

13. INDEPENDENT MARKET RESEARCH REPORT



VITAL FACTOR CONSULTING

Creating Winning Business Solutions

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The Board of Directors
Poh Kong Holdings Berhad
16-20 Jalan 52/4
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Dear Sir/Madam

Assessment of the Gold Jewellery Industry in Malaysia

The following is a summary of the Independent Assessment of the Gold Jewellery Industry in Malaysia prepared by Vital Factor Consulting Sdn Bhd for inclusion in the Prospectus of Poh Kong Holdings Berhad (herein together with all its subsidiaries will be referred to as Poh Kong Group) in relation to its proposed listing on the Main Board of the Malaysia Securities Exchange Berhad.

1. Background

- 1.1 Poh Kong Group is principally involved in the business of Manufacturing and Retailing of Gold Jewellery.
- 1.2 As an integrated Gold Jeweller, Poh Kong Group's main business activities include the following:
 - Gold recovery and refinery;
 - Design of Jewellery;
 - Manufacturing of Jewellery;
 - Retailing of Jewellery.
- 1.3 For the financial year ended 31 July 2003, the total revenue of Poh Kong Group amounted to RM293.6 million. Gold Jewellery represented approximately 78% of the total Group revenue.

2. Industry Overview

- 2.1 According to the Malaysian Industrial Development Authority, the Jewellery Industry comprises the following sub-sectors:
 - natural, or cultured pearls and precious or semi-precious stones;
 - precious metals and metals clad with precious metal;
 - Jewellery, Goldsmiths' and Silversmiths' wares and other articles.
- 2.2 The Jewellery Industry plays an important role in the Malaysian economy. This industry is a major foreign exchange earner with exports of approximately RM2.2 billion in 2002. For the first nine months of 2003 (January to September 2003), exports of Jewellery amounted to RM2.1 billion (Source: Department of Statistics).

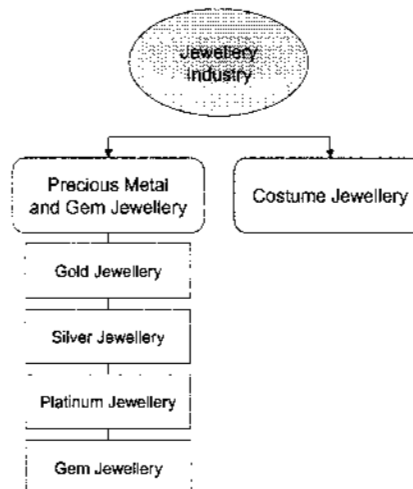
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- 2.3 The Jewellery Industry is also a major generator of employment in Malaysia. In 2003, the industry employed approximately 16,000 people in the work force (*Source: Malaysian Industrial Development Authority*).
- 2.4 Jewellery production in Malaysia started on a small scale focusing on Gold and Silver and mainly supplying to the local market. Today, it has grown and diversified into the manufacturing of Gold, Platinum and costume Jewellery (*Source: Industry Brief February 2001, Malaysian Industrial Development Authority*).
- 2.5 The importance of the Jewellery Industry is also reflected by the fact that it is regarded as a promoted activity under the List of Promoted Products/Activities (*Source: Malaysian Industrial Development Authority*). This indicates the Malaysian Government's interest in nurturing the growth and development of this industry.

3. Industry Structure

- 3.1 The structure of the Jewellery Industry is fragmented with many players in each category.
- 3.2 Following are the different categories within the Jewellery Industry:

**Figure 1 Overall Jewellery Industry Structure**

- 3.3 Jewellery is essentially divided into two segments:
- precious metal and gem Jewellery;
 - costume/imitation Jewellery.
- 3.4 Precious metal and gem Jewellery comprise mainly Jewellery that is exclusively made from precious metals including Gold, Silver and Platinum. Jewellery with gems including any of the precious metals set with diamonds, sapphires, rubies, emeralds and others. This also includes semi-precious stones such as opal, quartz, topaz, amethyst, jade and many others.

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- 3.5 The segment of precious metal and gem Jewellery is usually higher priced and the main distinction can be found in its established tradition of high-quality Jewellery making, which involves highly skilled artisans and specialists. Precious metal and gem Jewellery are typically available in specialised Jewellery stores with the exception of Silver Jewellery, which are also available in non-specialised retail outlets.
- 3.6 In contrast, Costume Jewellery is made of many different types of materials including plastics, glass, metals and many others. This also includes imitation Jewellery of other materials. This segment of Jewellery is highly influenced by fashion trends and is mostly found in a wide variety of outlets including department and fashion stores to street markets. Generally, the price range of Costume Jewellery is significantly lower compared to Precious Metal and Gem Jewellery.
- 3.7 As Poh Kong Group is a manufacturer and retailer of Gold Jewellery, it operates within the Precious Metal and Gem Jewellery sector. A small proportion of its business operations include Gold Jewellery that is set with gems.
- 3.8 Precious Metal and Gem Jewellery sector can also be further segmented by the different types of materials used and these include the following:

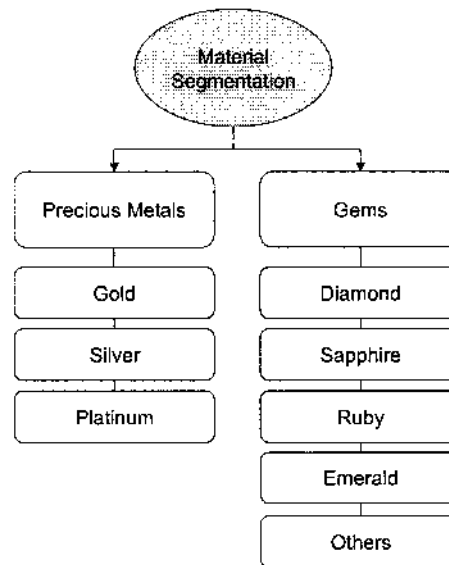


Figure 2 Material Segmentation within Precious Metal and Gem Jewellery

- 3.9 Precious metals refer to Gold, Silver or Platinum. Platinum also includes iridium, osmium, palladium, rhodium and ruthenium. Typically this category of Jewellery also combines a small proportion of other types of metals for example, copper, nickel, zinc, silicon, cobalt, chromium and titanium.
- 3.10 Gems are also commonly referred as gemstones, or precious or semi-precious stones. Predominantly, Jewellery with gems would incorporate some form of precious metal. The common precious gems used within the Jewellery Industry include diamonds, rubies, sapphires and emeralds. Semi-precious stones include opal, topaz, amethyst and jade. Pearls are also included as Gems within the Industry, although it is not a geological material.

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4. Industry Life-Cycle

- 4.1 The life-cycle of the Gold Jewellery Industry is relatively **matured** but continues to experience **growth** particularly in consumption, imports and exports.
- 4.2 The relative maturity of the Gold Jewellery Industry can be attributed to its beginning from as far back as 4,000 years ago. However, today, the industry has moved from individually hand-made Jewellery, relying on craft skills and simple hand tools, to incorporate mass production methods using sophisticated equipment and machineries.
- 4.3 Although manufacturing processes and technology have developed significantly, some of the manufacturing processes, for example wax casting, continue to be based on traditional methods.
- 4.4 Most of recent and continuing developments are focused on product design and material science in creating Gold alloys with different colours and properties.
- 4.5 Despite its relative maturity, Gold Jewellery continues to experience growth in Malaysia based on the following observations:
- On average, each household spent approximately RM7.42 per month on Jewellery, rings and precious stones including Gold Jewellery in 1998/99 compared to RM6.41 per month in 1993/94, representing a growth of 15.8% between the two periods (*Source: Report on Household Expenditure Survey, Malaysia 1993/94 and 1998/99, Department of Statistics*).
 - Between 1998 and 2002, the import value of Jewellery Industry increased at an average annual growth rate of 9.5% to reach RM4.1 billion. For the first nine months of 2003, import value of the Jewellery Industry increased by 6.7% amounting to RM3.2 billion compared to the same period in 2002 (*Source: Department of Statistics*).
 - Between 1998 and 2002, the export value of Jewellery Industry increased at an average annual growth rate of 1.2% to reach RM2.2 billion. For the first nine months of 2003, export value of Jewellery Industry increased by 23.5% amounting to RM2.1 billion compared to the same period in 2002 (*Source: Department of Statistics*).

5. Government Legislation, Policies and Incentives

5.1 Government Policies

- 5.1.1 Apart from the normal manufacturing licence, there are no material government laws, regulations and policies that may impede on the performance and growth of the Manufacture and Retail of Gold Jewellery Industry.
- 5.1.2 Generally, there are no import tariffs on the import of Gold and precious gems as raw materials. With the implementation of AFTA (Asean Free Trade Area), import tax will be between 0% to 5% for Asean members, and 10% tax for all other countries for imported Jewellery (*Source: Royal Customs and Excise Department*).

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5.2 Government Legislation on Verification of Gold and Silver Content

- 5.2.1 On the 4th October 2002, the Ministry of Domestic Trade and Consumer Affairs announced a proposed new legislation on precious metal, especially for Gold and Sterling Silver requiring retailers of Gold Jewellery to send their products to an independent body to analyse and verify the exact content of the products. However, to-date this has not been implemented.

5.3 Government Incentives

- 5.3.1 Jewellery of Precious Metal is listed as a promoted activity/product eligible for consideration of Pioneer Status and Investment Tax Allowance under the Promotion of Investments Act 1986.

- 5.3.2 To be eligible for the above incentives under promoted activities/products, manufacturers have to meet the following criteria:

- Minimum value-added of 20%;
- The ratio of management, technical and supervisory group (including craftsman) to total employment should not be less than 45%.

- 5.3.3 In addition, the Manufacture of Jewellery and Related Products are also listed as one of the promoted products for Small Scale Industries.

Following are some of the criteria for consideration of Pioneer Status:

- Small scale manufacturing companies have to be incorporated in Malaysia;
- Shareholders' fund must not exceed RM500,000;
- Malaysian equity of at least 70%.

- 5.3.4 In addition, to qualify for the Pioneer Status incentives, small-scale companies have to comply with any one of the following criteria:

- the company's finished products should be used as raw materials or components by the manufacturing industries;
- the company's products shall substitute imports and the local material content is more than 50% in terms of value;
- the project contributes towards the socio-economic development of the rural population.

(Source: Malaysian Industrial Development Authority)

6. Labour Usage

- 6.1 Based on Sales per Employee, the Manufacture of Jewellery and Related Articles Sector utilised approximately 1.7 times more labour resources for each Ringgit of sales generated compared with the Overall Manufacturing Industry in 2002. *(Source: Monthly Manufacturing Statistics August 2003, Department of Statistics)*

7. Supply and Supply Dependencies

- 7.1 In 2002, sales value of the Manufacture of Jewellery and Related Articles including Gold Jewellery increased by 0.7% to reach approximately RM350.1 million (based on 24 establishments with more than 20 employees).

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- 7.2 Between 1998 and 2002, sales value of the Manufacture of Jewellery and Related Articles including Gold Jewellery declined by an average annual rate of 8.7% (Source: *Monthly Manufacturing Statistics August 2003, Department of Statistics*).
- 7.3 Between 1998 and 2002, import value of Jewellery including Gold Jewellery increased at an average annual rate of 9.5%. For the first nine months of 2003, import value of Jewellery Industry increased by 6.7% compared to the same period in 2002 (Source: *Department of Statistics*).
- 7.4 The major raw materials required for the Manufacturing of Gold Jewellery are as follows:
- Gold;
 - Base Metals clad with Gold;
 - Precious Stones and Semi-precious Stones;
 - Synthetic Precious/Semi-precious Stones.
- 7.5 In 2001, there were 9 Gold mines within Malaysia and the production of Gold decreased marginally by 1.5% to reach approximately 3,965 kilograms (Source: *Malaysian Minerals Yearbook 2001, Minerals and Geoscience Department Malaysia, Ministry of Primary Industries Malaysia*).
- 7.6 Generally, the major base metal raw material for manufacturing of Gold Jewellery is Gold, which is mainly derived from overseas sources. In 2002, the import value of Gold (Including Gold Plated With Platinum) Unwrought or In Semi-Manufactured Forms, or In Powder Form amounted to approximately RM3.0 billion. For the first nine months of 2003, import value under this category amounted to RM3.2 billion (Source: *Department of Statistics*).
- 7.7 In 2002, imports of Gold (including Gold plated with platinum) Unwrought or In Semi-Manufactured Forms, or In Powder Form comprised approximately 71% of the total imports of jewellery. For the first nine months of 2003, imports of Gold under this category comprised approximately 68% of total imports of jewellery (Source: *Department of Statistics*).
- 7.8 Between 1998 and 2002, the import value of Base Metals or Silver, Clad With Gold, Not Further Worked than Semi-Manufactured declined at an average annual rate of 35.8%.
- 7.9 In 2002, the import value of Base Metals or Silver, Clad With Gold, Not Further Worked than Semi-Manufactured declined by 91.7% to reach approximately RM809,000. For the first nine months of 2003, import value under this category increased significantly by 510.0% amounting to RM3.6 million compared to the same period in 2002.
- 7.10 In 2001, the import value of Diamonds, whether or Not Worked, but Not Mounted or Set declined by 36.9% to reach approximately RM151.5 million. However, in 2002, imports increased by 22.4% to RM185.5 million. For the first nine months of 2003, import value under this category increased by 10.5% amounting to RM159.3 million compared to the same period in 2002.
- 7.11 Between 1998 and 2002, the import value of Diamonds, whether or Not Worked, but Not Mounted or Set increased at an average annual rate of 3.3%.

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- 7.12 In 2002, the import value of Pearls, Natural or Cultured (whether or not Worked or Graded but not Strung, Mounted or Set; Pearls, Natural or Cultured, Temporarily Strung for Convenience of Transport), declined by 29.7% to RM2.5 million. For the first nine months of 2003, import value under this category decreased by 53.3% amounting to approximately RM988,000 compared to the same period in 2002
- 7.13 Between 1998 and 2002, the import value of Pearls, Natural or Cultured (whether or not Worked or Graded but not Strung, Mounted or Set; Pearls, Natural or Cultured, Temporarily Strung for Convenience of Transport), increased at an average annual rate of 39.0%.
- 7.14 In 2002, the import value of Precious Stones (Other than Diamonds) and Semi-Precious Stones, whether or not Worked or Graded but not Strung, Mounted or Set; Ungraded Precious Stones (Other than Diamonds) and Semi-Precious Stones, Temporarily Strung for Convenience of Transport increased by 19.2% to RM8.0 million. For the first nine months of 2003, import value under this category increased by 19.2% amounting to RM6.5 million compared to the same period in 2002.
- 7.15 Between 1998 and 2002, the import value of Precious Stones (Other Than Diamonds) and Semi-Precious Stones, whether or not Worked or Graded but not Strung, Mounted or Set; Ungraded Precious Stones (Other than Diamonds) and Semi-Precious Stones, Temporarily Strung for Convenience of Transport decreased at an average annual rate of 2.8%.
- 7.16 In 2002, the import value of Articles of Jewellery and Parts Thereof, of Precious Metal or of Metal Clad with Precious Metal (including Gold Jewellery) increased by 0.4% to reach approximately RM53.0 million. For the first nine months of 2003, import value under this category declined by 20.3% amounting to RM32.4 million compared to the same period in 2002.
- 7.17 Between 1998 and 2002, the import value of Articles of Jewellery and Parts Thereof, of Precious Metal or of Metal Clad with Precious Metal (including Gold Jewellery) grew at an average annual rate of 24.0% from RM22.4 million in 1998 to RM53.0 million in 2002.

(Source: Department of Statistics)

8. Demand and Demand Dependencies

- 8.1 Demand for Gold Jewellery Industry is ultimately dependent on the consumers. As such, some of the following factors that will impact on consumer demand and expenditure on Gold Jewellery are:
- increasing affluence of the population;
 - growing sophistication in lifestyles;
 - growth in disposable income;
 - general population growth.
- 8.2 The mean monthly household income grew at an average annual rate of 5.2% between 1995 and 1999. In 1999, the mean monthly household income reached RM2,472.
- 8.3 The increase in affluence will mean greater affordability thus stimulating demand for products and services within the Manufacture and Retail of Gold Jewellery.

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- 8.4 Between 1993/94 and 1998/99, the average monthly expenditure per household increased at an average annual rate of 7.0% amounting to RM1,631 per household.
- 8.5 According to the Department of Statistics, Gold Jewellery is classified under Jewellery, Rings and Precious Stones group. Between 1993/94 and 1998/99, the average monthly household expenditure on Jewellery, Rings and Precious Stones increased at an average annual rate of approximately 3.0%.
- 8.6 Growth in monthly household expenditure will continue to provide opportunities for the Manufacture and Retail of Gold Jewellery Industry.
- 8.7 Household spending patterns in urban areas are higher compared to rural areas. Urban households spend an average of RM377.20 per month compared to RM193.97 per month in rural households.
- 8.8 Between 1993/94 and 1998/99, the average monthly household expenditure on Jewellery, Rings and Precious Stones of urban and rural areas grew at an average annual rate of approximately 3.1% and 2.4% respectively.

(Source: Report on Household Expenditure Survey 1993/94 and 1998/99 Malaysia, Department of Statistics)

- 8.9 The population of Malaysia grew steadily at an average rate of 2.0% per annum from 1996 to 2000. In 2000, the population was estimated at 22.3 million, an increase of 2.0% over the previous year.
- 8.10 According to the Eighth Malaysia Plan 2001-2005, population is expected to reach 26 million by year 2005. *(Source: Eighth Malaysia Plan 2001-2005, Economic Planning Unit)*

9. Competitive Nature and Intensity

- 9.1 Operators within the Gold Jewellery Industry face **normal** competitive conditions.

9.2 Retailing of Gold Jewellery

- 9.2.1 Competition among **retailers** in the Gold Jewellery Industry within Malaysia is **intense** based on the following observations:

- In 2003, it was estimated that there were 3,000 Gold Jewellery retail outlets within Malaysia, of which approximately 1,500 were members of the Federation of Goldsmiths and Jewellers Association of Malaysia *(Source: Federation of Goldsmiths and Jewellers Association of Malaysia and Primary Market Research undertaken by Vital Factor Consulting Sdn Bhd).*
- Competition is further fuelled by a number of other factors, including among others:
 - . product pricing;
 - . product design;
 - . product quality;
 - . retailer's reputation;
 - . corporate and product branding;
 - . location of retail outlets.

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- The industry also faces competition from imports. Between 1998 and 2002, the import value of Jewellery, Goldsmiths' and Silversmiths' wares and articles of precious or semi-precious materials decreased at an average annual rate of 6.3% to reach RM465.2 million (Source: *Monthly External Trade Statistics December 1999 and 2002, Department of Statistics*).
- Between 1998 and 2002, the import value of Jewellery and Parts of precious metal or clad with precious metals increased at an average annual growth rate of 24.0% to reach RM53.0 million (Source: *Department of Statistics*).
- Barriers to entry for pure retailing of Jewellery is relatively low as capital set-up costs are low.
- There is also competition by type of Jewellery as the most common substitutes for Gold Jewellery are those made from Silver or Platinum, and the much lower priced Costume Jewellery.

9.2.2 However operators with integrated operations incorporating in-house design, manufacturing and retailing would have some competitive advantages derived from exclusive product design, product quality, cost control and benefits from economies of scale.

9.3 Manufacturing of Gold Jewellery

9.3.1 Competition among **manufacturers** in the Gold Jewellery Industry within Malaysia is **moderate** based on the following observations:

- According to Malaysian Industrial Development Authority (MIDA), there are approximately 48 companies issued with manufacturing licences and currently only 23 companies are currently in production (Source: *Malaysian Industrial Development Authority*).
- Capital requirements are also higher amounting to approximately RM3 million to RM4 million for a basic set-up.
- Skilled labour also acts as a barrier to entry.

9.3.2 Despite the lower number of manufacturers in Malaysia, imports contribute to the competitive pressure.

10. Key Players in the Industry

10.1 Some of the major operators in the Gold Jewellery Industry with operations incorporating manufacturing and retailing in Malaysia are as follows:

- Poh Kong Holdings Berhad;
- Habib Corporation Berhad;
- DeGem Berhad;
- OE Fine Jewellery Sdn Bhd;
- Wah Chan Gold & Jewellery Corporation Sdn Bhd;
- Selberan Jewellery Sdn Bhd;
- Tomei Gold & Jewellery Holding (M) Sdn Bhd.

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11. Barriers to Entry

11.1 Government Regulations

11.1.1 Government barriers to entry are **low**.

11.1.2 Apart from the normal manufacturing licence, there are no specific Government regulations and policies governing the entry of operators of Manufacturing and Retail of Gold Jewellery (Source: *Malaysian Industrial Development Authority*).

11.1.3 Generally, there are no import tariffs on the import of Gold and precious gems as raw materials for the manufacturing of Gold Jewellery (Source: *Royal Customs and Excise Department, Malaysia*).

11.1.4 Currently the import of completed forms of Gold Jewellery is subjected to import duties and this provides some form of barriers to entry for imports.

Products	Import Duties (%)	ASEAN *CEPT (%)
Articles of Jewellery of other precious metals, whether or not plated or clad with precious metal	10	5
Articles of Jewellery of base metal clad with precious metals	10	5

* Common Effective Preferential Tariff (Source: *Malaysian Customs Tariff 2003*)

Figure 5 Import Tariffs

11.1.5 However, import duties will be reduced to between 0% and 5% with the implementation of Asean Free Trade Area (AFTA).

11.1.6 CEPT is the mechanism by which tariffs on goods traded within the Asean region which meet a 40% Asean content requirement, will be subjected to a reduction of the abovementioned range of tariff by 2003.

11.2 Capital and Set-up Costs

11.2.1 The barriers to entry are **low** for the Retail of Gold Jewellery and **moderate** for the Manufacturing of Gold Jewellery.

11.2.2 The capital cost requirements can be divided into the following:

- As a retailer of Gold Jewellery, the capital and set-up cost is less intensive compared to a manufacturer.
- On average, it would require approximately RM500,000 (excluding land and building) including stock to establish a small retail operation.
- As a fabricator of Gold Jewellery, the capital investment is more intensive.

On average, it may require approximately RM3 to RM4 million (excluding land and building) to set-up the entire fabricating process including the purchasing of the raw materials such as Gold and precious gems. It would however, be for a basic set-up incorporating refining, stamping and casting.

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11.2.3 As the above equipment represents only the basic equipment required to set-up a medium-sized manufacturing plant, it is restricted in terms of capacity.

11.2.4 However to operate profitably, capital cost starts to escalate as there is requirement to have more equipment and machinery to generate a higher volume of output. A manufacturing plant has to be of a certain size in order to achieve economies of scale.

11.3 Technical Skills and Expertise in the Manufacturing of Gold Jewellery

11.3.1 Generally the level of technical skills required in the Manufacturing of Gold Jewellery Industry is **high** as the nature of the industry is dependent on craftsmanship and skilled labour in the following areas:

- design of Jewellery;
- customised hand crafted Jewellery including engraving and detailing;
- design of Jewellery mould for casting;
- operations of the furnace and casting equipment;
- operations of stamping equipment;
- operations of the refinery processes.

11.3.2 In addition, there is also the requirement to have the training, expertise and experience in handling and selecting gems.

11.3.3 It is therefore common in this industry to have higher labour costs, compared to other manufacturing sectors that has lower requirement for technical skills.

11.3.4 The higher level of technical skills and expertise required provides a significant barrier to entry for new entrants.

11.4 Track Record and Market Reputation

11.4.1 In the Gold Jewellery Industry, trustworthiness and established market reputation are critical in the business of trading and retailing in precious metals and gems.

11.4.2 This is because precious metals and gems are high priced items and many consumers do not have the expertise to assess the quality and authenticity of Jewellery. Thus, consumers rely significantly on retailers to represent their goods accurately.

11.4.3 Thus, new entrants into the industry will require time to build track record in order to establish a strong customer base in this industry.

11.4.4 Established operators with strong track records are likely to have major advantages over newer operators.

12. Barriers to Exit

12.1 Barriers to exit for Gold Jewellery are **low**.

12.2 In terms of manufacturing, most of the machinery and equipment may be sold to other operators within Gold Jewellery Industry.

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- 12.3 According to Malaysian Industrial Development Authority (MIDA), there are about 48 Jewellery companies with manufacturing licences and of these, 23 are currently in production (*Source: Malaysian Industrial Development Authority*).
- 12.4 For retailers, capital cost is low and Jewellery stocks can easily be sold to other retailers.
- 12.5 In 2003, it was estimated that there were 3,000 Gold Jewellery retail outlets within Malaysia (*Source: Federation of Goldsmiths and Jewellers Association of Malaysia and Primary Market Research undertaken by Vital Factor Consulting Sdn Bhd*).

13. Industry Outlook and Growth Forecast

- 13.1 The outlook of the Gold Jewellery Industry is **favourable**.
- 13.2 The Gold Jewellery Industry is forecasted to grow at approximately **3% to 5%** per annum for the next five years.
- 13.3 Growth in the Jewellery Industry will be primarily driven by increases in household consumption and export performances of Jewellery, supported by increases in imports of Jewellery and generally favourable socio-economic factors:

13.3.1 Growth in Consumption

The Jewellery Industry is dependent on local consumption with the market size estimated at **RM1.9 billion** in 2003. As such, increase in local consumption would be one of the main drivers of growth for the Jewellery Industry in Malaysia.

- Based on the growth of the average household expenditure on Jewellery, Rings and Precious Stones (including Gold Jewellery) and number of households between 1993/94 and 1998/1999, consumption grew by an estimated average annual rate of **6.7%** per annum. (*Source: Report on Household Expenditure Survey 1993/94 and 1998/99 Malaysia, Eighth Malaysia Plan 2001 – 2005, Economic Planning Unit, Prime Minister's Department, and computed by Vital Factor Consulting Sdn Bhd*);

13.3.2 Growth in Export

Increase in export is an indication of the success of the local Jewellery Industry in meeting the needs of overseas markets. This success would provide the basis for future growth, as the local industry is able to address a significantly larger global market.

- Between 1998 and 2002, the export value of the Total Jewellery Industry increased at an average annual rate of **1.2%** amounting to RM2.2 billion in 2002. For the first nine months of 2003, export value of Total Jewellery Industry increased by **23.5%** amounting to RM2.1 billion compared to the same period in 2002 (*Source: Department of Statistics*).

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13.3.3 Growth in Imports

Growth in imports provides an indication for the growth in demand for Jewellery, either for local consumption or for export and re-export. Growth in any of these three factors would help drive growth within the Jewellery Industry in Malaysia.

Growth in imports for local consumption would indicate growth for retailers of Jewellery, and import substitution opportunities for manufacturers.

Growth in imports for export and re-export will indicate growth for Jewellery manufacturers and traders as they add value to the imported Jewellery before being exported or re-exported.

- Between 1998 and 2002, the import value of the total Jewellery, Industry increased at an average annual rate of **9.5%** amounting to RM4.1 billion in 2002 (Source: Department of Statistics).

13.3.4 Growth in Income, Expenditure and Population

Jewellery is primarily a consumer-based item and as such the socio-economics of the Malaysian population would have an impact on the growth of the Jewellery industry.

Jewellery is a discretionary and sometimes investment item, growth in disposable income and household expenditure could provide the platform for increased Jewellery consumption to drive growth to the Jewellery Industry.

- From 1993/94 to 1998/99, the average monthly household expenditure increased at an average annual rate of **7.0%**. (Source: Report on Household Expenditure Survey 1993/94 and 1998/99 Malaysia, Department of Statistics);
- Between 1995 and 1999, the mean monthly gross household income in Malaysia grew by an average annual rate of **5.2%** (Source: Yearbook of Statistics Malaysia 2002, Department of Statistics);
- The population of Malaysia grew at an average rate of **2.2%** per annum from 2000 to 2003 (Source: Mid-term Review of the Eight Malaysia Plan 2001-2005).

- 13.4 Despite the growth figures recorded for local consumption, imports and exports for the Jewellery Industry in Malaysia, growth is somewhat moderated by the decline within the Jewellery manufacturing sector.

13.4.1 Decline in Manufacturing

- Between 1998 and 2002, sales value of the Manufacture of Jewellery and Related Articles including Gold Jewellery declined at an average annual rate of **8.7%** (Source: Monthly Manufacturing Statistics August 2003, Department of Statistics);

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Mitigating Factors

- In 2002, sales value of the Manufacture of Jewellery and Related Articles including Gold Jewellery increased marginally by 0.6% (based on 24 establishments with more than 20 employees) (Source: *Monthly Manufacturing Statistics August 2003, Department of Statistics*);
- The size of the Jewellery Manufacturing sector is relatively small which amounted to RM350.1 million (based on 24 establishments with more than 20 employees) in 2002 (Source: *Monthly Manufacturing Statistics August 2003, Department of Statistics*) representing approximately 19% of the total local market size of RM1.8 billion in 2002 (Source: *Department of Statistics and computed by Vital Factor Consulting Sdn Bhd*). As such, its declining trend does not significantly impact on the outlook of the overall local Gold Jewellery market.

14. Areas of Growth and Opportunities**Exports**

- 14.1 There are significant opportunities for operators of Gold Jewellery to focus on exports, particularly with the implementation of AFTA. This will enable operators to diversify and reduce reliance on the local market.
- 14.2 Export opportunities apply equally to manufacturers as well as retailers, who may wish to set-up retail outlets in overseas countries.
- 14.3 Export value of Jewellery, Goldsmiths' and Silversmiths' Wares and Articles of Precious or Semi-Precious Materials increased at an average annual rate of 0.2% between 1998 and 2002. In 2002, the export value of Jewellery, Goldsmiths' and Silversmiths' Wares and Articles of Precious or Semi-Precious Materials reached RM1.6 billion (Source: *Monthly External Trade Statistics December 1999 and 2002, Department of Statistics*).
- 14.4 The continuing growth in exports of Jewellery indicates a strong market demand for Malaysian Jewellery products. This will present continuing opportunities for operators in Malaysia.

Targeting Younger Age Groups

- 14.5 With the growing affluence of the population, there are significant opportunities to target the younger age groups including teenagers and consumers in their 20's.
- 14.6 In 2000, Malaysia's population aged between 15 and 29 years of age amounted to approximately 6.0 million (Source: *Vital Statistics Special Edition 2000, Department of Statistics*).
- 14.7 This group of consumers has different requirements and is more likely to purchase Gold Jewellery as accessories and fashionable items. However this group of consumers is also most likely to be influenced by changing fashion trends.

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- 14.8 To appeal to this group of consumers would require a totally new range of design of Gold Jewellery. This will include different branding, pricing, marketing and promotions to target this niche market effectively.

Building Brand Equity

- 14.9 Branding and development of brand equity is critical in the Gold Jewellery Industry as it enables operators to command a premium for their products. Some of the successful brands are Cartier, Tiffany and Co. and Bvlgari, all of which are synonymous with product quality and craftsmanship.
- 14.10 Apart from designs of jewellery, brands also enable operators to distinguish themselves from competitors.
- 14.11 There are opportunities for local operators to build strong brand equity by focusing on marketing and brand development.
- 14.12 In addition, if local operators are able to build their brands to world-class standards, opportunities for exports are significantly higher compared to those without recognised brands.

Franchising

- 14.13 Within the Gold Jewellery Industry, there are opportunities for franchising of Jewellery retail outlets. This system enables operators to expand the number of retail outlets without the need for capital investment or involvement in direct management and operations.
- 14.14 As the range of Jewellery is sourced and supplied by the main franchisers, product quality, image and marketing will be centrally controlled.
- 14.15 Franchising systems not only provide franchisers with royalties, but also a wide network of customers as well as resellers of new products.
- 14.16 Franchising systems are also exportable, providing incremental profits beyond the local market.

15. Threats and Risk Analysis**15.1 Changing Consumer Preferences and Substitute Products**

- 15.1.1 As Jewellery is closely tied to global fashion trends, changes in these trends may cause a tendency to switch from Gold to other more 'popular' substitutes or alternatives. This is the nature of an industry that is governed by changes in fashion and consumer preferences.
- 15.1.2 As a result, Gold Jewellery faces competition from other substitutes including, silver, platinum and costume Jewellery.
- 15.1.3 Between 1998 and 2002, the import value of silver (including silver plated with gold and platinum, unwrought or in semi-manufacture form) increased at an average annual rate of 16.7% to reach approximately RM307.2 million in 2002 (*Source: Department of Statistics*).

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- 15.1.4 In 2001, the total world demand for silver jewellery and silverware increased by approximately 2% to 287.6 million ounces (*Source: World Silver Survey 2002, Gold Fields Mineral Services Ltd*).
- 15.1.5 Between 1997 and 2001, the global demand for the manufacturing of Platinum Jewellery increased at an average annual rate of 4.2% to reach approximately 2.5 million ounces in 2001 (*Source: Platinum 2002, Johnson Matthey*).
- 15.1.6 As for costume jewellery, this mainly caters to the lower-end of the market. The price range for costume jewellery is much lower and more affordable compared to other precious metal including Gold Jewellery.
- 15.1.7 The general perception of costume jewellery is mainly as a fashion accessory, however it may also provide an affordable substitute for Gold Jewellery.
- 15.1.8 According to the Malaysian Industrial Development Authority, there are approximately four manufacturers of costume jewellery (*Source: Malaysian Industrial Development Authority*).
- 15.1.9 Between 1998 and 2002, the import value of imitation jewellery (including costume jewellery) increased at an average annual rate of 10.1% to reach RM14.7 million in 2002 (*Source: Department of Statistics*).

Mitigating Factors

- 15.1.10 Gold Jewellery is commonly viewed as a form of investment with the option for consumers to trade-in or sell-back to retailers. This is particularly prevalent in Asian countries. Jewellery of other types of precious metals has not been able to offer consumers with similar benefits or options. Therefore the additional investment benefits of Gold Jewellery will help to somewhat minimise the impact of changing consumer preferences to other precious metals or materials.
- 15.1.11 The use of White Gold also provides some mitigation to consumers' preferences for Silver as the colour and looks of White Gold is similar to Silver.
- 15.1.12 Operators who are able to cater to the changing consumer preferences by monitoring global trends in consumers are more adept in being able to compete effectively with other types of Jewellery.
- 15.1.13 In addition, operators with in-house design and manufacturing capabilities are in a stronger position to react quickly to meet consumer needs.

15.2 Fluctuations in World Prices for Gold

- 15.2.1 As Gold is a major raw material for the manufacturing of Gold Jewellery, operators will be exposed to fluctuations in world prices. Prices of Gold tend to increase during times of crisis such as an impending threat of war or world economic downturn as Gold is the next most liquid form of investment after cash, stocks and bonds.
- 15.2.2 Fluctuations in world prices for Gold will directly impact on the cost of raw materials for operators in the manufacturing of Gold Jewellery.

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- 15.2.3 In addition, the increase in Gold prices may also adversely affect consumer demand reducing the affordability for Gold Jewellery.

Mitigating Factors

- 15.2.4 In the Gold Jewellery industry, any increases in the price of Gold are passed back immediately to the consumer at the point of purchase. This will somewhat reduce the impact of rising cost of raw materials on operations.
- 15.2.5 The spread between buying and selling prices provides some buffer for operators within the industry.
- 15.2.6 For purchasers of Gold Jewellery as investment items, a sustainable high price would create wealth for owners and possibly spur higher purchases from an investment perspective.

15.3 Competition from Imports

- 15.3.1 There is a significant proportion of imported Gold Jewellery in Malaysia, either sold through authorised dealers or carried under original brand names. Some of these imported jewellery are backed by prominent and well-established brand names with innovative designs and products, for example Tiffany & Co, Cartier and Bvlgari.
- 15.3.2 In addition, these global brands allocate significant expenditure in promotions and advertising to continually increase brand equity.

Mitigating Factors

- 15.3.3 Local manufacturers have some advantage over imported brands in their ability to tailor design to local market needs and preferences that are better suited to Asian fashion and lifestyle, as well as taking into consideration cultural differences and affordability.
- 15.3.4 More importantly, global brand names tend to service niche market sectors due to the high pricing of its Jewellery products.
- 15.3.5 As such, local manufacturers are able to compete more effectively based on price and customising products to local consumer requirements.
- 15.3.6 Local players with a strong brand recognition, established reputation with an extensive distribution network and a wide range of products would be in a better position to face the competitive pressure from global players in the market.
- 15.3.7 In addition, the Government has imposed a 10% tax for imports of finished Jewellery from non-Asean countries. The import tax will provide some form of protection to local operators, although this is likely to be reduced with the implementation of AFTA.

15.4 Implementation of Asean Free Trade Area (AFTA)

- 15.4.1 With the implementation of AFTA in 2003, the reduction of import duties to 0% or 5% would make imports competitive against locally manufactured products.

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Mitigating Factors

- 15.4.2 Threats of imports, if any, only affect local manufacturers directly. Impact on retailers would either be positive or neutral.
- 15.4.3 New import entrants into the Malaysian market would need to invest significant effort and time to develop and market their products to gain acceptance from local retailers and consumers. This would provide some advantages to existing local players at least in the short to medium term.
- 15.4.4 Local players with good track record, established distribution, integrated operations and wide range of products would be in a better position to face the increased competitive pressure from the potential new players in the market.
- 15.4.5 As Gold is a commodity and is based on world prices, imported Jewellery does not have any advantages from the raw material perspective. Any cost advantages would mainly be derived from labour, which in Malaysia usually represents a small component of total product price.

15.5 Dependency on Imports of Gold as Raw Material

- 15.5.1 The Gold Jewellery industry is dependent on imports of Gold as a major raw material. Although Malaysia also has its own local supply of Gold, the amount of Gold mined is so small that it is insufficient to meet the total requirements of the industry. In 2001, local production of Gold from its mining operations amounted to 3,965 tonnes (*Source: Malaysian Minerals Yearbook 2001, Minerals and Geosciences Department Malaysia, Ministry of Primary Industries Malaysia*)
- 15.5.2 In 2002, Malaysia's import value of Gold (including Gold Plated with Platinum) Unwrought or in Semi-Manufactured Forms, or in Powder Form reached RM3.0 billion.

Mitigating Factors

- 15.5.3 As Gold is a commodity, there are ample sources of supply in the world market. From that perspective, any shortages in supply are minimised.
- 15.5.4 In 2002, Switzerland is the major source of imports of Gold (including Gold Plated With Platinum) Unwrought or In Semi-Manufactured Forms, or In Powder Form having contributed approximately 53% of total imports.
- 15.5.5 In 2002, some of the other countries of imports include:
- Singapore
 - Japan
 - Hong Kong.

15.6 Exposure to Foreign Exchange Fluctuations

- 15.6.1 The industry is also vulnerable to fluctuations in foreign exchange. This applies to Gold as raw material for manufacturing as well as finished products.

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- 15.6.2 As a consumer-based product, consumer demand is highly dependent on the price. An unfavourable foreign exchange movement against the Ringgit would either reduce consumer demand as prices would need to be increased or operators' profitability would suffer if they decide to absorb the price increases.

Mitigating Factors

- 15.6.3 The current pegging of the Ringgit to the United States' Dollar (USD) has helped significantly in stabilising the Ringgit against the USD. As most imports are quoted in USD, this has helped significantly in stabilising prices and enabling importers to better plan their business operations.
- 15.6.4 However, Malaysia's current fixed currency regime may change at any time and may have a direct impact on importers.

15.7 Economic Slowdown

- 15.7.1 As Gold Jewellery is high priced and considered a luxury item, any downturn in the Malaysian economy would reduce disposable income and consumer confidence. This would ultimately impact on consumer expenditure on luxury goods including Gold Jewellery.

Mitigating Factors

- 15.7.2 Operators with strong brand recognition, financial stability, extensive and established distribution network, and a wide and diverse range of products would be better able to survive the impact of a slowdown.
- 15.7.3 In addition, operators that export their products overseas will effectively be able to reduce some of their dependency on the local economy.
- 15.7.4 To some extent, the fact that Gold Jewellery is sometimes purchased for its investment value, it may be more resilient to an economic downturn compared to other types of Jewellery like silver or diamond.

16. Market Size

- 16.1 In 2003, the market size for the Jewellery Industry was estimated at **RM1.9 billion** (Source: Department of Statistics and computed by Vital Factor Consulting Sdn Bhd).

17. Market Share and Position of Poh Kong Group

- 17.1 Based on Poh Kong Group's revenue of RM293.6 million for the financial year ended 31 July 2003, the market share of Poh Kong Group was estimated at **15%**. This was based on the total market size of the Jewellery Industry in Malaysia in 2003.
- 17.2 As at 31 December 2003, Poh Kong Group has 54 retail outlets in Malaysia. Based on the number of retail outlets, Poh Kong Group was the **market leader** within the Jewellery Industry in Malaysia in 2003 (Source: Primary Market Research undertaken by Vital Factor Consulting Sdn Bhd).

13. **INDEPENDENT MARKET RESEARCH REPORT (Cont'd)**



VITAL FACTOR CONSULTING

Creating Winning Business Solutions

Vital Factor Consulting Sdn Bhd has prepared this report in an independent and objective manner and has taken all reasonable consideration and care to ensure the accuracy and completeness of the report. It is our opinion that the report represents a true and fair assessment of the industry within the limitations of, among others, secondary statistics and information, and primary market research. Our assessment is for the overall industry and may not necessarily reflect the individual performance of any company. We do not take any responsibilities for the decisions or actions of the readers of this document. This report should not be taken as a recommendation to buy or not to buy the shares of any company.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Wai Ling', with a long horizontal flourish extending to the right.

Wong Wai Ling
Director
Vital Factor Consulting Sdn Bhd

14. DIRECTORS' REPORT

(To be prepared for inclusion in the Prospectus)

POH KONG HOLDINGS BERHAD (586139-K)

10th Floor, Tower Block,
Kompleks Antarabangsa,
Jalan Sultan Ismail,
50250 Kuala Lumpur.

Date: **26 JAN 2004**

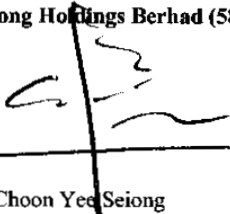
The Shareholders of
POH KONG HOLDINGS BERHAD (586139-K)

Dear Sir/ Madam,

On behalf of the Directors of Poh Kong Holdings Berhad ("PKHB"), I report after due inquiry that during the period from 31 July 2003 (being the date to which the latest audited financial statements of PKHB and its subsidiary ("PKHB Group") have been made up to **19 JAN 2004**

- (a) the business of PKHB Group has, in the opinion of the Directors, been satisfactorily maintained;
- (b) in the opinion of the Directors, no circumstances have arisen subsequent to the last audited financial statements of the PKHB Group which have adversely affected the trading or the value of the assets of the PKHB Group;
- (c) the current assets of the PKHB Group appear in the books at values which are believed to be realisable in the ordinary course of business;
- (d) save as disclosed in this Prospectus, there are no contingent liabilities by reason of any guarantees given by the PKHB Group; and
- (e) there have been, since the last audited financial statements of PKHB Group, no default or any known event that could give rise to a default situation, in respect of payments of either interest and/or principal sums in relation to any borrowings in which the Directors are aware of; and
- (f) save as disclosed in the Accountants' Report and the Proforma Consolidated Balance Sheet in this Prospectus, there have been no changes in published reserves nor any unusual factors affecting the profit of the PKHB Group since the last audited financial statements of PKHB and its subsidiary companies.

Yours faithfully,
For and on behalf of the Board of Directors of
Poh Kong Holdings Berhad (586139-K)



Dato' Choon Yee Seiong
Executive Chairman/ Group Managing Director

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