

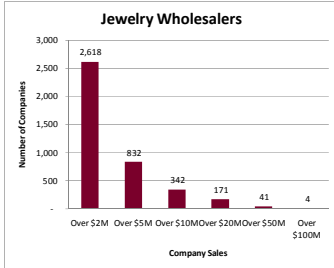
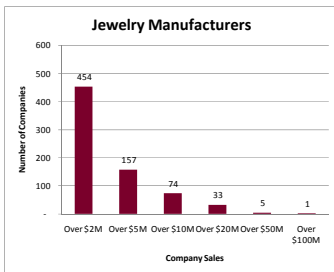
SECTOR SPOTLIGHT:

JEWELRY MANUFACTURING & DISTRIBUTION

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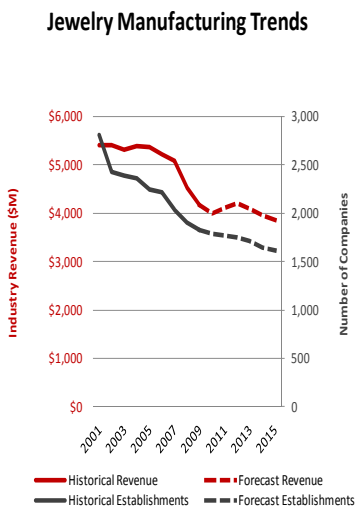


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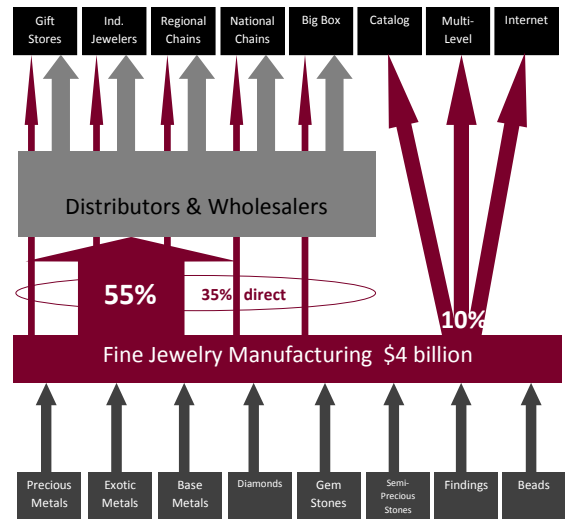
Source: IBISworld 2010

FINE JEWELRY MANUFACTURING & WHOLESALE DISTRIBUTION

This report covers the U.S. industrial sectors that are dedicated to the manufacturing and distribution of fine jewelry. For the purposes of this report, "Fine Jewelry" includes rings, bracelets, earrings, pins, necklaces, and other items worn on the body that are manufactured from precious and exotic metals, diamonds, gems, and semi-precious stones. This report excludes watches, costume jewelry, silverware, and gold and silver coin and bullion. Our research also excludes jewelry retail stores and suppliers of precious metals, gems, and stones to jewelry manufacturing companies.

We estimate that the domestic fine jewelry market is approximately \$4 billion, measured at the wholesale value of products sourced and produced by domestic jewelry manufacturers. There are more than 2,000 independent U.S. – based jewelry manufacturing enterprises. Many of these are very small enterprises. Our research identified about 700 manufacturers with reported revenues greater than \$2 million. A list of the top 25 manufacturers is included inside this report.

Approximately 55% of the products from these manufacturers are sold to distributors that re-sell to the retail sales channel. The distinctions between manufacturers and distributors in the jewelry marketplace are often blurry. Distributors perform the business functions of stocking inventory and consolidating orders from a range of manufacturers to individual retail enterprises. Distributors also carry accounts receivable from their retail customers. Distributors primarily focus on serving bricks-and-mortar customers. There are more than 5,000 enterprises that distribute jewelry, diamonds, gemstones, and precious metals. Our research has identified over 2,000 jewelry distributors with revenues over \$2 million. A list of the top 25 distributors is included inside this report.



Outside of the traditional distribution channel, approximately 35% of jewelry is sold directly from the manufacturer to the retailer. Another 10% of the market is served directly from the manufacturer to catalog sales, multi-level marketing sales, and sales over the internet.

INDUSTRY TRENDS

The last five years have been tough on the jewelry manufacturing industry. A combination of economic recession, increasing precious metal and gem prices, and increasing foreign competition have driven the total industry sales down from \$5½ billion to \$4 billion over the last ten years. This represents a negative 4% per year growth rate. Industry projections indicate that this erosion may stabilize when consumer confidence stabilizes, with a forecast for a slight increase in 2011 and 2012, resulting in a negative 1% per year decline in revenues over the next five years.

The effect of this decline is shown more clearly in the reduction of the number of manufacturers over the same period. Between 2001 and 2010, nine hundred manufacturers were sold or closed, representing a 5% annual decrease in the number of companies. This trend is projected to continue, with the loss of another two hundred to three hundred companies by the year 2015.

If there is good news in this, it is that those companies that continue in business will grow from the loss of competitors. Between 2001 and 2010, average size of manufacturing companies increased from \$3.1 million to \$3.6 million. If the projected trends in industry revenues and enterprises continues, average business size will increase to \$3.9 million by 2015. Those that continue will grow by acquiring good, smaller companies, or simply picking up business from those that fail.

TOP INDUSTRY COMPANIES

The top 20 manufacturers and wholesale companies are listed below. Distinctions between manufacturers and distributors are somewhat blurred in this industry. Many manufacturers also distribute product made by other companies. Our classification is intended to show where the pre-dominance of a company's sales are derived. Our list excludes companies that produce and sell student jewelry, including Balfour, Herff-Jones, American Achievement, and Jostens.

Rank	Jewelry Manufacturing	Sales \$M
1	CMJ Mfg	\$897
2	Stuller, Inc.	\$888
3	Tiffany & Co (manufacturing)	\$517
4	Bitu Collection	\$90
5	Finecraft Fine Jewellery	\$69
6	The Richline Group	\$55
7	Chateau D'Argent	\$52
8	P & B Manufacturing Co	\$52
9	Uncas Manufacturing	\$47
10	Tessler & Weiss / Premesco	\$46
11	Dakota West	\$45
12	Premier Manufacturing Co	\$45
13	Relios Inc	\$45
14	Trading Corp Of America	\$45
15	Terryberry Corp	\$45
16	Chapal Zenray Inc	\$39
17	A & Z Hayward Co	\$37
18	Marathon Co	\$37
19	Metal Marketplace	\$36
20	Nuco Products Inc	\$34

Rank	Jewelry Wholesale	Sales \$M
1	Konstantino Treasures Inc	\$200
2	MGM Mfr	\$150
3	Gemstone Development	\$114
4	Frederick Goldman (DIANA)	\$100
5	Erica Lyons Jewelry Inc	\$86
6	New Gold Mfg. & Whole.	\$80
7	Idea Nuova Inc	\$80
8	Lazerd Kaplan	\$80
9	Rosey Blue Inc	\$75
10	Pandora Jewelry LLC	\$70
11	Chain & Charm Jewelry Mfg.	\$70
12	Garbo Creations Inc	\$69
13	South Dakota Gold Co	\$65
14	Metalfab Inc	\$65
15	Essential Designs	\$65
16	Golden Stella	\$60
17	Bijouterie Carmen Inc	\$59
18	Adamas Diamond Corp	\$58
19	International Jewelry Traders	\$58
20	Indian Jewelers Supply	\$56

source: CFA Research

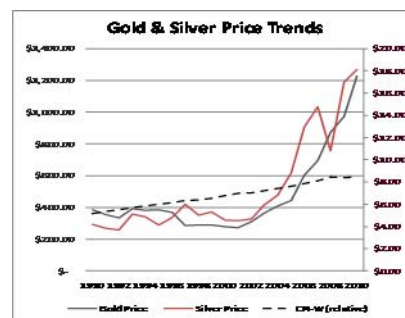
EXTERNAL INDUSTRY DRIVERS

The jewelry manufacturing industry is subject to significant external forces that drive the volume and profitability of companies in the sector. Operators are challenged by adapting to these outside factors that affect their businesses.

Bridal Jewelry. Bridal jewelry, which includes engagement, wedding, and anniversary rings, represents over half of the sales volume in fine jewelry. There is a long-term cultural base for purchases of bridal jewelry but it is subject to changing marriage rates and pricing is subject to overall consumer sentiment. As consumer outlook softens, buyers purchase lower-cost bridal jewelry.

Consumer Sentiment. Fine jewelry is a discretionary purchase that reacts to consumer sentiment. Disposable income, inflation rates, interest rates and credit availability, home values, and unemployment all factor into the decision to buy fine jewelry.

Materials Costs. Close to 60% of the cost in fine jewelry is represented by the precious metals and stones. Cost of these materials fluctuate over the short term and have risen over the long term. Recent increases in prices of silver and gold have put pressure on margins and profits in the jewelry manufacturing industry. Some of these increases can be passed on to consumers, some can be substituted by lower-value materials, but in some cases the consumer substitutes other luxury goods like electronics, clothing, or vacations in its place.



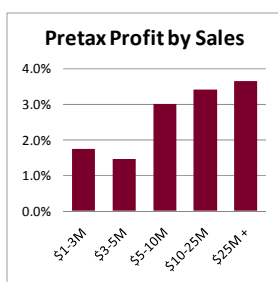
Offshore Manufacturing. Over the last five years, competition from overseas manufacturers has increased. Labor and wages represent roughly 14% of cost for domestic manufacturers and jewelry has a low freight-to-value cost. This means that offshore manufacturers can save on labor and air-freight product quickly to the U.S. market. Domestic manufacturers are facing increasing competition from overseas producers. Many U.S. based companies are building offshore factories or developing relationships with overseas companies to reduce their costs.

Tax and Regulatory. The majority of manufacturers that are small businesses are subject to increasing taxation and regulation at both the Federal and State levels. Increasing employee costs and regulatory requirements constrain companies abilities to grow.

INTERNAL COMPANY SUCCESS DRIVERS

The best companies in the jewelry manufacturing industry have management teams that are focused on the key factors that drive operating results.

Distribution Network. Jewelry manufacturers are highly dependent on the strength and breadth of their distribution network. Sales representatives promote manufacturers' products to distributors and to retail customers. Good management, strong relationships with customers, and effectiveness of the sales representative teams all have a direct effect on the company's success in the marketplace.



Size and Economies of Scale. Jewelry manufacturing is a straight-forward process that can be started up with small investment. This is why more than half the companies have less than \$2 million in sales. However, the industry has significant economies of scale that drives value to those companies that are larger. Efficiencies in production and purchasing drive lower manufacturing costs. Sales reach and marketing promotion drive greater sales and profits exponentially

with increased volume and field coverage.

Asset Management. Manufacturing and distribution companies in the jewelry industry are "current asset heavy". This means that, relative to many other industries, companies in this industry support large account receivables and inventories. High receivables are related to sales terms that involve "dating" of invoices for payment terms and seasonality of products. High inventories are the result of the high-value of raw materials and finished goods, the wide range of product sizes and designs required to support a product line, consignment inventories, and the need for high-value sales samples. The capital invested in these current assets is a business risk due to (1) allowances for returns and re-stocking, (2) customer default and bankruptcy, (3) market price shifts on metals and stones, (4) product obsolescence, (5) theft and pilferage. Successful companies in this industry work hard to minimize the investment in these assets.

Financial Leverage. The complementary side to the "asset-heavy" nature of the business is that banks, in general, consider accounts receivable and inventory strong collateral for lending. Accounts receivable with current account customers and inventories with floor values on precious metals and stones make good collateral for banks. The positive aspect to this is that it makes it easy for companies to borrow against these assets to grow their business; the bad news is that it is tempting for less-profitable companies to borrow against assets to meet operating needs and erode their net worth.

Seasonality. The jewelry niche is subject to seasonality at the retail end that reverberates through to the manufacturing and distribution companies. Christmas, Valentine's Day, and Mother's Day are all seasonal spikes in demand. To a lesser extent, college graduations, Easter and the spring bridal season also bump demand. Manufacturers and suppliers are required to plan for and anticipate the design and volume needs for these seasonal demands.

FACTORS DRIVING MERGERS & ACQUISITIONS

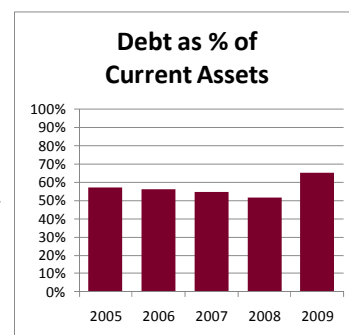
Merger and acquisition (M&A) activity in the jewelry manufacturing and distribution industry is driven by a number of factors, both industry-related and internal to individual companies. Deals that are being done in this sector are typically because the company has a higher value to certain buyers than the value of its ongoing cash flow to the current owner. Some of the specific situations are these:

Economies of Scale. In this industry, like many others, larger companies are more profitable than small ones. Large companies with more efficient manufacturing and more efficient use of assets can generate more earnings than the current owner of a small company can make on the same dollar amount of sales. In this industry, small companies have a higher value to larger companies than they do to their current owners.

Access to Channels. Acquiring companies often pay a premium to acquire other companies who have stronger sales channels in certain market niches. A company with a strong channel position in internet sales will be an attractive target for a buyer who does not have a presence in that channel

Shrinking Marketplace. Companies facing declining sales in a shrinking overall marketplace may realize a higher value by selling today to a stronger buyer instead of riding the decline down to a liquidation of the company.

Over-Leverage. The high value of collateral tempts some companies to over-leverage their assets and borrow to cover salaries and expenses during a time of lower profits. Average debt increased to over 65% of current assets in 2009. In this situation, owners may want to find a buyer who puts a premium value on the ongoing business as an alternative to having an asset liquidation with lenders.



Ownership Succession. Jewelry manufacturing and distribution is an old and respected industry. Many companies in this industry are well past their first inter-generational ownership transfer. Some, however, have no family succession option. For these companies, a sale now may be the way to maximize the overall family wealth for future generations.

Small Business Climate. Over the last two years, the business climate for small companies has continued to worsen. Increasing regulations, benefits mandates, and limited credit have all hurt private company owners. The outlook for increasing taxes on both earnings and capital gains, increasing health care costs, and continued regulations all make it more beneficial for owners who plan to sell their companies to act sooner rather than later.

VALUATION METRICS

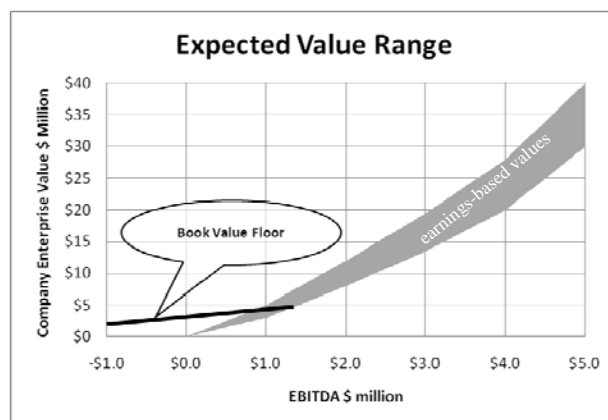
Valuation of private companies in the jewelry industry are driven by multiple factors. Profitable companies are valued primarily for the future earnings expected from the company. Marginally-profitable jewelry companies are more commonly valued based on the value of their current assets (accounts receivable and inventory).

The starting point for value is the company's operating cash flow. This is commonly described as Earnings Before Interest Taxes Depreciation and Amortization, or EBITDA. This represents a common basis of comparison of cash flows for all companies regardless of the amount of debt that they have on their balance sheet, because it measures earnings before interest expense. It is also comparable for companies with different tax liabilities because it measures earnings before taxes. Finally, depreciation and amortization expenses are accounting entries that have no cash effect on earnings. Most companies in the jewelry business have relatively low depreciation and amortization expenses.

Earnings Based Value. Profitable companies are often valued as a multiple of EBITDA. Private companies typically are sold for an EBITDA multiple that increases by the size of the earnings. A typical range of earnings based valuation for jewelry companies is shown as the grey-shaded area in the chart. A company with EBITDA of \$1 million could expect a valuation in the range of 3 to 5 times, for a value between \$3 million and \$5 million. Larger companies will draw larger multiples, with a \$3 million EBITDA company expecting a value in the range of 4.5 to 6.5 times earnings.

Asset Based Value. The jewelry industry is somewhat unique in valuation because the value of accounts receivable and inventory are easily determined and can be converted to cash quickly. This means that companies that are not profitable, or even those that are losing money, will have a floor value determined by the current marked value of their inventories and receivables. This bottom limit is shown by the black line on the valuation chart.

Value Drivers. Companies that are involved in strategic mergers and acquisitions in the jewelry sector can look to certain fundamental value drivers. Acquiring companies should look for these in the companies that they buy; selling companies should focus the negotiations on highlighting these attributes.



- **Large companies are worth more.** As the table shows, larger earnings driver larger valuation multiples. Small companies are worth more to large company buyers simply because their earnings are valued at a higher multiple. This is in addition to the cost savings that are derived from a successful merger.
- **Market channels have value.** Proven market channels that bring a buyer access to new customers add value to the seller's company.
- **High margins bring a premium.** Higher than industry average gross margin and operating margin indicate a well-run company with strong market position. High-margin companies have higher value compared to companies with similar earnings but at lower margins.
- **Asset efficiency is important.** The jewelry business typically carries high customer receivables and in inventories. Those companies with a lower asset-to-sales ratio are typically valued at the higher end of the range because it takes less invested capital to support their earnings.
- **Assets are a floor.** Even companies that are not profitable can be sold for a price that relates to the value of their assets. Quality of accounts receivable and of inventory will determine the exact percentage of those assets that will be valuable to a buyer.
- **Consistent history.** Companies with a consistent history of profits attract more buyer value than those with an up-and-down record.

ABOUT CORPORATE FINANCE ASSOCIATES

This **Industry Spotlight** report was prepared by the Minneapolis office of CFA as a service to owners of companies in the Jewelry manufacturing and distribution sector. The information contained herein is derived from public sources and incorporates analysis and conclusions from CFA's research department. If you have any comments or corrections, we would like to hear from you directly. For further information, contact:

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