



Sarine Technologies

(SARINE SP/SARI.SI)

Gem in the rough

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- **The diamond market is recovering from the COVID-19 trough**, as sales of rough diamonds are back at healthy levels. Sarine should benefit from a normalization of industrial activity.
- **Software complements hard rocks.** Sarine's Diamond Journey addresses the growing concerns of sustainable, conflict-free diamonds, while e-Grading could be a game changer in the diamond grading industry.
- **Other positive developments** include the recent raid by Indian tax authorities on Diyora & Bhanderi Company (DBC), as well as Sarine's dual listing plans in Tel Aviv.
- Our earlier report of an Underperform call was based off an erroneous currency calculation. Our Target Price is derived off 25 x US\$0.019 EPS = US\$0.49, which equates to around S\$0.65, assuming 1 USD = 1.34 SGD.
- We re-issue the initiation with an **OUTPERFORM** rating. Sarine looks to report 1Q21 results in the 2nd week of May. Further upside from our target price can come from positive e-Grading progress or stronger than expected equipment sales.

Investment Thesis:

Diamond market recovery. The reduction of rough diamond supply due to COVID-19 has aided in reducing excess inventories from prior years, while diamond sales have picked up since 4Q20, leading to favourable price dynamics. We expect Sarine to see a rebound in equipment sales and recurring revenue from the increased rate of activity in the diamond markets.

Software complements hard rocks. With almost 20% of diamond retail sales occurring online, the diamond industry faces the challenge of staying relevant to the next generation of consumers, whom care about speed, convenience and transparency. Diamond Journey and e-Grading are features that Sarine believes will meet these needs.

And other good news. The recent raid by Indian tax authorities on DBC, as well as Sarine's dual listing plans serve as positive tailwinds for the stock.

Forecasts. We expect sales to rebound 25% in 2021, and a return to profitability levels similar to 2017-2018. However, we do not expect Sarine to breach US\$60mn sales by 2022, as COVID-19 cases climb again in India. Profit margins are unlikely to reach the high double digits as enjoyed by Sarine in the past, as management expects to continue spending to push out e-Grading and Diamond Journey.

Outperform (Initiation)		Performance (Absolute)	
Price as of 6 May 21 (SGD)	0.58	1 Month (%)	-6.2
12M TP (\$)	0.65	3 Month (%)	-10.7
Previous TP (\$)	NA	12 Month (%)	169.5
Upside, incl div (%)	17.6	Perf. vs STI Index (Red)	
Trading data			
Mkt Cap (\$mn)	201		
Issued Shares (mn)	350		
Vol - 3M Daily avg (mn)	2.7		
Val - 3M Daily avg (\$mn)	1.6		
Free Float (%)	77.2%		
Major Shareholders		Previous Recommendations	
Axxion SA	9.2%		
Harel Ehud	7.4%		
FIL Ltd	5.0%		

Financials & Key Operating Statistics					
YE Dec (US\$ m)	2019	2020	2021F	2022F	2023F
Revenue	51,323	40,968	51,353	57,199	57,883
Gross Profit	29,584	27,070	33,893	37,752	38,203
PATMI	(1,372)	2,365	5,946	6,800	7,025
EPS (US cents)	(0.39)	0.68	1.70	1.94	2.01
EPS growth (%)	(118.1%)	(272.8%)	151.4%	14.4%	3.3%
DPS (US cents)	0.80	0.50	1.00	1.00	1.00
Div Yield (%)	1.9%	1.2%	2.3%	2.3%	2.3%
Net Profit Margin (%)	(2.7%)	5.8%	11.6%	11.9%	12.1%
Net Gearing (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
Price / Earnings (x)	(108.0)	63.5	25.2	22.1	21.4
Price / Book (x)	3.39	3.31	3.14	2.95	2.77
ROE (%)	-4.6%	3.9%	9.5%	10.3%	10.0%

Source: Company data, KGI Research

Valuation & Action:

We initiate with an **OUTPERFORM** and a Target Price of US\$0.49 (S\$0.65), based on 25x P/E of FY2022F EPS. We like Sarine's turnaround story, although the return of COVID-19 cases in India could dampen business recovery in the latter half of 2021. We value the e-Grading business separately at around US\$0.30-0.60 (S\$0.40-0.80), but do not account it into our Target Price, until we observe for sufficient adoption rates within the industry.

Risks: Additional waves of COVID-19, which will disrupt working conditions within the industry. Growing synthetic diamond industry. Forex risks.

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Investment Thesis

Upstream: Diamond market bounces back

Upstream – market sentiment has improved

Diamond prices remain in a long-term uptrend despite the challenging environment over the past 10 years.

Prices in the diamond industry remain in a long-term uptrend, but have experienced a correction in the past 10 years, caused by a supply-demand imbalance. Rough diamond production peaked in 2017 at about 152 million carats, a 20% increase over usual production volume of 120-130mn carats, due to substantial increased production from Canada and Botswana.

In 2020, the diamond industry experienced both supply and demand shocks due to COVID-19, with production volume estimated to be between 111 and 119mn carats, a low not seen since the 2009 recession. Rough diamond sales were also heavily impaired during the early innings of COVID-19, with DeBeers reporting just US\$50mn of sales for the whole of 2Q20. However, rough diamond sales have rapidly picked up since 4Q20, with 6 consecutive cycles since October 2020 to achieve more than US\$400mn of sales.

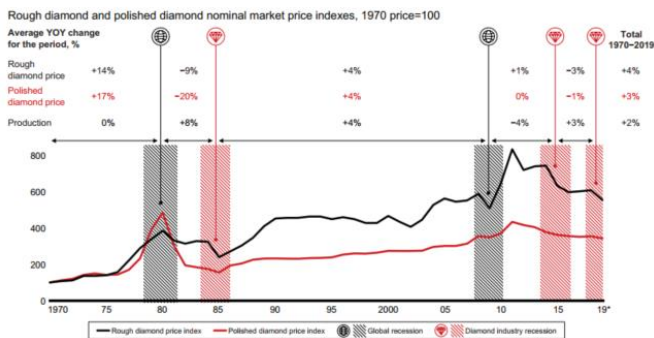
With overall market recovery, we expect Sarine to see a rebound in recurring revenues from the full suite of services provided to industry players. Sarine has reported Galaxy’s annualized scanning rate to be around 27 million for 4Q20, over 40% higher than the 18-19 million achieved in 2019 and 2020. Sarine management has also given strong guidance regarding Galaxy system sales, with expectations of matching or surpassing the record 145 systems sold in 2019.

In 2021 and the next few years, global rough diamond supply is projected to stay stable at 110-120mn carats/year, where the increased production of reopened profitable mines in 2021 could be offset by the November 2020 closure of the Argyle mine in Australia. While the reduced global rough stone pipeline could possibly mean less stones to pass through Sarine’s scanners, we view the overall situation to be a net boon for Sarine as:

- 1) The overall market recovery, due to a reduction of excess diamond inventory, and stabilization of the supply chain has improved business sentiment amongst Sarine’s customers, which has a strong positive influence on equipment sales.
- 2) Sarine’s Meteor and Meteorite scanners have not reached peak market penetration, as they were introduced to the Galaxy family in 2015 and 2018 respectively. Thus there remains headroom for scanning numbers to increase.
- 3) The bulk of un-scanned stones are much smaller, under the 0.9 carat range, with Sarine adopting a flat monthly charge instead of a per-carat use charge. Going forward, Sarine’s recurring revenues will be less dependent on the size of pipeline and more dependent on whether the pipeline continues running, leading to active machinery usage.

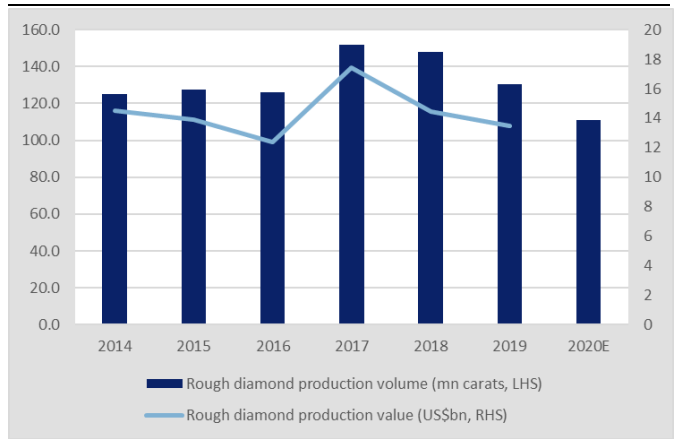
Figure 1: Price index of rough and polished diamond since 1970

Figure 36: Since 1970, the industry has experienced healthy long-term price growth for rough and polished diamonds



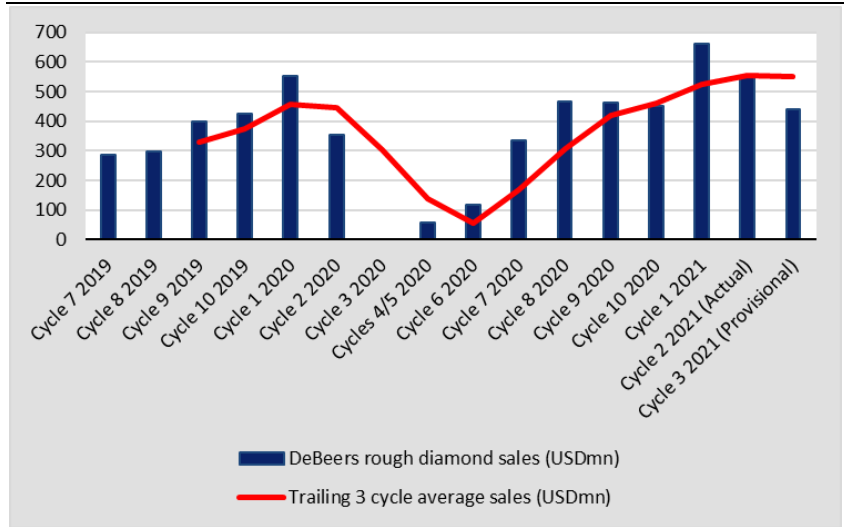
Source: Bain & Co.

Figure 2: Rough diamond production value and volume from 2014.



Source: Rapaport, Statista

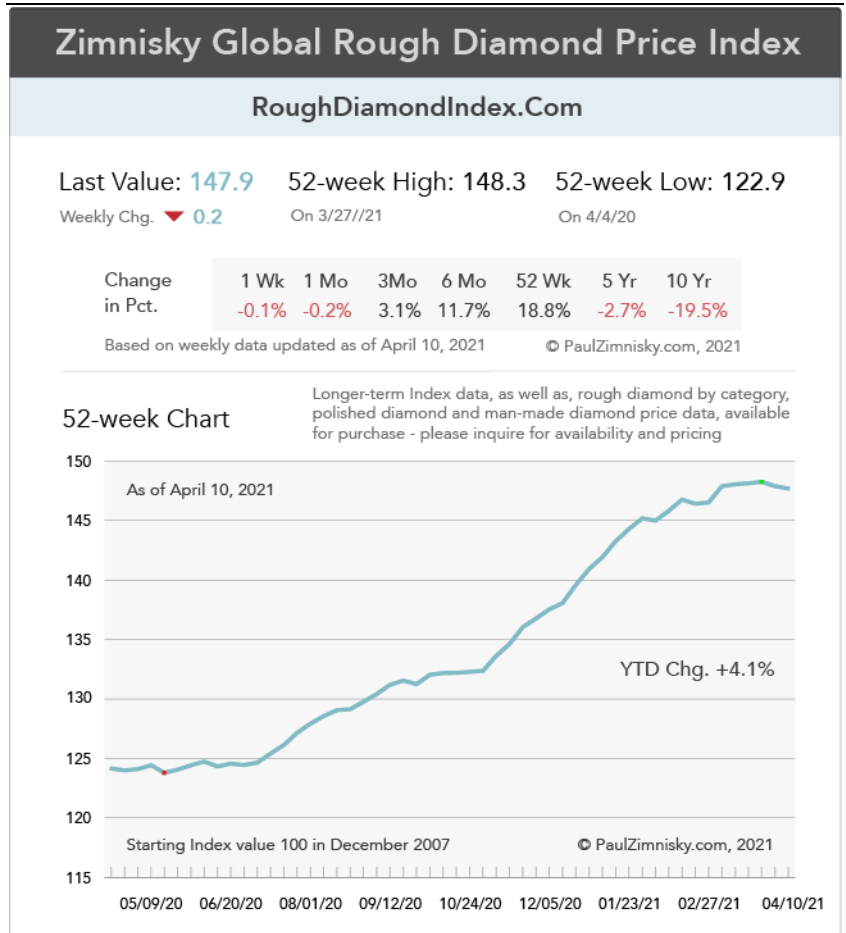
Figure 3: DeBeers rough diamond sales have trended up in 4Q20, with momentum carrying into 2021



Source: DeBeers, KGI Research

Rough diamond prices have recovered in 2021 due to a reduction of excess diamond inventory, and stabilization of the supply chain.

Figure 4: Rough diamond prices reach a fresh high after a multi-year downtrend



Source: paulzimnisky.com

Downstream – Demand for speed, convenience, and transparency can drive software innovation in a hard rock industry

The rise of online sale channels continues, with COVID-19 as a major catalyst for e-commerce. The diamond business was no exception as consumers were less able or willing to visit jewelry retail shops. According to Bain, up to 20% of diamond retail sales occurred online, an increase from around 13% in 2019. This is fairly in line with e-commerce penetration rates in most countries with developed e-commerce infrastructure, such as the US, China, South Korea etc, and marks a remarkable shift in consumer sentiment towards speed and convenience, even with big-ticket luxury purchases such as diamonds.

Additionally, the rise of social consumerism has led to demand for sustainable and conflict-free diamond production amongst consumers. Earlier attempts by the diamond industry to avoid conflict diamonds such as the standards guidance by the Responsible Jewellery Council (RJC), the leading standards authority in the diamond industry, or the Kimberley Process Certification Scheme were largely inadequate. Legacy certification standards did not require full traceability, transparency or on-the-ground human rights assessments from their members. Retailers that can incorporate such forms of additional data to their featured diamonds can expect a smoother sales process.

Figure 5: Focus on ESG at the downstream can create further brand differentiation, leading to opportunities for new tools and equipment



Source: Human Rights Watch

Sarine Profile – now offering traceability through Diamond Journey

Sarine is making inroads into the Business-to-Business-to-Consumer (B2B2C) segment with the introduction of Sarine Diamond Journey.

Sarine has adopted to consumers' demand by introducing Sarine Diamond Journey to retailers. Due to Sarine's ties throughout the industry, Sarine is able to get actual data input from miner to retailer regarding each diamond, where data collection is handled by Sarine's scanners. The implementation from the miners' end has minimal additional input costs, and by scanning the diamonds, miners can also register their rough stones for digital tenders, which is beneficial if miners choose to sell their diamonds remotely instead of the traditional auction approach. Diamond Journey has seen the support of Alrosa, the world's largest diamond producer by carats, Lucara and Grib, with other miners running pilot tests.

Sarine plans to integrate Diamond Journey into its suite of downstream solutions. Other products include Sarine Verto, for 3D jewelry imaging; Sarine Light, for light performance grading; DiaMension, Sarine Clarity and Sarine Color, products for automated grading three of the 4Cs; Sarine Loupe and Sarine Connect, for improving the user experience through better video imagery and digital inventory visualisation; TruMatch, for identity verification during purchase; and finally Sarine Profile, which will be the one-stop platform to access the relevant information related to the consumer's diamond purchase.

While Sarine is not the only player in town addressing traceability issues, it has several advantages.

We note that Sarine is not the only player addressing the traceability issue, as players across the industry are also looking to add traceability capabilities as a part of their marketing strategy. Other notable mentions in this space include De Beers' Tracr, Berkshire Hathaway's Richline/IBM collaboration on TrustChain, and Everledger/Gemological Institute of America (GIA)/JD.com's inter-blockchain collaboration to help reduce diamond fraud in the Chinese diamond retail and e-commerce market. Overall we expect Sarine's Diamond Journey solution to be more sustainable and gain wider adoption than the rest as:

- 1) Everledger/GIA/JD is not implementing a miner-to-retailer solution, and does not address the global market.
- 2) TrustChain has not released any news over the past year, and its initiative currently remains limited to the diamonds from the 6 styles of engagement rings that it is trialling since 2018.
- 3) Sarine's all-in-one package in Sarine Profile provides much more to retailers and customers than peers' standalone products.
- 4) Diamond Journey is able to deliver value to other necessary partners (i.e. digital tenders for miners) and is much more easily implemented through Sarine's existing machines, whereas De Beers, Richline or GIA may require higher input costs in order to incentivise partners on the other ends of the supply chain to participate

Better positioned for a slice of the diamond grading market by going digital

Diamond Journey works hand in hand with e-Grading, the next major software offering by Sarine. Diamond grading operates between the mid-stream and downstream, and is an additional process used to create a consistent standard for describing a diamond's characteristics. Since 1992, Sarine has been introducing tools to perform automated measurements of a diamond's 4Cs, the 4 main characteristics of Carat, Cut, Color and Clarity which dominates diamond grading and subsequently diamond valuation. In 2020, Sarine packaged the tools into e-Grading, where manufacturers and other industry players can use Sarine's tools to grade in-house without having to go off-site to a gemmological lab for grading. This will help customers save time and reduce their in-house costs of doing 4C grading. Without the need for human labour, e-grading is also substantially cheaper than traditional 4C grading, enabling lab-grown diamonds (LGD) as a potential market for grading services as well.

Sarine estimates the current diamond grading market to be around US\$500mn a year, where the Gemological Institute of America (GIA) takes up a substantial portion of market share, while the American Gem Society (AGS), European Gemological Laboratory (EGL) and the International Gemological Institute (IGI) compete for what remains. GIA's certifications are largely preferred over its peers as the company is known for its consistent and reliable grading, and as a result improves its diamond trading liquidity and sometimes its market value. Currently, traditional diamond grading by GIA takes around seven days. In recent months, COVID-19 restrictions combined with an increased demand for rough buying has led to a turnaround time of up to 25 days.

Let the e-Grading wars begin? Sarine has to capitalize on first-mover advantage

While e-Grading has its benefits in reducing turnover time and costs, **market adoption rate will be a key challenge to tackle for the grading industry**. Sarine has ventured into automated grading solutions since 2016, but have yet to break even on the business, which currently accounts for less than 3% of sales. On July 2020, GIA has also announced interest in automated grading, through a partnership with IBM to bring AI to diamond grading. We see this first step by GIA as a symbolic for the industry, as acknowledgement that non-human diamond grading could be the long-term solution for the market. Sarine's first mover advantage may be eroded by GIA and other grading institutes if they fail to win customers over in time.

While GIA and Sarine are targeting larger diamonds as the initial focus group, we note that a bottom-up approach could also be feasible in the market. Major Chinese diamond retailer Chow Tai Fook has launched its own AI diamond certificates, with their own numeric-based grading scale for stones weighing 0.3 carats or less through T Mark, the retailer's diamond brand.

Other tailwinds align for 2021 rebound

As DeBeers reports yet another strong selling cycle in April with over US\$400mn of sales, Sarine's share prices saw strong positive momentum, climbing to a 27-month high. Sarine's latest commentary within the financial statements confirmed that market activity in the diamond market, as well as demand for their diamond making equipment has rebounded from COVID lows.

Say No to Piracy

Sarine also observes a secondary tailwind in the form of improved regulatory attention to software and hardware piracy issues in India, which have plagued the company for more than 5 years. Sarine's core business comes from the sale of its DiaExpert and Galaxy diamond scanning machines as well as a pay-per-use business model where customers also pay Sarine based on the quantity and weight of rough stones scanned. In the earlier years, piracy largely took the form of software hacks, in which diamond manufacturers can manipulate Sarine Galaxy's mapping system to underreport the weight of rough stones scanned, thus having to pay less to Sarine. However, recent years saw the emergence of entire counterfeit machines that run with the pirated software.

Since 2017, Sarine has taken an active approach in taking legal action against competitors whom are likely infringing Sarine's intellectual property rights. Sarine's efforts to sue for copyright and patent infringement have started to bore fruit in 2021 with a raid by Indian tax authorities on Diyora & Bhandari Company (DBC), a diamond scanning firm that Sarine have alleged since 2017 to be the main culprit in copying its technology. We expect this raid to have positive spillover effects for Sarine, where manufacturers may stick to Sarine's products to avoid the threat of a police raid, disrupting operations.

Sarine's homecoming: dual listing to improve investment visibility

Israel owns the world's largest diamond trading centre in Tel Aviv, and are the top diamond net exporter in the world. Recently, institutional investor interest has risen on the Tel-Aviv Stock Exchange (TASE) for technological companies, with more initial public offerings (IPO) in the first quarter of 2021 than the whole of 2020 for the exchange. TASE is expecting as many as 70 IPOs for the first half of 2021, versus 30 for the whole of 2020 and just 7 in 2019. We expect Sarine's homecoming dual list to benefit from the increased attention in Israel's stock market.

Piracy has been a challenge, but recent developments are a good first step.

The potential dual-listing has partially helped lift Sarine's share price year-to-date by giving it more visibility.

Valuation

Sarine’s share price has more than tripled from COVID-19 lows, and is up over 30% year-to-date (30 Dec close: S\$0.435) from the recovery of the diamond industry as well as favorable regulatory enforcement.

Financial attributes

Revenues:

Core business

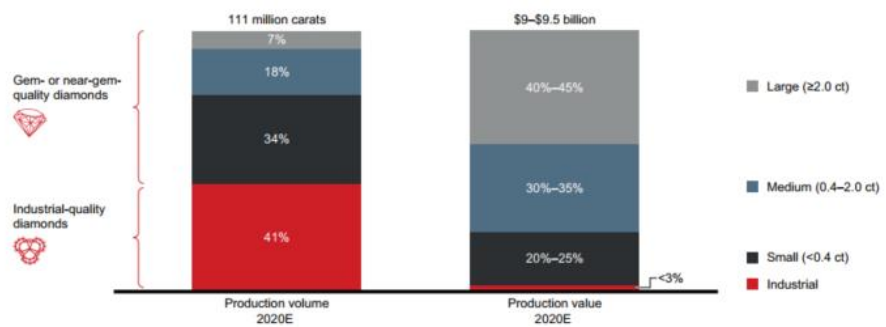
While sales of Solaris and Galaxy have tapered down after 11-12 years of production, we expect sales runway for Meteor and Meteorite systems to continue, as the < 1 carat diamond market remains fairly underpenetrated. For instance, Meteorite targets the < 0.4 carat segment, which accounts for about 57% of rough diamonds produced in 2020, according to Bain. Having only been in the market for 2-3 years, we expect Meteorite to continue strong sales for the next 5-7 years. Additionally, while DiaExpert and Advisor does stone planning for 60 to 100 million of stones annually, Galaxy scans are currently only around the 20 million/year mark, indicating potential headroom for the Galaxy installed base to double or triple before reaching peak market penetration.

We forecast for 120/135/150 Galaxy system sales in 2021/2022/2023, with an Average Sale Price between US\$65,000-74,000. We assume Galaxy system sales remain ~20% of product sales, and forecast maintenance and services revenue to grow 17%/8%/8%. Thus we expect Sarine to reach pre-COVID sales in 2021, while 2022 figures will fall short of 2018’s output of ~US\$58.5mn sales.

Figure 6: Small/medium sized diamonds (<2.0ct) account for almost 90% of gem-quality diamonds produced

Figure 12: Medium and large diamonds accounted for ~25% of production in carats but nearly 70%–80% in value in US dollars

Rough diamond production by size groups in volume and in value, 2020E



Source: Bain & Co.

Operating Statistics:

We expect Sarine to maintain mid 60% gross margins going forward, as sales of high margin Galaxy and downstream Sarine products are likely to be balanced by sales of lower margin products such as Meteorite. While Sales & Marketing and Administrative expenses have been reined in during COVID-19, we expect an increase over 2020 lows as traditional marketing activities are reinstated, and Sarine is likely to continue spending on IP protection and litigation activities.

Figure 7: Key operating metrics for Sarine

Financials (US\$'000), YE December	2016	2017	2018	2019	2020	2021F	2022F	2023F
Revenue (YoY %)	-	(19.1%)	(0.2%)	(12.3%)	(20.2%)	25.4%	11.4%	1.2%
Gross Margin (%)	69.3%	67.1%	65.9%	57.6%	66.1%	66.0%	66.0%	66.0%
EBITDA	25,938	13,259	14,116	5,918	9,013	11,988	12,653	12,574
EBITDA Margin (%)	35.8%	22.6%	24.1%	11.5%	22.0%	23.3%	22.1%	21.7%
Net Profit Margin (%)	24.8%	9.8%	13.0%	(2.7%)	5.8%	11.6%	11.9%	12.1%
Profit Drivers								
Percentage of revenues (%)								
COG	(30.7%)	(32.9%)	(34.1%)	(42.4%)	(33.9%)	(34.0%)	(34.0%)	(34.0%)
Other operating income	1.2%	0.6%	0.8%	0.8%	0.5%	0.5%	0.5%	0.5%
R&D expenses	(15.0%)	(17.9%)	(15.9%)	(15.9%)	(16.6%)	(16.0%)	(16.0%)	(16.0%)
S&M costs	(18.7%)	(23.2%)	(22.7%)	(26.4%)	(23.9%)	(21.0%)	(22.0%)	(22.0%)
Administrative expenses	(6.4%)	(9.9%)	(10.3%)	(13.2%)	(14.0%)	(12.5%)	(11.3%)	(11.0%)
Other operating expenses	-	-	-	-	-	-	-	-
Depreciation	3.2%	3.3%	3.3%	6.0%	7.2%	5.1%	4.0%	3.6%
Interest expense / total debt	-	-	-	-	(28.5%)	(30.0%)	(30.0%)	(30.0%)
Income tax / PBT	(18.1%)	(38.9%)	(25.1%)	(412.5%)	(41.0%)	(23.0%)	(23.0%)	(23.0%)
NCI / Profits	-	-	-	-	-	-	-	-

Source: KGI Research

e-Grading

We value the e-Grading business separately from Sarine's current business, on the basis of it having the potential of shaping the whole business composition in the future. We provided a 10 year forecast for e-Grading, based on the assumptions provided by Sarine management. Overall, at an 8% discount rate, we see the e-Grading business to be valued at around US\$0.30-0.60/share, if it manages to reach its optimal growth trajectory of a low double digit market share in a US\$500mn+ grading market.

Figure 8: e-Grading's valuation

Financials (US\$'000), YE December	2020	2021F	2022F	2023F	2024F	2025F	2026F	2027F	2028F
e-Grading valuation									
Grading market size (US\$ '000)	500,000	500,000	500,000	500,000	500,000	500,000	500,000	500,000	500,000
Sarine's market share	-	0.5%	1.0%	1.5%	3.0%	4.0%	5.0%	8.0%	9.0%
Revenue	-	2,500	5,000	7,500	15,000	20,000	25,000	40,000	45,000
PBT margin (%)	-	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%
PBT	-	875	1,750	2,625	5,250	7,000	8,750	14,000	15,750
Tax rate	-	-	-	-	-	-	-	-	-
Net profit	-	875	1,750	2,625	5,250	7,000	8,750	14,000	15,750
Shares outstanding ('000)	-	349,832	349,832	349,832	349,832	349,832	349,832	349,832	349,832
EPS	-	0.0025	0.0050	0.0075	0.0150	0.0200	0.0250	0.0400	0.0450
PE multiple	-	25.00	25.00	25.00	25.00	25.00	25.00	25.00	25.00
e-Grading's value/share	-	0.06	0.13	0.19	0.38	0.50	0.63	1.00	1.13
Discount rate	8%	-	-	-	-	-	-	-	-
Value in 2021 (USD/share)	-	0.06	0.12	0.16	0.30	0.37	0.43	0.63	0.66

Source: KGI Research

Figure 9: e-Grading's sensitivity analysis of Market Share vs PBT margin in 2030 and implied 2021 share price

	Market Share										
	0.63	2%	4%	6%	8%	10%	12%	14%	16%	18%	20%
PBT Margin (%)	15%	0.05	0.11	0.16	0.21	0.27	0.32	0.38	0.43	0.48	0.54
	20%	0.07	0.14	0.21	0.29	0.36	0.43	0.50	0.57	0.64	0.71
	25%	0.09	0.18	0.27	0.36	0.45	0.54	0.63	0.71	0.80	0.89
	30%	0.11	0.21	0.32	0.43	0.54	0.64	0.75	0.86	0.97	1.07
	35%	0.13	0.25	0.38	0.50	0.63	0.75	0.88	1.00	1.13	1.25
	40%	0.14	0.29	0.43	0.57	0.71	0.86	1.00	1.14	1.29	1.43
	45%	0.16	0.32	0.48	0.64	0.80	0.97	1.13	1.29	1.45	1.61
	50%	0.18	0.36	0.54	0.71	0.89	1.07	1.25	1.43	1.61	1.79

Source: KGI Research

Figure 10: e-Grading's sensitivity analysis Market Share vs discount rate in 2030 and implied 2021 share price

	Market Share										
	0.63	2%	4%	6%	8%	10%	12%	14%	16%	18%	20%
Discount rate	6.0%	0.15	0.30	0.44	0.59	0.74	0.89	1.04	1.18	1.33	1.48
	6.5%	0.14	0.28	0.43	0.57	0.71	0.85	0.99	1.14	1.28	1.42
	7.0%	0.14	0.27	0.41	0.54	0.68	0.82	0.95	1.09	1.22	1.36
	7.5%	0.13	0.26	0.39	0.52	0.65	0.78	0.91	1.04	1.17	1.30
	8.0%	0.13	0.25	0.38	0.50	0.63	0.75	0.88	1.00	1.13	1.25
	8.5%	0.12	0.24	0.36	0.48	0.60	0.72	0.84	0.96	1.08	1.20
	9.0%	0.12	0.23	0.35	0.46	0.58	0.69	0.81	0.92	1.04	1.15
	9.5%	0.11	0.22	0.33	0.44	0.55	0.66	0.77	0.88	0.99	1.11

Source: KGI Research

Valuation: Comparable companies

Sarine boasts no publicly listed comparable company, given their unique business position. We provide peer comparables to other measurement companies in different sectors, as well as companies in the upstream and downstream of the diamond supply chain.

Historically, Sarine’s shares traded at <20x P/E prior to 2013, and experienced a re-rating since 2014 with a P/E trading bands consistently above 20x, even through periods of falling sales and profitability. We use a bullish 25x P/E peg for Sarine similar to our 25x peg for the e-Grading business. This takes our FY2022 target price to US\$0.49 (\$\$0.65, taking 1 USD = 1.34 SGD assumption), around a 13% upside from today’s price.

Figure 11: Peer comparison table

BB ticker	Company Name	Last Price (local \$)	Currency Adj. Market Cap (US\$ m)	Dividend Yield (%)		Net Gearing (%)	P/E (x)		P/B (x)		(YTD) Price Performance	(1YR) Price Performance	(1YR) Total Returns (%)
				FY19	FY20F		12M	Forward	Historical	Forward			
SARINE SP	SARINE TECHNOLOGIES LTD	SGD 0.60	156	1.6	-	-34.6	66.7	NA	1.8	-	41.7	158.7	166.7
Upstream													
ALRS RX	ALROSA PJSC	RUB 108.69	10,600	1.7	12.2	11.7	24.6	10.0	2.7	3.4	10.5	74.7	81.9
NMDC IN	NMDC LTD	INR 156.00	6,173	6.6	4.1	-6.8	13.4	7.6	0.9	1.5	36.3	93.7	105.4
LUC CN	LUCARA DIAMOND CORP	CAD 0.79	255	0.0	0.0	13.1	NA	6.8	0.8	-	51.9	46.3	46.3
PDL LN	PETRA DIAMONDS LTD	GBP 1.55	209	0.0	0.0	6963.2	NA	7.2	0.6	-	-14.2	-22.4	-22.4
BDM AU	BURGUNDY DIAMOND MINES LTD	AUD 0.39	82	0.0	-	-103.5	NA	NA	4.2	-	29.4	369.9	369.9
Average			3,464	1.7	4.1	1,375.6	19.0	7.9	1.8	2.5	42.8	112.4	116.2
Median			255	-	2.1	11.7	19.0	7.4	0.9	2.5	36.3	74.7	81.9
Retailers													
1929 HK	CHOW TAI FOOK JEWELLERY GROU	HKD 12.28	15,809	5.8	3.2	64.1	34.1	24.1	2.1	4.4	25.9	85.5	91.3
PNDORA DC	PANDORA A/S	DKK 702.20	11,371	0.0	1.9	42.6	35.5	18.3	9.2	7.4	3.1	193.8	193.8
SIG US	SIGNET JEWELERS LTD	USD 59.75	3,128	0.0	0.2	27.2	37.9	13.0	1.8	2.3	119.1	558.0	558.0
900905 CH	LAO FENG XIANG CO LTD-B	USD 3.02	3,326	-	7.4	23.7	5.5	5.6	1.2	1.1	4.0	8.2	13.7
VGM IN	VAIBHAV GLOBAL LTD	INR 4314.95	1,898	1.6	-	-20.7	73.6	NA	3.3	-	76.3	349.5	355.5
Average			7,106	1.8	3.2	27.4	37.3	15.2	3.5	3.8	45.7	239.0	242.5
Median			3,326	0.8	2.5	27.2	35.5	15.6	2.1	3.3	25.9	193.8	193.8
Measurement companies													
ARD IT	ARAD LTD	ILs 4550.00	346	1.6	-	27.5	22.1	NA	2.9	-	-7.4	-17.8	-16.5
CAMT US	CAMTEK LTD	USD 34.06	1,476	0.0	-	-45.9	44.8	24.5	4.2	5.7	55.5	248.3	248.3
ALTEV FP	ENVEA	EUR 110.50	225	-	1.0	-15.6	19.2	20.2	-	2.1	0.5	12.5	13.5
NVMI IT	NOVA MEASURING INSTRUMENTS	ILs 30760.00	2,675	-	0.0	-56.4	NA	37.1	-	7.4	35.7	138.8	138.8
Average			1,181	0.8	0.5	(22.6)	28.7	27.3	3.5	5.1	21.1	95.5	96.0
Median			911	0.8	0.5	(30.8)	22.1	24.5	3.5	5.7	18.1	75.7	76.2

*Negative Net Gearing = net cash position

Source: Bloomberg, KGI Research

Key Risks

COVID resurgence – 2H21 results could see a downturn, again.

COVID-19 cases in India have surged in April and May behind new COVID variants and poor adherence to safety protocols. While Sarine has announced that there is no current material impact on the group's business activities, the company notes that "if the current health situation is not alleviated, the May summer break may be extended for the entire month's duration, or, possibly, beyond." As of 5th May, daily COVID-19 infection case counts have been falling in Surat, where diamond cutting and polishing operations are located. A return to lockdown state will dampen 2H21 results for the company, and spells further downside from our current estimates.

Synthetic diamonds – can natural diamonds stay as Veblen goods?

We expect the synthetic diamond industry to continue posing a sizeable threat to the legacy natural diamond industry, as production cost for synthetic diamonds are likely to continue getting cheaper over time. While Sarine has products that also serve the synthetic diamond industry, Sarine is currently less well positioned versus other machine makers in catering to the demands of the synthetic diamond industry.

According to Bain, lab-grown diamond (LGD) production has reached 6 to 7 million carats in 2020, about 5-6% of natural diamond production, with 50-60% being manufactured in China. Amongst incumbents, the current strategy by De Beers is to create a price discrimination strategy between LGDs and natural diamonds through Lightbox Jewelry. By marketing LGDs as fun, fashion, and light-hearted, De Beers aims to create the distinction between LGDs and natural diamonds, so customers continue to reserve natural diamonds for major events such as engagements.

In recent news, Pandora, another major jewelry maker, has announced plans to stop selling mined diamonds and shift completely to LGDs for its jewelry pieces. As the synthetic diamond industry continues to grow, Sarine has to find cost-effective solutions for these new customers, or risk losing addressable market share.

Company Overview

Sarine has been listed on the SGX since 2005 and has paid dividends every year, except in 2009 during the global financial crisis (GFC).

Established in 1988, Sarine Technologies Ltd develops, manufactures, markets and sells precision technology products for the processing, grading and trade of diamonds and gemstones, utilised throughout the entire diamond industry value chain.

Through DiaExpert, Advisor and Galaxy, Sarine is able to assist diamond miners with the evaluation of their rough stones and determine a more accurate intrinsic value of their inventory. Sarine has also introduced computer-based technologies at the diamond cutting and polishing stage, which has improved the overall diamond yield, and provides the Quazer brand of laser cutters to midstream polished diamond manufacturers. Sarine provides the DiaMension and self-branded Sarine series of diamond grading machines in order to grade polished diamonds according to the 4Cs (Carat, Clarity, Color, Cut), with the DiaMension HD being the only device approved by the Gemological Institute of America (GIA) for symmetry grading.

Sarine’s most recent product is Verto, an innovative imaging solution that generates exceptionally high-quality video displays, derived from but a handful of images captured by any common smartphone and enables jewellery manufacturers, wholesalers and retailers to provide their customers with interactive capabilities to view the piece from multiple perspectives and personalise the setting as well as the types, sizes, and colours of stones, etc. Recently, Sarine has combined all its downstream offerings into Sarine Profile, a one-stop solution for retailers and customers to retrieve necessary information about their diamonds’ characteristics.

Figure 12: Sarine’s products through the diamond industry value chain

Our Technologies Span Entire Value Chain *SARINE*

Sarine Technologies, through its application of patented solutions (proprietary mechanics, electronics, optics, lasers and sophisticated software) is a global leader in the development of systems used throughout the entire diamond value chain, from mine to retail, from rough diamonds evaluation, trading, planning and polishing to polished diamonds grading and wholesale and retail trade.



Source: Company reports

Financials
USD

FYE 31 December					
INCOME STATEMENT (USD '000)					
	2019	2020	2021F	2022F	2023F
Revenues	51,323	40,968	51,353	57,199	57,883
Cost of sales	(21,739)	(13,898)	(17,460)	(19,448)	(19,680)
Gross profit	29,584	27,070	33,893	37,752	38,203
Sales & Marketing expenses	(13,535)	(9,773)	(10,784)	(12,584)	(12,734)
General & Admin expenses	(6,764)	(5,738)	(6,419)	(6,464)	(6,367)
Other operating income	422	219	275	306	309
Other operating expenses	–	–	–	–	–
Finance costs	(1,084)	(974)	(1,026)	(1,026)	(1,026)
Share of (loss) / profit of associates, net	–	–	–	–	–
Profit before income tax	439	4,008	7,722	8,832	9,123
Income tax	(1,811)	(1,643)	(1,776)	(2,031)	(2,098)
Profit for the year	(1,372)	2,365	5,946	6,800	7,025
Non-controlling interests	–	–	–	–	–
PATMI	(1,372)	2,365	5,946	6,800	7,025
BALANCE SHEET (USD '000)					
	2019	2020	2021F	2022F	2023F
Cash and cash equivalents	18,284	21,081	26,959	33,298	39,536
Other current assets	33,036	36,278	36,278	36,278	36,278
Total current assets	51,320	57,359	63,237	69,576	75,814
Property, plant and equipment	13,474	12,279	11,365	10,575	9,896
Intangible assets	3,625	2,563	1,922	1,442	1,081
Other non-current assets	8,716	7,665	6,677	5,798	5,014
Total non-current assets	25,815	22,507	19,964	17,815	15,991
Total assets	77,135	79,866	83,201	87,391	91,805
Trade and other payables	3,907	1,868	1,868	1,868	1,868
Loans and contract liabilities	1,311	1,303	1,303	1,303	1,303
Other current liabilities	6,547	7,276	7,276	7,276	7,276
Total current liabilities	11,765	10,447	10,447	10,447	10,447
Borrowings	–	3,141	3,141	3,141	3,141
Other non-current liabilities	5,950	5,587	5,587	5,587	5,587
Total non-current liabilities	5,950	8,728	8,728	8,728	8,728
Total liabilities	17,715	19,175	19,175	19,175	19,175
Total equity	59,420	60,691	64,026	68,216	72,630
Total liabilities and equity	77,135	79,866	83,201	87,391	91,805
CASH FLOW STATEMENT (USD '000)					
	2019	2020	2021F	2022F	2023F
Profit before tax	(1,372)	2,365	5,946	6,800	7,025
Adjustments	7,390	6,865	3,240	2,795	2,424
Operating cash flows before WC changes	6,018	9,230	9,186	9,595	9,449
Change in working capital	4,214	(10,292)	–	–	–
Income tax paid	(2,080)	(645)	–	–	–
Other adjustments	(231)	(261)	–	–	–
Cash flows from operations	7,921	(1,968)	9,186	9,595	9,449
Capital expenditure	(834)	(765)	(697)	(645)	(600)
Short-term investments, net	831	4,887	–	–	–
Others	485	321	–	–	–
Cash flows from investing	482	4,443	(697)	(645)	(600)
Lease payments	(1,264)	(1,266)	–	–	–
Dividends paid	(5,259)	(1,049)	(2,611)	(2,611)	(2,611)
Interest paid	(497)	(399)	–	–	–
Other financing cashflow	–	3,107	–	–	–
Cash flows from financing	(7,020)	393	(2,611)	(2,611)	(2,611)
FX Effects, Others	69	(71)	–	–	–
Net increase in cash	1,383	2,868	5,878	6,339	6,238
Beginning Cash	16,832	18,284	21,081	26,959	33,298
Ending cash	18,284	21,081	26,959	33,298	39,536
KEY RATIOS					
	2019	2020	2021F	2022F	2023F
EPS (USD cents)	(0.39)	0.68	1.70	1.94	2.01
DPS (USD cents)	0.80	0.50	1.00	1.00	1.00
Dividend yield (%)	1.9%	1.2%	2.3%	2.3%	2.3%
NAV per share (USD)	0.2	0.2	0.2	0.2	0.2
Price/NAV (x)	3.4	3.3	3.1	2.9	2.8
Profitability					
EBITDA Margin (%)	11.5%	22.0%	23.3%	22.1%	21.7%
Net Margin (%)	(2.7%)	5.8%	11.6%	11.9%	12.1%
ROE (ex. Property FV gain) (%)	(4.6%)	3.9%	9.5%	10.3%	10.0%
ROA (ex. Property FV gain) (%)	(2.8%)	3.0%	7.3%	8.0%	7.8%
Financial Structure					
Interest Coverage Ratio (x)	1.4	5.1	8.5	9.6	9.9
Gearing Ratio (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash

KGI's Ratings

Rating	Definition
Outperform (OP)	We take a positive view on the stock. The stock is expected to outperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
Neutral (N)	We take a neutral view on the stock. The stock is expected to perform in line with the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
Underperform (U)	We take a negative view on the stock. The stock is expected to underperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
Not Rated (NR)	The stock is not rated by KGI Securities.
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