**RESULTS REPORT**

25 May 2012

Degem Bhd		Market Price:	RM0.85
		Market Capitalisation:	RM113.9m
		Board:	Main Market
Recommendation:	BUY	Sector:	Consumer Products
Target Price:	RM1.03	Stock Code/Name:	7119 / DEGEM

Analyst: Edmund Tham

KEY FINANCIALS

Key Stock Statistics	2012E
Earnings/Sh. (sen)	14.7
P/E Ratio (x)	5.8
Dividend/Share (sen)	3.0
NTA/Share (RM)	1.42
Book Value/Share (RM)	1.43
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

PERFORMANCE – 1Q/FY12

1Q/ 31 Mar	1Q12	1Q11	yoy %	4Q11	qoq %
Rev (RMm)	60.6	47.2	28.2	62.8	(3.6)
EBIT (RMm)	5.6	5.2	7.4	13.5	(58.5)
NPAT*(RMm)	4.6	3.8	21.5	9.8	(52.9)
EPS (sen)	3.4	2.8	21.5	7.3	(52.9)

*NPATMI (net profit after tax & minority interest)

Degem's 1Q/FY12 revenue (for quarter ended 31st March 2012) was generally within our earlier expectations.

“Q1 – within expectations”

The group recorded revenue of RM60.6 million and NPATMI of RM4.6 million for 1Q/FY12. These items were 28.2% and 21.5% higher y-o-y, respectively. The better revenue was mainly due to the strong contribution from its Retail business segment. This segment enjoyed an increase in demand, better sales mix and an increase in the number of outlets.

“Strong performance by Retail segment”

The Manufacturing business segment of the group caters mainly internally – i.e. to the group's Retail segment. According to group management, the drop in profit for the group's Manufacturing segment during the period was mainly due to the restructuring of certain expenses.

“Weaker q-o-q numbers due to cyclical factor and earlier accounting item”

Ratios Analysis	2009	2010	2011	2012E
Book Value/Sh. (RM)	1.08	1.15	1.31	1.43
Earnings/Sh. (sen)	11.4	9.7	17.5	14.7
Dividend/Sh. (sen)	2.0	3.0	3.0	3.0
Div. Payout Ratio (%)	13.1	23.3	12.9	15.3
P/E Ratio (x)	7.4	8.8	4.9	5.8
P/Book Value (x)	0.79	0.74	0.65	0.59
Dividend Yield (%)	2.4	3.5	3.5	3.5
ROE (%)	10.6	8.4	13.3	10.2
Net Gearing (or Cash) (x)	0.06	0.04	0.07	0.07

*50 sen par value

P&L Analysis (RM mil)	2009	2010	2011	2012E
Year end: Dec 31				
Revenue	189.4	185.3	219.7	243.0
Operating Profit	23.5	23.0	36.0	30.7
Depreciation	(3.1)	(2.2)	(2.2)	(2.2)
Interest Expenses	(1.3)	(1.5)	(1.6)	(1.7)
Profit before Tax (PBT)	22.2	20.5	34.4	29.0
Effective Tax Rate (%)	30.8	34.4	27.9	27.2
NPATMI	15.3	13.0	23.4	19.6
Operating Margin (%)	12.4	12.4	16.4	12.6
PBT Margin (%)	11.7	11.0	15.7	11.9
NPATMI Margin (%)	8.1	7.0	10.6	8.1

*2012 figures & 2011 dividends are our estimates

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Compared to the preceding 4Q/FY11, the group's revenue and NPATMI were lower by 3.6% and 52.9% q-o-q, respectively. According to the group's statement – the lower profit of the quarter is in-line with the cyclical trend of the group's business. We believe this could be referring to the volatility in gold prices. We also recall that the group's 4Q/FY11 profits benefited from lower costs and a RM4.2 million accounting item – being the reversal of the group's "allowance on slow-moving finished goods".

OUTLOOK/CORP. UPDATES

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.

"BNM: GDP growth expected to be 4%-5%"

Malaysia's gross domestic product (GDP) grew at a slower pace of 4.7% in 1Q/2012 (compared with 5.1% in 1Q/2011 and 5.2% in 4Q/2011), which is not too surprising, given the challenging external environment. Bank Negara Malaysia (BNM) governor Tan Sri Dr Zeti Akhtar Aziz had said that BNM still expects Malaysia to grow between 4% and 5% during the full year 2012.

Malaysia had reported a reasonable inflation figure (CPI) of 2.3% (1Q/2012). Bank Negara Malaysia (BNM) had still maintained its overnight policy rate (OPR) at an accommodative 3.0%. According to the Malaysian Department of Statistics' March 2012 data, the country recorded the following – Manufacturing Sales (+3.1% y-o-y), Industrial Production Index (IPI) (+0.6% y-o-y), Exports (-0.1% y-o-y) and Imports (+1.6% y-o-y). Export growth seems weak currently.

"Focus on Diamonds & Gemstones"

Degem's management is **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.

Currently, the group's business is focused on a mixture of precious metals with diamonds and precious stones. This is 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 management focuses on design and craftsmanship excellence, a strong brand name, expanding its range of products and maintaining a strong operating margin.

"Exploring Regional opportunities"

The group had expanded regionally, and we see this as a beneficial move in the long term, given the expected solid growth in GDP and population rates within Asia. According to a news article, Degem is exploring opportunities to expand its operations to 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.

"Demand for Gold"

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 marked-to-market, with buying and

Results Report

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selling rates displayed online. The current public appetite for gold bars is due to the solid gold prices (currently around the **USD1550/ounce** level). The group plans to grow their gold bar business to about RM10-15 million in revenue eventually.

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.

VALUATION/CONCLUSION

“Same DPS expected”

For FY10 ended 31st December 2010, Degan'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. Currently, no dividends have been proposed for its FY11 yet. While we are not informed of group management's dividend plans, tentatively – we have assumed the same DPS for its FY11 and FY12.

“Underperformed the KLCI”

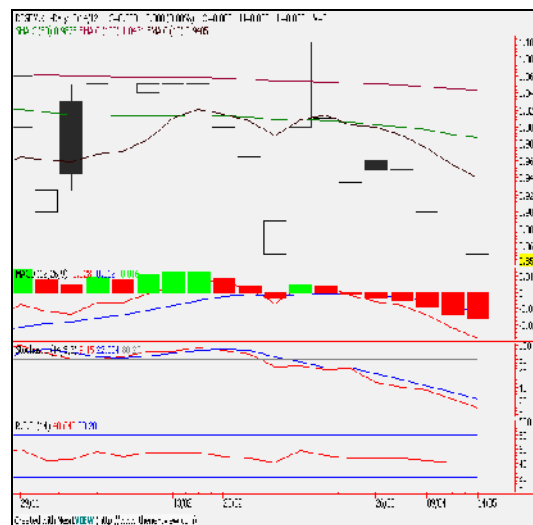
Degan (-11.9%) has **underperformed the KLCI** (+1.3%) in 2012 thus far. During the past year, global equity markets have been impacted by the Arab Spring unrest in the Middle East/North Africa, sovereign debt issue in Europe, debt ceiling issue in the US and the Tohoku natural disaster in Japan. Furthermore, Degan is not a particularly large market-cap stock, and this may put a dampener on its market visibility and trading volume.

“Maintain Buy Call”

Based on our forecast of Degan's FY12 EPS and estimated P/E of 7 times, we set a **FY12-end Target Price (TP) of RM1.03**. This TP represents a 21.2% upside from its current market price. Our TP for Degan reflects a P/BV of 0.7 times over its FY12F BV/share. We note that Degan's P/E and P/BV valuations, ROEs and dividend yields are at reasonable levels. Degan's management appears prudent with its cash management and minimal gearing levels.

The group faces **routine risks** from possible fluctuating raw material and FX rates, uneven monthly sales (due to festive seasons) and any

Degan: Share Price



Source: NextView

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