

INITIATION REPORT

3 December 2014

Name of PLC: Poh Kong Holdings Berhad (PKHB)	Target Price:	RM 0.78
Business Summary : Retailing and manufacturing of gold jewellery, gems, diamonds, precious stones and gold investment products in Malaysia		
Major Shareholders : Dato' Choon Yee Seiong and family as at 2-Dec-2013		63.86%
PLC Website : www.pohkong.com.my	Recommendation:	BUY
	Market Capitalisation:	RM 170.3m
	Current Price :	RM 0.415
	Market / Sector:	Consumer
	Stock Code:	5080
Analyst : Lim Boon Ngee Tel : +603 2163 3200; Email : bnlim@nra.com.my		

Key Stock Statistics	2013	2014	2015F	2016F
EPS (sen)	8.3	3.2	4.7	8.2
P/E (x)	5.0	12.8	8.9	5.0
Dividend/Share (sen)	1.4	1.0	1.0	1.0
NTA/Share (RM)	1.07	1.09	1.13	1.20
Book Value/Share (RM)	1.08	1.09	1.13	1.20
Issued Capital (mil shares)	410.4	410.4	410.4	410.4
52-weeks Share Price Range (RM)			0.41 - 0.49	

Per Share Data	2013	2014	2015F	2016F
Year-end 31 Jul				
Book Value (RM)	1.08	1.09	1.13	1.20
Operating Cash Flow (sen)	1.5	(2.1)	6.2	5.2
Earnings (sen)	8.3	3.2	4.7	8.2
Dividend (sen)	1.4	1.0	1.0	1.0
Payout Ratio (%)	16.9	30.8	21.4	12.2
PER (x)	5.0	12.8	8.9	5.0
P/Cash Flow (x)	28.4	(20.1)	6.7	8.0
P/Book Value (x)	0.4	0.4	0.4	0.3
Dividend Yield (%)	3.4	2.4	2.4	2.4
ROE (%)	8.2	3.0	4.2	7.1
Net Gearing (%)	50.5	57.5	51.5	46.5

P&L Analysis (RM mil)	2013	2014	2015F	2016F
Revenue	975.8	798.9	825.4	906.5
EBITDA	64.3	45.8	50.9	70.9
Depreciation	(10.1)	(10.4)	(10.9)	(11.4)
Net interest income	(13.7)	(13.6)	(14.5)	(14.4)
Pre-tax Profit	40.6	21.9	25.6	45.0
Effective Tax Rate (%)	(16.3)	(39.1)	(25.0)	(25.0)
Net Profit	34.0	13.3	19.2	33.8
EBITDA Margin (%)	6.6	5.7	6.2	7.8
Pre-tax Margin (%)	4.2	2.7	3.1	5.0
Net-Margin (%)	3.5	1.7	2.3	3.7

1. Investment Highlights/Summary

- PKHB is an integrated one-stop jeweller, from manufacturer to retailer of gold jewellery, gems, diamonds, precious stones and gold investment products in Malaysia.
- PKHB operates 106 retail outlets located in shopping malls to sub-urban centres nationwide.
- We believe that PKHB is the leading retailer in terms of turnover and the number of outlets in Malaysia.
- The demand for gold jewellery and gold-related investment products are dependent on the volatility of gold prices. Its profit margin is susceptible to sharp fluctuations in gold prices. Against the backdrop of a steep drop in gold price, its profitability was eroded in FY14, as its gold inventory was procured at a high price. However, its profitability would be normalised when its current gold inventory is replenished at current lower price.
- We like PKHB for its strong management team, long-term track record, wide retail coverage and strong branding, although it's currently facing headwinds of declining gold price and slower consumer spending.
- We are initiating coverage on PKHB with a BUY recommendation for its rich assets backing. Not only its share price of RM0.42 is sharply below its book value of RM1.09, it is also unjustifiably lower than its cash backing (inclusive of gold inventory) of RM0.78.

2. Company Background/Overview

- History

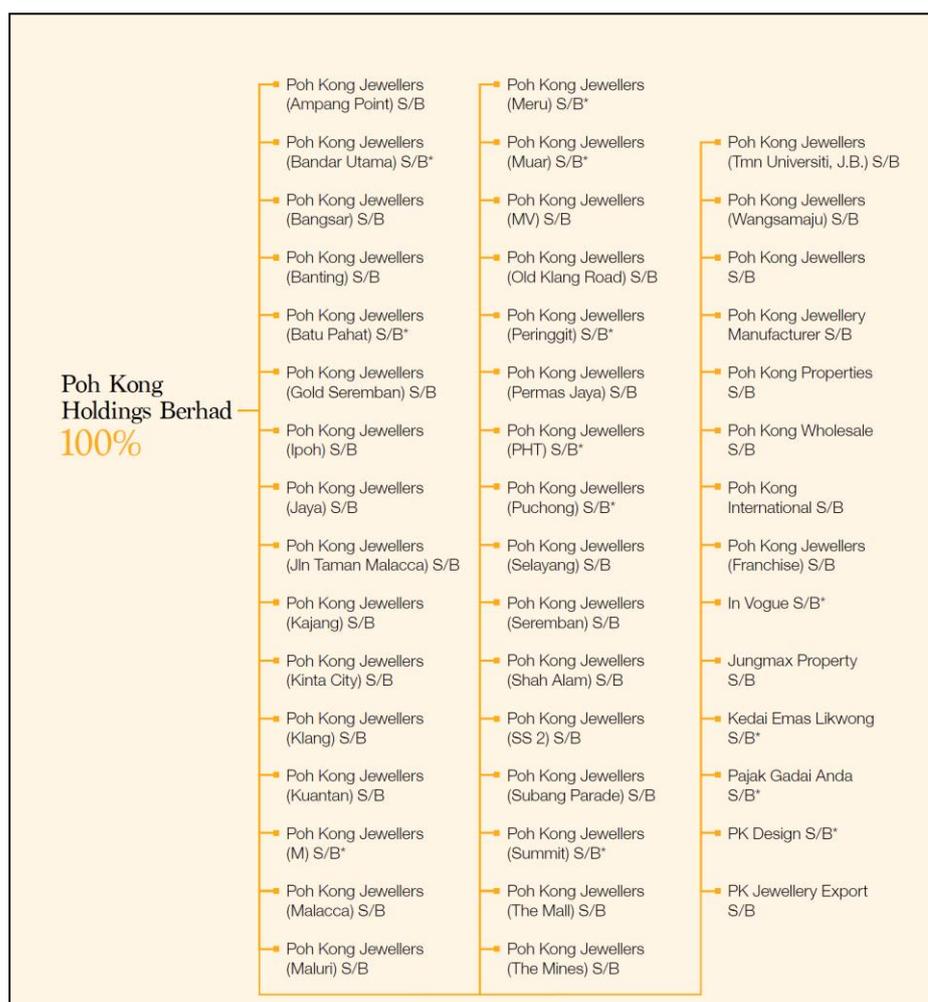
Poh Kong Jewellers (PJK) was established in 1976 by Dato' Eddie Choon, now Poh Kong Holdings Berhad (PKHB)'s Executive Chairman and Group Managing Director. PJK opened its first outlet in at Jalan 52/4, Petaling Jaya, which has been PKHB's headquarter until today.

PKHB is an integrated one-stop jeweller, from manufacturer to retailer of gold jewellery, gems, diamonds, precious stones and gold investment products in Malaysia. Today, it is a full-fledged, retail chain store specialising in jewellery retailing nationwide with 106 stores nationwide as at end-Jul-2014. In addition, it also has a manufacturing facility in Shah Alam. Poh Kong Jewellery Manufacturer Sdn Bhd, set up in 2001 for RM12m.

PKHB designs and manufactures a variety of jewellery products under in-house brands such as Tranz, Anggun, Auspicious, Happy Love and Hemera Diamond, the world's most brilliant diamond with 101 facets, as well as Bunga Raya gold bar (for gold investment products). In addition, PKHB is also the appointed sole distributor for world-renowned international jewellery brands such as Schoeffel-branded luxury pearls from Germany (for South East Asia) and Luca Carati, one of Italy's oldest and most prestigious jewellers (for Malaysia), Moraglione 1922 from Italy and Angel Diamond from Canada.

PKHB was listed on the Main Market (formerly known as main board) of Bursa Malaysia on 9-Mar-2004.

- Corporate structure



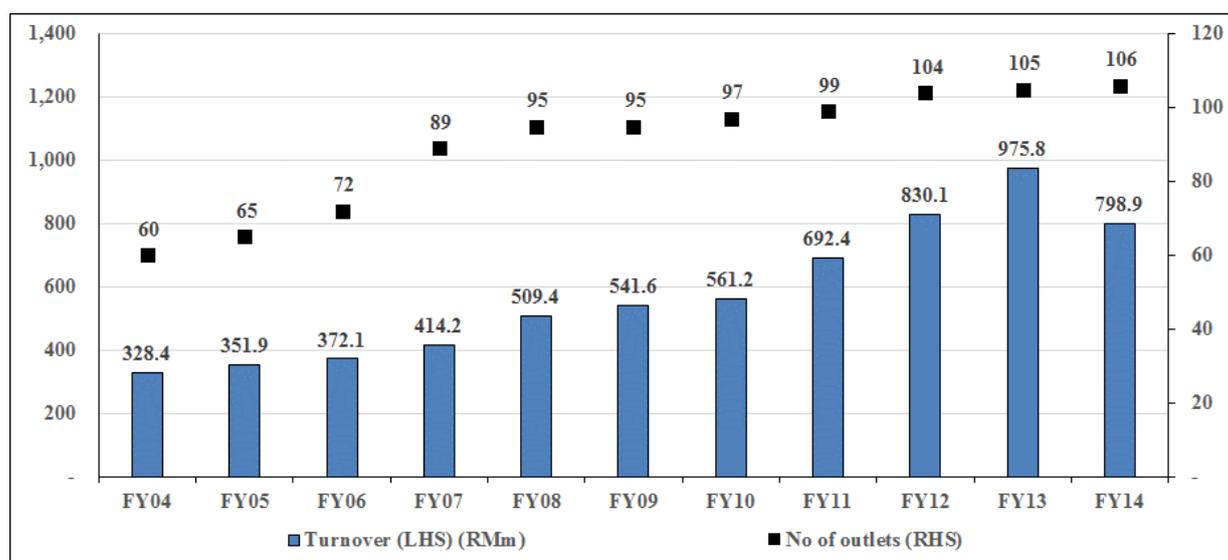
- **Key areas of operation**

Retailing

PKHB operates 106 retail outlets located in shopping malls to sub-urban centres nationwide. Its retail concepts include the flagship Poh Kong brand, upscale Poh Kong Gallery, Diamond & Gold, Diamond Boutique, Jade Gallery, Gold Boutique and Oro Bianco. These concept stores offer a wide range of jewellery from gold-related jewellery to gold investment products, diamonds and coloured gems.

Although its retail outlets are scattered nationwide, retail outlets located within Selangor and Kuala Lumpur contributed around 70% of total revenue.

Historical turnover and no. of outlets



Gold-based jewellery is its main product. Apart from yellow-gold jewellery, it offers a wide range of diamond, jade, pearl, gems, and coloured stones that caters to various taste and preferences of different races in Malaysia. Its yellow gold jewellery is promoted under the Poh Kong's in-house brands, such as the Anggun Series, Happy Love Collection, Tranz Collection and The Art of Auspicious Jewellery. In CY13, it launched another in-house brand for diamond products, the Hemera Diamond, the world's most brilliant diamond with 101 facets. In addition, PKHB is also the licensee for Disney Jewellery. PKHB also offers gold investment products such as gold bars, bullions, wafers and coins.

Manufacturing

PKHB has an one-stop integrated set-up in both retailing and in-house manufacturing operations. Poh Kong Jewellery Manufacturer Sdn Bhd, which was set up in 2001, produces and supplies majority of PKHB's finished gold jewellery.

The plant is equipped with a modern technology facility where the designers and craftsmen create new in-house designs, seasonal jewellery, as well as exclusive products based on the Group's research and development activities. The plant also has a gold recovery and refinery system which enables the PKHB Group to refine all trade-in jewellery and used gold at a lower cost compared to the market rate as a form of raw materials for its production of finished jewellery.

3. Financial Review

Historical turnover and PBT performance

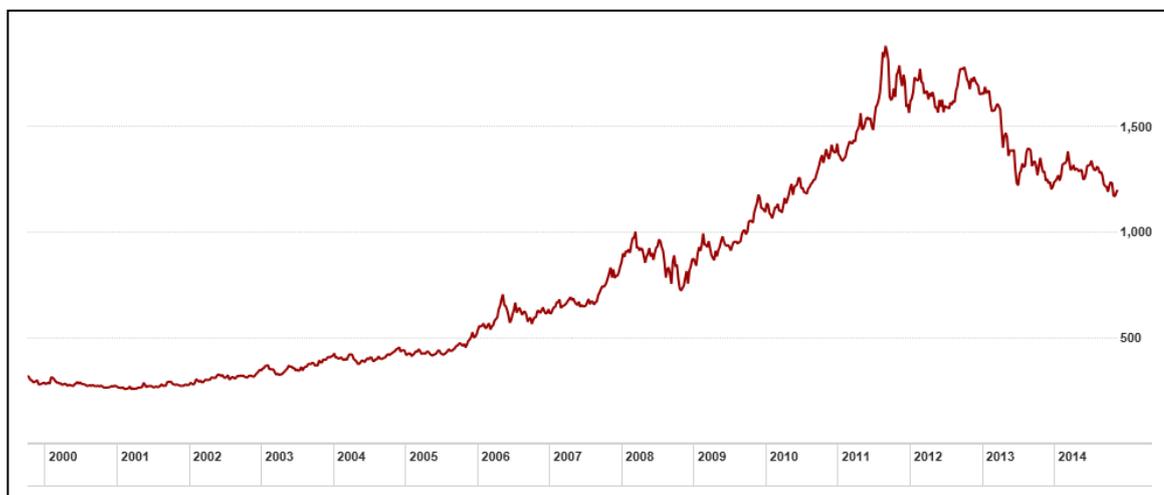
FYE Jul	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14
Turnover (RMm)	328.45	351.90	372.12	414.24	509.35	541.64	561.24	692.42	830.12	975.78	798.94
PBT (RMm)	24.10	22.42	35.14	25.37	39.96	38.56	44.80	57.67	70.95	40.57	21.87
PBT margin (%)	7.3%	6.4%	9.4%	6.1%	7.8%	7.1%	8.0%	8.3%	8.5%	4.2%	2.7%

- Historically, PKHB's turnover growth has been underpinned by stores expansion which grew from 60 stores in FY04 to 106 stores in FY14. In addition, its topline turnover is also driven by the higher gold prices which translated into higher selling prices to its customers.
- The demand for gold jewellery and gold-related investment products are dependent on the volatility of gold prices. This was more evident in the recent 2-3 years where the decline in gold price had led to lower turnover.
- Profit margin is susceptible to sharp fluctuations in gold prices. There is a time lag of 3-6 months between the purchase of gold bullions and the conclusion of sales at retail outlets. As the retail's unit price is based on the prevailing international gold price and its gold inventory is procured at a high price, PKHB's profitability will be eroded if the gold price is in a continuous declining trend. During FY13-FY14, as international gold price had been on a steeper downtrend, PHB's PBT was correspondingly eroded.

Average gold price and historical PBT margin



Historical gold price



4. Recent Developments

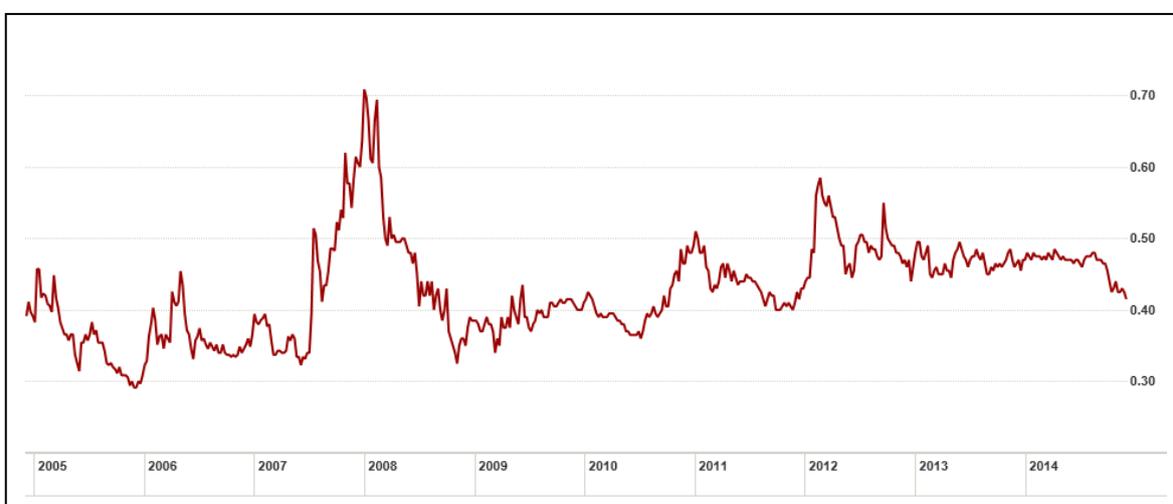
- As part of the restructuring plan on internal re-organisation initiated since Dec-2011, PKHB has embarked on the consolidation of all retail business under Poh Kong Jewellers Sdn Bhd, which will be the sole entity managing all its retail outlets. Pursuant to this exercise, the winding-up process of all its non-key and dormant subsidiaries has been progressively carried out.

5. Competitive Analysis

PKHB possesses some competitive strengths due to the following factors:

- We believe PKHB is Malaysia's fastest growing and largest jewellery retail chain store in terms of turnover and the number of outlets in Malaysia. This allows the company to have first mover advantage in the high traffic shopping malls and better bargaining power over the mall owners as compared to its peers.
- Extensive retail coverage of 106 retail outlets nationwide. PKHB also differentiates its retail concept to meet the needs of its customers with specialty stores such as Poh Kong Gallery, Jade Gallery, Gold Boutique, Diamond & Gold, Diamond Boutique and Oro Bianco.
- R&D, in-house brands and comprehensive product range. Poh Kong is synonymous with innovative design, craftsmanship and superior quality jewellery. This is supported by its design team and own manufacturing operation. It can also meet the demand of different customers through its comprehensive product offerings such as Tranz, Happy Love, Anggun, The Art of Auspicious Jewellery and Hemera Diamond.

Share Price Chart of PKHB



Although there is no official statistics for the gold and jewellery industry in Malaysia, we believe that PKHB is the leading retailer in terms of turnover and the number of outlets in Malaysia.

Comparative valuations	PKHB	Tomei *	Degem *	Niche Capital *
Share price (RM) @ 1-Dec-2014	0.42	0.54	0.85	0.13
Market cap (RMm)	170.3	74.8	113.9	14.7
CY14 P/E (x)	12.8	10.5	6.8	2.4
Latest P/BV (x)	0.4	0.4	0.5	1.3

* *annualised*

6. Earnings Outlook

- After years of store expansion, PKHB plans to consolidate its retail position in the marketplace by driving productivity of individual store. Longer-term, the continuous store expansion depends on the availability of the development of new shopping malls.
- PKHB plans to drive a larger market share by enhancing and differentiating its product offerings to each target market segment.

7. Key Investment Risks

- A severe slowdown in Malaysian economy could hurt consumer spending as they might delay their spending on discretionary items such as jewellery.
- The continuous declining trend in international gold price would erode profit margins. However, PKHB only keeps a gold inventory of 3-4 months. As its stock is replenished at prevailing lower market price, its profit margin will normalise.
- Gold investment products would lose its appeal as a form of investment in a sluggish gold market.

8. Balance Sheet

Although PKHB is in net debt position, most of its borrowings are tied down in the form of gold inventory mostly jewellery, precious stones and gold ornaments. As at end-FY14, this amounted to RM577.66m. This part of gold inventory is cash equivalent and can be easily liquidated for cash. If this gold inventory were to be added back to its current net debt position of RM258.18m, it would have boosted a net cash (or cash equivalent) of RM319.48m (RM0.78/share)

9. Valuation and Recommendation

- We like PKHB for its strong management team, long-term track record, wide retail coverage and strong branding, although it's currently facing headwinds of declining gold price and slower consumer spending.
- We are initiating coverage on PKHB with a BUY recommendation for its rich assets backing. Not only its share price of RM0.42 is sharply below its book value of RM1.09, it is also unjustifiably lower than its cash backing (inclusive of gold inventory) of RM0.78.

Disclosures/Disclaimer

Investment ratings:

Buy (generally >10% upside over the next 12 months)

Hold (generally negative 10% downside to positive 10% upside over the next 12 months)

Sell (generally >10% downside over the next 12 months)

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