

Sector Improves; Infosmart Opens in Brazil; Buy Rating Reiterated.

At a Glance

Price & Valuation

Price	\$0.30
52-Week High	\$1.25
52-Week Low	\$0.22
Market Value (MV)	\$40.3M
Enterprise Value (EV)*	\$62.0M
Book Value/Share	\$0.11
P/Adjusted E 2006e	12.1x
P/Adj.E 2006e/Growth	0.1x
P/E 2007e	8.9x
Price/Book	2.6x

Trading Information

Shares Out.	134.4M
Adjusted Shares Out.	191.7M
Avg. Daily Vol., 90-day	30,777
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
Equity	\$18.6M
Total Debt/Equity	31.0%
Inventory Turnover	12.1x
Return on Equity*	21.8%
Return on Inv. Capital	38.9%
Revenue 2007e	\$34.1
Net Income 2007e	\$5.4
No. of Employees	105

*Based on 191.7 million shares.

Source: Reuters, Bloomberg, Griffen-Rose.

Summary

- **Systemic fundamentals have improved; sector due for a re-rating.** The optical disc manufacturing industry is looking healthier now than in 2005-6. In 2006 CMC Magnetics Corp., the world's top manufacturer, raised its holding in Prodisc Technology Inc., a leading competitor, to almost 12% of Prodisc's outstanding shares, in a deal designed to stop price wars between the two. Furthermore, CMC's nominee became Prodisc's president. Ritek Corp., the world's number two manufacturer, backed these moves. The three companies account for over 35% of global writable DVD (DVDR) supply. Their cooperation is expected to retard capacity expansion and cut the bloodletting that softened DVDR prices across the globe in 2006. Moreover, the average price of the principal raw material for optical storage media products - polycarbonate (PC) - dropped from over \$3.5/kg in 2005 to about \$2.5/kg at the end of 2006 as additional PC capacity came on-stream. Mass optical disc manufacturers are also benefiting from the continuing trend, by research-oriented optical disc producers such as Japan's Hitachi Maxell, toward outsourcing production. These factors are boosting the industry's profitability. CMC's net income rose 346% in the nine months to September, 2006, compared with the prior year period. Princo Corp., which has about 5% of global capacity, cut its net losses by 88% during 2006. Ritek's operating margin turned positive in October/November 2006 and the company has predicted continued profitability in 2007. Although Taiwanese output dipped during the long 2007 Chinese New Year celebrations, market sentiment toward the sector is improving and we expect valuations to follow suit.
- **Infosmart moves smartly to Brazil.** In February, we initiated coverage on Infosmart Group, Inc., which has shifted nearly half its production capacity to Brazil in a bid to become the country's leading DVDR maker. On March 8, Infosmart formally opened its Brazilian factory. Brazil's 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 hazardingly smuggled, rather than locally made. Brazil's DVD home video market is growing at over 20% per year. 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.
- **Profitability should rise.** Infosmart expects to generate revenues of about \$15 million from its Brazilian plant in 2007, in line with our expectations in February. The company has so far been silent about replacing, in Hong Kong, the capacity that has been shifted to Brazil, so we have no reason to alter our expectations regarding sales volumes and revenues, which we project will be about \$34 million in 2007, 34% above expected 2006 revenues. At present we project that in 2007 higher margins expected in Brazil compared with Hong Kong will be partially offset by higher production volume in Hong Kong versus Brazil, and as a result expected 2007 (2007e) gross margin will be about 29.2% versus 27.5% for 2006e.
- **Perspective affirmed.** Accordingly we maintain our February perspective, which is that Infosmart's current share price undervalues its prospects given: (a) its experience in CDR and DVDR manufacturing; (b) its history of running core operations profitably, even during the industry's tough 2005-6 period; (c) the likely success of its Brazilian operations, since Brazilian content replicators are hungry for steady supplies of good quality writable optical discs. We reiterate our buy rating and \$0.54 per share valuation at the 6 to 12 month horizon. An investment in Infosmart would be speculative because of the size and youth of the company, its geographic sphere of operations, and the high proportion of insider-held stock.

Projected Infosmart EPS (cents), 2007-2008

	Q1 Mar	Q2 Jun	Q3 Sep	Q4 Dec	Full 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 weighted average shares outstanding.

Source: Griffen-Rose.

Valuation Perspective: IFSG (OTC BB)

(DJII: 12,110.41 S&P 600 SC: 399.88 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.

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