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RESULTS REPORT

24 Feb 2012

Degem Bhd		***Market Price:***	*RM1.10*
		Market Capitalisation:	*RM147.4m*
		Board:	*Main Market*
Recommendation:	*BUY*	***Sector:***	*Consumer Products*
Target Price:	*RM1.28*	***Stock Code/Name:***	*7119 / DEGEM*

***Analyst**: Edmund Tham*

KEY FINANCIALS

Key Stock Statistics	2012F
Earnings/Sh. (sen)	16.6
P/E Ratio (x)	6.6
Dividend/Share (sen)	3.0
NTA/Share (RM)	1.44
Book Value/Share (RM)	1.45
Issued Capital (mil shares)	134.0
52-weeks share price (RM)	0.63 – 1.10
Major Shareholder:	%
.Legion Master S/B / Choong family	55.9

Ratios Analysis	2009	2010	2011	2012F
Book Value/Sh. (RM)	1.08	1.15	1.31	1.45
Earnings/Sh. (sen)	11.4	9.7	17.5	16.6
Dividend/Sh. (sen)	2.0	3.0	3.0	3.0
Div. Payout Ratio (%)	13.1	23.3	12.9	13.5
P/E Ratio (x)	9.6	11.4	6.3	6.6
P/Book Value (x)	1.0	1.0	0.8	0.8
Dividend Yield (%)	1.8	2.7	2.7	2.7
ROE (%)	10.6	8.4	13.3	11.4
Net Gearing (or Cash) (x)	0.06	0.04	0.07	0.11

**50 sen par value*

P&L Analysis (RM mil)	2009	2010	2011	2012F
Year end: Dec 31				
Revenue	189.4	185.3	219.7	229.4
Operating Profit	23.5	23.0	36.0	33.9
Depreciation	(3.1)	(2.2)	(2.2)	(2.2)
Interest Expenses	(1.3)	(1.5)	(1.6)	(1.7)
Profit before Tax (PBT)	22.2	20.5	34.4	32.2
Effective Tax Rate (%)	30.8	34.4	27.9	26.4
NPATMI	15.3	13.0	23.4	22.3
Operating Margin (%)	12.4	12.4	16.4	14.8
PBT Margin (%)	11.7	11.0	15.7	14.0
NPATMI Margin (%)	8.1	7.0	10.6	9.7

**2012 figures & 2011 dividends are our estimates*

PERFORMANCE – 4Q/FY11

4Q/ 31 Dec	4Q11	4Q10	yoy %	3Q11	qoq%
Rev (RMm)	62.8	59.7	5.2	57.0	10.3
EBIT (RMm)	13.5	6.9	96.2	7.5	79.5
NPAT*(RMm)	9.8	5.3	84.6	5.8	68.5
EPS (sen)	7.3	4.0	84.6	4.3	68.5

12M/ 31 Dec	FY11	FY10	yoy %
Rev (RMm)	219.7	185.3	18.6
EBIT (RMm)	32.0	18.6	72.2
NPAT*(RMm)	23.4	13.0	80.6
EPS (sen)	17.5	9.7	80.6

**NPATMI (net profit after tax & minority interest)*

Degem's 4Q/FY11 revenue (for quarter ended 31st December 2011) was within our earlier expectations. Group NPATMI however, surprised on the upside due to a year-end accounting item.

"4Q revenue within expectations"

During 4Q/FY11, the group recorded revenue of RM62.8 million, an increase of 5.2% y-o-y. Most of the revenue came from the group's Retail business segment. The other segment is the Manufacturing segment. The Manufacturing segment caters mainly for the Retail segment of the group. Group NPATMI came in at RM9.8 million, an increase of 84.6% y-o-y. The group's improved Retail performance was mainly due to a combination of **increase in demand, higher product prices and increased number of outlets.**

"Year-end item bumps up NPATMI further"

At the end FY11, the group had revised its estimates with respect to the "allowance on slow

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moving finished goods" in light of the higher raw material prices. Consequently, the group's profit before tax (PBT) of the Retail segment during the year included an amount of RM4.2 million (the accounting item being the reversal of the "allowance on slow moving finished goods".

OUTLOOK/CORP. UPDATES

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

"Steady domestic growth"

Malaysia had reported a reasonable unemployment rate of 3.1% (November 2011) and CPI of 2.7% (January 2012). Bank Negara Malaysia (BNM) had still maintained its overnight policy rate (OPR) at 3.0%. Meanwhile, Malaysia recorded a solid 4Q/2011 GDP growth of 5.2%, amidst weak economic growth in the developed regions (US, EU and Japan). Export growth was slower than before.

According to the consulting firm **Retail Group Malaysia** (RGM), Malaysian retailers are expected to perform better in 2012 by 6%, despite of the woes in Europe and the US, which affects consumer sentiment. Overall, retailers (ranging from groceries to jewellery and clothing to furniture) in Malaysia, are expected to achieve 6.5% in sales growth during FY11.

Meanwhile, **Malaysia Retailers Association** members held a more optimistic view of the industry in the last quarter of 2011, expecting an overall 10% rise in sales. The departmental store-cum-supermarket operators are expecting business to maintain a 9.4% growth while departmental store operators expect operations to recover slightly with 3.7% growth. Fashion and fashion accessory retailers projected a 14.9% growth while those in other specialty stores expect a fast expansion pace at 15.9%.

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, 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.

"Regional expansion"

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. The group currently has 13 Diamond & Platinum outlets (including 1 in Brunei), 8 DeGem outlets (5 in Malaysia, 2 in Singapore and 1 in Jakarta, Indonesia) and a design cum distribution centre in Hong Kong.

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 above the **USD1750/ounce** level). The group plans to

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grow their gold bar business to about RM10-15 million in revenue eventually.

To recap, in October 2011, Degem had 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 4Q/FY11, the group repurchased 6,000 of its issued shares from the open market at an average price of RM1.02 per share. The total consideration paid for the repurchase including transaction costs was around RM6,109. As at 31st December 2011, a total of 1,942,800 shares repurchased were held at a total cost of around RM1,922,668. 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 Q4 results release date. 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

For FY10 ended 31st 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 and paid out on 22nd August 2011. In recent years, we find that Degem's dividend payouts average around the 15-20% level. Currently, **no dividends have been proposed for its FY11 yet**.

Degem (+14.0%) has **outperformed the KLCI** (+1.8%) in 2012 thus far. During the past year, 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.

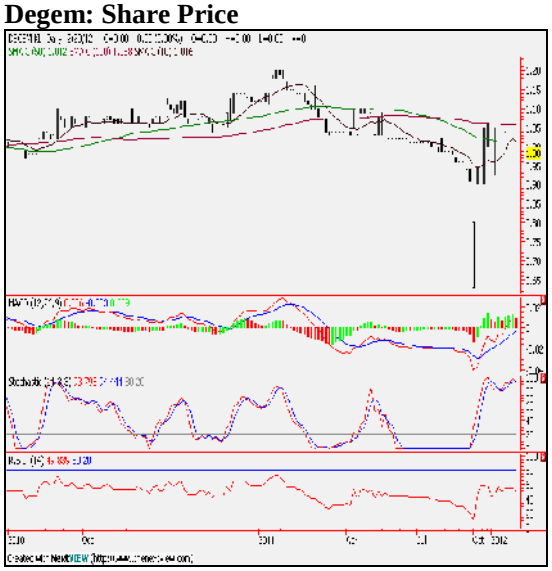
"Maintain Buy Call"

Based on our forecast of Degem's FY12 EPS and estimated P/E of 7.7 times, we set a **FY12-end Target Price (TP) of RM1.28.** This TP represents a 16.4% upside from its current market price. Our TP for Degem reflects a P/BV of 0.9 times over its FY12F BV/share.

We note that Degem's P/E and P/BV valuations are reasonable, they are not among the most undemanding within the domestic Jewellery sector. Degem's management appears prudent with its cash management and minimal gearing levels, while its ROEs and dividend yields are at a reasonable level.

The group faces routine risks from possible fluctuating raw material and FX 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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