

Company Updates

Monday, 2nd July 2007
PP7084/11/2006

SJ Securities Sdn. Bhd.
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Degem Berhad

OVERWEIGHT

Fair Value:

A real gem...

RM1.43 (+14.4%)

Stock Data

Price (RM)	1.25
Stock code	7119
Bloomberg Ticker	DGEM MK
Listing	Main Board
Share Cap (RM mn)	67.00
Market Cap (RM mn)	167.50
Par value (RM)	0.50
52-wk high (RM)	1.68
52-wk low (RM)	0.64
Major Shareholders	Legion Master Sdn Bhd (51.7%)

Financial Data

12 Months Trailing	
PER (x)	13.2
BV per share (RM)	0.8
P/BV (x)	1.5
ROE (%)	4.5
Beta (x)	0.8
Altman Z Score	2.6
Dividend yield (%)	2.0

Relative Performance

1-month (%)	16.2
3-month (%)	46.5
6-month (%)	32.3
12-month (%)	6.2
YTD (%)	32.3

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We are feeling more upbeat about Degem's prospect upon our recent meeting with management. Below are the keytakes from the meeting:

- **Strong growth post Group's restructuring.** We expect Degem to enjoy strong earnings growth going forward upon undergoing a series of painful restructuring exercises last year where some of the board members left the Group.
- **Diversion of PYT brand to focus on Degem and D&P.** Degem has disposed of its jewellery business under the PYT brand to 2 former director for the total sum of RM20.3mn. Management informed us that the disposal of PYT brand enabled Degem to save about RM1.0mn per year while allowing the Group to build and strengthen its existing Degem and Diamond & Platinum (D&P) brands.
- **International expansion plan and more show rooms.** The Group is in the midst of carving a presence in Middle East and Vietnam by the end of this year. Going forward, the Group is planning to set up more stores in Malaysia, Singapore Vietnam and Jakarta. Management revealed that 5 new outlets will be opened within this year and another 2 by next year. Among them, one each will be opened in Mid-valley, KL Pavilion, and Kota Kinabalu while other 2 will be opened in Singapore's key area.
- **Favorable demographics and strong consumption growth.** We believe demographics in Malaysia are favourable for the Group's business where Degem has a potential lucrative market with 7.8mn females aged between 15 to 64. Furthermore, we anticipate that consumption growth to be strong in second half in view of rising civil servants' salaries coupled with multiplier effects from upcycles in commodities and construction related sectors. In addition, the purchasing power parity (PPP) for Malaysia, Brunei, Singapore, Hong Kong and Vietnam also showing an upward trend.
- **Sustainable growth.** According to a report on Jewellery, Watches and Clocks by Freedonia Group, demand for fine jewellery is expected to register a sustainable growth rate of about 4.3% per annum and is forecasted to grow to USD13.7bn in 2009. We believe this is achievable supported by strong population growth and rising per capita income in the global economy.
- **Upgrade to OVERWEIGHT.** We have revised upwards our target price for Degem to **RM1.43** pegging on forward PE of 11x. We believe Degem serves as a good proxy to the strong growth in consumption pattern. Upgrade to **OVERWEIGHT**.

Financial Analysis				
<i>P&L Analysis (RMmn)</i>	2005	2006	2007E	2008F
Year-end: 31 st Dec				
Revenue	108.2	144.2	173.1	204.2
EBIT	8.2	20.4	21.3	26.2
Depreciation	(1.9)	(1.9)	(1.6)	(1.7)
Interest Expenses	(1.3)	(1.2)	(0.5)	(0.7)
Pre-tax Profit	11.3	17.3	19.2	23.9
Taxation	(2.1)	(4.7)	(5.4)	(6.7)
Net Profit	4.8	12.7	13.9	17.2
EBIT Margin (%)	7.6	14.2	12.3	12.8
Pre-tax Margin (%)	6.4	12.0	11.1	11.7
Net-Margin (%)	4.4	8.8	8.0	8.4
Revenue Growth (%)	(20.1)	33.3	20.0	18.0
EBIT Growth (%)	(53.6)	149.0	2.0	23.0
Pre-tax Growth (%)	(57.2)	53.4	11.0	24.2
Net Growth (%)	(54.6)	163.8	9.4	24.2

Brighter prospects post Group's restructuring. We expect Degem to enjoy strong earnings growth going forward upon undergoing a series of painful restructuring exercises last year where some of the board members left the Group. The Group registered its first historical losses in forth quarter FY05 after suffering from the dispute among the board of directors with regards the direction of the Group. Nonetheless, we believe that the incidence is unlikely to recur in the future since the existing management team has mutual understanding with regards to the Group's direction going forward.

Management guided that there will be two new management team carrying out its existing operations. Degem will be managed by the management which is experienced in dealing with middle-to-high-end segment. Meanwhile, its relatively new Degem's Diamond and Platinum (D&P) brands will be handled by young and experienced management team to cater for the trendier and younger consumer market.

Key Management Team		
Position	Current Appointment	Previous Experience
Mr Choong Kai Soon	Executive Director-responsible for the manufacturing divisions of the Group as well as in enforcing quality control during manufacturing and on-the-job training to craftsmen in the Group.	Over 34 years experience in gemstone industry.
Mr Choong Kai Fatt	Executive Director-responsible for the purchasing and marketing operations of the Group.	Over 20 years experience in the jewellery business. Qualified gemologist since 1989.
Mr Choong Khoi Onn	Executive Director-responsible for the financial and administrative matter of the Group.	Audit assistant of Kassim, Chan & Co.
Mr Choong Kay Cheong	Executive Director	Project manager of Yuza Sdn. Bhd

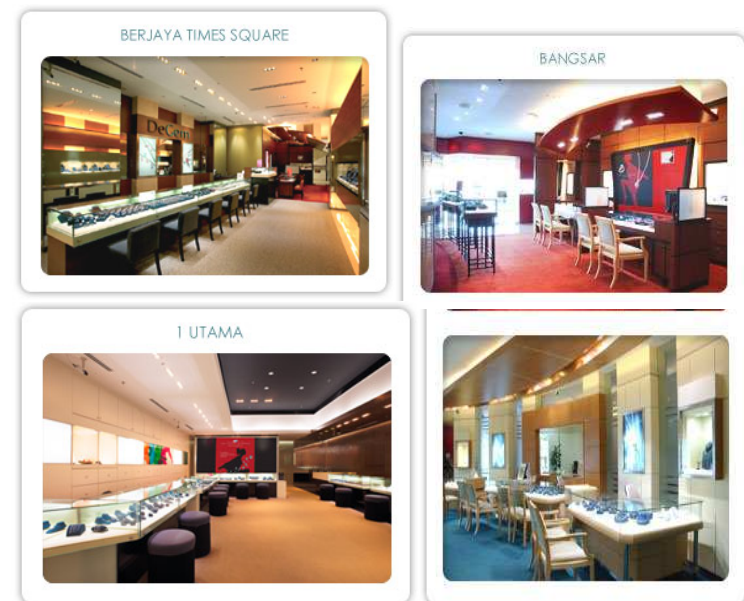
Diverse business under PYT brand to focus on Degem and D&P.

Degem has disposed of its jewellery business under the PYT brand to 2 former director for the total sum of RM20.3mn. Management informed us that the disposal of PYT brand enabled Degem to save about RM1.0mn per year while allowing the Group to build and strengthen its existing Degem and Diamond & Platinum (D&P) brands.

International expansion plans...Degem has established its footprint in Indonesia, Singapore and Brunei. In addition, the Group has also commenced a jewellery design and distribution business in Hong Kong. The Group is in the midst of carving a presence in Middle East and Vietnam by the end of this year.

...and more show rooms. At present, Degem has a total of 17 showrooms throughout Peninsular Malaysia of which ten showrooms are located in Kuala Lumpur and Selangor while two in Penang and one each in Johor Bahru, Ipoh, Indonesia, Singapore and Brunei. Going forward, the Group plans to set up more stores in Malaysia, Singapore, Vietnam and Jakarta. Management revealed that four new outlets will be opened within this year and another two by next year.

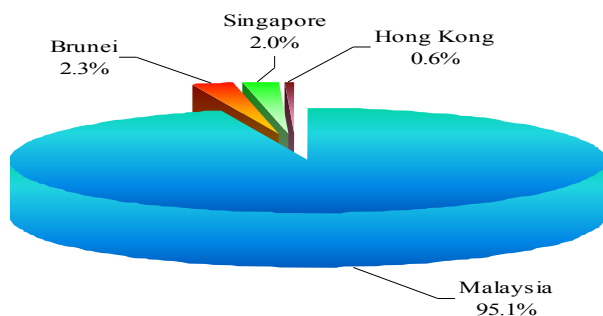
Some of the outlets



Source: Company

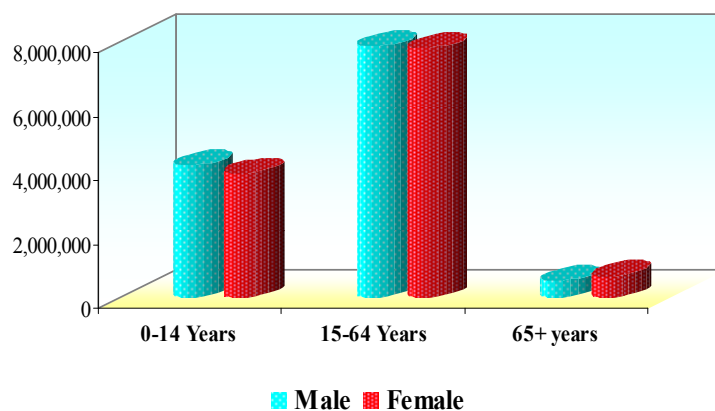
Favorable demographics and strong consumption growth. We gather the customer of Degem is predominantly female and aged between 35 to 65. Approximately 95% of the Group's revenue was contributed by its domestic business. We believe demographics in Malaysia are favourable for the Group's business where Degem has a potential lucrative market with 7.8mn females aged between 15 to 64. Furthermore, we anticipate that domestic consumption growth to be strong in 2H in view of rising civil servants' salaries coupled with multiplier effects from upcycles in commodities and construction related sectors. In addition, the purchasing power parity (PPP) for Malaysia, Brunei, Singapore, Hong Kong and Vietnam also showing an upward trend.

Revenue Breakdown



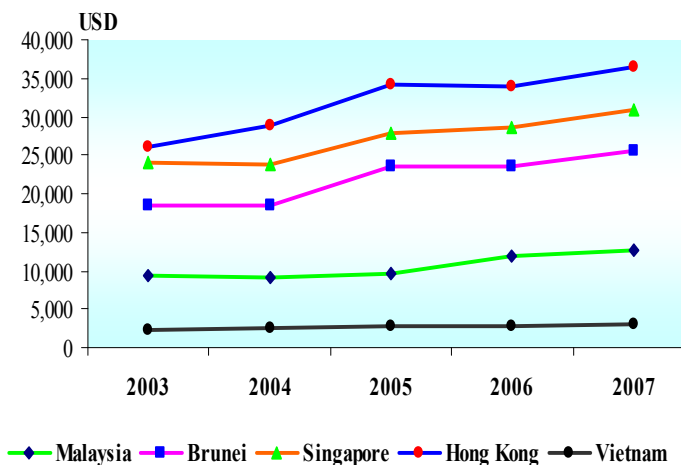
Source: Company

Malaysia Population (2007 estimated)



Source: CIA World Fact Book, SJ

GDP - per capita (PPP)

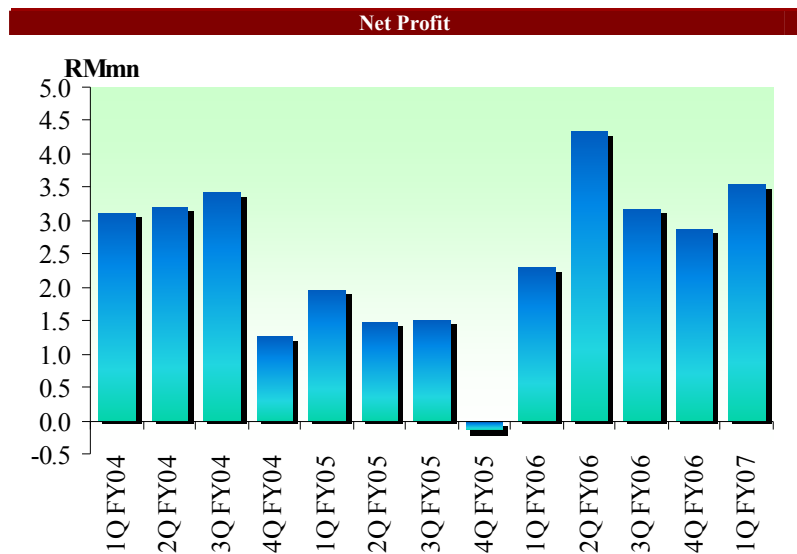


PPP= Purchasing Power Parity
Source: CIA World Fact Book, SJ

Sustainable growth. According to a report on Jewellery, Watches and Clocks by Freedonia Group, demand for fine jewellery is expected to register a sustainable growth rate of about 4.3% per annum and is forecasted to grow to USD13.7bn in 2009. We believe this is achievable supported by strong population growth and rising per capita income in the global economy.

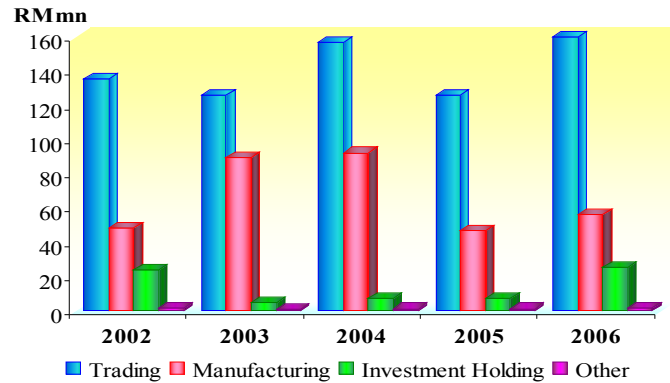
No significant domestic competitors. We understand that the Group does not faced significant competitions since it is operating in a high end niche market and focusing on gemstones and lifestyle jewellery while most of its competitors are concentrating on the mass market and gold business. Gold represents only about 5% or less of Degem's business. In addition, the barriers to entry the gemstone industry are high due to specialised expertise and experience needed in the manufacturing of gemstones and jewellery.

Strong earnings growth expected. Malaysia economy is expected to post solid growth in 2007, with real GDP expanding by 5.7%, supported by sustained global growth and resilient domestic demand. We also anticipate that domestic consumption growth to remain strong in second half in view of rising civil servants' salaries coupled with multiplier effects from upcycles in commodities and construction related sectors. As such, we expect Degem's net profit to grow between 9% to 24.2% between FY07 and FY08 due to strong revenue growth coupled with sustainable profit margin assumptions.



Source: Company

Revenue Breakdown

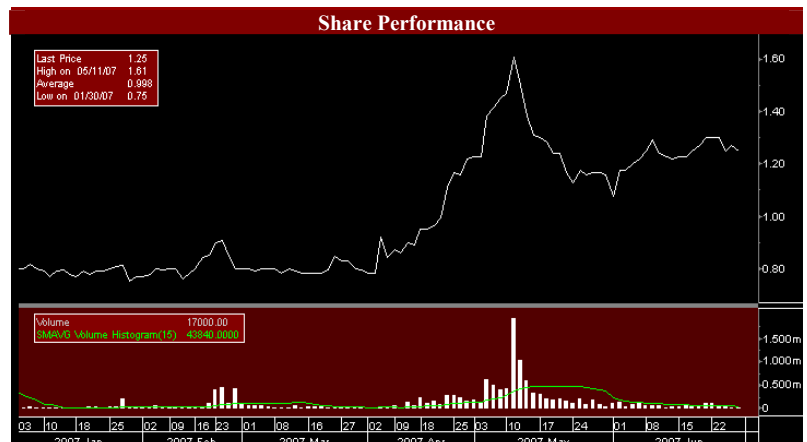


Source: Company

Valuation. We are confident that Degem will continue to post better results as the improvement of the economic situation and the growth in consumer demand. We have revised upwards our target price for Degem to **RM1.43** pegging on forward PE of 11x. We believe Degem serves as a good proxy to the strong growth in consumption pattern. Upgrade to **OVERWEIGHT**.

Per Share Data				
<u>Per Share Data</u>	<u>2005</u>	<u>2006</u>	<u>2007E</u>	<u>2008F</u>
Book Value (RM)	0.83	0.78	0.86	0.95
Cash Flow (RM)	-	20.82	0.15	0.15
Earnings (RM)	0.04	0.09	0.10	0.13
Dividend (RM)	0.02	0.33	0.33	0.33
Payout Ratio(%)	60.34	349.21	319.26	257.03
PER (x)	18.34	8.10	12.58	10.13
P/Cash Flow (x)	-	0.04	8.56	8.47
P/Book Value (x)	0.80	0.98	1.51	1.37
Dividend Yield (%)	3.29	43.14	43.14	43.14
ROE (%)	4.36	12.09	11.98	13.53
Net Gearing (x)	0.26	24.79	22.47	20.42

Share Performance



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Company 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. 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