STANDARD &POOR'S

Degem

Recommendation: **BUY**

Stock Code: 7119 Bloomberg: DGEM MK Price: MYR1.28 12-Month Target Price: MYR1.43 Date: May 21, 2007

Board: Main

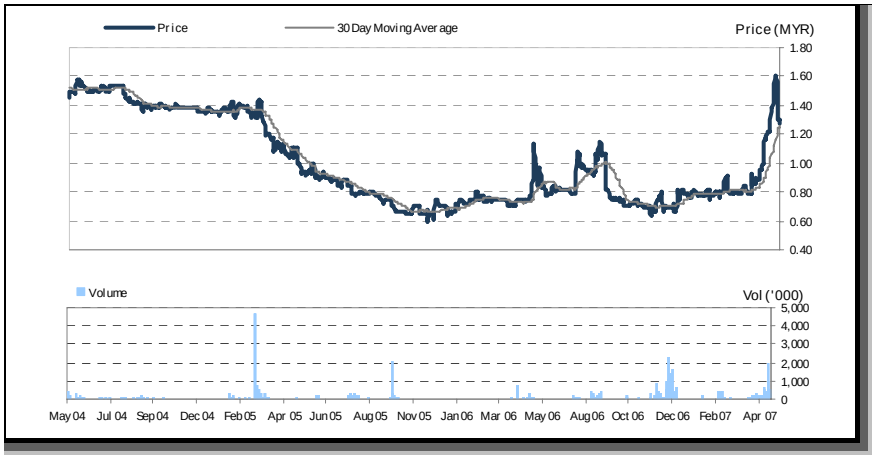
Sector: Consumer Products

GICS: Consumer Discretionary/Apparel, Accessories & Luxury Goods

Market Value - Total: MYR171.5 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



Recent Developments

- Degem's earnings has normalized after a successful restructuring of its business in 2006. The revamped management and board are now focused on internal reorganization and external expansion. After disposing a large part of PYT, Degem wants to develop the DeGem and Diamond & Platinum (D&P) brands and expand its presence in the region.
- Degem now operates a total of 17 retail outlets in Malaysia, a 60%-owned distribution office in Singapore, a design and wholesale center in Hong Kong and a franchise shop in Jarkata. In 2006, domestic revenue made up 95% of total revenue. The balance came from its overseas operations. Over the next two years, Degem plans to open to two more stores in Malaysia and subsequently to concentrate on strengthening its operations. In the overseas markets, Degem will open three shops in Singapore (of which two will be D&P outlets) and it aims to add one shop in Vietnam.
- Degem's Jakarta and Singapore shops were profitable as at 1Q07, reflecting successful business positioning and strong consumer spending. Its regional expansion will help to broaden revenue as the domestic market becomes more competitive and saturated. In Singapore, the strong economic growth is supporting demand. Degem believes its competitive strength lies in being an integrated business that produces and designs its own jewelry, which gives it an edge over peers in terms of pricing.

Recommendation & Investment Risks

- We have raised our 12-month target price to MYR1.43 from MYR0.92 after raising our earnings projections and updating our valuation parameters. We are maintaining our Buy recommendation.
- We view positively Degem's strategy to focus on brand development and to go regional. We are also encouraged by management's emphasis on operational efficiency. Management is studying ways to improve margins, including improving inventory management.
- Our target price is based on DCF analysis. Key assumptions include: 2007-2010 FCF CAGR of 11.7% (vs. 6.3% previously), terminal growth rate of 3% (unchanged) and WACC of 9.9%-10.7% (vs. 9.6%-10.5% previously). Our target price includes a projected net DPS of 1.8 sen.
- Risks to our recommendation and target price include unsuccessful or delays in domestic and overseas expansion.

Earnings Outlook

- We are raising our 2007 and 2008 net profit forecasts by 4.9% and 13.4% after adjusting our revenue and margin assumptions. We have also upped our longer-term earnings forecasts to reflect our optimism.

Key Stock Statistics

FY Dec.	2006	2007E
Reported EPS (sen)	10.3	8.6
PER (x)	12.5	14.9
Dividend/Share (sen)	19.0	2.5
NTA/Share (MYR)	0.73	0.79
Book Value/Share (MYR)	0.79	0.85
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	0.85
Cash Flow (sen)	9.8	4.9	9.5	10.2
Reported Earnings (sen)	8.4	3.5	10.3	8.6
Dividend (sen)	3.0	2.5	19.0	2.5
Payout Ratio (%)	27.4	52.3	168.3	21.0
PER (x)	15.3	37.1	12.5	14.9
P/Cash Flow (x)	13.1	26.4	13.4	12.5
P/Book Value (x)	1.7	1.6	1.6	1.5
Dividend Yield (%)	2.3	2.0	14.8	2.0
ROE (%)	11.5	4.5	10.1	10.5
Net Gearing (%)	25.4	25.8	25.7	18.1

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Profit & Loss

FY Dec. / MYR mln	2005	2006	2007E	2008E
Reported Revenue	108.2	143.9	158.4	187.4
Reported Operating Profit	9.2	19.2	18.3	20.7
Depreciation & Amortization	-1.9	-1.9	-2.2	-2.4
Net Interest Income / (Expense)	-1.2	-1.9	-2.1	-1.9
Reported Pre-tax Profit	8.0	17.2	15.8	18.2
Effective Tax Rate (%)	41.3	19.7	27.0	26.0
Reported Net Profit	4.6	13.8	11.5	13.5
Reported Operating Margin (%)	8.5	13.4	11.6	11.1
Reported Pre-tax Margin (%)	7.4	11.9	10.0	9.7
Reported Net Margin (%)	4.3	9.6	7.3	7.2

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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Recommendation and Target Price History

Date	Recommendation	Target Price
New	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



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