**RESULTS REPORT**

29 Aug 2012

Degem Bhd		Market Price:	RM0.87
		Market Capitalisation:	RM116.6m
		Board:	Main Market
Recommendation:	HOLD	Sector:	Consumer Products
Target Price:	RM0.98	Stock Code/Name:	7119 / DEGEM

Analyst: Edmund Tham

KEY FINANCIALS

Key Stock Statistics	2013F
Earnings/Sh. (sen)	15.1
P/E Ratio (x)	5.8
Dividend/Share (sen)	3.0
NTA/Share (RM)	1.53
Book Value/Share (RM)	1.54
Issued Capital (mil shares)	134.0
52-weeks share price (RM)	0.63 – 1.10
Major Shareholder:	%
.Legion Master S/B / Choong family	56.1
.BSI SA	10.4
.Morgan Stanley & Co Int.Plc	9.4

*50 sen par value

Ratios Analysis	2010	2011	2012E	2013F
Book Value/Sh. (RM)	1.15	1.31	1.42	1.54
Earnings/Sh. (sen)	9.7	17.5	13.8	15.1
Dividend/Sh. (sen)	3.0	0.0	0.0	0.0
Div. Payout Ratio (%)	23.3	0.0	0.0	0.0
P/E Ratio (x)	9.0	5.0	6.3	5.8
P/Book Value (x)	0.76	0.66	0.61	0.56
Dividend Yield (%)	3.4	0.0	0.0	0.0
ROE (%)	8.4	13.3	9.7	9.8
Net Gearing (or Cash) (x)	0.04	0.07	0.08	0.05

* 2012-2013 figures are our estimates

#Future dividend policy unclear

P&L Analysis (RM mil)	2010	2011	2012E	2013F
Year end: Dec 31				
Revenue	185.3	219.7	242.6	256.2
Operating Profit	23.0	36.0	28.4	31.0
Depreciation	(2.2)	(2.2)	(2.2)	(2.2)
Interest Expenses	(1.5)	(1.6)	(1.6)	(1.6)
Profit before Tax (PBT)	20.5	34.4	26.8	29.4
Effective Tax Rate (%)	34.4	27.9	26.4	25.9
NPATMI	13.0	23.4	18.4	20.4
Operating Margin (%)	12.4	16.4	11.7	12.1
PBT Margin (%)	11.0	15.7	11.0	11.5
NPATMI Margin (%)	7.0	10.6	7.6	8.0

*2012-2013 figures are our estimates

PERFORMANCE – 2Q/FY12

1Q/ 30 Jun	2Q12	2Q11	yoy %	1Q12	qoq %
Rev (RMm)	54.7	52.6	3.8	60.6	(9.8)
EBIT (RMm)	4.2	5.8	(27.4)	5.6	(24.8)
NPAT*(RMm)	3.4	4.0	(15.0)	4.6	(26.8)
EPS (sen)	2.5	3.0	(15.0)	3.4	(26.8)

1H/ 30 Jun	1H/12	1H/11	yoy %
Rev (RMm)	115.2	99.9	15.4
EBIT (RMm)	9.8	11.0	(10.9)
NPAT*(RMm)	8.0	7.8	2.8
EPS (sen)	6.0	5.8	2.8

*NPATMI (net profit after tax & minority interest)

#EPS based on 134 million shares

Degem's 2Q/FY12 revenue (for quarter ended 30th June 2012) was within our earlier expectations while NPATMI was slightly below.

“Q2 – revenue within, NPATMI below”

During 2Q/FY12, the group recorded revenue of RM54.7 million and NPATMI of RM3.4 million. This was a difference of +3.8% and -15.0% y-o-y, respectively. Revenue was higher due to the increase in demand and the increase in number of retail outlets. The lower NPATMI was mainly due to the overhead expenses of new retail outlets, as well as expenses for more promotional activities held by the group during the quarter.

“Higher costs due to new retail shops & promotional activities”

For 1H/FY12, the group's revenue of RM115.2 million and NPATMI of RM8.0 million was 15.4% and 2.8% higher y-o-y, respectively. The higher revenue was due to the performance of

All information, views and advice are given in good faith but without legal responsibility. Mercury Securities Sdn. Bhd. or companies or individuals connected with it may have used research material before publication and may have positions in or may be materially interested in any stocks in the markets mentioned.

This report has been prepared by Mercury Securities Sdn Bhd for purposes of CMDR-Bursa Research Scheme ("CBRS") administered by Bursa Malaysia Berhad and has been compensated to undertake the scheme. Mercury Securities Sdn Bhd has produced this report independent of any influence from CBRS or the subject company. For more information about CBRS and other research reports, please visit Bursa Malaysia's website at: http://www.bursamalaysia.com/website/bm/listed_companies/cmdr_bursa_research_scheme/



the group's retail segment. Meanwhile, the group's manufacturing segment (which mainly caters to internal group needs) recorded slow revenue growth and lower margins.

OUTLOOK/CORP. UPDATES

In spite of the **Eurozone crisis** and the cautious sentiment globally, the Malaysian economy is still growing at a reasonable pace during the year and we expect Degem's revenues to grow in tandem during the year, as well.

Looking at **local economic data** – Malaysia had reported a reasonable Inflation figure (CPI) of +1.4% (July 2012) and Unemployment figure of 3.0% (June 2012). Bank Negara Malaysia (BNM) had still maintained its Overnight Policy Rate (OPR) at an accommodative 3.0%.

Meanwhile, Malaysia recorded a **solid 2Q/2012 GDP growth of 5.4%**, amidst weak economic growth in the developed regions (the US, Eurozone and Japan). The latest available data, June 2012 y-o-y figures appear promising – Exports +5.4%, Imports +3.6%, IPI +3.7% and Manufacturing Sales +6.3%.

“Focus on Diamonds & Gemstones”

Degem's business is more **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.

Group management places emphasis on design and craftsmanship excellence, a strong brand name, product range expansion and operating margin maintenance. The group aims 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 group's domestic operations had expanded with the opening of 2 new D&P showrooms in Subang Parade and Sutera Mall (Skudai, Johor) in the year 2011. The group is also currently in the midst of a makeover of all its D&P showrooms to enhance the shopping experience of its customers.

“Eyeing regional expansion”

The group had expanded regionally, and we see this as a positive move in the long term, given the expected solid GDP growth and population rates within a number of countries in Asia. According to a news article, Degem is exploring opportunities to expand its operations in Saudi Arabia and Thailand, as soon as it finds a suitable business partner.

The group currently has 15 Diamond & Platinum outlets (including 1 in Brunei), 8 DeGem outlets (5 in Malaysia, 2 in Singapore and 1 in Jakarta Indonesia under license) and a design cum distribution centre in Hong Kong. The Hong Kong centre assists the group's venture into the wholesale business, which supplies to markets such as Europe, Asia Pacific, the Middle East and Southeast Asia.

During FY11, the group had added **Gold Bullion** to its stable of products. Gold Bullion is highly sought after as an investment to hedge against the erosion of value of money from inflation. Prices of the group's Gold Bullion (denominations between 20g and 1kg) are quoted mark-to-market, with buying and selling rates displayed online. The public appetite for gold bars is due to the solid gold prices (currently above the **USD1650/ounce** level). The group plans to grow its gold bar business to achieve about RM10-15 million in revenue eventually.

Results Report

This report has been prepared by Mercury Securities Sdn Bhd for purposes of CMDF-Bursa Research Scheme (“CBRS”) administered by Bursa Malaysia Berhad and has been compensated to undertake the scheme. Mercury Securities Sdn Bhd has produced this report independent of any influence from CBRS or the subject company. For more information about CBRS and other research reports, please visit Bursa Malaysia's website at: http://www.bursamalaysia.com/website/bm/listed_companies/cmdf_bursa_research_scheme/



The group had also added the **“Forevermark” brand of diamonds** to its range of products during FY11. The brand is renowned for its commitment to rigorous environmental and ethical standards. This brand is available at all DeGem showrooms and selected Diamond & Platinum (D&P) showrooms.

VALUATION/CONCLUSION

“Future dividend policy poser”

For FY10 ended 31st December 2010, Degem’s BOD had paid out a first and final dividend per share (DPS) of 6% (3 sen DPS) less 25% tax, amounting to around RM3 million in August 2011. Even though the most recent AGM was held in May 2012, **no dividends have been proposed for its FY11.**

According to the Chairman’s Statement in the group’s FY11 annual report, the group’s Board of Directors (BOD) will not be proposing a dividend at present due to the group’s anticipated cash flows needs (for expansion and capital expenditure plans that are in the pipeline). As such, we are unsure of the group’s future dividend policy for its FY12 - FY13.

“Underperformed the KLCI”

Degem (-9.8%) has **underperformed the KLCI** (+7.4%) 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.

“Revise to Hold Call”

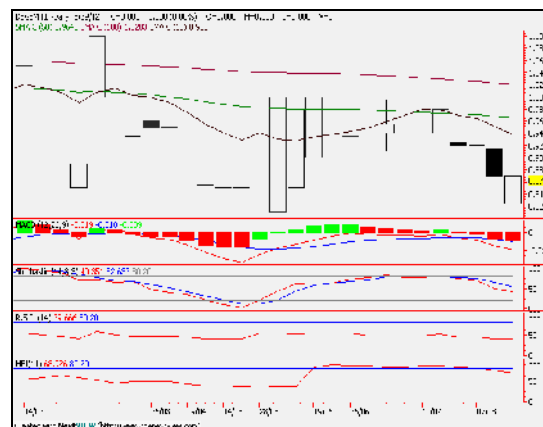
Based on our forecast of Degem’s FY13 EPS and estimated P/E of 6.5 times, we set a **FY13-end Target Price (TP) of RM0.98** (representing a Hold Call). This TP represents a 12.6% upside from the market price on the date

of this report. Our TP for Degem reflects a P/BV of 0.64 times over its FY13F BV/share.

Basically our Hold Call reflects the **cautious external environment**, the group’s **weak earnings growth** and also the **uncertain dividend policy**. Nevertheless, on the plus side, we note Degem’s undemanding P/E and P/BV valuations, reasonable ROE and minimal gearing levels.

The group faces possible **routine risks** from fluctuating raw material prices (precious metals and gemstones) and foreign exchange (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

All information, views and advice are given in good faith but without legal responsibility. Mercury Securities Sdn Bhd, or companies or individuals connected with it may have used research material before publication and may have positions in or may be materially interested in any stocks in the markets mentioned.

This report has been prepared by Mercury Securities Sdn Bhd for purposes of CMDF-Bursa Research Scheme (“CBRS”) administered by Bursa Malaysia Berhad and has been compensated to undertake the scheme. Mercury Securities Sdn Bhd has produced this report independent of any influence from CBRS or the subject company. For more information about CBRS and other research reports, please visit Bursa Malaysia’s website at: http://www.bursamalaysia.com/website/bm/listed_companies/cmdf_bursa_research_scheme/