

China Gold and Silver Jewelry Market Channel Report, 2007-2008

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1.2 Overall Market Size

1.2.1 Long-term Trend

China's bijouterie industry is far better than expectation in growth rate. An early estimate showed that sales value of the industry would reach CNY180 billion by 2010. But the sales value had maintained an annual growth of CNY20 billion since 2005 and stood at CNY180 billion in 2007, reaching the expectation three years ahead of schedule. The latest rough estimate from industry association shows that the sales value will reach 200 billion by 2010.

Starting from 2003, the total jewelry retail sales (over quota) stepped into a rapid growth period since 2003 and even rose 41.7% year on year to CNY45.98 billion in the whole year of 2007, with five-year compound annual growth rate from 2003-2007 reaching 25.9%.

Jewelry Retail Sales (over quota) and Growth Rate in China, 2002-2007

Quota Standard: Annual Sales over CNY5 million (including CNY5 million)

Year	2002	2003	2004	2005	2006	2007
Retail (CNY100 Million)	145.6	164.1	216.1	255.7	324.5	459.8
Growth Rate		12.7%	31.7%	18.3 %	26.9%	41.7%

Source: National Bureau of Statistics of China, ResearchInChina

6.1 Shanghai Lao Fengxiang Co., Ltd.

6.1.1 Company Profile

The company was founded in 1848 with a long history of one and a half century. In China's jewelry industry, Lao Fengxiang is the first one to become one of the "Top 500 Asian Brands" and also the only Chinese jewelry enterprise granted the title of "Global Top100 Jewelry Companies".

In Dec.1998, China First Pencil Co., Ltd. became the controlling shareholder of Lao Fengxiang with the registered capital of CNY136 million, holding 50.44% shares.

Currently, Lao Fengxiang has more than 20 subsidiaries, four professional jewelry factories, over 60 jewelry shop chains, over 300 franchised stores and more than 1000 distributors.

6.1.2 Business Modes

Lao Fengxiang has a sound industrial chain from R&D, design to production and marketing. Basically all products in Lao Fengxiang jewelry store (gold, platinum and diamond etc.) are produced by Lao Fengxiang itself.

Lao Fengxiang Business Modes

Items	Business Modes
Procurement	Purchasing gold and platinum directly from Shanghai Gold Exchange and purchasing other raw materials from other suppliers.
Design	The design team contains more than 100 designers. This excellent team has obtained over 130 awards in the jewelry design contests both at home and abroad.
Manufacturing and Processing	Its advantage in processing is reflected in the precious metal production such as gold and platinum. The high and medium-end products are produced by Lao Fengxiang itself but other products are processed by OEMs. The processing of jewel and jade is completed by cooperation with Shanghai Arts and Crafts Company.
Marketing	Its self-managed jewelry stores are in charge of retailing. The franchised stores and distributors undertake the wholesale.

Source: Company Annual Report and Shenyin & Wanguo Securities Co., Ltd.

6.1.3 Marketing Channels

Lao Fengxiang expanded its marketing networks continuously, setting up jewelry shop chains, designated counters, franchised stores and developing regional distributors. Currently Lao Fengxiang has stores in 29 provinces, cities and autonomous regions only except for Inner Mongolia and Tibet. Shanghai has more than 40 Lao Fengxiang Jewelry Shop Chains.

Jewelry store is the retailing main force of Lao Fengxiang. Jewelry stores are basically directly-managed by the company itself. Most of them concentrate in Shanghai and few are situated in Zhejiang, Jiangsu and Hubei provinces. The company is very prudent to set up directly-managed jewelry stores outside of Shanghai, so the expansion of jewelry stores is not very fast. There were 57 Lao Fengxiang jewelry stores in 2007 and it is estimated to reach about 60 currently.

Regional Distribution of Lao Fengxiang Jewelry Stores

Places	Qty.
Shanghai	48
Jiangsu	2
Zhejiang	3
Other places	4
Total	57

Source: Lao Fengxiang & CICC

Most of Lao Fengxiang franchised stores are run by distributors entitled the franchise. In principle, these stores can only sell jewelries of Lao Fengxiang brand and purchase the products from Lao Fengxiang at wholesale. The expansion of franchised stores developed very fast. There are more than 300 Lao Fengxiang franchised stores currently. As for the self-managed franchised store, Lao Fengxiang had 33 this kind of store in 2005, increasing to 80 in 2006 and reaching 100 currently.

Regional Distribution of Lao Fengxiang Self-Managed Franchised Stores

Regions	Franchised Store Qty.
Jiangsu	33
Zhejiang	27
Anhui	23
Jiangxi	6
Other regions	12

Source: Lao Fengxiang

Lao Fengxiang sells the jewelries to distributors at wholesale, and then distributors sell them to customers at retail. Now Lao Fengxiang has more than 1000 distributors all over the country, which are expected to reach 2000 in 2010.

Most jewelry stores of Lao Fengxiang concentrate in Shanghai, followed by Jiangsu, Zhejiang and Anhui, which respectively has 20 franchised stores at least. Compared to the above four regions, other places' performance is a bit inferior.

6.1.4 Advantages and Disadvantages

Advantages: 1). Few Chinese jewelry operators have the ability of design, but Lao Fengxiang is a rare one. Its reputation is obviously superior to other local brands. 2). 21.99% shares are held by the company executives and some other key men. So the company can form an effective management and employee incentive systems. 3). Extensive marketing networks and high market share. 4). Lao Fengxiang owns many properties in Shanghai CBD. So it doesn't have too much pressure of paying the rising rents.

Part of Lao Fengxiang Real Estates

Address	Area (sq m)	Market Price (CNY10,000/sq m)	Fair Value
in vicinity of Temple of Town God	1200	14	168
Nanjing Road	2000	14	280
Arts & Crafts Mansion	4000	5	200
Yuyuan Plant	6000	1	60
Xuhui Store	200	8	16
Total	13400		724

Source: Annual Report from China First Pencil Co., Ltd. and CICC

Disadvantages: 1). The design is not fashionable enough. It is very popular with the middle-aged and senior customers but not attractive for the young people. The situation has been improved greatly in recent years. 2). Compared to those international jewelry companies such as Chow Tai Fook and Chow Sang Sang, Lao Fengxiang doesn't have too much advantage in controlling the procurement cost. It has not been authorized as a signholder of DTC.

6.1.5 Operation

Lao Fengxiang achieved the sales revenue of CNY6.106 billion in 2007, up 62.7% than the previous year. CAGR in the past four years were all above 40%. The fast growth of the company's sales revenue was mainly driven by the gold jewelry. The revenue of gold jewelry reached CNY4.278 billion in 2007, up 86% year on year.

Lao Fengxiang Main Business Revenue and Growth Rate, 2004-2007

Year	2004	2005	2006	2007
Sales Revenue (CNY Billion)	1.991	2.732	3.942	5.885
Growth Rate		37.22%	44.29%	49.29%

Source: ResearchInChina

In 2007, Lao Fengxiang reached the net profit of CNY177 million, up 69.78% year on year. The ratio of wholesale revenue to retail revenue increased to the current 6:4 from the previous 5:5. Because the gross profit margin of wholesale is rather lower than the retail, the company's gross profit margin reduced a lot. However, thanks to the improving management level and decreasing ratio of management expenditure/operating revenue, the profit margin in 2007 is still higher than the previous year.

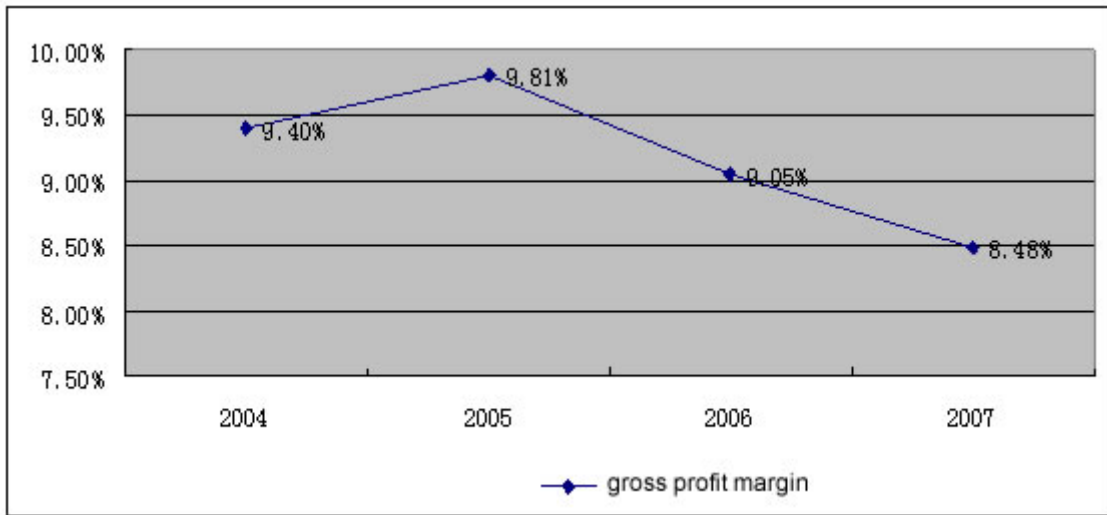
Lao Fengxiang Major Profitability Indices, 2004-2007

Year	2004	2005	2006	2007
Gross profit (CNY million)				
Gross profit margin				
Growth rate of gross profit				
Net profit (CNY million)				
Net profit margin				

Source: China First Pencil Co., Ltd. and ResearchInChina

No matter the retail or the wholesale, Lao Fengxiang operates its own brand all the time. Lao Fengxiang can be regarded as the high-end consumer good brand, so it should have possessed the characteristics of high gross profit margin, high cost rate and high net profit margin. On the contrary, the company is with the features of low gross/net profit margin and low cost rate, which should be attributed to two reasons. Firstly, the company takes gold jewelry as the main product, but gold jewelry's gross profit margin is too low. In addition, neither the brand nor the design has the added value. Secondly, the wholesale takes a larger share in the company's sales.

Lao Fengxiang Gross Profit Margin, 2004-2007



Source: ResearchInChina



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