

Sarine Technologies (SARIN SP)

Share Price: SGD2.53

MCap (USD): 661M

Singapore

Target Price: SGD3.18 (+26%)

ADTV (USD): 0.5M

Industrials

BUY

(Upgrade)

Still game-changing; U/G to BUY

- Upgrade to BUY from HOLD following price correction. DCF TP raised from SGD2.98 to SGD3.18 on USD strength despite 4-9% cuts in EPS.
- Beyond transient liquidity crunch, margin-squeezed rough manufacturers have incentives to upgrade technologies.
- Game-changing products to revolutionise industry practices and inspire adoption.

Flat 4Q sales guidance

Rough diamond manufacturers in India are tackling: 1) lower bank credit; 2) INR depreciation against USD; and 3) higher increase in rough diamond than polished prices. We believe these may have triggered Sarine's 22% price correction from its SGD3.23 peak in Nov 2014. Sarine has met with such issues before, in 3Q12 and 3Q13, when its sales were dampened for a quarter or so. It subsequently bounced back from pent-up demand. 4Q14 sales are likely to take a hit but Sarine guides that it would at least match 4Q13's USD16.7m.

Products remain game-changing

While we cut FY14E-16E EPS by 4-9% to reflect weaker sales from these challenges, we note that Sarine's Galaxy, Sarine Light and Sarine Loupe remain game-changing technologies. These continue to have the potential to revolutionise industry practices and encourage customer adoption to improve their work flows. Key risk would be competing products which have so far been few.

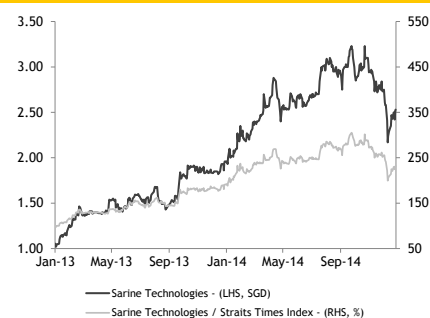
Our earnings cuts are negated by higher USD/SGD exchange-rate assumptions of 1.30 from 1.25. Consequently, we raise our DCF-based TP (WACC: 9.6%) from SGD2.98 to SGD3.18. Implied FY15E/16E PER based on our TP is 23.7x/17.6x. In our view, current price correction presents a good buying opportunity. We upgrade Sarine from HOLD to BUY.

FYE Dec (USD m)	FY12A	FY13A	FY14E	FY15E	FY16E
Revenue	63.8	76.4	86.5	95.0	114.5
EBITDA	28.0	33.9	37.9	47.1	61.5
Core net profit	20.8	23.9	27.9	36.0	48.5
Core FDEPS (cts)	6.0	6.8	7.6	9.9	13.3
Core FDEPS growth(%)	17.9	12.9	12.3	29.2	34.6
Net DPS (cts)	4.1	5.4	4.5	3.6	3.6
Core FD P/E (x)	31.5	27.9	24.8	19.2	14.3
P/BV (x)	11.4	9.7	8.5	6.6	4.9
Net dividend yield (%)	2.1	2.8	2.4	1.9	1.9
ROAE (%)	39.8	38.7	38.4	40.5	41.3
ROAA (%)	32.2	32.0	31.7	34.0	35.5
EV/EBITDA (x)	8.6	14.0	16.2	12.5	9.0
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash

Key Data

52w high/low (SGD)	3.23/1.93
3m avg turnover (USDm)	0.5
Free float (%)	42.9
Issued shares (m)	349
Market capitalization	SGD882.1M
Major shareholders:	
-Sarin Research & Development	28.7%
-Interhightech	12.7%
-FIL Investment Management	8.0%

Share Price Performance



	1 Mth	3 Mth	12 Mth
Absolute(%)	(9.0)	(20.7)	30.4
Relative to index (%)	(9.5)	(22.6)	22.9

Maybank vs Market

	Positive	Neutral	Negative
Market Recs	0	3	0
	Maybank Consensus		% +/-
Target Price (SGD)	3.18	3.05	4.1
'14 PATMI (USDm)	28	28	(1.0)
'15 PATMI (USDm)	36	38	(6.3)

Source: FactSet; Maybank

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Short-term issues

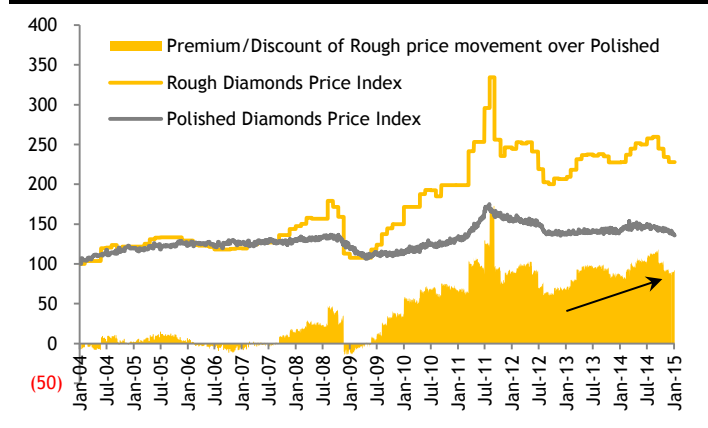
Transient challenges to bring down short-term sales. Indian rough diamond manufacturers are facing a number of challenges, which may impair their ability to invest in capital equipment, short term. These include:

- 1) Reduced bank credit. Antwerp Diamond Bank has wound down its business while Standard Chartered has cut its lending exposure to the sector. [[10 Nov 13: Credit crunch hits](#)]
- 2) Faster rise in rough diamond prices relative to polished prices.
- 3) INR depreciation against USD.

These are expected to bring down 4Q14 and possibly 1Q15 sales for Sarine as its customers hold back capex. We believe the 3% depreciation of INR against USD in Dec 2014 may have exacerbated its recent selldown.

Figure 1: Premium/discount of rough to polished prices

Faster rise in rough diamond prices with slower rise in polished prices has been pinching the margins of manufacturers



Source: Bloomberg, Maybank KE

Figure 2: USD/INR exchange rates

INR depreciated severely in Dec 2014



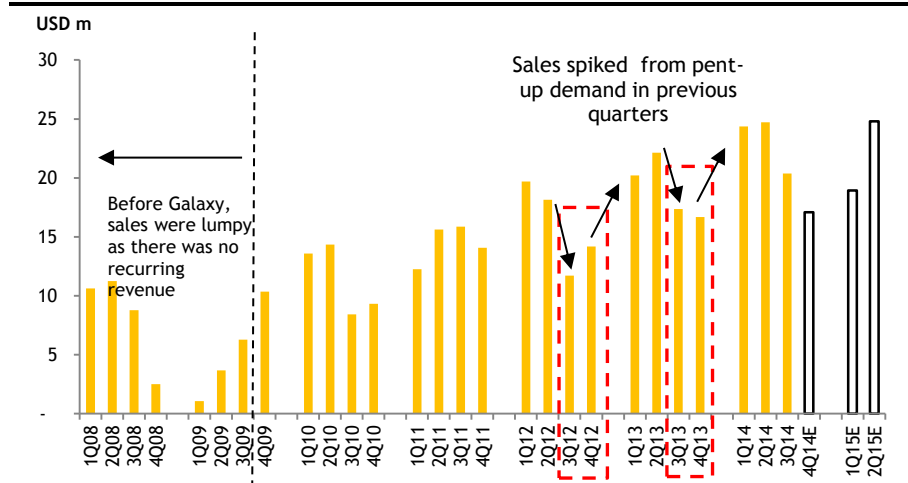
Source: Bloomberg

Such issues have depressed sales before. Nevertheless, high rough diamond prices and INR depreciation are transient issues that have affected the industry before, in 3Q12 and 3Q13. Sarine reported lower sales during those periods when manufacturers held back their spending on big-ticket items. See our past notes: [[4 Nov 13: Recognising its Worth](#)], [[14 Nov 12: Focus on long-term structural growth](#)].

Usually followed by strong rebounds. Its lower sales in 3Q12 and 3Q13 were followed by spikes in 4Q12-1Q13 and 1Q14 respectively (Figures 3 & 4), when the issues eased and customers made purchases on pent-up demand.

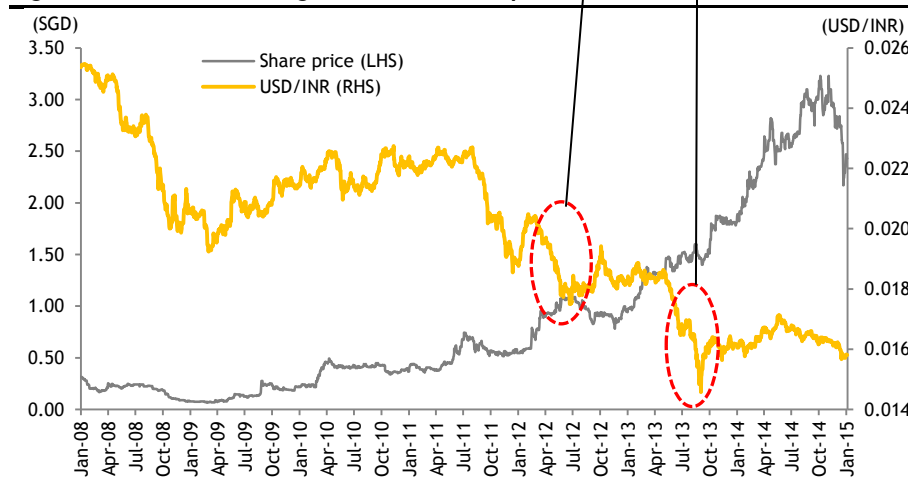
Effect of ADB's collapse on Indian diamond sector not as bad. The reduction in bank credit is of greater concern as the industry would need to find alternative financing. However, in terms of credit exposure to India (which accounts for 80% of Sarine's sales), Antwerp-based ADB is estimated to have direct exposure of USD200m to India out of its total lending of USD1.6b. In comparison, Indian banks collectively lend USD6-7b to the diamond trade. In fact, this credit crunch may weed out many speculative dealers who rely on large credit for diamond trading. If so, this could provide more stability to rough diamond prices.

Figure 3: Sarine's quarterly revenue



Source: Company, Maybank KE

Figure 4: USD/INR exchange rates and share price



Source: Bloomberg, Maybank KE

Reasons attributed to sales weakness

3Q10

- High rough diamond prices vs polished.
- Slowdown in capex after record 1H10.
- Cautious sentiment on macro-economic weakness.

3Q12

- Credit and liquidity issues in India.
- High rough diamond prices vs polished.

3Q13

- Weakened INR versus USD.
- Credit and liquidity issues in India.
- High rough diamond prices vs polished.

3Q14 - 1Q15

- Weakened INR versus USD.
- Credit and liquidity issues in India.
- High rough diamond prices vs polished.

Note also that 2H is usually weaker also because of the Diwali holiday in India where companies typically take a 2-3 weeks break.

Long-term game changers; Upgrade to BUY

Long-term incentives to upgrade technologies. In our opinion, margin-squeezed manufacturers have long-term incentives to upgrade their technologies to stay competitive and improve operational efficiencies. Sarine's Galaxy, Sarine Light and Sarine Loupe remain game-changing products with the potential to revolutionise industry practices. This likely explains its bounce in sales after each liquidity crisis.

Upgrade to BUY from HOLD, TP raised to SGD3.18. We cut FY14E-16E earnings by 4-9% for more conservative revenue assumptions. Despite our EPS cuts, our DCF-based TP rises to SGD3.18 from SGD2.98, as we now use a USD/SGD exchange rate of 1.30 vs 1.25 previously. Upgrade to BUY.

Figure 5: DCF valuation

(USD m)	FY15E	FY16E	FY17E	FY18E	FY19E
Net income	36.0	48.5	56.9	66.0	70.6
Less: Minority interest	0.0	0.0	0.0	0.0	0.0
Net income to equity holders	36.0	48.5	56.9	66.0	70.6
Add: Depreciation & amortisation	4.3	4.2	2.3	1.5	1.5
Add: Other non-cash charges	0.0	0.0	0.0	0.0	0.0
Add: After-tax interest expense	0.2	0.2	0.7	0.8	0.8
Less: Fixed capital investments	(1.2)	(1.2)	(1.2)	(1.2)	(1.2)
Less: Working capital investments	(0.3)	(2.6)	(1.8)	(1.4)	(1.5)
FCFF	39.0	49.0	56.8	65.7	70.1
PV of FCFF	39.0	44.7	47.3	49.8	48.5
Sum of PV of FCFF (FY16E-FY19E)	190.4				
Terminal value	936.8				
PV of terminal value	648.5				
Firm value	838.9				
Net debt/(cash)	(51.3)				
Equity value	890.1				
No. of shares (m)	364.4				
Equity value per share (USD)	2.443				
Exchange rate	1.30				
Equity value per share (SGD)	3.18				

Source: Maybank KE

Figure 6: Assumptions for our DCF valuation

Equity weight	100%	WACC	9.63%
Debt weight	0%	Terminal growth rate	2.0%
Risk-free rate	3.00%		
Market risk premium	8.50%		
Beta	0.78		
Cost of equity	9.6%		
Cost of debt	5.0%		
Tax rate	16.5%		

Source: Bloomberg, Maybank KE

Figure 7: DCF sensitivity to WACC and terminal growth rates

		WACC					
		8%	9%	9.6%	11%	12%	13%
Terminal growth rate	0%	3.18	2.84	2.66	2.34	2.15	1.99
	1%	3.54	3.11	2.89	2.50	2.28	2.10
	2%	4.01	3.45	3.18	2.71	2.45	2.23
	3%	4.67	3.91	3.55	2.96	2.64	2.39
	4%	5.67	4.56	4.06	3.29	2.89	2.58

Source: Maybank KE

Figure 8: Valuations of diamond miners and retailers

	Mkt cap		Target	Last	Last	FYE	EPS growth (%)			EV/EBITDA (x)			P/E (x)			P/BV (x)			ROE (%)			Div yield (%)			
	(USD m)	Curr					Rec	price	price	FY13A	FY14E	FY15E	FY13A	FY14E	FY15E	FY13A	FY14E	FY15E	FY13A	FY14E	FY15E	FY13A	FY14E	FY15E	FY13A
Anglo American plc	24,830	GBP	N.R.	N.A.	11.81	12	(36.1)	(320.8)	5.1	4.5	5.0	4.7	n.m.	11.1	10.6	0.9	0.7	0.7	(3.2)	7.0	6.5	4.4	4.6	4.8	
Mountain Province	577	CND	N.R.	N.A.	5.04	12	600.0	(83.9)	138.9	n.m.	n.m.	n.m.	n.m.	n.m.	n.m.	5.6	2.2	2.6	(30.5)	(2.8)	(5.1)	0.0	0.0	0.0	
Dominion Diamond	1,515	CND	N.R.	N.A.	21.04	01	1,332.5	(79.4)	8.5	8.2	3.6	4.1	3.6	17.5	16.1	1.2	1.1	1.0	43.6	6.7	6.7	n.a.	0.3	0.3	
Diamond Miners							632.1	(161.4)	50.8	6.4	4.3	4.4	3.6	14.3	13.3	2.5	1.4	1.4	3.3	3.6	2.7	2.2	1.6	1.7	
Tiffany & Co.	13,600	USD	N.R.	N.A.	105.14	01	(56.6)	205.4	13.6	15.2	12.9	11.7	74.6	24.4	21.5	5.0	4.4	4.0	6.8	19.2	19.5	1.3	1.4	1.6	
Signet Jewelers	10,114	USD	N.R.	N.A.	126.14	01	4.8	22.1	20.3	23.3	14.7	12.4	27.7	22.7	18.8	3.9	3.5	3.1	15.1	16.4	17.6	0.4	0.6	0.7	
Blue Nile	416	USD	N.R.	N.A.	35.11	12	34.9	(2.1)	19.7	21.8	16.3	14.5	41.3	42.2	35.2	11.2	19.1	10.7	39.8	33.4	38.9	0.0	0.0	0.0	
Diamond Retailers							(88.9)	75.1	17.9	20.1	14.6	12.9	36.2	29.8	25.2	5.0	9.0	5.9	17.2	23.0	25.3	0.4	0.7	0.7	
Sarine Technologies	656	SGD	Buy		3.18	2.53	12	12.9	12.3	29.2	17.8	15.9	12.8	27.7	24.6	19.1	9.9	8.4	6.6	37.8	37.3	38.7	2.9	2.4	1.9

Source: FactSet, Maybank KE

FYE 31 Dec	FY12A	FY13A	FY14E	FY15E	FY16E
Key Metrics					
P/E (reported) (x)	30.9	27.5	23.7	18.4	13.6
Core P/E (x)	30.9	27.5	23.7	18.4	13.6
Core FD P/E (x)	31.5	27.9	24.8	19.2	14.3
P/BV (x)	11.4	9.7	8.5	6.6	4.9
P/NTA (x)	13.7	11.1	9.2	6.8	4.9
Net dividend yield (%)	2.1	2.8	2.4	1.9	1.9
FCF yield (%)	3.0	1.9	4.7	5.8	7.2
EV/EBITDA (x)	8.6	14.0	16.2	12.5	9.0
EV/EBIT (x)	9.8	15.9	18.4	13.8	9.7

INCOME STATEMENT (USD m)

Revenue	63.8	76.4	86.5	95.0	114.5
Gross profit	43.4	54.6	62.6	71.8	88.0
EBITDA	28.0	33.9	37.9	47.1	61.5
Depreciation	(1.5)	(1.6)	(2.1)	(1.8)	(1.7)
Amortisation	(2.1)	(2.4)	(2.6)	(2.6)	(2.6)
EBIT	24.5	29.8	33.2	42.8	57.3
Net interest income / (exp)	0.1	0.0	0.2	0.3	0.6
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	24.5	29.8	33.4	43.1	57.9
Income tax	(3.8)	(5.9)	(5.5)	(7.1)	(9.5)
Minorities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	20.8	23.9	27.9	36.0	48.5
Core net profit	20.8	23.9	27.9	36.0	48.5

BALANCE SHEET (USD m)

Cash & Short Term Investments	36.3	33.1	46.9	71.5	106.3
Accounts receivable	8.8	19.6	21.2	23.3	28.1
Inventory	6.8	8.5	9.2	8.9	10.2
Property, Plant & Equip (net)	5.5	10.7	9.8	9.2	8.8
Intangible assets	9.2	8.4	5.8	3.2	0.7
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	1.1	1.4	1.4	1.4	1.4
Total assets	67.8	81.6	94.3	117.5	155.4
ST interest bearing debt	0.0	0.0	0.0	0.0	0.0
Accounts payable	2.0	3.3	3.6	3.5	4.0
LT interest bearing debt	0.0	0.0	0.0	0.0	0.0
Other liabilities	10.0	11.0	13.0	14.0	17.0
Total Liabilities	11.7	14.3	16.5	17.5	20.8
Shareholders Equity	56.1	67.3	77.8	100.0	134.6
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	56.1	67.3	77.8	100.0	134.6
Total liabilities and equity	67.8	81.6	94.3	117.5	155.4

CASH FLOW (USD m)

Pretax profit	24.5	29.8	33.4	43.1	57.9
Depreciation & amortisation	3.5	4.1	4.7	4.3	4.2
Adj net interest (income)/exp	(0.1)	(0.0)	(0.2)	(0.3)	(0.6)
Change in working capital	27.2	18.3	40.8	46.6	56.3
Cash taxes paid	(4.8)	(7.4)	(6.8)	(7.2)	(9.8)
Other operating cash flow	4.8	9.4	6.8	7.2	9.8
Cash flow from operations	23.2	19.6	32.5	39.6	49.1
Capex	(4.2)	(7.3)	(1.2)	(1.2)	(1.2)
Free cash flow	19.0	12.3	31.3	38.4	47.9
Dividends paid	(13.7)	(18.1)	(17.4)	(13.8)	(13.8)
Equity raised / (purchased)	(0.2)	1.5	0.0	0.0	0.0
Change in Debt	(0.9)	(0.7)	0.0	0.0	0.0
Other invest/financing cash flow	0.7	5.8	0.2	0.3	1.6
Effect of exch rate changes	(0.0)	0.1	0.0	0.0	0.0
Net cash flow	4.8	0.9	14.0	24.9	34.6

FYE 31 Dec	FY12A	FY13A	FY14E	FY15E	FY16E
Key Ratios					
Growth ratios (%)					
Revenue growth	10.3	19.8	13.3	9.8	20.5
EBITDA growth	14.1	21.1	11.8	24.3	30.7
EBIT growth	15.1	21.8	11.5	28.8	34.0
Pretax growth	14.4	21.6	12.0	29.0	34.5
Reported net profit growth	19.5	15.1	16.7	29.2	34.6
Core net profit growth	19.5	15.1	16.7	29.2	34.6
Profitability ratios (%)					
EBITDA margin	43.9	44.4	43.8	49.6	53.7
EBIT margin	38.4	39.0	38.4	45.0	50.1
Pretax profit margin	38.5	39.0	38.6	45.3	50.6
Payout ratio	66.0	78.2	55.9	34.6	25.7
DuPont analysis					
Net profit margin (%)	32.6	31.3	32.2	37.9	42.3
Revenue/Assets (x)	0.9	0.9	0.9	0.8	0.7
Assets/Equity (x)	1.2	1.2	1.2	1.2	1.2
ROAE (%)	39.8	38.7	38.4	40.5	41.3
ROAA (%)	32.2	32.0	31.7	34.0	35.5
Liquidity & Efficiency					
Cash conversion cycle	122.1	149.9	166.0	169.8	159.4
Days receivable outstanding	47.6	67.0	84.9	84.4	80.8
Days inventory outstanding	115.8	127.1	133.2	140.6	129.4
Days payables outstanding	41.3	44.2	52.1	55.2	50.8
Dividend cover (x)	1.5	1.3	1.8	2.9	3.9
Current ratio (x)	4.7	4.4	4.8	6.0	7.1
Leverage & Expense Analysis					
Asset/Liability (x)	5.8	5.7	5.7	6.7	7.5
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Net interest cover (x)	na	na	na	na	na
Debt/EBITDA (x)	0.0	0.0	0.0	0.0	0.0
Capex/revenue (%)	6.6	9.5	1.4	1.3	1.0
Net debt/ (net cash)	(36.3)	(33.1)	(46.9)	(71.5)	(106.3)

Source: Company; Maybank

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