STANDARD
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Degem

Recommendation: **STRONG BUY**

Stock Code: 7119 Bloomberg: DGEM MK Price: MYR1.18 12-Month Target Price: MYR1.43 Date: June 6, 2007

Board: Main

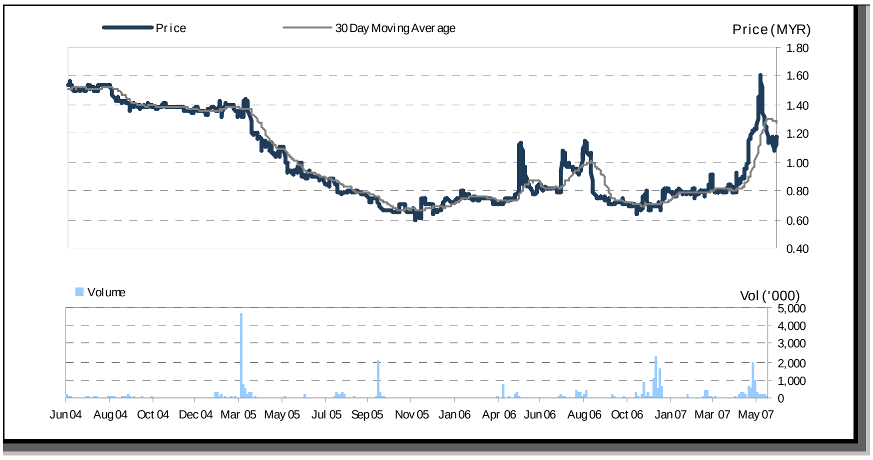
Sector: Consumer Products

GICS: Consumer Discretionary/Apparel, Accessories & Luxury Goods

Market Value - Total: MYR158.1 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 jewlery. Listed in October 2001, it was transferred to the Main Board in June 2003.

Analyst: Alison Seng



Results Review & Earnings Outlook

- Net profit soared 55.5% YoY to MYR3.5 mln in 1Q07 attributed to increased sales and better margins. The results beat our expectations due to better-than-expected margins, which more than offset the slightly weaker-than-expected sales. 1Q net profit was equivalent to 30% of our original full-year projection.

- Revenue grew 14.4% YoY to MYR33.8 mln in 1Q07 reflecting stronger consumer demand for its jewelry products. Degem benefited from improvement in the economy and effective marketing and promotional activities.

- Gross profit margin improved to 40.1% in 1Q07 (vs. 1Q06: 31.4%) due to higher selling prices. Degem was able to pass on the increased costs of raw materials to customers due to the strong demand. The improvement in the gross profit margin helped to offset a 42% YoY increase in operating costs to MYR8.8 mln and a higher effective tax rate of 27% (vs. 1Q06: 22.4%).

- We are raising our 2007 and 2008 net profit projections by 12.2% and 9.0% despite modestly trimming our revenue forecasts (by 0.7% for 2007 and 5.4% for 2008). We have raised our gross profit margin assumption as our previous forecasts appear overly conservative.

Recommendation & Investment Risks

- We upgrade our recommendation to Strong Buy from Buy with an unchanged 12-month target price of MYR1.43. The potential upside to our target price is now more attractive after the recent correction in the share price.

- We remain optimistic on Degem's outlook. Following the restructuring in 2006, Degem is now focused on strengthening its presence in the domestic and overseas markets and improving operational efficiency. It will set up new stores in Malaysia, Singapore and Vietnam over the next two years to boost revenue and profits.

- Although we have raised our earnings projections, our target price remains unchanged after the updating of our valuation parameters. Our target price is based on DCF analysis. Key assumptions include: 2007-2010 FCF CAGR of 11.1% (vs. 11.7% previously), terminal growth of 3% (unchanged) and WACC of 9.8%-10.7% (vs. 9.9%-10.7% previously). Our target price includes a projected net DPS of 1.8 sen.

- Key risk to our recommendation and target price is unsuccessful or delays in domestic and overseas expansion.

Key Stock Statistics

FY Dec.	2006	2007E
Reported EPS (sen)	10.3	9.6
PER (x)	11.5	12.2
Dividend/Share (sen)	19.0	2.5
NTA/Share (MYR)	0.73	0.81
Book Value/Share (MYR)	0.79	0.86
No. of Outstanding Shares (mln)	134.0	
52-week Share Price Range (MYR)	0.64 - 1.61	
Major Shareholders:	%	
Legion Master Sdn. Bhd.	51.7	
Employees Provident Fund	8.7	

Per Share Data

FY Dec.	2004	2005	2006	2007E
Book Value (MYR)	0.76	0.82	0.79	0.86
Cash Flow (sen)	9.8	4.9	9.5	11.3
Reported Earnings (sen)	8.4	3.5	10.3	9.6
Dividend (sen)	3.0	2.5	19.0	2.5
Payout Ratio (%)	27.4	52.3	168.3	18.7
PER (x)	14.1	34.2	11.5	12.2
P/Cash Flow (x)	12.0	24.3	12.4	10.5
P/Book Value (x)	1.5	1.4	1.5	1.4
Dividend Yield (%)	2.5	2.1	16.1	2.1
ROE (%)	11.5	4.5	10.1	11.7
Net Gearing (%)	25.4	25.8	25.7	17.7

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Quarterly Performance

FY Dec. / MYR mln	1Q07	1Q06	% Change
Reported Revenue	33.8	29.5	14.4
Reported Operating Profit	NA	NA	NA
Depreciation & Amortization	-0.4	-0.5	-8.8
Net Interest Income / (Expense)	NA	NA	NA
Reported Pre-tax Profit	5.0	2.9	70.6
Reported Net Profit	3.5	2.3	55.5
Reported Operating Margin (%)	NA	NA	-
Reported Pre-tax Margin (%)	14.9	10.0	-
Reported Net Margin (%)	10.5	7.7	-

Source: Company data

Profit & Loss

FY Dec. / MYR mln	2005	2006	2007E	2008E
Reported Revenue	108.2	143.9	157.2	177.3
Reported Operating Profit	9.2	19.2	20.2	22.4
Depreciation & Amortization	-1.9	-1.9	-2.2	-2.5
Net Interest Income / (Expense)	-1.2	-1.9	-2.1	-1.9
Reported Pre-tax Profit	8.0	17.2	17.7	19.8
Effective Tax Rate (%)	41.3	19.7	27.0	26.0
Reported Net Profit	4.6	13.8	12.9	14.7
Reported Operating Margin (%)	8.5	13.4	12.9	12.6
Reported Pre-tax Margin (%)	7.4	11.9	11.3	11.2
Reported Net Margin (%)	4.3	9.6	8.2	8.3

Source: Company data, S&P Equity Research

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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.

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Recommendation and Target Price History

Date	Recommendation	Target Price
New	Strong Buy	1.43
21-May-07	Buy	1.43
12-Mar-07	Buy	0.92
6-Dec-06	Buy	0.84
17-Aug-06	Hold	1.12
22-Jun-06	Hold	0.87
1-Mar-06	Strong Sell	0.40
5-Jan-06	Strong Sell	0.45