



RESULTS REPORT

20 May 2011

Degem Bhd		Market Price:	RM1.03
		Market Capitalisation:	RM138.0m
		Board:	Main Market
Recommendation:	HOLD	Sector:	Consumer Products
Target Price:	RM1.16	Stock Code/Name:	7119 / DEGEM

Analyst: Edmund Tham

KEY FINANCIALS

Key Stock Statistics	2011E
Earnings/Sh. (sen)	11.9
P/E Ratio (x)	8.6
Dividend/Share (sen)	3.0
NTA/Share (RM)	1.23
Book Value/Share (RM)	1.25
Issued Capital (mil shares)	134.0
52-weeks share price (RM)	0.93 – 1.22
Major Shareholder:	%
Legion Master S/B / Choong family	55.9

Per Share Data	2008	2009	2010	2011E
Book Value/Sh. (RM)	0.99	1.08	1.15	1.25
Earnings/Sh. (sen)	10.7	11.4	9.7	11.9
Dividend/Sh. (sen)	2.5	2.0	3.0	3.0
Div. Payout Ratio (%)	17.5	13.1	15.5	18.8
P/E Ratio (x)	9.9	9.0	10.7	8.6
P/Book Value (x)	1.0	1.0	0.9	0.8
Dividend Yield (%)	2.4	1.9	2.9	2.9
ROE (%)	10.9	10.6	8.4	9.6
Net Gearing (or Cash) (x)	0.08	0.06	0.04	0.01

*50 sen par value

P&L Analysis (RM mil)	2008	2009	2010	2011E
Year end: Dec 31				
Revenue	209.8	189.4	185.3	199.9
Operating Profit	21.7	23.5	23.0	25.2
Depreciation	(2.1)	(3.1)	(2.2)	(2.3)
Interest Expenses	(1.7)	(1.3)	(1.5)	(1.5)
Pre-tax Profit	20.0	22.2	20.5	23.7
Effective Tax Rate (%)	29.2	30.8	34.4	28.3
Net Profit after Tax & MI	14.4	15.3	13.0	16.0
Operating Margin (%)	10.4	12.4	12.4	12.6
Pre-tax Margin (%)	9.5	11.7	11.0	11.9
Net Margin (%)	6.8	8.1	7.0	8.0

PERFORMANCE – 1Q/FY11

1Q/ 31 Mar	1Q11	1Q10	yov %	4Q10	qoq%
Rev (RMm)	47.2	38.7	22.1	59.7	(20.9)
EBIT (RMm)	5.2	4.4	19.3	6.9	(24.2)
NPAT*(RMm)	3.8	3.1	24.4	5.3	(28.4)
EPS (sen)	2.8	2.3	24.4	4.0	(28.4)

*NPATMI

“Slightly above expectations”

Degem’s 1Q/FY11 (quarter ended 31st March 2011) results were slightly above our earlier expectations.

“Positive Q1 performance”

Degem recorded a positive 1Q/FY11 revenue of RM47.2 million, which was higher by 22.1% y-o-y. We note that the Chinese New Year festivities and Valentine’s Day occurred during the quarter.

The group’s 1Q/FY11 net profit after tax and minority interest (NPATMI) of RM3.8 million was higher by 24.4% y-o-y versus 1Q/FY10.

Nevertheless, q-o-q comparisons were not as favourable due to the even stronger results in the preceding 4Q/FY10 (quarter ended 31st December 2010). During 1Q/FY11, the group’s revenue of RM47.2 million and NPATMI RM3.8 million were lower by 20.9% and 28.4% respectively, versus 4Q/FY10.

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OUTLOOK/CORP. UPDATES

The domestic economy has been growing at a reasonable rate during the past year and we expect the Degem's revenues to grow in tandem during the year 2011, as well.

"Steady domestic economic growth"

Malaysia had reported a very respectable 1Q/2011 GDP growth of +4.6%, stable 4Q/2010 unemployment rate of 3.2% and CPI of 3.2% (April 2011). Meanwhile, Bank Negara Malaysia (BNM) had raised its overnight policy rate (OPR) of 2.75% to 3.0% and the statutory reserve requirement (SRR) of 2% to 3% to rein-in inflationary pressures.

According to Retail Group Malaysia (RGM) which tabulates retail data, Malaysia's retail industry recorded sales growth of 8.5% in the fourth quarter of 2010, higher than the earlier estimate of 6% by RGM. The rising prices of retail goods and year-end holidays contributed to the strong growth during the last three months of 2010, according to data in RGM's Malaysia Retail Industry Report. For full-year 2010, the domestic retail industry had increased by 8.4% compared to 2009.

"Focus on Diamond & Gemstone Jewellery"

Degem's management has focused on the diamond and gemstone fine jewellery segment. The fine jewellery segment appears to provide higher profit margins than gold products per se, as they are not any "association price guidelines", unlike that for yellow gold products. However, we believe that the demand for fine jewellery could be more susceptible to the volatility in economic conditions and hence consumer optimism and buying sentiment.

Currently, the group's business is focused on a mixture of precious metals with diamonds and precious stones. This is to capture both the middle and upper class markets and also the young and trendy market. The management also focuses on design and craftsmanship excellence, strong brand name and maintaining a strong

operating margin. The group had expanded regionally, and we see this as a beneficial move in the long term, given the expected growth in GDP and population within the ASEAN region.

Degem had started selling gold bars in the form of 20gm, 50gm, 100gm, 500gm and 1kg since February 2011 due to the current public appetite for it and the strong gold prices (currently around the USD1500/ounce level). The group plans to grow the gold bar business to about RM10-15 million in revenue. Meanwhile, DeGem would explore outlet expansion cautiously. The group has a relatively new outlet at Marina Bay Sands in Singapore.

"Share buy-backs"

During 1Q/FY11, there was no share repurchased. As at 31st March 2011, a total of 1,934,800 shares repurchased were held at a total cost of around RM1.9 million. The shares repurchased are being held as treasury shares in accordance with Section 67A of the Companies Act 1965. None of the treasury shares held were resold or cancelled during the quarter under review and up to the release of Q1 results. Degem's management plans to use the treasury shares for future share dividends or to be sold for profits when the market timing is right.

VALUATION/CONCLUSION

Degem paid out 4% (i.e. 2 sen) gross dividend per share (DPS) on its shares of par value RM0.50 for its FY09. In April 2011, Degem's Board of Directors (BOD) had proposed a first and final tax dividend of 6% (i.e. 3 sen) less 25% tax for its FY10 ended 31st December 2010, subject to the shareholders' approval at the AGM. This dividend payout was higher than we expected earlier. In recent years, we find that its dividend payouts are quite consistently within the 10-20% range.

"Proposed FY10 dividends higher than we expected"



With a relatively weak adjusted beta (correlation factor) of 0.35 to the KLCI, Degem (-8.0%) has underperformed the KLCI (+1.6%) this year. In recent months, global equity markets have been impacted by the political unrest in the Middle East/North Africa, public debt issue in Europe and the Tohoku earthquake/tsunami in Japan. Furthermore, Degem is not a particularly large market-cap stock, and this may put a dampener on its market visibility and trading volume.

“Hold Call, with upward bias”

Based on our forecast of Degem’s FY11 EPS and estimated P/E of 10 times, we set a **FY11-end Target Price (TP) of RM1.19**. This TP represents a 16.0% upside from its current market price. Our TP for Degem reflects a P/BV of 0.96 times over its FY11F BV/share. Currently, we are maintaining a Hold Call, with an upward bias, based on its promising Q1 results. If the next 1-2 quarters also show stronger results, we might upgrade our call on Degem to a Buy Call.

Meanwhile, the domestic “Clothing & Accessories” sector’s average P/E and P/BV is 8.2 times and 0.91 times, respectively. We find that Degem’s P/E and P/BV valuations are **not among the most undemanding** within its sector, domestically.

“Prudent cash management”

Degem’s management appears conservative in terms of its cash management and gearing levels, while its ROEs are quite reasonable. We foresee that Degem may even reach a net cash position (i.e. cash > borrowings) by its FY12.

The group also faces routine risks from fluctuating raw material and foreign exchange rates, uneven monthly sales (due to festive seasons) and any consumer pessimism amidst stiff competition from its peers. Going forward, the group’s upside would be largely dependent on its management’s marketing and growth strategy, and also on the overall economic conditions.

Degem: Share Price



Source: NextView

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