

**RESULTS REPORT**

24 Nov 2011

<b>Degem Bhd</b>		<b>Market Price:</b>	RM1.05
		<b>Market Capitalisation:</b>	RM140.7m
		<b>Board:</b>	Main Market
<b>Recommendation:</b>	BUY	<b>Sector:</b>	Consumer Products
<b>Target Price:</b>	RM1.29	<b>Stock Code/Name:</b>	7119 / DEGEM

Analyst: Edmund Tham

**KEY FINANCIALS**

<b>Key Stock Statistics</b>	<b>2012F</b>
Earnings/Sh. (sen)	15.2
P/E Ratio (x)	6.9
Dividend/Share (sen)	3.0
NTA/Share (RM)	1.37
Book Value/Share (RM)	1.40
Issued Capital (mil shares)	134.0
52-weeks share price (RM)	0.63 – 1.22
Major Shareholder:	%
Legion Master S/B / Choong family	55.9

<b>Ratios Analysis</b>	<b>2009</b>	<b>2010</b>	<b>2011E</b>	<b>2012F</b>
Book Value/Sh. (RM)	1.08	1.15	1.27	1.40
Earnings/Sh. (sen)	11.4	9.7	13.9	15.2
Dividend/Sh. (sen)	2.0	3.0	3.0	3.0
Div. Payout Ratio (%)	13.1	23.3	16.2	14.8
P/E Ratio (x)	9.2	10.9	7.6	6.9
P/Book Value (x)	1.0	0.9	0.8	0.8
Dividend Yield (%)	1.9	2.9	2.9	2.9
ROE (%)	10.6	8.4	10.9	10.9
Net Gearing (or Cash) (x)	0.06	0.04	0.07	0.11

\*50 sen par value

<b>P&amp;L Analysis (RM mil)</b>	<b>2009</b>	<b>2010</b>	<b>2011E</b>	<b>2012F</b>
<b>Year end: Dec 31</b>				
Revenue	189.4	185.3	217.2	224.2
Operating Profit	23.5	23.0	29.1	31.4
Depreciation	(3.1)	(2.2)	(2.5)	(2.7)
Interest Expenses	(1.3)	(1.5)	(1.6)	(1.8)
Profit before Tax (PBT)	22.2	20.5	27.4	29.7
Effective Tax Rate (%)	30.8	34.4	26.8	26.1
NPATMI	15.3	13.0	18.6	20.4
Operating Margin (%)	12.4	12.4	13.4	14.0
PBT Margin (%)	11.7	11.0	12.6	13.2
NPATMI Margin (%)	8.1	7.0	8.6	9.1

\*FY11 and FY12 figures are our estimates

**PERFORMANCE – 3Q/FY11**

<b>3Q/ 30 Sep</b>	<b>3Q11</b>	<b>3Q10</b>	<b>yov %</b>	<b>2Q11</b>	<b>qoq%</b>
Rev (RMm)	57.0	44.1	29.1	52.6	8.2
EBIT (RMm)	7.5	4.1	85.3	5.8	29.6
NPAT*(RMm)	5.8	2.9	100.4	4.0	46.4
EPS (sen)	4.3	2.2	100.4	3.0	46.4

<b>9M/ 30 Sep</b>	<b>9M/11</b>	<b>9M/10</b>	<b>yov %</b>
Rev (RMm)	156.9	125.5	25.0
EBIT (RMm)	18.5	11.7	58.1
NPAT*(RMm)	13.6	8.8	53.8
EPS (sen)	10.1	6.6	53.8

\*NPATMI

Degem's 3Q/FY11 results (for quarter ended 30<sup>th</sup> September 2011) were generally within our earlier expectations.

**“3Q results within expectations”**

During 3Q/FY11, the group registered revenue of RM57.0 million compared to RM44.1 million in the corresponding 3Q/FY10, an increase of 29.1% y-o-y. This increase is due to higher sales during the quarter. We note that the Hari Raya Aidilfitri festivities fell during the quarter. Group NPATMI (net profit after tax and minority interest) for the quarter was RM5.8 million, 100.4% higher y-o-y.

**“Aidilfitri festivities may have aided solid results”**

For 9M/FY11, the group registered revenue of RM156.9 million compared to RM125.5 million in the corresponding 9M/FY10, an increase of 25.0%. Group NPATMI for the nine-month period was RM13.6 million, higher by 53.8%, compared to the corresponding 9M/FY10.

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During 3Q/FY11, the group registered revenue of RM57.0 million and NPATMI of RM5.8 million. These figures were higher by 8.2% and 46.4% respectively, compared to the corresponding figures during the preceding 2Q/FY11.

## OUTLOOK/CORP. UPDATES

The Malaysian economy has been growing at a reasonable rate during the current year and we expect Degem's revenues to grow in tandem during the year, as well. Malaysia's Ministry of Finance has forecasted 5.0-5.5% GDP growth for 2011 and 5.0-6.0% for 2012.

### “Steady domestic growth”

**Malaysia** had reported a reasonable 2Q/2011 unemployment rate of 3.0% and CPI of 3.4% (October 2011). On 11<sup>th</sup> November 2011, Bank Negara Malaysia (BNM) had maintained its accommodative Overnight Policy Rate (OPR) at 3.0%. Meanwhile, Malaysia's GDP growth in 3Q/2011 amounted to 5.8%, despite of the volatile global financial markets and also economic weakness in the developed regions (US, EU and Japan).

Degem's management is **focused on the diamond and gemstone fine jewellery segment**, which makes up most of the group's revenues. 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 retail shops) and also the young and trendy market

(Diamond & Platinum retail shops). 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.

### “Exploring regional opportunities”

The group had expanded regionally, and we see this as a beneficial move in the long term, given the expected solid growth in GDP and population rates within Asia. According to a recent news article, Degem is exploring opportunities to expand its operations to Saudi Arabia and Thailand, as soon as it finds a suitable business partner. Degem currently has 13 Diamond & Platinum outlets and 8 DeGem outlets (5 in Malaysia, 2 in Singapore and 1 in Jakarta, Indonesia).

### “Contributions from gold segment still small”

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 **USD1700/ounce** level). The group plans to grow their gold bar business to about RM10-15 million in revenue eventually.

### “New partnership with Forevermark”

As reported in the press, Degem recently announced its partnership with Forevermark, a brand which is part of the renowned De Beers group of companies. Under this partnership, Degem and Diamond & Platinum would become the only authorised Forevermark Jewellers in Malaysia. Earlier on, Forevermark had received acclaim and success in growing Asian markets such as China, Hong Kong and India.

During 3Q/FY11, there were no shares repurchased by Degem. As at 30<sup>th</sup> September 2011, a total of 1,936,800 shares repurchased were held at a total cost of RM1,916,559.60. 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 Q3 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.

In October 2011, a wholly-owned company of Degem Bhd, Diamond & Platinum S/B ("D&P"), incorporated a new subsidiary, D & P Franchise Pte Ltd ("DPFPL") in Hong Kong. The issued and paid-up share capital of DPFPL is HKD2 divided into 2 shares of HKD1 each held wholly by D&P. DPFPL has not commenced operations since the date of incorporation. The intended principal activity of DPFPL is franchising.

## VALUATION/CONCLUSION

For FY10 ended 31<sup>st</sup> December 2010, Degem's BOD had recommended a first and final dividend of 6% (3.0 sen per share) less 25% tax amounting to RM2,971,467 which was subsequently approved by the shareholders at the AGM held on 21<sup>st</sup> June 2011. The dividend was duly paid on 22<sup>nd</sup> August 2011. In recent years, we find that Degem's dividend payouts average around the 15-20% level.

### “Relatively steady dividend payout”

Even with a relatively weak adjusted beta (correlation factor) of 0.36 to the KLCI, Degem (-6.3%) has slightly underperformed the KLCI (-4.7%) this year. In recent months, global equity markets have been impacted by the Arab Spring unrest in the Middle East/North Africa, sovereign 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.

### “Maintain Buy Call”

Based on our forecast of Degem's FY12 EPS and estimated P/E of 8.5 times, we set a **FY12-end Target Price (TP) of RM1.29**. This TP represents a 23.0% upside from its current market price. Our TP for Degem reflects a P/BV of 0.9 times over its FY12F BV/share.

Meanwhile, the domestic “Clothing & Accessories” sector's average P/E and P/BV is 7.0 times and 0.8 times, respectively. As such, we note that Degem's P/E and P/BV valuations are not among the most undemanding within the domestic sector. Degem's management appears prudent with its cash management and minimal gearing levels, while its ROEs are at a reasonable level.

The group faces routine risks from possible fluctuating raw material and foreign exchange rates, uneven monthly sales (due to festive seasons) and any consumer pessimism amidst competition from other jewellers. 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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