

Singapore Company Update

Sarine Technologies

Bloomberg: SARINE SP | Reuters: SARI.SI

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DBS Group Research . Equity

19 May 2022

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HOLD (Upgrade from FULLY VALUED)

Last Traded Price (18 May 2022): S\$0.460 (STI : 3,225.35)

Price Target 12-mth: S\$0.50 (9% upside) (Prev S\$0.45)

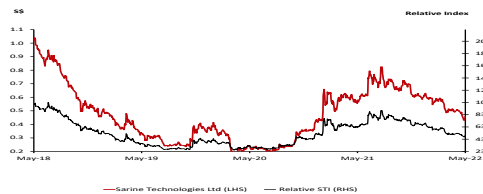
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What's New

- 1Q22 revenue of US\$15.6m was in line while net profit at US\$3.4m was higher than expected on robust gross margins of 71.8%
- Trade revenues continued to gain traction, reaching 11.6% of overall revenues in 1Q22
- Upgrade to HOLD with higher TP of S\$0.50 from \$0.45 previously

Price Relative



Forecasts and Valuation

FY Dec (US\$m)	2021A	2022F	2023F	2024F
Revenue	62.1	57.2	59.4	63.0
EBITDA	22.2	14.6	15.2	16.3
Pre-tax Profit	18.9	12.3	13.1	14.3
Net Profit	16.5	9.81	10.5	11.4
Net Pft (Pre Ex.)	16.5	9.81	10.5	11.4
Net Pft Gth (Pre-ex) (%)	595.8	(40.4)	7.1	8.7
EPS (S cts)	6.52	3.89	4.17	4.53
EPS Pre Ex. (S cts)	6.52	3.89	4.17	4.53
EPS Gth Pre Ex (%)	593	(40)	7	9
Diluted EPS (S cts)	6.52	3.89	4.17	4.53
Net DPS (S cts)	2.78	2.78	2.78	2.78
BV Per Share (S cts)	28.0	29.1	30.5	32.2
PE (X)	7.1	11.9	11.1	10.2
PE Pre Ex. (X)	7.1	11.9	11.1	10.2
P/Cash Flow (X)	5.5	6.3	9.7	9.3
EV/EBITDA (X)	3.6	4.8	4.4	3.8
Net Div Yield (%)	6.0	6.0	6.0	6.0
P/Book Value (X)	1.7	1.6	1.5	1.4
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	25.1	13.6	14.0	14.5
Earnings Rev (%)		26	22	8
Consensus EPS (S cts)		4.10	4.50	5.60
Other Broker Recs:		B: 1	S: 1	H: 0

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P.

Growing trade revenues to lift margins

Investment Thesis:

Burgeoning trade revenues to lift margins: Russian-Ukraine crisis is accelerating demand for diamond traceability.

According to our channel checks, the Russian-Ukraine crisis has accelerated interest in traceability solutions by 1-2 years as companies avoid Russian mined diamonds. In 1Q22, trade revenues inched up to 11.6% of overall revenues (vs 8% in FY21, and 11% in 2H21). A growing trade revenues segment is positive for gross margins.

Adopt a cautious stance given the ongoing Russia-Ukraine crisis.

While Sarine's business was not affected in 1Q22, stricter sanctions on Alrosa were enacted in April. At the same time, US demand for Russian diamonds has declined. If the Russia-Ukraine war persists, we could see a weaker diamond industry.

Exceptional growth in 2021 unlikely to be sustained. The remarkable growth rates in 2021 were caused by a myriad of factors such as induced demand due to consumer spending boosted by stimulus checks, favourable polished and rough spreads, a low base effect in 2020.

Valuation:

Upgrade to HOLD with higher TP of S\$0.50, from S\$0.45 previously. Our TP of 50cts is based on the average of 1) 12.5x (20% discount to historical mean) and 2) peer average of 14x. We have taken a 20% discount to the historical average PE to reflect the ongoing macroeconomic and geopolitical headwinds and risks.

Where we differ:

We are more cautious on revenue assumptions given the ongoing Russia-Ukraine crisis.

Key Risks to Our View:

Prolonged Russia-Ukraine Crisis, longer than expected bifurcation of rough supply, stagnant trade revenue

At A Glance

Issued Capital (m shrs)	351
Mkt. Cap (S\$m/US\$m)	162 / 117
Major Shareholders (%)	
Axxion S.A	9.2
Harel Ehud	7.4
Free Float (%)	78.6
3m Avg. Daily Val (US\$m)	0.07
GIC Industry : Industrials / Capital Goods	



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WHAT'S NEW

1Q22 revenue in line with expectations; stronger margins than expected

Results Review

1Q22 revenue came in at US\$15.6 million, in line with expectations. This forms 27% of our full year forecasts for FY22. 1Q22's revenue is 9.9% lower compared to 1Q21 due to the exceptionally strong first quarter last year.

Net profit of US\$3.4 million was higher than expected on robust gross margins of 71.8%. The higher-than-expected gross margins can be attributed to the increasing proportion of trade revenues as well as the sale of higher end galaxy machines. In 1Q22, Sarine delivered 17 Galaxy-family systems comprising one Galaxy Ultra, five Galaxy models, two Meteor and nine Meteorites.

No material impact from the Russia-Ukraine crisis in 1Q22. Russian rough diamonds continued to flow into the pipeline in the first quarter. The utilization rates of Sarine's inclusion mapping systems did not differ significantly compared to late 2021, recording 100,000 stones daily on average. This indicates that midstream polishing activities were generally not too affected by the Russia-Ukraine crisis.

Trade revenues gaining traction, reaching 11.6% of overall revenues in 1Q22. Trade revenues consist of revenue from the Sarine Profile, the Sarine Diamond Journey, and digital tenders. Sarine's traceability and grading solutions has gained acceptance by luxury brands such as Maison Boucheron. In April, we continue to see adoption from the Aura Blockchain Consortium and Bonas Group. Keep a lookout on more customer acquisitions that could drive trade revenues.

Our Thoughts

We are adopting a cautious stance given that the Russia-Ukraine crisis is still ongoing. While Sarine's business was not materially affected in 1Q22, we note that the stricter sanctions on Alrosa were enacted in April. The US has placed Alrosa on the Specially Designated Nationals list, which bans Alrosa from trading with Americans and kicks it out of the US banking system. Alrosa has cancelled its last sale in April and reports indicate that they are unlikely to sell large volumes in May given the sanctions. At the same time, US demand for Russian diamonds has declined. Firms such as Tiffany and Co and Signet have

stopped purchasing diamonds mined in Russia. If the Russia-Ukraine crisis persists, the flow of Russian rough diamonds could be impacted, which could lead to a weaker outlook.

Expect bifurcation of diamonds supply. Given that the US government has placed Alrosa on the Office of Foreign Assets Control (OFAC) list of banned entities and some US companies have ceased their purchases of Russian mined diamonds, manufacturers are starting to separate goods to serve different markets. It is expected that Russian supply will shift towards China, although demand may be hampered by the resurgence of Covid-19 cases and lockdowns.

Diamond manufacturing in India remained steady in 1Q22. India's cut and polished exports are a good indicator of manufacturing and production activity of diamond manufacturers. An increase in midstream diamond manufacturing activity translates to higher recurrent revenue from diamond scanning.

India's cut and polished exports (USD \$m)



Source: GJEPC, DBS Bank

Going forward, slowdown in diamond manufacturing is likely, although extent of slowdown is still uncertain. Scanning data from Sarine has shown less polishing activity partially due to the summer vacation in India which resulted in a slowdown in business operations of manufacturers. Another possible reason for manufacturing slowdown could be the expected decline in inventories of rough, possibly constraining diamond manufacturing activity, at least until a more robust bifurcation of Russian supply. While US retail sales have remained stable, we are also keeping a close watch on the impact of rising interest rates and inflation.

Poor visibility on rough and polished price spreads.

Given that the polished and diamond prices are impacted by a myriad of factors, it is challenging to predict the difference in rough and polished prices. Nonetheless, apart from the price of small rough diamonds that have risen 20% since the beginning of March, the overall market price of diamonds is lower than their February highs. Manufacturers who purchase rough diamonds now are poised to enjoy better margins compared to the same period in February. Historically, better midstream manufacturer margins have translated to higher capital equipment sales for Sarine.

Burgeoning trade revenues to lift margins: Russian-Ukraine crisis has accelerated demand for diamond traceability.

According to our channel checks, the Russian-Ukraine crisis has accelerated interest in traceability solutions by 1-2 years as companies avoid Russian mined diamonds. As at 1Q22, trade revenues have inched up to 11.6% of overall revenues (vs 8% in FY21 and 11% in 2H21). A growing trade segment will positively impact gross margins as the cost of providing these services is much lower compared to capital equipment sales.

Upgrade to HOLD with higher TP of S\$0.50, from S\$0.45 previously.

Since our last report, Sarine's share price has corrected to near our previous target price on normalization of top and bottom lines. Our revenue

assumptions remain unchanged, but we have revised our margin assumptions upwards on acceleration in the trade services segment in light of the Russia-Ukraine crisis. We have increased our margin assumptions to 70.0%/70.5%/71.0% from 68%/69%/70% for FY22/FY23/FY24. Our EPS is revised upwards to 2.79 UScts and 2.99 UScts by 26.4% and 22.2% for FY22/FY23 respectively.

Our TP of 50cts is based on the average of 1) 12.5x (20% discount to historical mean) and 2) peer average of 14x. We have taken a 20% discount to the historical average PE to reflect the ongoing macroeconomic and geopolitical headwinds and risks. We have assumed an exchange rate of 1.36 (USD/SGD).

Company Background

Sarine Technologies Ltd. Develops, manufactures, markets, and sells precision technology products for the processing, grading, and trade of diamonds utilized throughout the diamond industry value chain from upstream, midstream, and downstream. Sarine Technologies' products span the areas of inclusion mapping, planning, sawing & shaping, polishing & cut finishing, laser inscription, visualization & grading, and trade.

Income Statement (US\$m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Revenue	41.0	62.1	57.2	59.4	63.0
Cost of Goods Sold	(13.9)	(16.3)	(17.1)	(17.5)	(18.3)
Gross Profit	27.1	45.8	40.0	41.9	44.7
Other Opng (Exp)/Inc	(22.3)	(26.9)	(27.9)	(29.0)	(30.7)
Operating Profit	4.76	18.9	12.1	12.9	14.0
Other Non Opng (Exp)/Inc	0.0	0.27	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(0.8)	(0.3)	0.12	0.21	0.26
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	4.01	18.9	12.3	13.1	14.3
Tax	(1.6)	(2.5)	(2.5)	(2.6)	(2.9)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	2.37	16.5	9.81	10.5	11.4
Net Profit before Except.	2.37	16.5	9.81	10.5	11.4
EBITDA	8.79	22.2	14.6	15.2	16.3
Growth					
Revenue Gth (%)	(20.2)	51.6	(8.0)	4.0	6.0
EBITDA Gth (%)	60.0	152.5	(34.1)	3.4	7.9
Opg Profit Gth (%)	332.6	297.6	(35.9)	6.4	8.4
Net Profit Gth (Pre-ex) (%)	nm	595.8	(40.4)	7.1	8.7
Margins & Ratio					
Gross Margins (%)	66.1	73.8	70.0	70.5	71.0
Opg Profit Margin (%)	11.6	30.5	21.3	21.8	22.3
Net Profit Margin (%)	5.8	26.5	17.2	17.7	18.1
ROAE (%)	3.9	25.1	13.6	14.0	14.5
ROA (%)	3.0	19.6	10.9	11.2	11.6
ROCE (%)	2.4	22.3	12.9	13.4	13.9
Div Payout Ratio (%)	44.4	42.7	71.6	66.8	61.5
Net Interest Cover (x)	6.3	71.2	NM	NM	NM

Interim Income Statement (US\$m)

FY Dec	2H2019	1H2020	2H2020	1H2021	2H2021
Revenue	28.8	22.4	18.6	36.0	26.2
Cost of Goods Sold	(11.9)	(8.4)	(5.5)	(9.1)	(7.2)
Gross Profit	16.9	14.0	13.1	26.9	19.0
Other Oper. (Exp)/Inc	(14.1)	(11.8)	(10.5)	(12.8)	(13.8)
Operating Profit	2.82	2.15	2.62	14.0	5.17
Other Non Opng (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(0.4)	0.04	(0.8)	0.06	(0.3)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	2.45	2.18	1.83	14.1	4.84
Tax	(1.0)	(1.0)	(0.6)	(1.5)	(1.0)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Profit	1.44	1.17	1.19	12.6	3.88
Net profit bef Except.	1.44	1.17	1.19	12.6	3.88
EBITDA	4.96	2.15	2.62	14.0	5.17
Growth					
Revenue Gth (%)	27.9	(22.2)	(17.1)	93.7	(27.3)
EBITDA Gth (%)	829.2	(56.8)	22.1	436.1	(63.2)
Opg Profit Gth (%)	(264.1)	(23.9)	22.1	436.1	(63.2)
Net Profit Gth (%)	(151.3)	(18.8)	1.6	955.3	(69.2)
Margins					
Gross Margins (%)	58.8	62.4	70.5	74.7	72.6
Opg Profit Margins (%)	9.8	9.6	14.1	39.0	19.8
Net Profit Margins (%)	5.0	5.2	6.4	35.0	14.8

Source: Company, DBS Bank

Sarine Technologies

Balance Sheet (US\$m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Net Fixed Assets	12.3	11.4	10.5	9.68	8.85
Invt in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other LT Assets	10.2	8.74	8.36	8.36	8.36
Cash & ST Invt	27.4	36.4	46.6	50.3	54.3
Inventory	6.25	7.28	6.54	6.69	6.97
Debtors	22.0	23.6	19.1	19.9	21.1
Other Current Assets	1.76	1.06	1.06	1.06	1.06
Total Assets	79.9	88.4	92.2	95.9	101
ST Debt	0.28	0.0	0.0	0.0	0.0
Creditor	1.87	2.32	2.38	2.43	2.53
Other Current Liab	8.30	10.6	11.5	11.7	12.0
LT Debt	3.14	0.0	0.0	0.0	0.0
Other LT Liabilities	5.59	4.97	4.97	4.97	4.97
Shareholder's Equity	60.7	70.6	73.3	76.8	81.2
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Cap. & Liab.	79.9	88.4	92.2	95.9	101
Non-Cash Wkg. Capital	19.8	19.0	12.8	13.5	14.7
Net Cash/(Debt)	24.0	36.4	46.6	50.3	54.3
Debtors Turn (avg days)	162.9	133.9	136.5	119.9	118.8
Creditors Turn (avg days)	106.8	57.6	58.6	57.3	56.8
Inventory Turn (avg days)	216.4	185.8	172.2	157.6	156.3
Asset Turnover (x)	0.5	0.7	0.6	0.6	0.6
Current Ratio (x)	5.5	5.3	5.3	5.5	5.8
Quick Ratio (x)	4.7	4.6	4.7	5.0	5.2
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	22.4	N/A	N/A	N/A	N/A

Cash Flow Statement (US\$m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Pre-Tax Profit	4.01	18.9	12.3	13.1	14.3
Dep. & Amort.	4.03	3.00	2.50	2.22	2.33
Tax Paid	(1.6)	(2.5)	(1.5)	(2.5)	(2.6)
Assoc. & JV Inc/(loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	(10.7)	0.36	5.26	(0.9)	(1.4)
Other Operating CF	2.34	1.31	0.0	0.0	0.0
Net Operating CF	(2.0)	21.1	18.5	12.0	12.6
Capital Exp.(net)	(0.8)	(0.9)	(1.3)	(1.4)	(1.5)
Other Invt.(net)	4.89	(2.8)	(2.7)	(0.5)	(0.6)
Invt in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	0.32	0.39	0.0	0.0	0.0
Net Investing CF	4.44	(3.3)	(4.0)	(1.9)	(2.1)
Div Paid	(1.1)	(7.0)	(7.0)	(7.0)	(7.0)
Chg in Gross Debt	3.22	(3.4)	0.0	0.0	0.0
Capital Issues	(0.3)	(0.3)	0.0	0.0	0.0
Other Financing CF	(1.5)	(1.0)	0.0	0.0	0.0
Net Financing CF	0.39	(11.6)	(7.0)	(7.0)	(7.0)
Currency Adjustments	(0.1)	0.01	0.0	0.0	0.0
Chg in Cash	2.80	6.28	7.49	3.15	3.48
Opg CFPS (S cts)	3.48	8.23	5.26	5.12	5.54
Free CFPS (S cts)	(1.1)	8.02	6.84	4.22	4.40

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	11 Mar 22	0.51	0.45	FULLY VALUED

Note: Share price and Target price are adjusted for corporate actions.

Source: DBS Bank

Analyst: Sachin MITTAL

Singapore Research Team

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STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)
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*Share price appreciation + dividends

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