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RESULTS REPORT

22 Feb 2013

Degem Bhd		***Market Price:***	*RM0.80*
		Market Capitalisation:	*RM107.2m*
		Board:	*Main Market*
Recommendation:	*HOLD*	***Sector:***	*Consumer Products*
Target Price:	*RM0.82*	***Stock Code/Name:***	*7119 / DEGEM*

***Analyst**: Edmund Tham*

KEY FINANCIALS

Key Stock Statistics	2013F
Earnings/Sh. (sen)	20.4
P/E Ratio (x)	3.9
Dividend/Share (sen)	0.0
NTA/Share (RM)	1.60
Book Value/Share (RM)	1.60
Issued Capital (mil shares)	134.0
52-weeks share price (RM)	0.80 – 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	2012	2013F
Book Value/Sh. (RM)	1.15	1.31	1.41	1.60
Earnings/Sh. (sen)	9.7	17.5	16.2	20.4
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)	8.3	4.6	4.9	3.9
P/Book Value (x)	0.70	0.61	0.57	0.50
Dividend Yield (%)	3.8	0.0	0.0	0.0
ROE (%)	8.4	13.3	11.5	12.7
Net Gearing (or Cash) (x)	0.04	0.07	0.03	0.02

** 2013 figures are our estimates*
#Future dividend policy unclear

P&L Analysis (RM mil)	2010	2011	2012	2013F
Year end: Dec 31				
Revenue	185.3	219.7	250.8	270.0
Operating Profit	23.0	36.0	31.5	39.5
Depreciation	(2.2)	(2.2)	(2.6)	(2.7)
Interest Expenses	(1.5)	(1.6)	(1.7)	(1.8)
Profit before Tax (PBT)	20.5	34.4	29.8	37.7
Effective Tax Rate (%)	34.4	27.9	23.4	22.8
NPATMI	13.0	23.4	21.7	27.5
Operating Margin (%)	12.4	16.4	12.6	14.6
PBT Margin (%)	11.0	15.7	11.9	14.0
NPATMI Margin (%)	7.0	10.6	8.6	10.2

PERFORMANCE – 4Q/FY12

4Q/ 31 Dec	4Q12	4Q11	yoy %	3Q12	qoq%
Rev (RMm)	67.4	62.8	7.3	68.1	(1.0)
EBIT (RMm)	9.6	13.5	(29.0)	7.3	30.5
NPAT*(RMm)	7.6	9.8	(22.1)	6.0	26.3
EPS (sen)	5.7	7.3	(22.1)	4.5	26.3

12M/ 31 Dec	FY12	FY11	yoy %
Rev (RMm)	250.8	219.7	14.2
EBIT (RMm)	26.7	32.0	(16.5)
NPAT*(RMm)	21.7	23.4	(7.3)
EPS (sen)	16.2	17.5	(7.3)

**NPATMI (net profit after tax & minority interest)*
#EPS based on 134 million shares

Degem's 4Q/FY12 results (for quarter ended 31st December 2012) were generally within our earlier expectations.

"Q4 – results within expectations"

During 4Q/FY12, the group recorded revenue of RM67.4 million and NPATMI of RM7.6 million. The revenue was higher by 7.3% y-o-y while the NPATMI was lower by 22.1% y-o-y. The increased revenue was due to a higher contribution from both its Retail and Manufacturing business segments. An increase in demand and also number of outlets contributed to the better revenues.

Nevertheless, the group's profits were affected by the higher Cost Of Sales, Administrative and Sales & Marketing expenses. There were significant overhead expenses for the opening and renovation of new retail outlets.

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Versus the preceding 3Q/FY12, the group's 4Q/FY12 revenue was lower by 1.0% while its NPATMI was higher by 26.3% q-o-q. The group's Cost Of Sales was noticeably lower q-o-q. Generally, Q4 is a strong quarter for the group, in-line with the cyclical trend of the jewellery business.

OUTLOOK/CORP. UPDATES

In spite of the **Eurozone crisis**, US "Fiscal Cliff" concerns 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. Meanwhile, the group's management plans to continue with its efforts to strengthen its brands and gain wider recognition both locally and regionally.

"Domestic economy doing alright"

Malaysia's official government figures show a full year 2012 GDP growth of 5.1% and an expected 2013 GDP growth of 4.5-5.5%. Bank Negara Malaysia (BNM) has still maintained its accommodative overnight policy rate (OPR) at 3.0%. The external environment (particularly in the US, Japan and Europe) has remained lackluster.

"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. Degem is also the sole distributor of the renowned Lazare Diamond and Victor Mayer in Malaysia. 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, 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 also continually conducts a makeover of its showrooms to enhance the shopping experience of its customers.

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). The pride of Diamond & Platinum is its signature Estrella Diamond, whereby 8 perfectly symmetrical and identical hearts and arrows are bonded, alluding to the perfect symmetry and alignment of its facets.

"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. As at end-FY11, the group's foreign operations contributed about 22% of total group revenue.

"Gold Bullion sales"

During FY11, the group had added **Gold Bullion** (including bars and coins) 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 10g and 1kg) are quoted mark-to-market, with buying and selling rates displayed online. The

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public appetite for gold bars is due to the solid gold prices (currently around the **USD1580/ounce** level). The group plans to grow its gold bar business to achieve about RM10-15 million in revenue eventually. The group's website URL for bullion sales is **www.degembullion.com**. Currently, the group offers PAMP Suisse certified bars.

The group had 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

"No update on future dividend policy"

In 2012, **no dividends were proposed for its FY11.** According to the Chairman's Statement in the group's FY11 annual report, the group's Board of Directors (BOD) did not propose 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.

"Price unchanged"

Degem's price is unchanged (+0.0%) while the KLCI has **underperformed** (-4.0%) in 2013 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 & Fiscal Cliff issues 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.

"Maintain Hold Call"

Based on our forecast of Degem's FY13 EPS and estimated P/E of 4 times, we set a **FY13-end Target Price (TP) of RM0.82**. This TP represents a 2.5% upside from the market price on the date of this report. Our TP for Degem reflects a P/BV of 0.51 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, 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), slow inventory turnover 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, expansion and growth strategy, and also on the overall consumer sentiment and economic conditions.

Degem: Share Price

Source: Bursa

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