

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 jewelry. 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

All required disclosures and analyst certification appear on the last two pages of this report. Additional information is available upon request.

Redistribution or reproduction is prohibited without written permission. Copyright © 2007 The McGraw-Hill Companies, Inc.

Page 1 of 4

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

Standard & Poor's Equity Research Services

Standard & Poor's Equity Research Services U.S. includes Standard & Poor's Investment Advisory Services LLC; Standard & Poor's Equity Research Services Europe includes Standard & Poor's LLC- London and Standard & Poor's AB (Sweden); Standard & Poor's Equity Research Services Asia includes Standard & Poor's LLC's offices in Hong Kong, Singapore and Tokyo, Standard & Poor's Malaysia Sdn Bhd, and Standard & Poor's Information Services (Australia) Pty Ltd.

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.

Required Disclosures

All of the views expressed in this research report accurately reflect the research analyst's personal views regarding any and all of the subject securities or issuers. No part of analyst compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

Additional information is available upon request.

Other Disclosures

This report has been prepared and issued by Standard & Poor's and/or one of its affiliates. In the United States, research reports are prepared by Standard & Poor's Investment Advisory Services LLC ("SPIAS"). In the United States, research reports are issued by Standard & Poor's ("S&P"), in the United Kingdom by Standard & Poor's LLC ("S&P LLC"), which is authorized and regulated by the Financial Services Authority; in Hong Kong by Standard & Poor's LLC which is regulated by the Hong Kong Securities Futures Commission, in Singapore by Standard & Poor's LLC, which is regulated by the Monetary Authority of Singapore; in Japan by Standard & Poor's LLC, which is regulated by the Kanto Financial Bureau; in Sweden by Standard & Poor's AB ("S&P AB"), in Malaysia by Standard & Poor's Malaysia Sdn Bhd ("S&PM") which is regulated by the Securities Commission, in Australia by Standard & Poor's Information Services (Australia) Pty Ltd ("SPIS") which is regulated by the Australian Securities & Investments Commission and in Korea by SPIAS, which is also registered in Korea as a cross-border investment advisory company.

The research and analytical services performed by SPIAS, S&P LLC, S&P AB, S&PM, SPIS and SPIAS LLC (Korea) are each conducted separately from any other analytical activity of Standard & Poor's.

A reference to a particular investment or security by Standard & Poor's and/or one of its affiliates is not a recommendation to buy, sell, or hold such investment or security, nor is it considered to be investment advice.

CMDF-Bursa Research Scheme ("CBRS")

This report has been prepared by S&PM for purposes of CBRS administered by Bursa Malaysia Berhad, independent from any influence from CBRS or the subject company. S&P will receive total compensation of RM15,000 each year for each company covered by it under CBRS. For more information about CBRS, please visit Bursa Malaysia's website at: <http://www.bursamalaysia.com/website/bm/>

Disclaimers

This material is based upon information that we consider to be reliable, but neither S&P nor its affiliates warrant its completeness, accuracy or adequacy and it should not be relied upon as such. With respect to reports issued by S&P LLC-Japan and in the case of inconsistencies between the English and Japanese version of a report, the English version prevails. Neither S&P LLC nor S&P guarantees the accuracy of the translation. Assumptions, opinions and estimates constitute our judgment as of the date of this material and are subject to change without notice. Neither S&P nor its affiliates are responsible for any errors or omissions or for results obtained from the use of this information. Past performance is not necessarily indicative of future results.

This material is not intended as an offer or solicitation for the purchase or sale of any security or other financial instrument. Securities, financial instruments or strategies mentioned herein may not be suitable for all investors. Any opinions expressed herein are given in good faith, are subject to change without notice, and are only correct as of the stated date of their issue. Prices, values, or income from any securities or investments mentioned in this report may fall against the interests of the investor and the investor may get back less than the amount invested. Where an investment is described as being likely to yield income, please note that the amount of income that the investor will receive from such an investment may fluctuate. Where an investment or security is denominated in a different currency to the investor's currency of reference, changes in rates of exchange may have an adverse effect on the value, price or income of or from that investment to the investor. The information contained in this report does not constitute advice on the tax consequences of making any particular investment decision. This material does not take into account your particular investment objectives, financial situations or needs and is not intended as a recommendation of particular securities, financial instruments or strategies to you. Before acting on any recommendation in this material, you should consider whether it is suitable for your particular circumstances and, if necessary, seek professional advice.

For residents of the U.K. This report is only directed at and should only be relied on by persons outside of the United Kingdom or persons who are inside the United Kingdom and who have professional experience in matters relating to investments or who are high net worth persons, as defined in Article 19(5) or Article 49(2) (a) to (d) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, respectively.

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	1.43
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

