

Board: Main**Sector:** Consumer Products**GICS:** Consumer Discretionary/Apparel, Accessories & Luxury Goods**Market Value - Total:** MYR179.6 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. Listed in Oct. 2001, it was transferred to the Main Board in Jun. 2003.

Analyst: Alison Seng**Recent Developments**

- Degem reportedly hopes to increase revenue contribution from international sales to 50% of total revenue in five years from 10% currently. This represents an aggressive expansion into overseas markets, with Singapore being the primary focus. We understand that Degem plans to open D&P outlets in Singapore. D&P caters to the mid-to lower end market and targets the trendier and younger consumers and are typically located in shopping malls. Currently, Degem operates a 60%-owned sales office in Ngee Ann City and recorded sales of MYR2.8 mln in 2006 (or 2% of total revenue). This sale office targets mainly mid-to high-end market.
- Rising affluence and the government's promotion of tourism in Singapore will drive demand of refine and fashion jewelry. Singapore-listed Aspial-Lee Hwa Jewelry (ASP SP, S\$0.765, Not Ranked), which operates over 70 shops under four major brands, Aspial, Lee Hwa, Citigems and Goldheart will be among the strongest competitors. Nonetheless, Degem is confident that D&P could compete on quality, design and pricing.
- We expect Degem to show continued improvement in earnings following the restructuring of its business operations in 2006. We like its regional expansion strategy and if effectively executed, Degem should, in our opinion, thrive on the robust consumer discretionary spending trend in Asia fueled by economic expansion.

Recommendation & Investment Risks

- We are maintaining our Strong Buy recommendation and we are raising our DCF-based 12-month target price to MYR1.62 (from MYR1.43) after raising our long term earning growth forecast, updating the valuation parameters and rolling over the discount period.
- Our revised target price assumes: 2007-2010 FCF CAGR of 11.1%, terminal growth of 3.5% (vs. 3.0%) and WACC of 9.8%-10.7% (unchanged). Our target price includes a projected net DPS of 1.8 sen.
- Trading at 2008 PER of 12.2x based on our EPS forecast of 11 sen per share, valuation remains undemanding when compared to the stock's average historical rolling PER of 14.8x. Our target price implies a prospective PER of 14.8x.
- Key risk to our recommendation and target price is unsuccessful or delays in domestic and overseas expansion.

Earnings Outlook

- We are keeping our 2007 earnings forecast pending the release of 2Q07 results. 2Q06 net profit grew 193% YoY to MYR4.3 mln distorted by a MYR3.25 gain from disposal of land and buildings.

Key Stock Statistics

FY Dec.	2006	2007E
Reported EPS (sen)	10.3	9.6
PER (x)	13.0	13.9
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	
Diamond Landmark Sdn. Bhd.	7.8	

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)	16.0	38.8	13.0	13.9
P/Cash Flow (x)	13.7	27.6	14.1	11.9
P/Book Value (x)	1.8	1.6	1.7	1.6
Dividend Yield (%)	2.2	1.9	14.2	1.9
ROE (%)	11.5	4.5	10.1	11.7
Net Gearing (%)	25.4	25.8	25.7	17.7

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.

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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For residents of Malaysia. All queries in relation to this report should be referred to Alexander Chia, Desmond Ch'ng or Ching Wah Tam.

Recommendation and Target Price History

Date	Recommendation	Target Price
New	Strong Buy	1.62
6-Jun-07	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

