

Board: Main

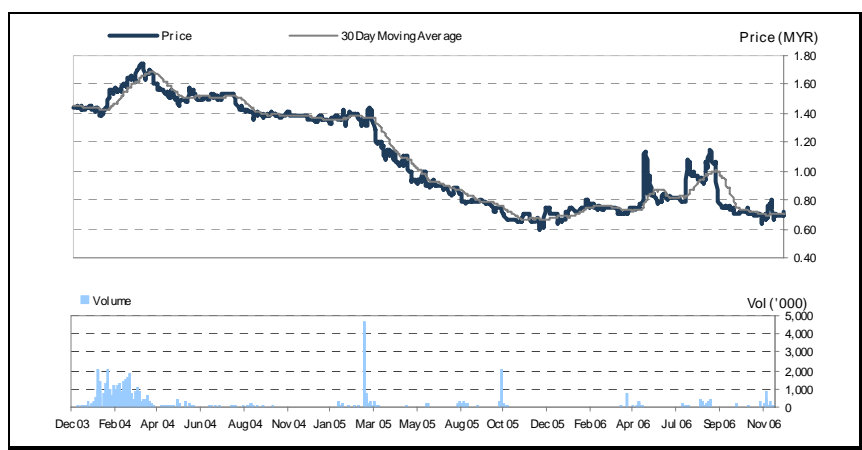
Sector: Consumer Products

GICS: Consumer Discretionary/Apparel, Accessories & Luxury Goods

Market Value - Total: MYR95.8 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 June 2003.

Analyst: Alison Seng



Results Review & Earnings Outlook

- Fueled by robust consumer spending and supported by increased promotion and marketing efforts, Degem's 3Q06 revenue grew 11.3% YoY to MYR33.4 mln, in line with our expectations. Net profit, which came in at MYR3.2 mln, up 109.6% YoY, was better than expected due to higher-than-expected margins.
- Degem has coped well in spite of firm commodities prices with gross profit margin improving to 36.9% in 3Q06 (vs. 34.8% in 3Q05). Operating cost was kept under control, declining by 9.8% YoY to MYR7.1 mln despite the higher revenue. This contributed to a better pre-tax profit margin of 15.5% in 3Q06 (vs. 7.9% in 3Q05).
- Degem believes that the recent restructuring exercise, in which it disposed some non-performing assets and streamlined its existing operations, will have positive impact on its profitability.
- We have lifted our 2006 and 2007 net profit forecasts by 8.2% to MYR10.9 mln and 11.9% to MYR9.7 mln respectively after updating our margin assumptions. 2006 net profit includes a one-off gain from the disposal of fixed assets and inventories amounting to MYR2.3 mln. We have also adjusted our capital expenditure and working capital requirements, which appeared conservative.

Recommendation & Investment Risks

- We have lowered our 12-month target price to MYR0.84 from MYR1.12 after updating our valuation parameters. We are upgrading our recommendation to Buy from Hold. Following the recent share price correction, there is a potential upside of 18% to our target price.
- Degem's earnings are normalizing following poor performance in 2005. We are optimistic that the restructuring will help the company focus on strengthening the Degem and Diamond and Platinum (D&P) brands to enhance its profitability.
- Our target price is based on DCF analysis. Key assumptions include: 2006-2010 FCF CAGR of 4.7% (8.4% previously), terminal growth rate of 3% (unchanged) and WACC of 9.5%-10.4% (vs. 9.6% previously). Our target price included a projected net DPS of 3.8 sen over the next 12 months. Our original target had included an 11.9 sen special net dividend already paid out in Sep.
- Trading at 2007 PER of 9.8x based on the forecasted EPS of 7.2 sen, valuation is not demanding compared with its historical median PER of about 13x.
- Risks to our recommendation and target price include failure to secure good shopping mall locations for future store expansion in Malaysia and unsuccessful overseas expansion.

Key Stock Statistics

FY Dec.	2005	2006E
Reported EPS (sen)	3.5	8.1
PER (x)	20.7	8.8
Dividend/Share (sen)	2.5	16.5
NTA/Share (MYR)	0.76	0.71
Book Value/Share (MYR)	0.82	0.76
No. of Outstanding Shares (mln)	134.0	
52-week Share Price Range (MYR)	0.64 - 1.15	
Major Shareholders:	%	
Legion Master Sdn. Bhd.	51.7	
Employees Provident Fund	8.7	

Per Share Data

FY Dec.	2003	2004	2005	2006E
Book Value (MYR)	0.70	0.76	0.82	0.76
Cash Flow (sen)	11.7	9.8	4.9	7.5
Reported Earnings (sen)	10.4	8.4	3.5	8.1
Dividend (sen)	2.5	3.0	2.5	16.5
Payout Ratio (%)	20.7	27.4	52.3	193.5
PER (x)	6.9	8.5	20.7	8.8
P/Cash Flow (x)	6.1	7.3	14.7	9.5
P/Book Value (x)	1.0	0.9	0.9	0.9
Dividend Yield (%)	3.5	4.2	3.5	23.1
ROE (%)	15.8	11.5	4.5	7.8
Net Gearing (%)	15.2	25.4	25.7	36.7

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

Redistribution or reproduction is prohibited without written permission. Copyright © 2006 The McGraw-Hill Companies, Inc.

Page 1 of 4

Quarterly Performance

FY Dec. / MYR mln	3Q06	3Q05	% Change
Reported Revenue	33.4	30.0	11.3
Reported Operating Profit	NA	NA	NA
Depreciation & Amortization	-0.4	-0.5	-7.5
Net Interest Income / (Expense)	NA	NA	NA
Reported Pre-tax Profit	5.2	2.4	>100
Reported Net Profit	3.2	1.5	>100
Reported Operating Margin (%)	NA	NA	-
Reported Pre-tax Margin (%)	15.5	7.9	-
Reported Net Margin (%)	9.5	5.1	-

Source: Company data

Profit & Loss

FY Dec. / MYR mln	2004	2005	2006E	2007E
Reported Revenue	135.3	108.2	133.0	140.8
Reported Operating Profit	17.8	9.2	17.3	15.8
Depreciation & Amortization	-1.8	-1.9	-1.8	-2.3
Net Interest Income / (Expense)	-1.5	-1.2	-2.1	-2.5
Reported Pre-tax Profit	16.2	8.0	15.1	13.3
Effective Tax Rate (%)	24.4	41.3	28.0	27.0
Reported Net Profit	10.6	4.6	10.9	9.7
Reported Operating Margin (%)	13.1	8.5	13.0	11.2
Reported Pre-tax Margin (%)	12.0	7.4	11.4	9.4
Reported Net Margin (%)	7.8	4.3	8.2	6.9

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.

CMDP-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 2001, respectively.

For residents of Malaysia. All queries in relation to this report should be referred to Alexander Chia, Lee Leng Hoe or Ching Wah Tam.

Recommendation and Target Price History

Date	Recommendation	Target Price
New	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

