All QC personnel must have a full understanding of the detailed specifications as per customers' orders prior to the commencement of the QC check. QC personnel then measure the thickness, size, moisture content and check the relevant species being produced strictly according to the specifications.

The Group's QC inspectors do not belong to any official certification body. However, the quality of their QC checks are good considering that the shipments have not failed any professional QC checks conducted by clients to-date. Each member of the QC team has at least 5 years of industry experience and is skilled in his area of responsibility. QC training in ARB comes in the form of on-the-job training, where the senior QC team members provide guidance to the more junior members.

In addition to the above, ARB's glue supplier, Sepangar Chemicals Sdn Bhd also conducts QC checks on the products to ensure that the products produced meet the standards of IHPA or JAS.

4.5.9 Product Development

The major concerns for the timber industry include – supply, cost of production and product diversity. The Group uses product development to help counter these concerns and steer ARB to greater profitability. While there is no formalised Research & Development ("R&D") department, all departments in the organisation are strongly encouraged to conduct product development and identify new methods of improving process flows, reducing costs and others. The Group keeps itself updated on the developments on new machinery that will shorten the production process or increase the yield from each log.

Hence, ARB invests time and financial resources in product development efforts to:-

(i) enhance the existing products and create new products,
(ii) have a shorter production cycle or lower production & operational cost using new techniques and supporting machinery;
(iii) provide customer satisfaction through quality and reliability; and
(iv) provide better and more consistent raw materials supplies to ensure consistent final products.

As at 7 January 2004, ARB has ten (10) personnel involved in the product development for downstream wood processing.

Currently the Group is developing a chemical treated Tego plywood for the export market. Despite its higher price, this product is expected to be well accepted in the market as it has a prolonged useful life. This is in line with the Group's objective to further add value to its products.

Below are some achievements of the product development efforts that have resulted in lower production cost as well as new product offerings:-

(i) Maximised utilisation of small diameter logs as finished products for the export market;
(ii) Variation in glue utilisation in the manufacturing process to enhance the plywood quality; and
(iii) New products such as chemical treated polyester plywood, which is of better quality and prolonged useful life.

For the past three (3) financial years, the Group has spent a total of RM0.537 million in product development.

4.6 Social Contribution to the Community

ARB is committed to creating a healthy and happy working environment for its people because a satisfied workforce is always equated to greater productivity and commitment. To date, the Group has invested approximately RM1.3 million (in cash and kind) into building the community facilities and other amenities. Some of these investments can be found in the table below.

Year	Beneficiary	Cash / In Kind	Purpose	RM
1995	Sabah Chinese High School	Sawn timber	Building of school hall	62,354
1996	SRJK (Cina) Chung Hwa	Sawn timber	Building of school hall	31,867
1996	Hospital Tawau	Cash	Haemodialisis Machine	32,000
1996	Rotary Club of Tawau	Sawn timber / Plywood / Labour Costs	Rotary Clinic of Kalabakan	120,352
1997	Parti Maju Sabah	Cash	-	100,000
1998	Sekolah Kebangsaan Kalabakan	Sawn timber / Plywood / Labour Costs	Teachers' Quarters	145,236
1998	Sekolah Ulu Kalabakan	Sawn timber / Plywood / Labour Costs	Teachers' Quarters	70,313
1998	SRJK (Cina) Yuk Chin	Sawn timber / Plywood / Cash	School Hall and New Classroom Building	452,000
2000	SJK (Cina) Yani, Pt. Yaani, Yong Peng, Johor	Cash	School Fund	100,000

4.7. Industry Overview

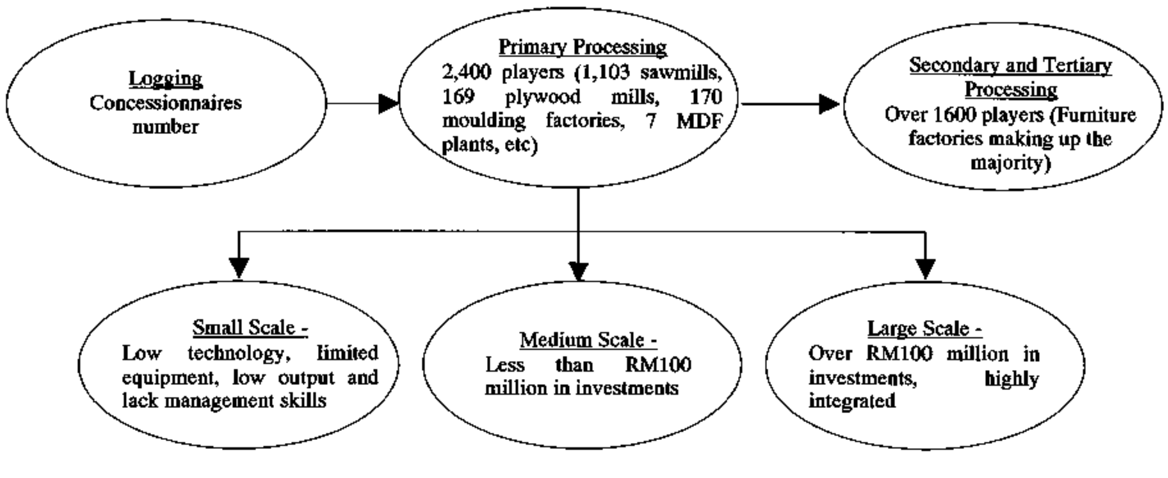
This section is based on the Independent Market Research Report prepared by ACNielsen.

At the end of 2002, Malaysia maintained 19.5 million hectares or 59.5% of its land area under forest cover, of which 14.3 million hectares or 73.3% are permanent reserved forest. Thus, supply of timber logs for the use in the manufacturing of timber products is limited. However, with the Governments support for sustainable forest management throughout Malaysia, the future supply of timber is ensured.

The forestry and timber continues to play a major role in the sosio-economic development of Malaysia, accounting for 1.2% of GDP and 4.3% of total export earnings in 2002. Over the last 20 years, the timber industry has progressed from primary processing of sawn timber and plywood to the processing of high value-added products as reflected in the export growth of these products. Being export-oriented, the timber industry has to be in tune with the dynamics of the international market environment. In response to requirements in certain markets for certification, a national timber certification scheme has been developed in Malaysia.

4.7.1 Industry Structure

With approximately 4,000 players involved in the wood-base industry, this industry is considered a highly fragmented one.



Source : ACNielsen

From the above, it can be said that the industry comprises many primary, secondary and tertiary processing companies.

The timber processing industry grew exponentially between the 1960's and the 1970's, when there were high incidences of conversion of forestland into agricultural land. During this period, international demand for tropical hardwood also increased due to the construction boom in many, then developing countries like US, Europe and Japan. With high demand came high selling prices and without any logging restrictions imposed, there was a proliferation of small-scale timber processing enterprises (especially for sawmiling and moulding) that were established.

The better-managed enterprises grew into medium and large-scale businesses with a high degree of technology and automation. The 1997/98 Asian economic crisis and the implementation of the Sustainable Forest Management system by the Malaysian government further consolidated this industry. Due to heavy restrictions and regulations, including the freezing of manufacturing licenses for wood-based products, the number of players in the industry had been stabilised by 1999. The sawmilling and panel products sub-sectors of the timber industry account for approximately 60% of the total players in the primary processing segment.

4.7.2 Industry Life-cycle

There are 3 different cycles facing the timber industry today. The upstream timber logging and sawn timber sectors are facing a period of decline (sunset industry), while the primary processing sector is facing a period of consolidation (maturing industry) and the newer value-added processing sectors encountering a period of growth (sunrise industry).

The decline in exports of sawn timber are largely due to the restriction in supply of timber by the government for export, the imposition of export levies on specific species of sawn timber, higher domestic prices due to supply shortage, reduction in global demand and anti-tropical hardwood sentiments, which have caused overseas customers to source for alternative substitutes.

Within the panel products sectors, plywood / veneer manufacturing is experiencing a phase of consolidation post 1997/98 Asian economic crisis. While this segment is still a major income earner, manufacturers are now looking towards further value-added products to diversify and spread business risks. Thus, the newer variants like Tego plywood and MDF have become more popular. However, due to the high start-up or expansion costs involved, only the large to medium scale players like ARB are able to sustain their business operations.

4.7.3 Industry Growth

In 1980, the entire timber industry contributed approximately RM4.4 billion on revenue (export revenue) to the Malaysian economy, and this grew to RM8.9 billion in 1990. This industry experienced a slight drop in contribution in 1995 (RM6.4 billion), rising again to RM10.9 billion in 1997. This uptrend continued and saw the year 2000 recording a contribution of RM17.7 billion. However, with the threat of the global economic slowdown, year 2001 export dipped 19.2% to RM 14.3 billion. This declined continued in year 2002, recording export revenue of RM12.6 billion in the first 10 months.

The percentage of contribution from each sub-sector for 2002 is as follows:-

- 28% Furniture (2001-27%)
- 25% Plywood (2001-25%)
- 15% Sawn Timber (2001-15%)
- 12% Timber Logs (2001-11%)
- 6% MDF (2001-6%)
- 3% Veneer (2001-3%)
- 4% Mouldings (2001-4%)
- 7% Others. (2001-9%)

The wood-based industry, under which the major bulk of ARB's business is categorised, has been growing at an average rate of 3.64% for the last 10 years from 1993 to 2002. Demand for houses and other socio-infrastructure development projects such as schools, hospitals and universities had a multiplier effect on wood-based industries. The production of particle board, carpentry and joinery as well as wood based panels and flooring, therefore, turned around to record gradual increases since September 2002, to achieve an overall output growth of 1.7% in the first six months of 2003 (January-June 2002:- 10.9%).

In accordance with the sustainable forest management policy adopted by Malaysia, the total hectarage for the annual allowable cut in permanent forests has been reduced to 1.36 million hectares under the Eight Malaysia Plan compared to 1.38 million hectares during the Seventh Malaysian Plan. Hence the overall production of saw logs is not expected to increase significantly in the near term. Sarawak and Peninsular Malaysia, which account for the bulk of the output, are expected to increase production by 8% to 13 million cubic metres (m^3) and 5 million cubic metres (m^3), respectively, underpinned by increase in demand for wood-based products in the world market, following brighter prospects of global economic recovery. In contrast, production of saw logs in Sabah is expected to decline by 39% to 3 million m^3. Subsequently, growth in value added of the forestry and logging sub-sector is expected to moderate to 2.2 % in 2003.

The wood-based industry, being a primarily export oriented industry (approximately 70% is exported), is highly dependent on the economic conditions globally. For example, in between 1991 – 1992, the industry experienced a slight drop due to economic slowdown in the West and the Gulf War. During this period, a drastic drop was avoided due to the domestic demand for wood-based products, where the local construction sector was entering a phase of growth. Other factors that affected the growth trend between 1994 - 1997 include the period of supply shortage, weak demand from overseas countries, competition from other timber producing countries as well as competition from other wood substitutes. However, economic recovery in the region and the floods in China, led to a positive turnaround in 1999 for this industry.

The panel products category leads in terms of production output and value compared to the other categories in the timber industry. It is followed closely by sawn timber with the fastest growing category being furniture-manufacturing. This is due to the shortage of logs for export and the Malaysian Government's encouragement to move into higher value-added manufacturing. The average growth from 1993 – 2002 for the panel products category is 8.39%, which is second to that of the furniture sector (which grew at 24.49%). A review of the latest manufacturing statistics reveal a similar trend for the export contributions, with the panel products sector leading at 35%, followed closely by the furniture sector at 28%. In terms of average export growth (1990 – 2002), the furniture sector is the fastest growing, with 26.3%, followed by the panel products at 14.8%. Sawn timber has been experiencing negative growth at –32.9% from 1990-2002, mainly due to the decrease in supply as the Government takes steps to ensure supply for more value-added manufacturing via sustainable forest management policy.

Whilst timber processing occurs throughout Malaysia, the most significant advances have been made in East Malaysia, with Sarawak taking the lead in the manufacture of value-added timber products. In terms of plywood production alone, Sarawak accounted for 63.1% of the countries production capabilities in 2002, followed by Sabah with 30.3% and Peninsular Malaysia with 6.6%. Sarawak grew from exporting RM257 million worth of panel products in 1991, to a value of RM2,336 million in 2002, while Sabah grew from exporting RM410 million to RM1,069 million respectively. Due to the huge progress made, East Malaysia now accounts for 51% of total wood-based exports from Malaysia. This share is expected to increase further due to the large supply of raw materials available in East Malaysia. The table below provides a listing of the major exported timber products from January – October 2002, for comparison purposes.

Products	**Peninsular Malaysia (RM'000)**	**Sabah (RM'000)**	**Sarawak (RM'000)**	**Total (RM'000)**	**% Share of Total**
Logs	4	120,775	1,328,919	1,449,698	12
Sawn Timber	847,427	375,868	617,574	1,840,869	15
Panel Products	892,178	1,069,207	2,335,520	4,296,905	35
Moulding & Joinery	910,955	180,045	166,778	1,257,778	10
Furniture	3,446,434	41,125	20,228	3,507,787	28
Total	**6,096,998**	**1,787,020**	**4,469,019**	**12,353,037**	**100**
Market Share (%)	49	15	36		

Between the period 1994 – June 2002, plywood prices ranges from RM600 to RM1,200 level. Due to the effects of the Asian economic crisis, plywood prices dipped to a low around RM900 level in 1998. The imposition of foreign exchange controls by the Malaysian Government with the Ringgit pegged at RM3.80 to a USD (lower than pre-capital control of RM2.50:USD1) have made Malaysian plywood prices competitive in the global market couple with stability in prices. With the rebound of the Asian economies post 1997/1998, this has help prices soar above RM1,200 in 1999 before stabilising at the RM1,000 – RM1,100 level in 2001. In 2002, plywood prices continued to face downward pressure.

4.7.4 Sabah Timber Industry Growth

The timber industry plays an extremely important role in the socio-economic development of Sabah. Export revenue generated in 2002 is in excess of RM2.2 billion. As a form of supply control, the Sabah Government has implemented the Sustainable Forest Management System, where long-term logging concessions are issued with stringent control measures, phasing out short-term licenses.

The State Government's aim is to further develop the wood-based industry in Sabah towards more value-added processing activities. Currently, sawmills and plywood factories still largely dominate this space. Steps have been taken by the Sabah Forestry Department to trim down the number of mills, by introducing a re-registration process to consolidate the current players and delete all inactive mills. Other measures include imposing a license approval freeze. Currently, the timber processing mill-installed capacity is at 9.6 million m^3 per annum, comprising of:-

- Sawmills – 4.2 million m^3
- Plywood/Veneer – 4.6 million m^3
- Pulp & Paper – 0.9 million m^3

Local supply of logs is 1.5 million m^3 per annum, which creates a huge gap between supply and demand. Imports of raw materials currently stand at 6-10% of raw materials used. In 2002, Sabah only accounts for approximately 10.9% of total log production for Malaysia.

4.7.5 Industry Players and Competition

There are over 4,000 players in the timber industry, with approximately 185 involved in the panel based sector. It is estimated that a few large players, who make up only about 20% (number) of the entire sector, generate over 80% of the recorded turnover for this sector.

The largest timber operators in Malaysia are found in Sarawak. This is mainly due to the state's supply of raw materials and transportation convenience (availability of the Rejang River and ports.). These players are the Rimbunan Hijau Group, the Samling Group, the WTK Group, the KTS Group, Limbang Trading and Pan Pacific Asia Bhd. In Sabah, the Group faces close competition with other players namely AikBee Resources Berhad, Evermaster Group Berhad, Permaju Industries Berhad and Tekala Corporation Berhad. Malaysia's main competitors are Indonesia, Thailand, Cambodia and Papua New Guinea.

Of the 185 panel products manufacturers, this can be further divided into plywood/veneer mills (169), MDF (7) and particleboard (9). 52 of the plywood mills are located in Peninsular Malaysia, 71 in Sabah and 46 in Sarawak. Jaya Tiasa Berhad (part of the Rimbunan Hijau Group) is the largest plywood and veneer producer in the country.

4.7.6 Laws and Regulations Governing the Industry

The purpose of the National Forestry Policy 1978 (revised 1992) is to conserve and manage the forest through sustainable management and the preservation of environmental stability. It has the following objectives:-

- ➢ To allocate sufficient land areas classified as Protection Forest, Production Forest, Amenity Forest and R&D Forest under the Permanent Forest Estate management programme.
- ➢ Efficient forest law enforcement.
- ➢ Sustainable forest management.
- ➢ Forest regeneration and rehabilitation.
- ➢ Promote efficient forest harvesting methods
- ➢ To strike a balance between the national industrial processing capacity and forest resource availability.
- ➢ To encourage Bumiputra participation.
- ➢ Forest plantation as a supplement, and to promote active private sector investment.
- ➢ Agro-forestry.
- ➢ Non-wood Forest Products for local consumption.
- ➢ Forestry research.
- ➢ Manpower development and training.
- ➢ Forestry education and extension.
- ➢ Conservation of biological diversity.
- ➢ Community forestry, recreation and tourism.
- ➢ Special scientific values
- ➢ International Co-operation.

In the Eighth Malaysian Plan, the Government has committed to identifying policies and incentives that will increase the production of capital goods and services in the country so as to achieve a favourable balance of payments, one of the main beneficiaries of this will be the manufacturing sector. Some of the initiatives include:-

- * establishing regional display and distribution centers in selected overseas markets,
- * specialised trade fairs,
- * introducing new products; and
- * use of e-commerce.

The MATRADE will be responsible for establishing a trade information portal to facilitate the objectives of the government.

Companies involved in the manufacturing sector are given tax exemptions, which benefits ARB in the following areas :-

- ➢ Exemption of statutory income equivalent to 10% of the value of increased exports, if the goods exported attain at least a 30% value-added increase; and
- ➢ Exemption of statutory income equivalent to 15% of the value of increased exports, if the goods exported attain at least a 50% value-added increase.

There are 3 major incentives available to companies in the manufacturing sector – Pioneer Status, Investment Tax Allowance and Reinvestment Allowance. In the case of ARB, the following may apply:-

(i) **Pioneer Status** – which allows the company to enjoy tax exemptions for 5 years from production day. Companies in East Malaysia only have to pay tax on 15% of their statutory income. AHSB enjoyed pioneer status for its decorative plywood (such as Polyester Plywood, Tego Plywood and Blockboard) under the Promotion of Investment Act, 1986 for a period of five (5) years, which has been expired on 19 January 2001. On 7 July 2003, AHSB has been granted an extension for another five (5) years, which will expire on 19 September 2006. The accumulated Tax Exempt Income related to this tax incentive amounted to RM17.114 million as at 31 August 2003 and is available for declaring tax free dividends. The Group has submitted an application to extend the Pioneer Status by expanding into new product manufacturing and currently pending approval.

(ii) **Investment Tax Allowance ("ITA")** – As an alternative to Pioneer Status, a company may also apply for ITA, which allows the company to offset 60% of their capital expenditure. Other conditions apply, and East Malaysian companies have higher percentages to be offset.

(iii) **Incentives for Reinvestment** – Reinvestment Allowance ("RA"), which allows companies that have at least 12 months of operational history to claim deductions on expenditure used for the expansion of production capacity, modernisation and upgrading of production facilities, diversification into related products and automation of production facilities. Applications will be reviewed and approved by the Inland Revenue Board ("IRB").

(iv) **Incentives for Exports** – Double deduction for promotion of exports. Companies that export manufactured products are eligible to claim double deduction for the following expenses – overseas advertising, supply of free samples abroad, export market research, preparation of tenders for supply of goods overseas, approved MITI trade exhibitions, overseas travel fares / accommodation, cost of maintaining a sales office abroad and professional fees incurred in packaging design for exports.

(v) **Industrial Building Allowance Incentive**, which provides an allowance of 10% of the qualifying expenditure, related to buildings used as warehouses for storing goods for export and re-exports.

(vi) **Training Incentives** in the form of tax deductions for both pre-employment training and Human Resources Development Fund ("HRDF") approved training.

(vii) **R&D incentives Double Deduction on Export Credit Insurance Premiums** - premium payments on export credit insurance are eligible for double deduction.

(viii) **Industrial Building Allowance** - an allowance of 10% of qualifying expenditure is granted in respect of buildings used as warehouses for storing goods for export and re-exports.

(ix) **Incentives for R&D** - Under the guidance of the Promotion of Investments Act 1986, companies maybe eligible to apply for Investment Tax Allowance ("ITA") of 50% of the qualifying capital expenditure incurred within 10 years and the ITA can be utilised to offset against 70% of the statutory income in the year of assessment.

(x) Exemptions from import duties for direct raw materials used in the manufacture of products for both the export and domestic market are also provided for by MIDA, subject to certain conditions being met.

(xi) Exemptions from import duties and sales tax for machinery and equipment are also available from MIDA.

(xii) Other incentives include incentives for the use of IT equipment and environmental protection equipment is also awarded.

4.7.7 Economic Outlook

(a) World Economy

Following a series of adverse in the first half of 2003, there are now increasing signs of a renewed recovery, and the balance of risks in April, tilted well to the downside has improved significantly. The latest World Output projections from IMF are as follows:-

World Economic Outlook – Real GDP Annual Percent Change

	1997	1998	1999	2000	2001	2002	2003	2004
World (%)	4.2	2.8	3.6	4.7	2.3	3.0	3.2	4.1

With major hostilities in Iraq indeed ending quickly, forward-looking indicators generally turned up, with equity markets strengthening markedly, accompanied by some pickup in business and consumer confidence, particularly in the United States, there was evidence of a rebound in the global economy, with global GDP growth is expected at 3.2% in 2003, rising to 4.1 % - close to trend- in 2004. Concurrent data initially remained weak, with industrial production and trade growth slowing markedly in the second quarter, reflecting continued after effects of the bursting of the equity price bubble and particularly in Asia- the impact of Severe Acute Respiratory Syndrome (SARS).

Most recently, however, there have been growing signs of a pickup in activity including investment particularly in the United States, Japan and some emerging market countries, notably in Asia. With inflationary pressures very subdued, macroeconomic policies have been eased further across the globe. Interest rates have been reduced in Europe and the United States, as well as in number of other industrial and emerging market countries; and fiscal policy has been further relaxed in the United States and a number of Asian countries.

The outlook for emerging markets continues to be driven to different extents by developments in industrial countries, external financing conditions, geopolitical factors and country-specific developments. In emerging markets in Asia, with the effects of SARS now waning, growth is expected to pick up in the second half of 2003 and remain strong in 2004, aided by timely additional policy easing and continued robust growth in China.

Among the industrial countries, recovery will continue to be led by the United States where despite a weak labor market and considerable excess capacity-current data have shown greatest signs of improvement, forward-looking indicators are strongest, and there is the most policy stimulus in the pipeline.
Other positive support activities that have and will continue to aid the global economy towards a speedier recovery include:

(i) Continued accommodative policies such as the easing of the monetary policies of major countries,
(ii) The resilience of the global financial infrastructure to a variety of substantial shocks; and
(iii) Strengthening economic fundamentals in many countries, especially in Asia

In the longer term, aggressive monetary and fiscal policy responses by major advanced economies and developing countries should bring world growth back on track. The Malaysian economy expanded by 4.2% in 2002 (2001: 0.4%). This recovery was mainly driven by strong consumption spending and supported by the external demand following the general overall recovery in the global economy.

(b) Singapore

After a sharp downturn in 2001, the economy recovered somewhat in 2002, though much less quickly than expected and expanding by only 2.2%. Growth was generally lower than in most other countries in East and Southeast Asia. The main factor was subdued domestic demand, particularly a decrease in fixed capital investment and private consumption. In contrast, external demand picked up in 2002. Several downside risks have become important recently and these may undermine the base-case scenario. The outbreak of SARS, over a prolonged period of time, had significantly affect Singapore's important tourism industry. A further delay in the recovery of global ICT demand would negatively impact growth.

In 2003-2004, Monetary Authority of Singapore (MAS) is likely to maintain the current monetary policy centered on the management of the exchange rate, recognizing the stability of the Singapore dollar is critically important for economic recovery through supporting financial activities and entrepot trade. Along with a stimulative fiscal policy, these moves will support recovery efforts in the country. Taken together with the government's firm policy stance to develop and upgrade service industries in which the economy has a comparative advantage, the domestic economic environment will be highly private sector-friendly in 2003-2004. However, external developments will remain the key drivers of growth.

Assuming that the world economy will continue to recover, GDP growth is forecast at 2.3% and 4.2% in 2003 and 2004, respectively. The reduction in income tax rates will boost disposable incomes and private consumption over these 2 years.

(c) **Taiwan, Republic of China**

In 2002, the economy steadily recovered. The monitoring indicator compiled by the Council for Economic Planning and Development in Taiwan, Republic of China signaled "stable" since April that year, after 15 months of a "weak" signal. GDP grew by 4.8% and 4.2% in the third and fourth quarter, respectively, compared with the same periods in 2001, for an outturn of 3.5% GDP growth for the whole year. Much of the recovery was based in the growth of exports and industrial production, in particular among electronics and information technology (IT) products. However, this was to a large extent offset by weak consumer sentiment arising from job insecurity, falling earnings, and the negative wealth effect that falling stock prices had already caused.

The slow but steady recovery in 2002 is expected to continue in 2003 and to improve in 2004 as the global economy strengthens further. Given that the PRC, through Hong Kong, China, has become the largest export market for Taiwan, Republic of China. The rapid growth of the PRC economy is expected to continue, exports are expected to be buoyant, remaining the driving force in sustaining economic recovery.

(d) **Republic of Korea**

The Republic of Korea (Korea) continued its brisk recovery in 2002, with GDP expanding by 6.3%. On the demand side, private consumption made the strongest contribution to growth in the first half of the year thanks to robust income growth, the wealth effect of rising property values, low interest rates and tax incentives. Consumption growth slowed in the second half, reflecting unusually bad weather, the relatively high level of accumulated debt, the end of a temporary tax exemption on certain durable goods and stricter regulation of consumer credit. An increase in exports offset the slowdown in consumer spending and construction investment, the latter of which decelerated noticeably following completion of projects for the World Cup and Asian Games sports events.

With strong real wage growth and high employment levels, GDP growth is expected to remain firm, though declining to 4.0% in 2003 before rising somewhat to 5.4% in 2004. The slowdown in consumer spending growth arising from tighter consumer credit and mortgage terms will be largely offset by rising exports to growing world markets, the end of global manufacturing downturn and a moderate revival of savings and business investment. There is, however, a downside risk stemming from rising uncertainty over developments in the north of the peninsula and the aftermath of the conflict in Iraq.

(e) **Malaysia**

After experiencing sluggish growth in 2001, the Malaysian economy rebounded strongly in 2002. Higher growth in 2002 bolstered optimism for a stronger economic performance in 2003 in anticipation of an improved world economic outlook. The prospect for a global economic recovery was, however, affected by recent geopolitical developments, in particular the war in Iraq, sporadic incidences of militancy and outbreak of the SARS. During the second quarter of 2003, consumer and business sentiments in regional economies were particularly affected by the anxiety of a probably prolonged and widespread SARS epidemic that curtailed transport and tourism-related activities besides trade and investment flows.

Against this adverse global environment and concerns of further weakening of the already sluggish global economy, the Malaysian government ("Government") has put in place a package of broad-base pro-growth measures in May 2003. The Government's proactive stimulus package, apart from providing immediate relief for the SARS-affected sectors, was to address structural and organisational issues towards sustaining economic growth in the medium and longer term. The strategic measures introduced boosted confidence necessary to stimulate domestic consumption and investment. In addition, the short war in Iraq and the quick containment of SARS provided the much-needed relief for the economy to ride over the difficult times and remain on track to a firmer growth trajectory.

Malaysia's sound economic fundamentals and expansionary fiscal and accommodative monetary policies, supplemented by the Government's proactive stimulus package, have helped to sustain high growth in the real gross domestic product ("GDP"). After expanding 4.5% in the first half of 2003 and with prospects of sustained growth in the second half of 2003, the economy is set to achieve its targeted growth of 4.5% in 2003, higher than the 4.1% in 2002.

The economy is expected to be driven by stronger domestic demand reinforced by a modest pick-up in external demand in the second half of 2003. Exports will continue to be buoyed by global economic recovery and the upturn in electronics, especially in information technology-related products and equipment. On the domestic front, consumer spending continues to pick up, on account of favourable commodity prices, positive wealth effect from better stock market performance as well as stimulus packages introduced in May 2003. All sectors registered positive growth with manufacturing and services driving the economy.

World growth and trade are expected to improve with most economic activities returning to normalcy. Business confidence and sentiment will, however, be cautiously optimistic against the backdrop of threats from terrorist attacks. World growth is still hinged on the modest performance of the United States of America ("USA") economy with the Euro area still marked by relative weakness although Japan, the world's second largest economy, is showing signs of a more definitive path of sustained positive growth. Overall, indications point towards an improved outlook and higher optimism for 2004 despite the downside risks. Upbeat stock market activities across major bourses into the second half of 2003 should bolster optimism for a firmer global economic recovery. Thus, world economy is expected to post a higher growth of 4.1% with the USA, Euro area and Japan registering growth of 3.6%, 2.3% and 1%, respectively in 2004.

4. INFORMATION ON THE ARB GROUP *(Cont'd)*

On the regional front, with the containment of SARS and the positive impact following the implementation of various economic relief packages introduced by SARS-affected countries, regional growth is envisaged to further accelerate in 2004. Together with most of the ASEAN economies gaining strength and with intra-regional trade expanding, the Malaysian economy is forecast to register a faster growth in 2004. Measures will be taken to develop and transform the agriculture and rural sector into a more dynamic income-generating economic base, with the agriculture sector being identified as the third engine of growth for the country. This sector is expected to capitalise on the Government's pro-growth measure to unveil its potential and contribute higher value-add to the economy.

Growth is expected to be broad-based with all sectors in the Malaysian economy registering higher output with services and manufacturing continuing to spearhead growth. Growth is also expected to emanate from the domestic sector as well as pick-up in the external sector, following improved world prospects. Following the introduction and implementation of comprehensive measures to enhance the vibrancy of the economy and the medium and long-term competitiveness of the private sector, the private sector is envisaged to drive economic growth in 2004 with private expenditure expected to be robust at 7.5% and further acceleration in private investment of 9.9%.

The strengthened macroeconomic fundamentals and a more broadly balanced economic structure with emerging new sources of growth will provide the foundation for sustained higher growth. Alongside pragmatic macroeconomic management and the pro-growth measures in place to support private sector initiatives, 2004 Budget will further enhance competitiveness and reinforce the resilience of the economy against likely destabilising external factors and garner higher economic growth for the country. The Malaysian economy is, therefore, targeted to achieve a stronger GDP growth of 5.5% - 6% for 2004.

On a longer term, the Eighth Malaysia Plan ("8MP") expect that from 2001 – 2005, growth will be led by the manufacturing and services sectors. Value added manufacturing would be growing at an average of 8.9% per annum from 2001 onwards. Growth in the agriculture, forestry and fishing sectors is anticipated to grow at 3.0% in 2002 and 2.3% in 2003. Malaysia is projecting to grow at an average of 7.5% per annum during the 8MP period (2001 – 2005) with low inflation and price stability. The private sector is envisaged to lead this growth with the public sector continuing its role in stimulating the economy. The economy will become less reliant on labour, in the country's efforts to develop a knowledge-based economy. Private investments are forecast to grow at 19% per annum and public investments at 1.1% per annum during the 8MP period (2001 – 2005). Supported by strong domestic demand and strong recovery in private investments, private consumption is expected to grow at 7.4% per annum while public consumption is expected to grow at 7.7% per annum during the 8MP period (2001 – 2005). It is expected that the per capita income will increase from RM13,359 in 2000 to RM17,779 in 2005, increasing private consumption per capita from RM6,198 in 2000 to RM9,073 in 2005.

4.7.8 Outlook of the Industry

Following a series of adverse shocks in the first half of 2003, there are now increasing sign of renewed recovery and the balance of risk – in April, titled well to the downside – has improved significantly. Amongst the industrialised economies, USA and Canada will take the lead in recovery, when the positive policy factors implemented by the governments take effect. Projections for the European countries, whilst having been revised downwards by organisations like the IMF are also poised for better economic well-being. However, the only major concern would be the increasing instability within the Japanese economy with 2 consecutive years of contraction and which developments are still unfolding at the time of this report, although Japan's GDP expanded at an annualised rate of 5.7% in the January-to-March 2002 from the previous three months.

Emerging market countries will fair well, depending on the structure of their economies and the strength of their economic fundamentals. Areas for greater concern include Argentina and other countries within Latin America where ARB currently does not conduct its business. Particularly in Asia, China and India, which are less exposed to external developments, may emerge the "pillars of economy".

In tandem with projected world economic growth, Malaysia is projecting to grow at an average of 7.5% per annum during the 8MP with low inflation and price stability. The private sector is envisaged to lead this growth with the public sector continuing its role in stimulating the economy. The economy will become less reliant on labour, in the country's efforts to develop a knowledge-based economy. Private investments are forecasted to grow at 19% annually and public investments at 1.1%. Supported by strong domestic demand and strong recovery in private investments, private consumption is expected to grow at 7.4% while public consumption is expected to grow at 7.7% per annum. It is expected that the per capita income will increase from RM13,359 in 2000 to RM17,779 in 2005, increasing private consumption per capita from RM6,198 in 2000 to RM9,073 in 2005.

The Malaysian Government's basis for growth in the 8MP period takes into account the challenges arising from a more liberal global economy and the impact of technological advancements. As such, greater efforts will be made to ensure the sustainability and resilience of the economy in the long term to achieve the country's Vision 2020 target.

In Malaysia, the Finance Minister tabled an expansionary budget for the year 2001 and the growth strategies in Malaysian Outline Perspective for 2001 – 2010 (OPP3) continue to focus on efforts to speed up economic recovery and re-vitalise domestic demand. Similarly, the 8MP identify expansionary strategies aimed at promoting growth. This has and will continue to have a direct positive impact on the manufacturing and timber industry. These efforts will result in higher disposable income and increased domestic consumption. This improved economic outlook is further substantiated by increases in production output, foreign investment expenditure in the country, a higher projected GDP growth and general uptrend of the Malaysian economy.

While this is the general trend for the manufacturing industry, it should be noted that export-oriented companies would probably fair better than domestic-oriented companies as they have a far wider geographical coverage than local based companies. Increased demand from other foreign countries can counter flaccid local demand and provide manufacturers with some form of insurance against local economic fluctuations. Since ARB's business is caters mainly to the export market, this trend will definitely benefit the Group.

Increased demand in the local construction industry and the global home improvement industries will ultimately lead to increase opportunities within the timber and wood-based products industries. The Malaysian government is encouraging all businesses with the intention of using the Internet as a means of channel expansion, to become Secure Electronic Transaction ("SET") compliant. In addition, incentives like the Oda Saja Home Computer Ownership Scheme have also increased the number of Internet PCs in Malaysia. On the global home improvement retail industry front, the internet is also becoming a popular business-to-business channel, with giant retailers like Home Depot (US), Lowe's (US), Payless Cashways / DIYonline.com (US) and Homebase / house2home.com (US) embarking on online projects in 2001. This wide spread phenomenon directly impacts the global retail and manufacturing industry as retailers and manufacturers worldwide begin to explore new markets for growth and expansion. Technology will open-up newer distribution channels for products and services, which are not restricted by time, distance and people. Technological advancements have also led to newer ways of manufacturing wood-based products. The trend will be to automate where possible and focus on customer service. With all these factors, a bright future is expected for the timber processing industry.

This is again a positive development for ARB since the Group is looking for new ways to expand their business and distribution channels.

4.7.9 Industry Overview Conclusion

Bigger industry players and players with good management strategies like ARB, are expected to be able to withstand peaks and lows of the timber industry, emerging from the recessions as profitable as ever due to their large export customer base. Many of the casualties that have been recorded were smaller companies with capital restrictions.

The outlook seems extremely optimistic for larger players due to the government's active efforts in pump priming the local economy, using manufacturing as an enabler. In addition, the Minister of Primary Industries, Datuk Seri Dr. Lim Keng Yaik, also noted that there are still vast market opportunities available both in the domestic and international arena. He stressed several important factors that would help propel the timber industry into achieving higher growth, including:-

- Increased cooperation amongst the industry players and increased sharing of knowledge.
- Continuously improve on the quality of the products to obtain international recognition.
- Engage in R&D to expand product range.
- Improve productivity using technology as a key enabler.

The Primary Industry Ministry has also formed the ASEAN Forest Products Industry Club ("AFPIC") in order to boost intra-ASEAN trade. This regional trade club will protect the interest of its members and promote the general business welfare of the AFPIC members in global trade.

On the longer term, the United Nations have projected an increase in demand for timber-based products, with demand for sawn timber growing at 2.3% from 1990 – 2010 and panel products growing at 4.8% for the same period. Due to some degree of substitution occurring in the panel products sector, the Asian Development Bank expects that MDF will be the fastest growing product post 2001, growing at 8.3% per annum. Some of the major reasons being that MDF can be made from non-commercial small logs, branches and wood chips, compared to that of plywood, which needs timber logs as raw materials. Growth is also projected for the other wood-based products.

Currently, even though there is no shortage in demand, a major concern for Malaysia is the supply of raw materials. While Sarawak does not face any major supply problems, its counterparts in Peninsular Malaysia and Sabah face acute shortage problems as discussed earlier. However, ARB's location in Kalabakan has enabled the Group to potentially tap into 736,895ha of the Commercial Forest in Tawau. With this in view, further industry consolidation is expected, with the eventual removal of the weaker operators form the industry. Ultimately, supply is "king" and the operators with ensured timber supplies and highly integrated operations are the ones that will remain.

The ARB Group is well poised for expansion and growth as they have adopted good management strategies and made prudent business decisions by focusing on areas in which the 8MP and 2004 budget places emphasis. In addition, the Group's quest for efficiency and productivity will help minimise operational costs, keeping the company lean and poised to take advantage of the resurgent construction and property development opportunities in the new millennium.

4.8 Major Customers

The Group's major customers comprise of intermediaries, construction companies and furniture makers both locally and overseas. The Group is not over dependent on a single customer for its revenue base. ARB's top ten customers for the financial period ended 31 August 2003 turnover are listed in the table below.

Name of Customer	Type of Business	Country of Origin	Years of Relationship	Sales For Financial Period Ended 31 August 2003 RM'000 / %
Chen Da Building Material Co Ltd	Wholesaler	Taiwan	1	1,733 (3.6%)
Hong Chuan Plank Co Ltd	Wholesaler	Taiwan	7	5,515 (11.4%)
K-One Timber Co Ltd	Wholesaler	Korea	5	1,595 (3.3%)
LSK Enterprise	Timber Agent	Malaysia	6	1,037 (2.1%)
Maindeal Enterprise	Wholesaler	Korea	6	1,786 (3.7%)
Sen Wan Timber (S) Pte Ltd	Wholesaler	Singapore	4	4,048 (8.4%)
Sung Chang Enterprise Co Ltd	Wholesaler	South Korea	3	3,470 (7.2%)
Thiam Peng Trading Pte Ltd	Wholesaler	Singapore	5	1,415 (2.9%)
Khaivy Corp Ltd	Wholesaler	Vietnam	1	2,135 (4.4%)
Selera Indah Sdn Bhd	Wholesaler	Malaysia	8	980 (2.0%)

4.9 Major Suppliers

ARB has 2 major types of suppliers, the first supplies timber logs as input into their manufacturing process and the other supplies Tego sheeting, glue and other chemicals required by the Group for their value-added products. Almost all of the raw materials required in the production process can be sourced locally within Malaysia, with the exception of Phenolic film. For the manufacture of Tego plywood, Phenolic film is imported from USA or Sweden.

As for timber logs, the Group is dependent on the supply of logs from Seraya Permai Sdn Bhd and Bintang Tawau Sdn Bhd as evidenced from the log supply agreements dated 6 May 2002 and 3 May 2002 respectively. The agreements are necessary to ensure adequacy and continuity of log supply to meet the Group's operation requirements.

ARB's top ten suppliers for the financial period ended 31 August 2003 are listed in the table below:-

Name of Suppliers	Type of Business	Country of Origin	Years of Relationship	Purchase For Financial Period Ended 31 August 2003 RM'000 / %
Seraya Permai Sdn Bhd	Timber Logs	Malaysia	2	17,262 (48.8%)
Affinity Spring Sdn Bhd	Timber Logs	Malaysia	2	3,875 (10.9%)
Ligreen Enterprise Sdn Bhd	Timber Logs	Malaysia	2	3,489 (9.9%)
Golden Bond Sdn Bhd	Timber Logs	Malaysia	4	1,848 (5.2%)
Bintang Tawau Sdn Bhd	Timber Logs	Malaysia	3	1,237 (3.5%)
Syarikat Wawasan 2020 Sdn Bhd	Fuel & oil	Malaysia	7	2,064 (5.8%)
Sepangar Chemical Industry Sdn Bhd	Glue & Chemical	Malaysia	7	1,539 (4.3%)
Sin Yik Heng Trading Sdn Bhd	Wood Putty, Repairing Tape, Packing Material, Etc	Malaysia	14	180 (0.5%)
Ebici Holdings Sdn Bhd	Phenolic Film	Malaysia	6	138 (0.4%)
Syarikat Perniagaan Marinja	Industrial Flour	Malaysia	5	266 (0.8%)

4.10 Future Plans of ARB Group

ARB has remained focused on its core businesses as an integrated manufacturer of plywood, blockboard, sawn timber and other wood products, rather than diversifying to other non-core businesses, thereby remaining profitable even during the Asian financial crisis between 1997-1998. ARB business grew during the economic downturn due to several factors:-

(i) Strong export market,
(ii) ARB's expansions into new plywood variants like Tego and polyester; and
(iii) Strategic location resulting in cost savings on transportation cost.

The Group's focus on consumer market research will enable the Group to respond quickly to any changes in consumer tastes. While their investments in new technology machinery and information systems will alleviate the dependence of labour and increase production efficiency, their 79% export based revenue has also worked as added insurance.

ARB trades with countries like Singapore, South Korea, Taiwan, Japan and China (via Hong Kong). The average growth of these countries has increaseed from a dismal 1.2% in 2001 to 4.0% in 2002. The average growth of these countries has been forecasted to reach 3.0% and 4,3% in 2003 and 2004 respectively. With such growth rate, there will be further evidence of increase in economic activities, such as the construction sector. In tandem with this, the demand for timber related products are expected to increase.

The global furniture market is projected to grow strongly. The total output value of world furniture reached USD200 billion in 2002. Malaysia furniture export is targeted to increase to about USD1.86 billion in 2007 from USD1.38 billion in 2002. As a manufacturer of timber related products, this bodes well for ARB.

The Group will also keep looking out for new opportunities to expand their revenue base through new product development, strategic alliances with international players and diversified investments. Overall, it will be the Group's strong commitment to innovation, developing their people and productivity/efficiency improvements that will back them in facing the challenges ahead. With this winning formula in place, the ARB Group is poised to enjoy the rewards of a bright and prosperous future.

4.11 Interruptions of Business For The Past Twelve (12) Months

The Group has not experienced any significant interruptions in its business which have had any significant effect on its operations during the last twelve (12) months.

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