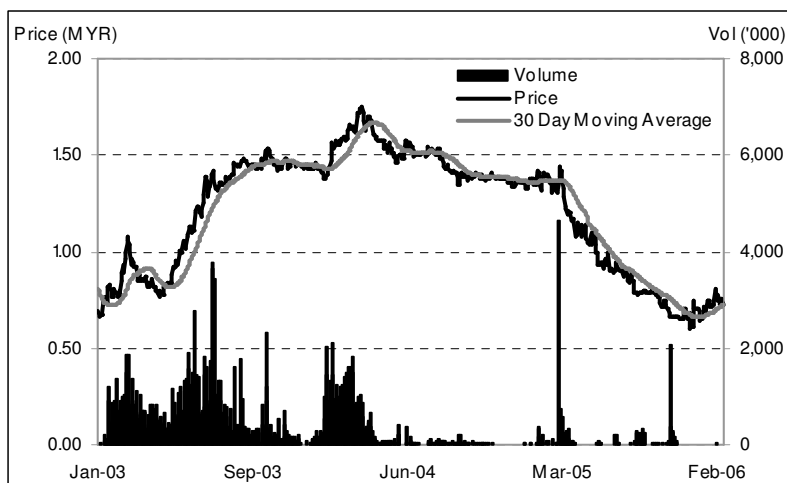


Board: Main**Sector:** Consumer Products**GICS:** Consumer Discretionary / Apparel, Accessories & Luxury Goods**Market Capitalization:** MYR97.8 mln

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

Analyst: Alison Seng

**Results Review & Earnings Outlook**

- Degem's 4Q05 net profit came in at -MYR0.13 mln, significantly weaker than our forecast of MYR1.9 mln. This brings full year net profit to MYR4.8 mln (-54.6% YoY), which is 29.4% lower than our estimate.
- The poor results can be attributed to lower sales and weaker margins. 4Q05 revenue dropped by 36.4% YoY to MYR26.2 mln and for the full year was MYR108.2 mln (-20.1%). Sales and margins were depressed by stiff competition. In 4Q05, the traditional festive season sales fell short of management's expectation. In 4Q05, Degem posted pretax loss of MYR0.25 mln vs. pretax profit of MYR2.7 mln in 4Q04.
- Given the disappointing results, we are lowering our net profit forecast for both 2006 and 2007 by 26% to MYR5.4 mln (+13.5%) and MYR5.8 mln (+6%), respectively following adjustments to our sales and margins assumptions. Our sales forecasts for 2006 and 2007 were cut by 3.1% to MYR117.7 mln (+8.8%) and MYR123.7 (+5.1%), respectively.
- No dividend was been declared for 2005.

Key Stock Statistics

FY Dec.	2005	2006F
EPS (sen)	3.6	4.1
PER (x)	20.3	18.0
Dividend/Share (sen)	0.0	0.0
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	

Recommendation & Investment Risks

- We lower our 12-month target price to MYR0.40 from MYR0.45 following our earnings revision.
- We retain a Strong Sell call on Degem. We remain concerned with Degem's ability to cope with the fierce competition in the jewelry industry. Rising energy prices may also weaken consumers' purchasing power on jewelry.
- Our target price is based on Discounted Cash Flow (DCF) analysis (key assumptions: 2006-2010 FCF CAGR of 4.9%, 0% terminal growth and WACC of 9.5%). The conservative assumptions are due to Degem's poor earnings track record and a lack of earnings visibility.
- Our analysis and forecasts carry a higher degree of uncertainty than normal because our attempts to meet with Degem's management to obtain additional information prior to preparing this report were unsuccessful.
- Risks to our recommendation and target price are stronger-than-expected demand for Degem's jewelry leading to revenue and margin improvements.

Per Share Data

FY Dec.	2003	2004	2005	2006F
Book Value (MYR)	0.70	0.72	0.82	0.86
Cash Flow (sen)	11.7	9.8	5.0	5.7
Earnings (sen)	10.4	8.4	3.6	4.1
Dividend (sen)	2.5	3.0	0.0	0.0
Payout Ratio (%)	17.3	27.4	0.0	0.0
PER (x)	7.0	8.7	20.3	18.0
P/Cash Flow (x)	6.2	7.4	14.6	12.8
P/Book Value (x)	1.0	1.0	0.9	0.8
Dividend Yield (%)	3.4	4.1	0.0	0.0
ROE (%)	15.8	11.5	4.7	4.8
Net Gearing (%)	15.0	25.2	26.3	20.4

Recommendation: **STRONG SELL**Stock Code: **7119**Bloomberg: **DEGEM MK**Price: **MYR0.73**12-Month Target Price: **MYR0.40**Date: **March 1, 2006****Quarterly Performance**

FY Dec. / MYR mln	4Q05	4Q04	% Change
Revenue	26.2	41.2	-36.4
Operating Profit (EBIT)	NA	NA	NA
Depreciation	NA	NA	NA
Net Interest Income / (Expense)	NA	NA	NA
Pretax Profit	-0.3	2.7	NM
Net Profit	-0.1	0.8	NM
Operating Margin (%)	NA	NA	-
Pretax Margin (%)	-1.0	6.6	-
Net Margin (%)	-0.5	2.0	-

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	8.2	8.9	9.4
Depreciation	-1.8	-1.9	-2.2	-2.3
Net Interest Income / (Expense)	-1.6	-1.3	-1.3	-1.3
Pretax Profit	16.2	6.9	7.7	8.1
Effective Tax Rate (%)	24.4	29.7	28.0	28.0
Net Profit	10.6	4.8	5.4	5.8
Operating Margin (%)	13.1	7.6	7.6	7.6
Pretax Margin (%)	12.0	6.4	6.5	6.6
Net Margin (%)	7.8	4.4	4.6	4.7

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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