0.54	0.49	0.44
	+10%	10.0%	0.60	0.58	0.57	0.55	0.50	0.45
	+20%	20.0%	0.61	0.59	0.58	0.56	0.51	0.46
	+30%	30.0%	0.62	0.61	0.59	0.58	0.52	0.47

Price/Share (191.7m shares) @kE 16.6%			FCF Adjustment					
		\$0.54	-30.0%	-20.0%	-10.0%	0.0%	10.0%	20.0%
Terminal Value Adjustment	-30%	-30.0%	0.38	0.40	0.41	0.42	0.44	0.45
	-20%	-20.0%	0.42	0.44	0.45	0.46	0.48	0.49
	-10%	-10.0%	0.46	0.47	0.49	0.50	0.51	0.53
	-	0.0%	0.50	0.51	0.52	0.54	0.55	0.56
	+10%	10.0%	0.54	0.55	0.56	0.58	0.59	0.60
	+20%	20.0%	0.57	0.59	0.60	0.61	0.63	0.64
	+30%	30.0%	0.61	0.62	0.64	0.65	0.66	0.68

Source: Griffen-Rose.

Table 24: Total Music Sales by Market in 2005 (Physical* & Digital, millions)

		Trade Revenues 2005				Retail Value 2005		
		U.S.\$	Local Currency	% Change	% Digital	U.S.\$	Local Currency	
1	U.S.	7,012	USD	7,012	-3%	9%	12,269	12,269
2	Japan	3,718	JPY	409,845	1%	7%	5,448	600,497
3	U.K.	2,162	GBP	1,189	-3%	3%	3,446	1,895
4	Germany	1,457	EUR	1,166	0%	3%	2,211	1,769
5	France	1,248	EUR	999	-2%	2%	1,990	1,592
6	Canada	544	CAD	659	-3%	3%	732	886
7	Australia	440	AUD	576	-10%	2%	674	883
8	Italy	428	EUR	343	0%	4%	669	535
9	Spain	369	EUR	295	-5%	1%	555	444
10	Brazil	265	BRL	645	-12%	1%	394	958
	Other	3,150					5,068	
	Total	20,795			-3%	5%	33,456	

Source: IFPI. *CD sales make up 98% of Brazil's music sales in physical format; cassettes make up the remainder.

Table 25: DVDR, HD DVDR and BDR Media Compared

Media	Single layer capacity			Dual layer capacity		
	DVDR	HD DVDR	BDR	DVDR	HD DVDR	BDR
Physical size						
12 cm, single-sided	4.7 GB	15 GB	25 GB	8.5 GB	30 GB	50 GB
Video storage						
SD @ MPEG-2	2 hrs	7 hrs	11.5 hrs	4 hrs	14 hrs	23 hrs
HD @ MPEG-2		2 hrs 40 mins	4 hrs 30 mins		5 hrs 25 mins	9 hrs
U.S. retail price/disc	\$0.28 (50-pack cake box) \$1.17 (6-pack in clamshell case)	\$18 (single disc in jewel case)**	\$20 (single disc in jewel case)*	\$1.95 (20-pack cake box) \$3.33 (3-pack in jewel case)	na***	\$48
Price/MB (cents)	6.0-24.8	120	80	22.9-39.2	na	90
Pre-recorded media (home entertainment)	\$13+	\$20+	\$20+	\$10-\$20	\$20-\$30	NA

Source: Griffen-Rose. *Sony, Philips, TDK, Memorex. **Ritek, Verbatim (NEC). ***On June 6, 2006, Verbatim announced it would begin manufacturing these from June 2006.

Table 26: DVD, HD DVD and Blu-ray Hardware Compared

Hardware	DVD	HD DVD	BD
Player data transfer rate (data)	21.6 Mbps	36.6 Mbps	36.6 Mbps
Data transfer rate (video/audio)		36.6 Mbps	54.0 Mbps
Write drives (PC)	\$31+	NA	At least \$750
Player price	\$55+	\$200 (X-Box 360), otherwise at least \$400	At least \$600

Source: Griffen-Rose.

Table 27: Summary of Key Differences between HD DVD and Blu-ray

	BD	HD DVD
Hardware support	Sony hardware support. A Blu-ray disc (BD) read only drive is incorporated in the PlayStation 3 and Sony's BD player. BDR drives offered in e.g. Sony, Dell & Hewlett Packard PCs. Players launched in 2006 from e.g. Samsung, Panasonic, Philips, Pioneer, LiteOn, Plextor are largely backward compatible with DVDs & sometimes also CDs.	Microsoft X-box 360 has an optional external HD DVD drive. Microsoft may include an internal HD DVD drive in a new generation of Xbox 360s. HD DVD ROM drives available in e.g. Hewlett Packard, Toshiba, and Fujitsu PCs. All players & drives backward compatible with DVDs and CDs. Players available from e.g. Toshiba, LG, RCA.
Major media support	Buena Vista Home Entertainment; Warner Bros; Paramount Pictures; MGM Studios; 20th Century Fox; Sony Pictures Entertainment (Columbia); The Walt Disney Company; Vivendi Universal Games; Electronic Arts.	Buena Vista Home Entertainment; Warner Bros.; Paramount Pictures; Universal Studios; New Line Cinema; The Weinstein Co.; Studio Canal.
Primary Backers	Sony, Philips.	Toshiba, Microsoft, Intel.
Alliances	The Blu-ray Disc Association developed the BD standard and was founded in 2002. The Association has over 170 members. Its Board of Directors consists of representatives from Apple, Dell, Hewlett Packard, Hitachi, LG Electronics, Mitsubishi Electric, Panasonic (Matsushita Electric), Pioneer, Philips, Samsung, Sharp, Sony, Sun Microsystems, TDK, Thomson, Twentieth Century Fox, Walt Disney, and Warner Bros. Many Association members also back HD DVD.	HD DVD was initially proposed in 2002 by Toshiba and NEC and later adopted by the DVD Forum in Nov. 2003. The DVD Forum is an alliance of over 230 manufacturers founded in 1995 by Hitachi, Panasonic (Matsushita Electric), Mitsubishi Electric, Pioneer, Philips Electronics, Sony, Thomson, Time Warner, Toshiba and JVC. Many Forum members back BD.
# of movies released as of November 27, 2006	131 titles in the U.S. and worldwide; 186 planned in the U.S. for remainder of 2006 & 2007.	170 titles worldwide, of which 118 in the U.S. and 52 in Japan; 222 planned for remainder of 2006 & 2007 of which 196 in the U.S. and 26 in Japan.
Supported by the adult entertainment industry?	Yes.	Yes.

Source: Griffen-Rose.

Appendix - Background Information

9.0. DVD+R Manufacturing Industry

9.1. Note on DVD discs

DVD write-once formats:

DVD-R
DVD+R

DVD rewritable formats:

DVD-RW
DVD+RW
DVD-RAM

DVD recordable and DVD rewritable refer to DVD optical disc formats that can be recorded (written, "burned"), either once or multiple times by laser. DVD recordable is a general term that refers to both write-once and rewritable formats, whereas DVD rewritable refers only to rewritable formats. The write-once formats are favored by licit and illicit content replicators. In comparison, the DVD-ROM is mass-produced by pressing and is usually used for original content; the end user cannot write on it.

Like writable compact discs (CD-Rs), DVD recordable uses dyes. Depending on the intensity of the laser, the reflective property of the dye on a particular spot will determine whether it is a peak or a valley representation from pressed DVD. The dyes give the disc those distinct colors on the shiny side. Dyes are also the reason playback is not guaranteed. Their reflective properties are not as good as with stamped DVDs (DVD-ROMs) that commonly have aluminum as the reflective layer.

Recordable DVDs are divided into three incompatible camps:

- DVD-R/DVD-RW (DVD "dash"). First DVD recordable format released in the market. Developed by Pioneer and backed by the DVD Forum. Has broader playback compatibility than the "+" especially with much older players. The dash format is based on an older CD-R/RW format for easy upgrade or migration for disc manufacturers.
- DVD+R/DVD+RW (DVD "plus"). Developed by Philips and Sony with their DVD+RW Alliance, the "+" format came out after the "-" format. Most DVD writable drives today read and write both DVD-R and DVD+R discs.
- DVD-RAM. As RAM stands for Random Access Memory, it works more or less like a hard-drive and was designed for corporate back-up use. Can only be read in drives that are DVD-RAM compatible. DVD Forum backs this format.

9.2. Types of DVD-/+R Manufacturers

There are two types of DVD-/+R manufacturers:

- Technology developers, such as TDK, Sony and Maxell. These companies include engage in R&D by developing dyes, stampers and different production techniques. They participate in the intellectual property pool associated with DVD production and retain production and duplication capacity. Many smaller R&D/dye and stamper technology companies retain production capacity sufficient for technology testing.
- Technology recipients/volume manufacturers, such as Infosmart, CMC and Ritek. These firms undertake little if any R&D and instead tend to work with R&D/technology companies.

Infosmart's competitors are numerous and include companies such as CMC Magnetics and UME Disc Group. According to data from market research firm Fujiwara-Rothchild, Taiwanese DVDR makers have an aggregate of two thirds of the global market share for DVDR. The write once DVD industry is divided in to Tiers I and II companies, and the rest. The Tier I versus Tier II distinction is not scientific.

Tier I companies are "high quality high capacity manufacturers":

- **Quality.** These companies produce discs of a quality that can be marketed under the top brand names such as TDK, Maxell, and Sony. Sony and TDK are, among other things, intellectual property houses that maintain close relationships with the top quality volume producers; in a sense the latter can be seen as outsourced production partners for the former. Top quality producers maintain high production standards, which include, for example, the ISO 9001 standard. ISO 9001 specifies the design, development and implementation of a quality management system to improve various aspects of business processes, quality and customer service. The ISO 9001:2000, which Infosmart has, is the current version of the ISO 9001 standard. Top producers also deliver a consistently high quality product – inferior manufacturers, for instance, sometimes skimp on the PCB content of their discs or shortcut production processes in order to save on costs; as a result their discs may be prone to warping unacceptably quickly or have other fidelity drawbacks.
- **Capacity.** Tier I companies are among the top five or six manufacturers by volume. For the DVD-R market this translates into manufacturers with global market share of at least 9% (the top 5 firms have about 75% of the market). For the DVD+R market the top five distinction doesn't mean very much because it is a far more fragmented market and the top five have only about 20% of the market.

- Tier I firms also tend to have the largest R&D teams and large sales and marketing teams.

Tier II companies are “high quality lower capacity manufacturers with little or no R&D”. Some firms like Infosmart produce high quality products but have lower production capacity than their Tier I rivals, and fail to be considered as “Tier II”. In our classification, such firms should have at least 1% global market share by output volume.

Other firms have low quality/low capacity production and fail to be considered as Tier II.

The Tier I and Tier II firms all compete with each other on price, product, quality and delivery times. Weapons of war include distribution networks and channel partnerships. Battles are fought in wholesale and retail markets around the world. Competitor mix varies by territory. Many of the companies have non-optical disc product lines. For instance, Ritek also produces organic light-emitting diodes, CMC produces floppy discs and Princo produces optoelectronic equipment and coating services. Infosmart is a pure DVDR player.

9.3. Industry Background

CD-R (750 MB)

Optical storage media was first introduced by Philips in the 1980s. In the beginning, optical media was mainly used for distributing software and music, replacing audiocassettes and videotapes as the mainstream storage media. Due to its low cost, portability and high capacity, the use of optical media has extended to other areas such as games, movies and general data storage. The magneto tape cassette that was used for music was been replaced by compact disc (CD), which was jointly developed by Philips and Sony more than 10 years ago.

DVDR (4.7 GB)

With files now megabytes and gigabytes in size the 750 MB capacity offered by CDs is too small for many uses. For filmed home entertainment, the single layer digital versatile disc (SL DVD), which has 4.7 GB capacity and is therefore able to deliver high quality images and sound, is rapidly replacing CDs, VCDs and VHS media. SL DVD is now a mainstream portable storage medium for many types of electronic data. Dual layer (DL) DVD discs offer 8.5 GB capacity, representing an 80% improvement in capacity over the current 4.7 GB standard.

Infosmart’s main product is the once-writable DVD disc. These discs are purchased and primarily used by individuals or businesses as backup or storage media for digital files or for the casual or professional replication of entertainment content. Demand is therefore mainly driven by:

- The spread of digital devices enabled with or capable of being connected to writable DVD drives, such as PCs, digital cameras and camcorders and DVD player/recorders.
- The increasing quality, and therefore data file size, of the information recorded.
- The replacement of the VHS cassette by the DVD disc as the medium of choice for filmed home entertainment.

HD DVDR (15 GB, 30 GB)

The new generation of optical media discs in North America and some Pacific countries is of high definition (HD) quality. There are two types of high definition technologies, namely HD DVD and Blu-ray (BD). The HD DVD and BD formats are incompatible, and their adherents have failed to agree on a unified format. The demand for writable HD discs will be driven by trends similar to those that have driven demand for DVD – in particular the desire to record HD filmed entertainment and music and back up electronic data of ever increasing quality and therefore file size. Broadcasters and film studios are increasing their output of HD films and television programming as consumers replace their standard definition television sets and DVD players with HD units.

Today HDTV services are widely available in Japan, the U.S., Canada, South Korea and Australia. In the U.S., the transition process is supported by terrestrial and satellite broadcasters looking for a powerful tool to improve the “stickiness” of television and strengthen defenses against internet broadcasting; manufacturers seeking to market new products; and consumers seeking the highest quality affordable experience with high value content such as sport and movies. Today, 95% of all households in the U.S. can receive HDTV from at least one network broadcaster; and more than 85% can receive an HDTV signal from three or more network broadcasters. As consumers become accustomed to HDTV’s superior viewing experience, the demand for HD recording and media will follow.

Within the next 5-8 years we expect HDTV to be an established consumer format in North America and advanced Asian countries and certain parts of Western Europe. The high, albeit reducing, cost of HD compatible TV components means that uptake in absolute, rather than relative, terms will continue to be steady rather than spectacular.

The total number of HDTV households worldwide, which are defined as households that receive and watch HD programming on an HD-capable TV set, grew by 60% in 2005 (see <http://www.marketresearch.com>) and, according to Informa Telecoms and Media (ITM), a business intelligence firm, will exceed 36 million by the end of 2006. ITM predicts that by 2010 HD will be a niche premium offering in Europe, rather than a mass-market one. Take up in the key European

markets will be 10-15% of total households until market take off in the mid 2010s. Euroconsult, a consulting firm, has forecast more aggressively that 19% of European homes will have an HDTV in 2010, rising to 54% in 2014/5. Even by 2010, HD penetration in Europe will probably still lag well behind the levels reached in the U.S. and the market leading countries of Asia. The market for DVDRs is therefore likely to remain strong in Europe well after the U.S. and Japan have turned to HD recordable media.

Table 28. Projected Take up of HDTV

HD homes (millions)	2006	2008	2010
France	0.4	1.2	2.9
Germany	0.5	2.1	5.3
U.K.	0.2	0.9	2.7
Rest of Europe	0.2	1.9	3.9
Europe Total	1.3	6.1	14.8
U.S.	21	36.3	48.3
Asia	13.9	29.4	38.6
Global Total	36.2	71.8	101.7

Source: Informa Media & Telecoms.

If it will take 5-8 years for HDTV to become established in advanced countries, it will take longer for its penetration into developing countries, whose use of current optical disc media is likely to continue to expand for some time.

9.4. Global Demand and Supply in 2006

CD-Rs

U&S estimates that global CD-R production has been broadly flat in 2006 compared with 2005, with volumes at 10.5 billion and 10.4 billion units respectively. However during the first half of 2006 (1H06), the CD-R media manufacturing industry witnessed a sudden shortage of supply because manufacturers had cut back excessively in 2005 in response to low profit margins. Nearly all of the disc manufacturers ran lines at maximum capacity in 1H06 in order to meet demand. CD-R manufacturing has expanded to new countries. Remarkably, Thailand now produces 3% of global CD-R output equivalent to 190 million discs.

Unusual demand predominantly came from significant European vendors, which were worried about the possible imposition by the European Union of an anti-dumping duty against a number of key CD-R manufacturing countries in South East Asia. These vendors seemingly over-ordered to avoid any price rises should the duty be put in place, adding to short-term supply shortages.

Polycarbonate suppliers decreased pricing to the Asian CD-R manufacturing industry in Q2 due to a polycarbonate over-supply situation and a limited increase in optical grade polycarbonate demand from Asia. CD-R manufacturers are anticipating that the polycarbonate price will continue to decrease further in the second half of 2006, as result of further anticipated increases in optical grade polycarbonate supply. If the polycarbonate price continues to decrease, market prices for CD-R media are likely to soften by

the end of this year or early 2007, when stockpile demand is expected to cool off. At the same time, new CD-R investment may well cause another oversupply cycle again in the near future. Firms like Infosmart that have flexible production lines can easily switch between DVDR and CD-R production.

For the 2007-2008 outlook for CD-Rs, the reader is referred to the discussion under section 4 on page 10 of this report.

DVDRs

Table 29. DVD-/R Output – Approximate Breakdown by Region

	Output volume (MM)		Volume Growth	Global Market Share	
	2005	2006	2006	2005	2006
Taiwan	2,648	3,550	34%	52%	56%
Other Asia	1,395	1,955	40%	28%	31%
Japan	668	699	5%	13%	11%
W. Europe	293	128	-56%	6%	2%
Rest of World	51	64	27%	1%	1%
Total (MM units)	5,054	6,396	27%	100%	100%

Source: Understanding & Solutions.

U&S estimates that Global DVDR output has grown 27% this year and will reach 6.4 billion units, powered by surges in Taiwanese production (34% growth) and Asian production excluding Taiwan and Japan (40% growth). Western Europe is projected to have decreased DVDR production by 56% from 293 million discs in 2005 to roughly 128 million discs this year. Japan is projected to have actually increased production by 5%, from 668 million discs to about 699 million DVDRs. Japan's strong showing is a reminder that wholesale market transition to blue laser formats is likely to be gradual.

Due to the conversion of CD-R lines to DVDR in 2005, the DVDR manufacturing industry continued to experience some overcapacity in the first months of 2006. Although new capacity has been added this year, this has largely been in the form of upgrading CD-R lines to DVDR production. Some manufacturers like Infosmart have converted DVDR capacity back to CD-R due to the CD-R supply shortage that began in December 2005.

Table 30. Actual and Projected Global DVD-/R Output by Type

	2004	2005	2006*	2007	2008	2009
DVD-R	1,489	3,039	3,594	4,769	5,463	6,019
DVD+R	993	2,015	2,802	3,682	4,320	4,655
Total	2,482	5,054	6,396	8,451	9,783	10,674
Growth	248%	104%	27%	32%	16%	9%

Source: Understanding & Solutions.

*Projections are from 2006 onwards.

Demand for higher speed DVDR media has increased steadily but there has been an oversupply situation overall for DVDR. Optodisc Technology and Prodisc Technology, facing financial pressures, eagerly competed for orders of 8x DVD+R/-R discs by lowering OEM quotations from \$0.15 to \$0.12 per disc. However, CMC Magnetics and Ritek, the top two makers of optical discs in Taiwan, indicated that their production capacities were booked up

and that they would not reduce OEM prices; this helped to stabilize 8x DVDR prices. Since Q4 last year, first-tier manufacturers have been running at 90-95% of their capacity for 16x DVD+R/-R. A large portion of DVD+R/-R discs produced by CMC and Ritek is for 16x speed, with present OEM prices ranging between \$0.18 and \$0.22 a disc. The increased 16x DVDR output caused price erosion from Q1 of this year.

With the growth in demand for higher speed discs, it is possible that there could be more investment in new dedicated DVDR lines from the first quarter of 2007 as many older CD-R lines that have been converted to DVDR are unable to manufacture the higher speed media. Many manufacturers in the second tier and below still have difficulty in producing 16x DVDR, so this is currently providing a positive business environment for the large manufacturers in both price and demand terms. The diminishing European manufacturing market is likely to provide further opportunities for Asia manufacturers in the near future.

For the 2007-2008 outlook for DVDRs, the reader is referred to the discussion under section 4 on page 10 of this report.

9.5. Why DVD is not Going Away Soon

Although optical media discs compete with other electronic storage media (see Table 31), they are cheap and established, and offer the best balance of portability, capacity, ease of use and cost for transporting and storing a broad range of data. Hardware platforms that make use of these discs, such as computers and entertainment recording and playing devices, are ubiquitous in advanced economies and selling rapidly in developing economies. The need for discs will remain for many years to come, although demand shifts can be expected. The advent of MP3 players and online downloads is beginning to erode the use of optical discs for music and computer software use in developed markets, but DVDs remain the medium of choice for filmed entertainment products, a role which will be enhanced as studios expand their output of high definition content, especially where bandwidth limitations are severe.

Demand Drivers for DVDR Hardware

DVD writer sales continue to grow strongly. The market dynamics are:

- The growth of DVD readers for movie watching has reached all facets of the market and is fast becoming the global technology of choice. The addition of DVD-Recorders in Personal Video Recorders (PVRs) is set to fuel a new application base for DVD writers and DVDR discs. DVD writers are under \$200 in PVRs where DVD is the primary storage technology, and under \$400 as the secondary storage with hard-drives. Most PVR users prefer the advantages of a hard-drive for content capture, but see the need for archiving to DVDR discs. DVD writers in PVR applications, whether it be a set-top or PC-based appliance, are likely to prove popular.
- DVD writers as backup storage for computers are a necessity in case of hard disc failure. Blue laser discs will enhance this.

Storing digital images has also become a requirement as digital cameras increase resolution and users build large libraries of images. However optical discs are losing the popular audio storage market because of the lack of DVD-audio handheld devices with form factors to match encroaching flash memory and hard-drive players.

- Emerging blue laser and HD formats have begun their campaign to challenge DVD/R capacities. Increasing demands of storage and the need to archive content may mean that high density formats ramp up sales even faster than DVD writers.

Demand Spreading to Emerging Markets

The explosive growth in the market for compact discs after their introduction in 1982/3 has led many to overestimate the speed with which new technology is sometimes adopted or current technology abandoned. Rates of technology adoption are as variable within OECD countries as they are between OECD and developing countries. Using internet penetration as an example, 29% of Denmark's population access the internet through a broadband subscription, compared with about 3% in Greece (OECD, June 2006); 14% of Brazil's population has internet access, compared with 43% in Chile and 70% in the U.S. Technology maybe mature in one territory but youthful in another, presenting growth opportunities for energetic firms ready to reapply well worn skills and trusted production techniques to a fresh cycle in the life of a familiar product. The value of such opportunities is further enhanced when, as in the case of Infosmart, the firm can generate additional returns while minimizing the incremental investment required.

Poverty and infrastructural issues explain why some countries lag others in adopting electronic technologies. For example, where electricity supply is unavailable, intermittent or unreliable, a battery powered CD player may be preferable to a device that directly or indirectly requires a mains electricity supply. In developing markets, CD and DVD players are far more affordable than MP3 players and entertainment hardware based on USB drives, flash memory or hard discs. Asian manufacturers using depreciated legacy equipment and low-cost labor can supply middle-class consumers in developing countries with optical disc players at locally acceptable prices. Demand for optical disc devices in developing markets is also supported by their lower network adoption costs compared with fixed memory alternatives. CD and DVD players depend on items such as televisions and headphones that are already owned or easily affordable by the consumer; MP3 players usually require PC ownership in addition to these items. Retail prices of music and movies pre-recorded on optical discs have been falling rapidly in developing markets, driven in particular by strong sales of low cost pirated material.

In developed countries, where CDs are being displaced by fixed storage devices, not by DVDs, optical discs are losing the handheld audio market. This process will also eventually affect CD sales in developing markets. Until then, in practical terms, the standard digital products available to consumers in developing parts of the world - that is most people in the world, given the huge populations of China (1.3 billion), India, Pakistan and

Bangladesh (1.4 billion), Africa (915 million) South America (370 million), Indonesia (200 million) – who want to buy movies or music for personal enjoyment are pre-recorded optical discs and the devices that play them. This will not change in the immediate future.

Growth in global optical disc markets will therefore be driven by two engines in the coming decade: developed market adoption of HD DVD and Blu-ray and developing market adoption of CDs and DVDs (and, much later, HD DVD and Blu-ray).

Storage Media Characteristics

Optical storage media, hard discs, USB drives and flash memory are the most commonly used computer storage media. Hard discs have up to 500 GB of capacity, cost around \$0.75/GB and are the most economical choice for large storage needs. However the hard disc is less versatile, more fragile and harder to install than optical storage media; it is also bulky and has poor portability.

Both USB drives and flash memory are compact in size, provide great portability and reusability, but are relatively expensive (\$70-100/GB) and have limited storage capacity (maximum only 1-2 GB). These devices are mainly used to store computer and music/home video files where portability is required. Floppy disc capacity is too small for multimedia or today's software files.

Table 31. Optical Media Types, January 2007

Product	Media Type	Storage Capacity	Retail Unit Price	Price per MB
Floppy Disc	Non- optical	1.44 MB	\$0.30	20.8
USB Drive	Non- optical	128 MB-4 GB	\$14-\$62	1.6-10.9
Hard Disc	Non- optical	250 GB-500 GB	\$80-\$280	0.03-0.06
CD-R	Optical	700 MB	\$0.16	0.02
DVD±R*	Optical	4.7 GB	\$0.28	0.01
DL DVD±R*	Optical	8.5 GB	\$1.63	0.02
HD DVDR**	Optical	15 GB	\$11.36	0.08
Blu-ray	Optical	25 GB	\$12.69	0.05

Source: Griffen-Rose.

For full movies or computer file backups, CD-R and DVDR offer large (from 750 MB to 9.4 GB) and economical (from \$0.18 to \$0.80 per disc) storage solutions. Rewritable DVD±RW discs are reusable but more expensive, and therefore less popular, than write-once DVD±R discs. HD DVD and Blu-ray represent the next optical media generation.

10.0. Why Blu-ray is not Necessarily a Mortal Threat

10.1. A False Contest?

The mass-market for recordable HD media has yet to arrive. Consumer recordable HD DVD drives have yet to be launched in the U.S. although, incongruously, 15 MB (but not 30 MB) HD DVDRs are available. Writable BD drives cost at least \$750 and are therefore not mass-market items. For investors in recordable

media manufacturers like Infosmart, the issue is whether the coming potential market, not the current market, for HD DVDR media will be negatively impacted by developments in the markets for prerecorded BD and HD DVD film and gaming media targeted at domestic audiences.

Games consoles tend to drive early adoption of technology because hardcore gamers, keen to get their hands on the latest titles, are prepared to buy the latest technology. Infosmart is currently aligned with HD DVD. There are three possible scenarios at the end of this format war:

- 1) One format will finally overtake the other;
- 2) Two different formats co-exist in the market; or
- 3) Combo players/drives/recorders which can support both formats will be widely adopted.

Option 3 would be compatible with options 1 or 2. The argument runs that it is difficult for optical media of two incompatible formats to co-exist in the market as that would force duplication in both hardware and down-stream products such as high definition video, audio and multimedia. In the long run, it would be uneconomical for movie studios and recording companies to keep producing two different formats for distribution.

A counter argument is that the wide adoption of a combo player/drive/recorder can help the consumers enjoy multimedia in both formats; any studio, if it wished, could adopt a single format for all its content. Combo players and pc drives machines are now being marketed – the first, LG's BH100 player and GGW-H10N drive, have been launched in January 2007. At current prices, these devices are not yet mass-market units but their prices will almost certainly fall. Combo drives are likely to make hardware manufacturers neutral between the two formats and encourage consumer adoption of HD technology generally.

10.2. Quality and Capacity

Theoretically, the greater capacity and data transfer rates for Blu-ray should allow movie studios to release their movies with higher quality video and audio than the HD DVD format.

On the quality issue, reports to date show that consumers experience the two formats as virtually identical – if anything, the HD DVD experience seems to be preferred. A report compiled by independent market analytics firm Cymfony scoured over 17,664 postings on various media sites, tech blogs and message forums over October and November 2006, and found that Blu-ray lagged far behind HD DVD in positive opinion. The research was not sponsored by any manufacturer or other organization affiliated with either HD DVD or Blu-ray technologies products (see www.cymfony.com/blu-ray.pdf).

On the capacity issue, the 15 GB HD DVD disc is at the lower end of currently acceptable HD capacity using MPEC 2 compression and the 30 GB disc enough to hold the longest feature films plus additional content. Both formats can raise disc capacity with further layering or by using both sides of the disc – Toshiba has announced the development of a triple layered 45 GB single-sided disc and a triple-layered single-sided BD would offer 75 GB.

The potential for greater capacity will always lie with BD for architectural reasons. Whether that matters commercially is a different matter. Most content released on HD DVD and BD to date has been on 30 GB (dual layer one sided) and 25 GB discs, respectively – this is the relevant capacity comparison at the present time because the 50 GB BD is too expensive and inconsistent in manufactured quality to carry mass entertainment content. Should this change, and the additional capacity required, it is highly possible that the 50 GB BD will face the 45 GB rather than 30 GB HD DVD.

It is even possible that the 45 GB HD DVD may become commercially available for mass media production sooner than the 50 GB BD. Alternatively, by the time capacity greater than 45 GB/50 GB is required, further advances in optical disc technology such as the Holographic Versatile Disc, which would have the capacity to hold up to 4,000 GB of information, might have moved the debate beyond HD DVD versus BD. However, should these two formats continue to dominate, it is likely that the long-term capacity advantage would lie with BD because its architecture allows for greater capacity per disc layer. Quad-layer BD discs (100 GB on one side) have been demonstrated and TDK recently announced that they have created an experimental BD disc capable of holding 200 GB of data on a single side.

Much depends on the speed with which demand for capacity develops and the evolution of disc manufacturing costs. For the present time market realities demonstrate that the 30 GB HD DVD and 25 GB BD are regarded as comparable media for mass entertainment content.

10.3. Content

BD has received broader support from the major movie studios as a successor to today's DVD format. Seven of the eight major movie studios (Warner, Paramount, Fox, Disney, Sony/Columbia, MGM and Lionsgate) have announced titles for BD, whereas HD DVD only has support from three major movie studios (Warner, Paramount and Universal). However, France's Studio Canal and many smaller studios such as New Line Cinema, Image Entertainment, Magnolia Pictures, the Weinstein Company, Ryko and Goldhil Entertainment, have announced that they will output titles in the HD DVD format. Fox, MGM and Canal Plus have some of the largest film libraries in the world. To date, more HD DVD than BD titles have been released, and this numerical advantage is expected to persist with releases in the near future. This is important to consumers because choosing the format with the most content support minimizes this risk of not being able to watch a movie on that format.

Two of the key reasons why more U.S. majors back BD are: Firstly, BD offers a dynamic encryption system called BD+, which together with a copy protection architecture called the Self-Protecting Digital Content (SPDC), can allow players judged "bad" (that is, playing copied content) to be effectively disabled. The BD+/SPDC system comes on top of digital watermarking and image constraint mechanisms and provides enhanced protection against unauthorized duplication. Image constraint gives studios the option of downgrading images, which are output over non-encrypted interfaces, to near standard definition levels. Secondly,

there is no regional playback control (RPC) in the existing HD DVD specification.

Image constraint is also offered by HD DVD players and watermarking is under active consideration. The BD+/SPDC system is highly controversial and may chill consumer enthusiasm for BD; were it to gain consumer acceptance, however, it could cement studio allegiance to BD if the protection offered by HD DVD were judged inadequate. Alternatively, should HD DVD prove hugely more popular than BD, the studios nonexclusive to BD may simply accept HD DVDs lower protection level and announce titles for HD DVD. Time will tell; until then it is likely BD will retain majority studio support.

However, the RPC issue will probably go away because either the DVD Forum will add region coding, or studios will back off their demand for it because it is outmoded. In the case of DVD, RPC has proven to be unenforceable, unrealistic, unpopular and futile. In a market dependent on international trade and under ever-increasing assault by freely downloadable content, the studios may come to accept that encumbering the next generation of physical media with region coding would be shortsighted and counterproductive.

In the long-term, it is impossible to say where the major studio content advantage lies because Sony/Columbia and Universal are the only two players exclusive to their respective camps. The others are not – they have simply announced that they have no plans to release titles on the competing format. Furthermore, assuming the DVD Forum enables RPC, nothing would stop studios from releasing a title under one format in one region and under the other format in a different region of the world.

The adult movie sector is neutral between the two formats because the Xbox 360 add-on and the PS3 are likely to guarantee home audiences in the short and long-term, respectively. This sector is important because early technology adopters are young men; it produces 11,000 titles a year and generates worldwide annual revenues of \$57 billion. Fittingly perhaps, the Xbox 360 HD DVD drive and the adult film "Deep Throat", re-mastered for HD DVD, were launched at the same time. Companies like Vivid Entertainment and Adult movie studio Digital Playground have announced that they will release titles on both HD DVD and Blu-ray formats.

Finally, it is impossible to judge how the role of the informal sector (parallel imports and pirated copies) will affect the fortunes of the two formats. The higher the volume, quality and variety, and lower the price, of available content for a format, whether licit or illicit, the more widely it will be adopted.

10.4. Hardware Support

Both formats have broad support from the world's leading consumer electronics, personal computer and media manufacturers. Sony, Philips and Toshiba are dedicated supporters of their camps, but the overwhelming majority of manufacturers support both standards and this neutrality will be strengthened as combo drives take hold. At the present time HD DVD players are cheaper but that does not necessarily reflect

underlying costs because manufacturers may be taking losses on early models in the hopes of buying a head start in the market place. Relative hardware costs will change as volumes ramp up and any price discounting abates. Combo drives, once available at mass-market prices and not significantly more expensive than single format drives, are likely to reduce the disc format contest in consumers' minds to content availability, needed storage capacity and price.

Table 32. Amazon's Top 3 Movies for the Home Entertainment Market by Category, December 4, 2006

Category	Sales Rank in Category	Title	Sales Rank in Entire DVD/HD Category
HD DVD	1	Superman: Returns	162
HD DVD	2	Batman Begins	352
HD DVD	3	Superman: The Movie	803
BD	1	Superman: Returns	394
BD	2	X-men 3: The last Stand	2279
BD	3	Kingdom of Heaven: Director's Cut	2373

Source: www.amazon.com.

Table 33. Amazon's Top 3 Movies for the Home Entertainment Market by Category, January 27, 2007

Category	Sales Rank in Category	Title	Sales Rank in Entire DVD/HD Category
HD DVD	1	The Departed	77
HD DVD	2	Babel	349
HD DVD	3	The Mummy Returns	477
BD	1	The Departed	75
BD	2	Flyboys	337
BD	3	The Guardian	360

Source: www.amazon.com.

10.5. Effects of the Gaming Console WAR

The cheapest HD player in the market now is the Xbox 360 add-on HD DVD player, at \$199. As of December 6, 2006, cumulative worldwide Xbox 360 sales are estimated at 8 million units. Microsoft expects cumulative sales to reach 10 million by the end of December 2006 and 13-15 million by the end of June 2007. Sony had forecast 400,000 PS3 units shipped for Day One of its U.S. launch, 1 million U.S. units by December 31, 2006 and 2 million units globally by the end of 2006. In the prior generation console wars, the PS2 sold 110 million units (71% market share) versus about 20 million units for the Xbox. Should market shares in the prior round of the gaming console war be reflected in the current round the PS3, which has a BD player, is likely overtake the Xbox 360 possibly at some point in late 2007 or in 2008.

The relevant question for a DVDR disc manufacturer is whether a high enough proportion of the owners of the 8 million Xbox 360s

already sold (or which shall be sold by the time PS3 sales catch up with Xbox 360 sales), will buy the HD player add-on quickly enough to accelerate the market penetration of HD DVD content and media and give the HD DVD format an early advantage over Blu-ray that will prove significant and durable.

10.4. Snapshot of the Home Video Market

To assess the current, albeit early, judgment of the relative popularity of the high definition formats, we took a look at the top three selling HD DVD and Blu-ray discs ranked by Amazon.com as of December 4, 2006, and January 28, 2007. The results, set out in Tables 30 and 31, show that both HD formats have become more popular relative to DVDs; and whereas HD DVDs outsold BDs in early December 2006, the situation by late January 2007 had reversed. Since both HD formats are in the early adoption stage, a judgment made month ago about which format would win based on the December 2006 results would have been as premature as a judgment based on the January 2007 results.

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