

<b>Degem Berhad (DGEM)</b>		<b>Price:</b>	RM0.75 @ 23 Sep 05
		<b>Market capitalisation:</b>	RM94.5mn
		<b>Board:</b>	Main
		<b>Sector:</b>	Consumer Products
<b>Stock Code:</b>	7119	<b>Recommendation:</b>	SELL

<b><u>Key Stock Statistics</u></b>	<b>2003</b>	<b>2004</b>
EPS (sen)	10.42	8.38
P/E (x)	5.95	7.40
Dividend/Share (RM)	0.01	0.04
NTA/Share (RM)	0.70	0.76
Book Value/Share (RM)	0.70	0.76
Issued Capital (mn shares)	63.00	126.00
52-wks Share Price Range	RM0.67 - RM1.53	RM0.84 - RM1.54
<b><u>Major Shareholders:</u></b>		
Government		
Others (specify) Legion Master Sdn Bhd (51.72%)		

<b><u>Per Share Data</u></b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005E</b>
Book Value (RM)	1.85	0.70	0.76	0.81
Cash Flow (sen)	9.27	-	-	2.00
Earnings (sen)	18.62	10.42	8.38	8.01
Dividend (sen)	5.00	2.50	3.00	3.00
Payout Ratio(%)	26.85	23.99	35.79	37.43
PER (x)	4.03	7.20	8.95	9.36
P/Cash Flow (x)	8.09	-	-	37.50
P/Book Value (x)	0.41	1.07	0.98	0.92
Dividend Yield (%)	6.67	3.33	4.00	4.00
ROE (%)	15.12	14.88	11.00	9.04
Net Gearing (%)	7.42	6.79	1.63	1.18

<b><u>P&amp;L Analysis</u></b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005E</b>
<b><u>(RMmn)</u></b>				
Year-end: 31 <sup>st</sup> Dec				
Revenue	102.3	114.0	135.3	125.4
EBITDA	19.3	22.3	19.6	18.4
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	15.3
Taxation	-3.8	-4.6	-4.0	-3.7
Net Profit	11.7	13.1	10.6	10.1
EBITDA Margin(%)	18.9	19.5	14.5	14.7
Pre-tax Margin(%)	16.5	17.0	12.0	12.2
Net-Margin(%)	11.5	11.5	7.8	8.1
Revenue Growth(%)	23.2	11.5	18.7	-7.3
EBITDA Growth(%)	15.1	742.2	16.0	-2.2
Pre-tax Growth(%)	20.2	14.6	-16.3	-5.6
Net Growth(%)	16.3	11.9	-19.6	-4.4

## 1. Investment Highlights/Summary

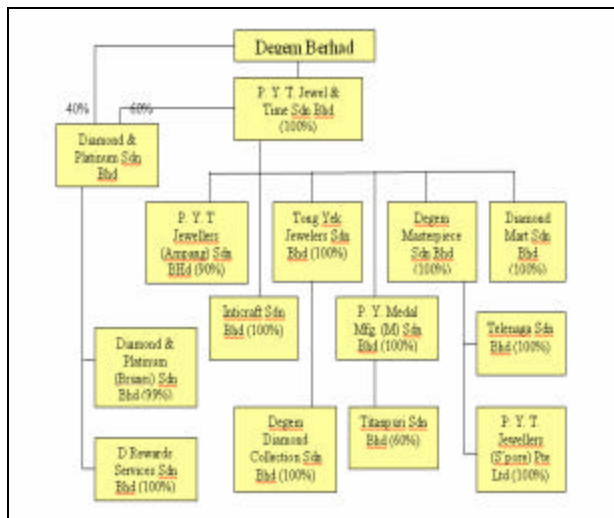
- Degem faces stiff competition from Habib Berhad, Poh Kong Corporation Berhad and Yikon Corporation Berhad.
- The Group has closed down retail outlets that were not profitable in last financial year even after spending huge set up cost.
- 2H FY05 result down 13% to RM51.9mn from RM89.8mn compared to its corresponding period in preceding year.
- Net profit margin decreased approximately from 35.8% in 2001 to 7.8% in 2004.
- We recommend a SELL on Degem.

## 2. Background

### Corporate Profile

Degem Berhad is a jewellery manufacturer and retailer. The company was listed on the Second Board on Oct 2001, and later transferred to Main Board in June 2003. It is currently involved in manufacturing and trading of gold medals and badges as well as some property investment. It is also the first jewellery trading and manufacturing company to be awarded ISO 9001 in Malaysia.

## Corporate Structure



**Subsidiaries.** The subsidiary companies and their principal activities are as follows:

Name of Subsidiary Company	Principal Activities
P. Y. T. Jewel & Time Sdn Bhd	Investment holding and trading in gold and jewellery
Tong Yek Jewellers Sdn Bhd	Investment holding and trading in gold and jewellery
Degem Masterpiece Sdn Bhd	Investment holding and trading in gold and jewellery
P. Y. Medal Mfg (M) Sdn Bhd	Investment holding and trading in gold medals and badges
Inticraft Sdn Bhd	Manufacturing and trading in gold jewellery
Diamond Mart Sdn Bhd	Property investment and provision of management services
P. Y. T. Jewellers (Ampang) Sdn Bhd	Trading in gold and jewellery
Diamond & Platinum	Trading in diamonds and jewellery
Degem Diamond Collections Sdn Bhd	Trading in diamonds and jewellery
Telenaga Sdn Bhd	Property investment and provision of management services
P. Y. T. Jeweller (Singapore) Pte Ltd	Dormant.
Titanpuri Sdn Bhd	Trading in diamonds and jewellery
D Rewards Services Sdn Bhd	Trading in diamonds and jewellery. Previously known as D & P 2 Jewellery Sdn Bhd.
Diamond & Platinum (B) Sdn Bhd	Trading in diamonds and jewellery

## Business

PYT Jewellers is one of Malaysia's most established and acclaimed homegrown brand in the local jewellery scene. The principal activities of the Company are investment holding and the provision of management services. It caters to the middle-to high-end fine jewellery market.

Today, there are four *PYT Jewellers* showrooms strategically located in high traffic residential/commercial areas within Klang Valley - PJ SS2 (headquarter), Subang Jaya, PJ State and Ampang.

The Company produces diamond jewellery under in-house brand names of *Rembrandt Collezione Hearts* and *Happy Eight Brilliant Cut Diamond* as well as *Schoeffel* which is an internationally-renowned fine jewellery.

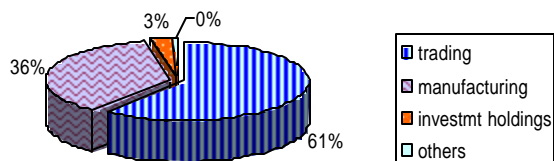
DeGem Berhad's retail network comprises of three distinct brands/retail concepts known as *PYT Jewellers* (fine quality collections), *Diamond & Platinum* (affordable contemporary) and *DeGem* (high-end fashion jewellery). DeGem Berhad has a total of 20 showrooms throughout Peninsular Malaysia of which 15 showrooms are located in Kuala Lumpur and Selangor while two in Penang and one each in Johor Bahru, Ipoh and Brunei as well as one manufacturing plant under its wings. The Group's operating businesses are organized according to three major activities:-

**Trading :** engaged in trading in gold, diamonds, jewellery, gold medals and badges

**Manufacturing :** engaged in manufacturing in gold, diamonds, jewellery, gold medals and badges

**Investment Holding :** engaged in the activities of investment holding and the provision of management services

**Revenue Breakdown by Business Segment in FY2004**



### 3. Valuation

There are currently approximately 1100 local manufacturers involved in the fabrication of gold jewellery in Malaysia.

At present, the closest comparables to Degem listed on the stock exchange are Habib Corporation Bhd, Poh Kong Bhd and Yikon Corporation Bhd whilst the unlisted competitors are Selberan Jewellery Sdn Bhd and Tomei Gold & Jewellery Holdings (M) Sdn Bhd.

In comparison, Poh Kong adopted a mass-market strategy, which has seen greater number of outlets being established while DeGem embarked on a differentiation strategy with emphasis on products uniqueness targeting at strategic market areas with high human traffic coupled with greater purchasing power.

Below is the comparison table of their financial performance for Degem Berhad, Habib Corporation Berhad, Poh Kong Berhad and Yikon Corporation Berhad.

<u>Comparative</u>	<u>Degem</u>	<u>Habib</u>	<u>Poh</u>	<u>Yikon</u>
<u>Valuation</u>			<u>Kong</u>	
Share Price (RM)	0.75	1.57	1.12	2.84
Market Capitalization (RMmn)	94.5	383.1	129.4	116.4
Average Daily Vol	0.09	1.2	0.02	0.1
PE FY03(x)	7.2	56.1	4.1	59.2
PE FY04(x)	9.4	56.1	4.0	157.8
P/NTA (x)	1.1	3.2	0.8	2.5
Yield	4.1%	1.1%	4.4%	-
EPS FY04 (sen)	8.4	4.1	27.7	1.8

### ***Brief Competitors Background.***

***Poh Kong Berhad*** – The Company has started its operation 28 years ago and was listed in Main Board of Bursa Malaysia on 9 Mar 2004. It is involved in all aspects of jewellery, from manufacturing and design, to the retailing of gold ornaments, fine gold and other gemset jewellery. The Company has its own house brand *Tranz* Collection of jewellery and its own manufacturing plant in Shah Alam. Poh Kong is the market leader in jewellery industry and has the largest jewellery retail chain in Malaysia. To date, the company has 61 outlets throughout Malaysia and a total workforce of approximately 1000 people.

***Habib Corporation Berhad*** – Habib was established in 1958 and today it is one of Malaysia's finest and most competitive players in the jewellery business. It is not only a major retailer, but also a major distributor and manufacturer of world class quality jewellery products ranging from finely crafted gold jewellery to elaborate creations of diamonds and gems. Habib has its own brands namely *HABIB*, *HABIB Prestige*, *HABIB Jewels*, *HABIB Gold* and *Miss HABIB*. The company has 15 boutiques across the country with a total workforce of approximately 350 people.

***Yikon Corporation Berhad*** – The Company is an export-oriented jewellery manufacturer listed on the Second Board of Bursa Malaysia on Jun 2002. The company has 7 retail outlets in China. During FY03, 98% of its sales were exported to the Middle East, and the remaining in other Asia countries.

### 4. Earning Outlook

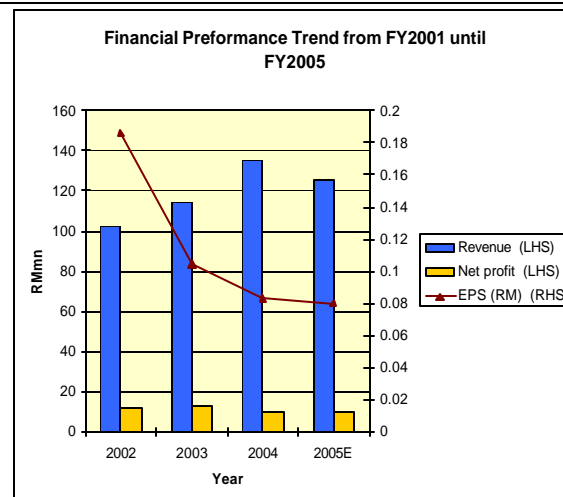
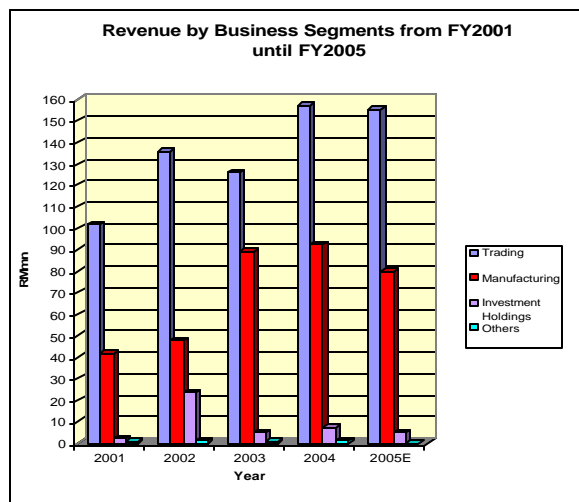
The Group posted an 18% increase in revenue from RM114mn last year to RM135mn in financial year ended 31 Dec 2004. In spite of higher turnover, net profit was lower at RM10.6mn. This is due to the lower gross profit margin resulting from stiff competition and also the following reasons:-

- One off charges for professional fees of approximately RM1.2mn incurred in relation to the issuance of Islamic Notes Facility and the acquisition of the remaining of 40% shares in Diamond & Platinum Sdn Bhd.
- Gold loan loss resulting from higher gold prices as at 31 Dec 2004.

- Shut down of a Diamond & Platinum outlet. Set up and promotional expenses of two new Degem outlets.

The Company's revenue increased from RM83.0mn in FY2001 to FY135.3mn in FY2004. This represents a CAGR of 17.7% per annum from FY2001 to FY2004. However, its net profit margin decreased approximately 35.8% to 7.8% in FY2004 as compared to FY2001.

Based on its recent 2H result, we believe its net profit would not improve owing to higher cost of operations especially in promotion and advertising as well as the impact of high oil prices. Outlook is also affected by stiff competition in the market. The Company may not be able to pass on the additional costs to its customers. We foresee a slight decrease of 10% in both the revenue and net profit. However, the net margins are expected to maintain at approximately 8% for FY2005. The manufacturing activity is expected to remain sluggish compared to other divisions in FY2005 due to over stocking last year and slower demand.



## 5. Recent Developments

The Group is in a leaner position following the closing down of unprofitable retail outlets in the last financial year, and relocating its human and capital resources to showrooms of better potential.

The acquisition of the remaining 40% interest in Diamond & Platinum which was completed in March 2005 is expected to boost its total revenue. During the period under review, Diamond & Platinum had launched its customer loyalty program and it may soon cover the entire Degem Group if the response is positive.

Going forward, the Group plans consolidate its local operation and expand overseas.

## 6. Investment Risk

- Degem's report was written without guidance from management and without a company visit. The report could contain factual errors and may not include the latest available information. Disclosures were limited to the posting in Bursa Malaysia and selected media reports.
- The Group is still in developing stage. It closed down unprofitable retail outlets after spending huge set up costs.
- Compare to its competitors, the Group does not have a good distribution network and geographical coverage throughout Malaysia. There are limited outlets available in strategic locations.

- Sales trend in jewellery trading has not been consistent. It registered a growth in trading sector of 23.68%, 8.41% and 20.38% in FY2002, FY2003 and FY2004 respectively.
- The competition is stiff. Huge amount of money needs to be allocated on promotion and advertising.

## 7. Balance Sheet

<u>Balance Sheet and Other Financial Data</u> (RMmn)	<u>FY2002</u>	<u>FY2003</u>	<u>FY2004</u>
Total Assets	113.8	142.2	174.6
Fixed Assets	23.3	26.0	26.2
Current Asset	90.4	116.2	148.4
Current Liabilities	26.8	42.7	70.1
Long Term Liabilities	5.8	6.0	1.6
Share Capital	42.0	63.0	63.0
Shareholders Funds	77.5	88.2	96.0

## 8. Effectiveness of Management

Analyst's perception of company's commitment to:-

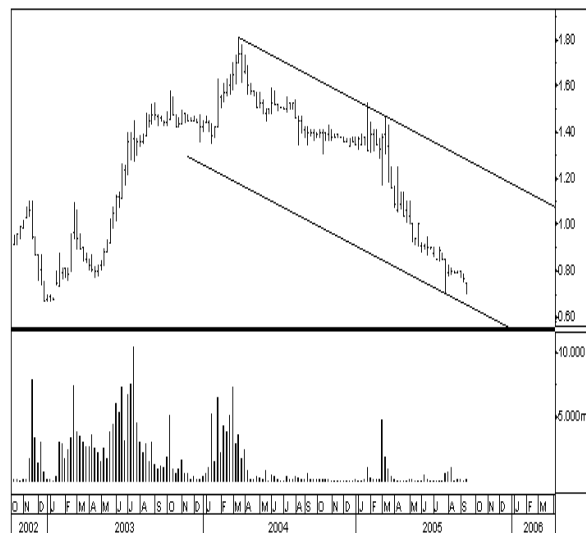
	Ranking
Delivering the corporate vision	3
Creating shareholder value	3
Practicing good governance	2
Communicating with investors	1

(Scale of 1-5; relatively low to high)

## 9. Recommendation

Compare to its peers, Degem is falling behind in its performance. Based on its 2H results, Degem's performance has been slowing down. Based on the prospective EPS of 8.4sen in FY06, we fairly value Degem at RM0.68 on a target PE of 8x FY06 earnings. Currently Degem is trading at RM0.75, which is 10.3% above our fair value. Thus, we recommend Degem a **SELL**.

## 10. Technical Analysis



### DEGEM (Stock code: 7119) – Down Trend Ending

Resistance: 0.92  
Support: 0.65, 0.70

Share price is at 0.75 on 20/9/05. The current down trend – since the 1.81 high in March 2004 – is nearing the end. Currently it is hovering at a support level of 0.70, with further support at the previous low of 0.65. With strong support in the 0.70-0.65 region, a technical rebound to 0.92 is likely.