



RESULTS REPORT

17 Aug 2011

Degem Bhd		Market Price:	RM0.98
		Market Capitalisation:	RM131.3m
		Board:	Main Market
Recommendation:	BUY	Sector:	Consumer Products
Target Price:	RM1.14	Stock Code/Name:	7119 / DEGEM

Analyst: Edmund Tham

KEY FINANCIALS

Key Stock Statistics	2011E
Earnings/Sh. (sen)	12.0
P/E Ratio (x)	8.1
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)	0.97 – 1.22
Major Shareholder:	%
Legion Master S/B / Choong family	55.9

PERFORMANCE – 2Q/FY11

2Q/ 30 Jun	2Q11	2Q10	yoy %	2Q11	qoq%
Rev (RMm)	52.6	42.7	23.4	47.2	11.4
EBIT (RMm)	5.8	3.3	76.2	5.2	11.3
NPAT*(RMm)	4.0	2.9	38.0	3.8	4.6
EPS (sen)	3.0	2.1	38.0	2.8	4.6

1H/ 30 Jun	1H/11	1H/10	yoy %
Rev (RMm)	99.9	81.4	22.7
EBIT (RMm)	11.0	7.7	43.7
NPAT*(RMm)	7.8	5.9	31.0
EPS (sen)	5.8	4.4	31.0

*NPATMI

Ratios Analysis	2008	2009	2010	2011E
Book Value/Sh. (RM)	0.99	1.08	1.15	1.25
Earnings/Sh. (sen)	10.4	11.4	9.7	12.0
Dividend/Sh. (sen)	2.5	2.0	3.0	3.0
Div. Payout Ratio (%)	18.0	13.1	23.3	18.7
P/E Ratio (x)	9.4	8.6	10.1	8.1
P/Book Value (x)	1.0	0.9	0.9	0.8
Dividend Yield (%)	2.6	2.0	3.1	3.1
ROE (%)	10.6	10.6	8.4	9.6
Net Gearing (or Cash) (x)	0.08	0.06	0.04	0.02

*50 sen par value

P&L Analysis (RM mil)	2008	2009	2010	2011E
Year end: Dec 31				
Revenue	209.8	189.4	185.3	208.8
Operating Profit	21.7	23.5	23.0	26.2
Depreciation	(2.1)	(3.1)	(2.2)	(2.3)
Interest Expenses	(1.7)	(1.3)	(1.5)	(1.6)
Pre-tax Profit	20.0	22.2	20.5	24.6
Effective Tax Rate (%)	29.2	30.8	34.4	28.3
Net Profit after Tax & MI	14.4	15.3	13.0	16.1
Operating Margin (%)	10.4	12.4	12.4	12.6
Pre-tax Margin (%)	9.5	11.7	11.0	11.8
Net Margin (%)	6.8	8.1	7.0	7.7

“Results within expectations”

Degem’s 1H/FY11 results (half year ended 30th June 2011) were generally within our earlier expectations.

“Positive Q2 performance”

The group recorded revenue of RM52.6 million for its 2Q/FY11, an increase of 23.4% y-o-y. Group net profit after tax and minority interest (NPATMI) during 2Q/FY11 was RM4.0 million, a substantial increase of 38.0% y-o-y.

Comparing versus 1Q/FY11, the group recorded a revenue increase of 11.4% q-o-q while its NPATMI grew by 4.6% q-o-q.

Looking at 1H/FY11 numbers, group revenue of RM99.9 million and NPATMI of RM7.8 million were higher 22.7% and 31.0% respectively, versus the comparative figures in 1H/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.

“Reasonable domestic growth”

Malaysia had reported stable 1Q/2011 unemployment rate of 3.1% and a CPI of 3.5% (July 2011). In early July 2011, Bank Negara Malaysia (BNM) had maintained its overnight policy rate (OPR) at 3.0% but raised the statutory reserve requirement (SRR) for banks from 3% to 4% in order to rein-in inflationary pressures.

According to BNM, Malaysia's 2Q/2011 GDP rose by 4%, following a revised 4.9% GDP growth in 1Q/2011. Europe's sovereign debt crisis and slower U.S. economic growth have damped the outlook for exports, putting pressure on Asian policy makers to delay further interest rate increases even as inflationary pressures rise. At the moment, BNM is still expecting a full-year GDP growth of around 5.0% for Malaysia.

“Niche: Diamond & Gemstone Jewellery”

Degem's management is focused on the diamond and gemstone fine jewellery segment. The fine jewellery segment generally provides higher profit margins than gold products per se, as they are not any “association price guidelines”, unlike that for 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. Usually, it is yellow gold jewellery that has the most resale value for consumers, unlike white gold and gemstone jewellery.

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 (Degem) and also the young and trendy market (Diamond &

Platinum). We also noted this branding and pricing strategy from our market survey in a few shopping malls within the Klang Valley.

The management focuses on design and craftsmanship excellence, a strong brand name, expanding its range of products 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 Asia.

“Lofty gold prices”

Degem had started selling gold bars in the form of 20gm, 50gm, 100gm, 500gm and 1kg since February 2011. The current public appetite for it is due to the strong gold prices (currently around the USD1800/ounce level). The group plans to grow their gold bar business to about RM10-15 million in revenue eventually.

“Share buy-backs”

During 2Q/FY11, the group repurchased 2,000 of its issued shares from the open market at an average price of RM1.08 per share. The total consideration paid for the repurchase including transaction costs was around RM2,204 and this was financed by internally generated funds. As at 30th June 2011, a total of around 1.94 million shares repurchased were held at a total cost of around RM1.92 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 up to the release date of Q2 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

A first and final tax dividend of 6% (3 sen on RM0.50 par) less tax of 25% for Degem's FY10



ended 31 December 2010 was approved by shareholders during the AGM held on 21st June 2011. The dividend will be paid on 22nd August 2011 to shareholders in the registrar's list as at 3rd August 2011. In recent years, we find that its dividend payouts are quite consistently around the 15-20% range.

“Consistent dividend payout”

With a relatively weak adjusted beta (correlation factor) of 0.29 to the KLCI, Degem (-12.5%) has underperformed the KLCI (-1.1%) this year. In recent months, global equity markets have been impacted by the Arab Spring unrest in the Middle East/North Africa, public debt issue in Europe, debt ceiling issue in the US and the Tohoku natural disaster 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. We are slightly concerned about the consistency in trading liquidity of this stock.

“Upgrade Call due to Strong 1H”

Based on our forecast of Degem's FY11 EPS and estimated P/E of 9.5 times, we set a **FY11-end Target Price (TP) of RM1.14**. This TP represents a 16.7% upside from its current market price. Our TP for Degem reflects a P/BV of 0.92 times over its FY11F BV/share. We upgrade our call on Degem to a Buy Call due to its strong 1H performance. We also noted that its market price had dropped a bit since our last report, leading to an increase in percentage-upside versus our TP.

Meanwhile, the domestic “Clothing & Accessories” sector's average P/E and P/BV is 7.2 times and 0.8 times, respectively. We hence note 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 (dwindling), 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 earnings upside would be largely dependent on its management's marketing and growth strategy, and also on the overall consumer sentiment and economic conditions.

Degem: Share Price



Source: NextView

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