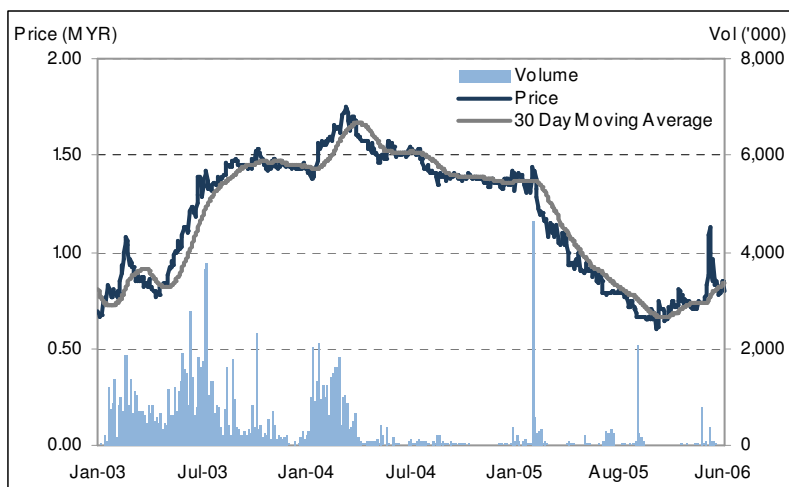


Board: Main**Sector:** Consumer Products**GICS:** Consumer Discretionary / Apparel, Accessories & Luxury Goods**Market Capitalization:** MYR109.9 mln

Summary: Founded in 1982, Degem is a leading jeweler in Malaysia focused on the domestic trading and manufacturing of diamonds, gemstones, pearls, white gold and platinum jewelry. Degem was listed on the Second Board in Oct. 2001, and was transferred to the Main Board in June 2003.

Analyst: Alison Seng



Results Review & Earnings Outlook

- Degem announced a 1Q06 net profit of MYR2.3 mln (+17% YoY) and revenue of MYR29.5 mln (+13.8% YoY) in 1Q06. While revenue was in line with expectations, net profit exceeded our forecast. 1Q06 net profit made up 42.6% of our original earnings projection of MYR5.4 mln.
- The better-than-expected results were attributed to stronger-than-expected festive period sales. 1Q is traditionally a strong quarter for Degem.
- Degem recently completed the sale of two showrooms, some fixed assets and inventories for MYR20.3 mln to PYT Gem Trade, a company owned by ex-director Choong Kai Sun. The asset disposal is part of its efforts to streamline its operation and focus on building the DeGem, Diamond and Platinum brands. According to the company, the disposal is expected to result in a net gain of MYR2.78 mln in 2006. Proceeds from the sale will be used for working capital.
- We have raised our net profit forecast in 2006 to MYR8.2 mln from MYR5.4 mln after adjusting our margin assumptions and including the exceptional income.

Recommendation & Investment Risks

- We upgrade our recommendation to Hold from Strong Sell after raising our 12-month target price to MYR0.87 from MYR0.40. We are encouraged by the better-than-expected results and efforts to streamline the business.
- Degem aims to expand overseas to the Middle East and will set up an office in Dubai prior to establishing a wholesale distribution network for its products in some Asian countries. We believe this strategy could help Degem to boost its earnings in the long term.
- We have raised our target price after raising our earnings. Our target price is based on DCF analysis. Key assumptions in our DCF calculation are 2006-2010 FCF CAGR of 4.9%, terminal growth rate of 3% (vs. 0% previously due to the better long-term growth outlook) and a WACC of 9.5%.
- Risks to our recommendation and target price are weaker-than-expected sales and earnings resulting from a sharper-than-expected slowdown in Malaysia's economic growth.

Key Stock Statistics

| | 2005 | 2006F |
|---------------------------------|-------------|-------|
| FY Dec. | | |
| EPS (sen) | 3.5 | 6.1 |
| PER (x) | 23.8 | 13.3 |
| Dividend/Share (sen) | 2.5 | 4.5 |
| NTA/Share (MYR) | 0.76 | 0.80 |
| Book Value/Share (MYR) | 0.82 | 0.86 |
| Issued Capital (mln shares) | 134.0 | |
| 52-week Share Price Range (MYR) | 0.59 - 1.46 | |
| Major Shareholders: | % | |
| Legion Master Sdn. Bhd. | 55.0 | |
| Employees Provident Fund | 11.3 | |
| Diamond Landmark Sdn. Bhd. | 6.9 | |

Per Share Data

| | 2003 | 2004 | 2005 | 2006F |
|--------------------|------|------|------|-------|
| FY Dec. | | | | |
| Book Value (MYR) | 0.70 | 0.72 | 0.82 | 0.86 |
| Cash Flow (sen) | 11.7 | 9.8 | 4.9 | 7.6 |
| Earnings (sen) | 10.4 | 8.4 | 3.5 | 6.1 |
| Dividend (sen) | 2.5 | 3.0 | 2.5 | 4.5 |
| Payout Ratio (%) | 17.3 | 27.4 | 52.3 | 52.3 |
| PER (x) | 7.9 | 9.8 | 23.8 | 13.3 |
| P/Cash Flow (x) | 7.0 | 8.4 | 16.9 | 10.8 |
| P/Book Value (x) | 1.2 | 1.1 | 1.0 | 1.0 |
| Dividend Yield (%) | 3.0 | 3.7 | 3.0 | 5.4 |
| ROE (%) | 15.8 | 11.5 | 4.5 | 7.3 |
| Net Gearing (%) | 15.0 | 25.2 | 25.5 | 17.9 |

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Page 1 of 3

Quarterly Performance

| FY Dec. / MYR mln | 1Q06 | 1Q05 | % Change |
|---------------------------------|------|------|----------|
| Revenue | 29.5 | 25.9 | 13.8 |
| Operating Profit (EBIT) | NA | NA | NA |
| Depreciation | -0.5 | -0.4 | 10.5 |
| Net Interest Income / (Expense) | NA | NA | NA |
| Pre-tax Profit | 2.9 | 2.5 | 18.0 |
| Net Profit | 2.3 | 2.0 | 17.0 |
| Operating Margin (%) | NA | NA | - |
| Pre-tax Margin (%) | 10.0 | 9.6 | - |
| Net Margin (%) | 7.7 | 7.5 | - |

Source: Company data

Profit & Loss

| FY Dec. / MYR mln | 2004 | 2005 | 2006F | 2007F |
|---------------------------------|-------|-------|-------|-------|
| Revenue | 135.3 | 108.2 | 117.7 | 123.7 |
| Operating Profit (EBIT) | 17.8 | 9.2 | 10.0 | 10.5 |
| Depreciation | -1.8 | -1.9 | -1.9 | -2.1 |
| Net Interest Income / (Expense) | -1.5 | -1.2 | -1.2 | -1.2 |
| Pre-tax Profit | 16.2 | 8.0 | 11.6 | 9.3 |
| Effective Tax Rate (%) | 24.4 | 41.3 | 28.0 | 28.0 |
| Net Profit | 10.6 | 4.6 | 8.2 | 6.6 |
| Operating Margin (%) | 13.1 | 8.5 | 8.5 | 8.5 |
| Pre-tax Margin (%) | 12.0 | 7.4 | 9.8 | 7.5 |
| Net Margin (%) | 7.8 | 4.3 | 7.0 | 5.4 |

Source: Company data, S&P Equity Research

Standard & Poor's Equity Research Services

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Glossary

Strong Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, by a wide margin over the coming 12 months, with shares rising in price on an absolute basis.

Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months, with shares rising in price on an absolute basis.

Hold: Total return is expected to closely approximate the total return of the KLCI or KL Emas Index respectively, over the coming 12 months with shares generally rising in price on an absolute basis.

Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months and share price is not anticipated to show a gain.

Strong Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months by a wide margin, with shares falling in price on an absolute basis.

S&P 12 Month Target Price – The S&P equity analyst's projection of the market price a given security will command 12 months hence, based on a combination of intrinsic, relative, and private market valuation metrics.

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