

Degem Bhd (DGEM)		Price:	RM 1.09 @ 16 Aug 06
		Market capitalisation:	RM144.76mn
		Board:	Main
		Sector:	Consumer Products
Stock Code:	7119	Recommendation:	Neutral

<u>Key stock statistics</u>	<u>2004</u>	<u>2005</u>	<u>Degem 2QFY06 Quarterly Results</u>	<u>2Q 2005</u>	<u>1Q 2006</u>	<u>2Q 2006</u>	<u>Change</u>	<u>Change</u>
EPS (sen)	8.38	3.60		RMmn	RMmn	RMmn	QoQ %	YoY %
P/E (x)	16.11	18.34	Revenue	26.05	29.52	39.04	32.3	49.9
Dividend/Sh are (RM)	0.02	0.03	Profit from Operations	9.52	3.64	12.85	252.8	34.9
NTA/Share (RM)	0.76	0.81	Finance Costs	(0.31)	(0.41)	(0.49)	(20.5)	(58.0)
Book Value/Share (RM)	0.76	0.83	Share of profit/(loss) of assoc. Com.	(6.86)	(0.29)	(6.82)	(2250.0)	(0.6)
Issued capital (mn shares)	126.00	134	Pre-Tax Profit	2.35	2.94	5.54	88.2	135.3
52-weeks Share Price Range (RM)		RM0.59- RM1.22	Taxation	(0.87)	(0.66)	(1.21)	(83.5)	(38.6)
Government		-	Minority Interest	(0.01)	(0.00)	(0.01)	(350.0)	(28.6)
Qthers (specify)		Legion Master Sdn Bhd (51.72%)	Net Profit	1.48	2.28	4.32	89.4	193.0

<u>Per Share Data</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006E</u>
Book Value (RM)	0.70	0.76	0.83	0.84
Cash Flow (RM)	-	-	0.00	0.03
Earnings (RM)	0.10	0.08	0.04	0.07
Dividend (RM)	0.03	0.02	0.02	0.02
Payout Ratio(%)	23.99	23.86	60.34	20.25
PER (x)	14.01	16.11	18.34	14.58
P/Cash Flow (x)	-	-	567.74	37.2
P/Book Value (x)	2.09	1.77	0.80	1.28
Dividend Yield (%)	1.71	1.48	3.29	1.39
ROE (%)	14.88	11.00	4.36	8.80
Net Gearing (x)	0.14	0.24	0.26	0.07

<u>P&L Analysis (RMmn)</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006E</u>
Year-end: 31 st Dec				
Revenue	114.0	135.3	108.2	135.2
EBIT	20.6	17.8	8.2	9.30
Depreciation	(1.6)	(1.8)	(1.9)	(1.5)
Interest Expenses	(1.3)	(1.6)	(1.3)	(0.4)
Pre-tax Profit	19.4	16.2	11.3	14.9
Taxation	(4.6)	(4.0)	(2.1)	(4.8)
Net Profit	13.1	10.6	4.8	9.9
EBIT Margin (%)	18.1	13.1	7.6	6.9
Pre-tax Margin (%)	17.0	12.0	6.4	11.0
Net-Margin (%)	11.5	7.8	4.4	7.3
Revenue Growth (%)	11.5	18.7	(20.1)	25.0
EBIT Growth (%)	15.2	(13.9)	(53.6)	12.8
Pre-tax Growth (%)	14.6	(16.3)	(57.2)	114.6
Net Growth (%)	11.9	(19.6)	(54.6)	106.9

<u>Degem 2QFY06, YTD Results</u>	<u>2Q 2005</u>	<u>2Q 2006</u>	<u>Change</u>
Revenue	51.99	68.56	31.88
Profit from Operations	19.43	22.41	15.32
Finance Costs	(0.63)	(0.90)	(43.63)
Share of profit/(loss) of assoc. Com.	(13.95)	(13.02)	6.68
Pre-Tax Profit	4.85	8.48	74.98
Taxation	(1.37)	(1.87)	(36.55)
Minority Interest	0.01	0.01	35.71
Net Profit	3.49	6.62	89.58
Operating Margin (%)	37.37	32.68	(12.56)
Pre-tax Margin (%)	9.33	12.37	32.68
Net Margin (%)	6.72	9.66	43.75
Basic EPS (sen)	2.57	4.93	91.83

1. Results commentary

Degem reported an increase of 193% in net profit to RM4.3mn in 2Q FY06 from RM1.5mn a year ago, backed by a double digit growth of 50% in revenue from RM26.1mn to RM39.0mn. In comparison to the 1Q FY06, the Group recorded a 32% growth in revenue and posted an impressive growth of 89% in pre tax profit from RM2.9mn to RM5.5mn for the quarter under review

For the first half ended June 30, 2005, net profit increased 89% to RM6.6mn from RM3.5mn previously. Revenue registered a growth of 32% from RM51.9mn a year ago. The basic earning per share increased to 4.93sen versus 2.57sen in the previous corresponding period. The results were attributed to the better sales experienced by the Group and gain on disposal of properties.

2. Earnings Outlook

In view of the astounding results posted by Degem for the first half, we have revised forecast for the Group as profitability and growth are improving. The disposal of two showrooms, some fixed assets and inventories worth some RM20.5mn are part of its efforts to streamline its operation, as it focuses on strengthening its relatively new Degem's, Diamond and Platinum (D&P) brands. This has strengthened our belief that the Group's earnings are on the rise and will be in line with our earnings expectations for the coming financial year.

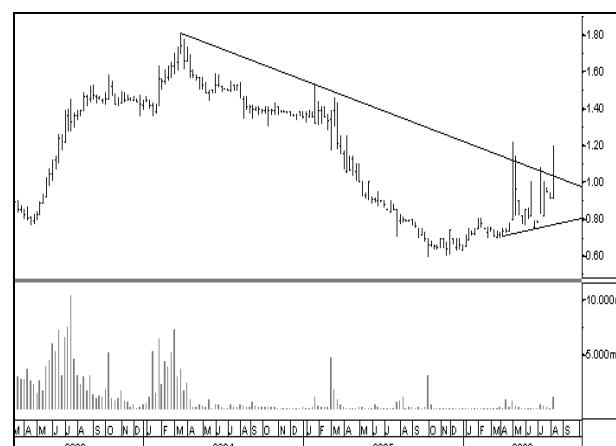
We also like the fact that initially the proceeds from the sale of assets which was initially planned to be used for working capital is now going to end up in the hands of shareholders. Degem surprised investors by declaring a special interim dividend of 16.5sen gross for financial year FY06. The Group had only recently announced the entitlement and payment dates for the FY05 dividend of 2.5sen gross. Due to the healthy cash flows from the proceeds on disposal, the Group is in a position to pay the FY05 dividend and the FY06 special interim dividend, amounting to RM18.4mn and the balance will be utilised as working capital.

3. Valuation & Recommendation

We are confident that Degem will continue to post better results. We also expect its recent efforts to streamline the business to bode well for the Group going forward.

We have upgraded our recommendation for Degem to **Neutral**. We have also revised our target price to **RM0.96**, based on prospective FY07 EPS of 7.4sen pegging a weighted average PE in jewellery industry of 13x.

4. Technical Analysis



DEGEM (Stock code: 7119) – Targeting 1.34

Resistance : 1.34

Support : 0.90

Share price is at 1.09 on 16/8/06. Following the upward push to 1.22 in May 2006, it may consolidate around the 0.90 region before staging further upward move to 1.34.