

Degem Bhd (DGEM)		Price:	RM 0.645 @ 29 Nov 05
		Market capitalisation:	RM81.27mn
		Board:	Main
		Sector:	Consumer Products
Stock Code:	7119	Recommendation:	SELL

<u>Key stock statistics</u>	<u>2003</u>	<u>2004</u>	<u>Quarterly Results</u>	<u>3Q 2004</u>	<u>2Q 2005</u>	<u>3Q 2005</u>	<u>Change</u>	<u>Change</u>
EPS (sen)	10.42	8.38		RMmn	RMmn	RMmn	QoQ %	YoY %
P/E	5.95	7.40	Revenue	34.4	26.1	30.0	15.1	(12.7)
Dividend/Share (RM)	0.01	0.04	Operating Profit	4.7	2.7	2.8	3.2	(41.7)
NTA/Share (RM)	0.70	0.76	EBITDA	4.7	2.7	2.8	3.2	(41.7)
Book Value/Share (RM)	0.70	0.76	Interest Expenses	(0.3)	(0.3)	(0.4)	25.3	21.8
Issued capital (mn shares)	63.00	126.00	Pre-tax Profit	4.4	2.4	2.4	0.3	(46.4)
52-weeks Share Price Range (RM)	RM0.67- RM1.53	RM0.84- RM1.54	Net Profit	3.4	1.5	1.5	2.9	(55.4)
Government	-	-	Operating Profit Margin (%)	13.7	10.2	9.2	(10.4)	(33.2)
Qthers (specify)	Legion Master Sdn Bhd (51.72%)		EBITDA Margin (%)	13.7	10.2	9.2	(10.4)	(33.2)

<u>Per Share Data</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005E</u>
Book Value (RM)	1.85	0.70	0.76	0.79
Cash Flow (sen)	9.27	-	-	2.00
Earnings (sen)	18.62	10.42	8.38	5.74
Dividend (sen)	5.00	2.50	3.00	2.50
Payout Ratio(%)	26.85	23.99	35.79	43.57
PER (x)	4.03	7.20	8.95	11.24
P/Cash Flow (x)	8.09	-	-	32.25
P/Book Value (x)	0.41	1.07	0.98	0.81
Dividend Yield (%)	6.67	3.33	4.00	3.33
ROE (%)	15.12	14.88	11.00	9.04
Net Gearing (x)	7.42	6.79	1.63	1.18

<u>P&L Analysis (RMmn)</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005E</u>
Year-end: 31 st Dec				
Revenue	102.3	114.0	135.3	11.05
EBITDA	19.3	22.3	19.6	14.4
Depreciation	(1.4)	(1.6)	(1.8)	(1.8)
Interest Expenses	(1.1)	(1.3)	(1.6)	(1.3)
Pre-tax Profit	16.9	19.4	16.2	11.3
Taxation	(3.8)	(4.6)	(4.0)	(3.2)
Net Profit	11.7	13.1	10.6	7.7
EBITDA Margin (%)	18.9	19.5	14.5	13.0
Pre-tax Margin (%)	16.5	17.0	12.0	10.2
Net-Margin (%)	11.5	11.5	7.8	6.9
Revenue Growth (%)	23.2	11.5	18.7	(11.9)
EBITDA Growth (%)	15.1	742.2	16.0	(21.8)
Pre-tax Growth (%)	20.2	14.6	(16.3)	(26.1)
Net Growth (%)	16.3	11.9	(19.6)	(24.2)

<u>Quarterly Results</u>	<u>3Q 2004</u>	<u>2Q 2005</u>	<u>3Q 2005</u>	<u>Change</u>	<u>Change</u>
Revenue	34.4	26.1	30.0	15.1	(12.7)
Operating Profit	4.7	2.7	2.8	3.2	(41.7)
EBITDA	4.7	2.7	2.8	3.2	(41.7)
Interest Expenses	(0.3)	(0.3)	(0.4)	25.3	21.8
Pre-tax Profit	4.4	2.4	2.4	0.3	(46.4)
Net Profit	3.4	1.5	1.5	2.9	(55.4)
Operating Profit Margin (%)	13.7	10.2	9.2	(10.4)	(33.2)
EBITDA Margin (%)	13.7	10.2	9.2	(10.4)	(33.2)
Pre-tax Margin (%)	12.8	9.0	7.9	(12.9)	(38.5)
Net Margin (%)	9.9	5.7	5.1	(10.6)	(48.9)
EPS (basic)	2.7	1.11	1.14	2.7	(57.8)

<u>Cumulative Quarterly Results</u>	<u>3Q04</u>	<u>3Q05</u>	<u>Change</u>
Revenue	94.1	82.0	(12.9)
Operating Profit	14.4	8.2	(42.8)
EBITDA	14.4	8.3	(42.2)
Interest Expenses	(0.9)	(1.1)	22.8
Pre-tax Profit	13.5	7.2	(46.6)
Net Profit	9.7	4.9	(49.3)
Operating Margin (%)	15.3	10.0	(34.4)
EBITDA Margin (%)	15.3	10.1	(33.6)
Pre-tax Margin (%)	14.3	8.8	(38.6)
Net Margin (%)	10.4	6.0	(41.7)
EPS (basic)	7.73	3.71	(52.0)

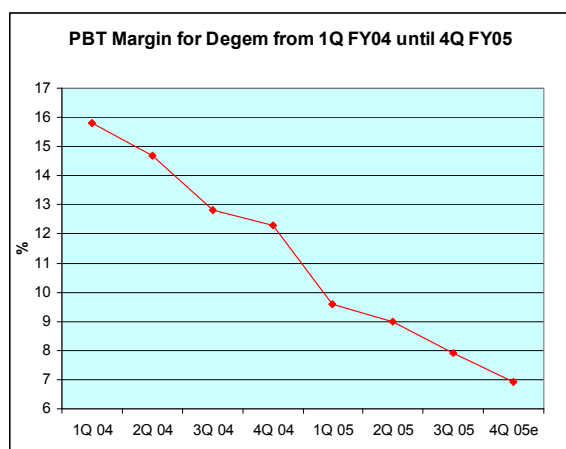
1.0 Results Commentary

The Group 3Q FY05 recorded a lower revenue of RM30.0mn as compared to RM34.4mn a year ago. Net profit declined 55.4% from RM3.4mn to RM1.5mn compared to last year. The lower sales and net profit were mainly due to stiff competition and weak consumer spending on jewellery.

Compared to its preceding quarter, revenue shown an increase of 14.9% from RM26.1mn to RM30.0mn due to successful sales campaign conducted by the Group. However, its net profit maintained at RM1.5mn as a result of lower margin.

2.0 Outlook

The Group had been experiencing a decline in PBT margin since 1Q FY04. We anticipate the trend to continue for FY05 due to stiff competition and a weaker consumer purchasing power. In order to maintain the sales, the Group lowered the price which resulted a lower margin. We believe its net profit would not improve owing to higher cost of operations especially in promotion and advertising.



Inventories had been growing y-o-y since 2001. We foresee the level of inventories will increase approximately 7% to RM132mn due to overstock.

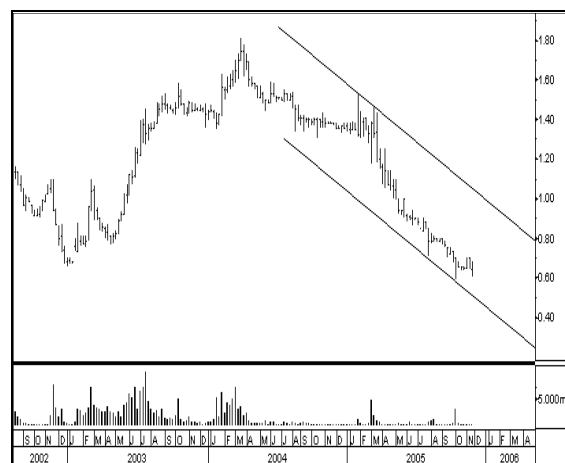
Lower production activities and trade activities can be seen from a big decline in its trade receivables as well as trade payables comparing the quarter against its preceding FY end. Trade receivables and trade payables declined by 88% and 42.3% respectively during the period.

3.0 Recommendation

Annualised revenue and EPS FY05 of RM109.3mn and 4.94sen are 12.9% and 38.2% lower than our expected RM125.4mn and 9.01sen respectively. The unexpected lower net profit was due to lower margin.

Due to its consistent declining quarterly results, we lower our EPS from 8.4sen to 5.7sen for FY05. Based on its prospective EPS FY05, we revised our valuation from RM0.68 to RM0.46, pegging the PE at 8x. The fair value may seem much lower. However for its consistent non performing results, weak market sentiment as well as weak consumer spending on jewellery, both the multiple and EPS seem reasonable. We maintain our sell recommendation on Degem.

4.0 Share Price Chart



DEGEM (Stock code: 7119) – Down Trend Ending

Resistance: 0.81
Support: 0.50

Share price is at 0.61 on 30/11/05. The current down trend – since the 1.81 high in March 2004 – is nearing the end due to the oversold situation. The downside is likely to be limited to the lower trendline at 0.50. Upside is at 0.81.