OPERATING ENVIRONMENT

The operating environment for retail businesses worldwide was still shrouded by economic uncertainties and depressed market sentiment. The continued global economic slowdown and the emergence of economic slumps in various countries had continued to wreck consumer confidence and consumption power. The Hong Kong retail industry inevitably suffered, in particular after the 911 events in the US, which aggravated the already shattered market confidence. On the other hand, Mainland China's retail industry was hailed by relative stable growth in consumption power, with retail sales of consumer goods rose by 10.1 per cent in 2001. As a result, the Group's shoes business in Mainland China benefited from the strong domestic market demand, and reported a slight increase in turnover during the period under review.

OPERATING RESULTS

During the year ended 28 February 2002, the Group's operating results continued to be adversely affected by the disappointing performance in the Hong Kong retail market. During the year under review, the Group's total turnover fell by 6 per cent from that of the previous year to HK$335 million, and the Group reported a loss attributable to shareholders of HK$64 million, as compared with a profit attributable to shareholders of HK$5 million in the financial year 2001.

Factors accounted for loss attributable to shareholders:

(1) provision of inventory was HK$15 million, representing an increase of HK$12 million from that of the previous year;

(2) revaluation deficit of HK$21 million on investment properties and impairment of other properties amounting to HK$19 million were introduced for accounting purposes;

(3) a loss after taxation but before provision of inventory, revaluation deficit and impairment of other properties of HK$16 million was incurred by Le Saunda Holdings Limited and its subsidiaries, against a net profit after taxation but before provision of inventory of HK$10 million of the previous year; and

(4) a profit after taxation of HK$7 million (2001: a loss after taxation of HK$2 million) reported by the jointly controlled entity during the year helped partially mitigate the Group's loss attributable to shareholders.

The Group increased its provision for inventory because specific provision amounted to HK$11 million was required for some of the goods with anticipated net sales proceeds below cost as of 28 February 2002.

During the year, revaluation deficit and impairment provisions were considered to be necessary to reflect the market value of the Group's properties in Hong Kong and Mainland China.

OPERATING RESULTS *(Continued)*

The disappointing operating results of Le Saunda Holdings Limited and its subsidiaries during the year were mainly due to decrease in gross profits by HK$53 million and an increase in finance costs of HK$1 million. However, the Group also reduced its operating expenses and taxation provision by HK$23 million and HK$5 million, respectively.

Reasons for decline in gross profit and operating expenses:

During the year, the Group's total turnover fell by 6 per cent from that of the previous year, as a result of price reduction to stimulate demand amid depressed market sentiment in Hong Kong and severe competition in Mainland China. Other price-cutting measures had also been used, including warehouse sales in Hong Kong to boost sales of slow-moving items.

The Group also cut back its production volume during the year to align with its efforts in lowering excessive inventory level. Despite reduced output level, the Group's fixed production overheads resulted in an increase in average unit cost of products produced during the year. Together with the high unit cost of the closing stock of the previous year, the average unit cost of sales for the year under review increased from HK$144 of the previous year to HK$163. As a result, the Group's gross profit margin reduced by 13 percentage points from the previous year to 39 per cent for the year ended 28 February 2002.

As a result of reduced turnover and gross profit margin, the Group's gross profit substantially decreased by HK$53 million from that of previous year to HK$131 million for the year under review.

During the year, the Group's operating expenses excluding the provision of inventory, revaluation deficit and impairment of other properties dropped by HK$23 million from that of the previous year to HK$149 million, mainly as a result of decreases in advertising expenses, shop rentals and selling commission by HK$9 million, HK$2 million and HK$3 million, respectively. Other factors accounted for the decline in the Group's operating expenses included: no provision required for closure of relevant retail shops and write-off of fixed assets due to the termination of e-commerce business; an exchange rate gain of HK$1 million for the year under review due to depreciation of Italian Lire to Hong Kong dollars, when compared with an exchange loss of HK$1 million in the previous year, and a decrease of HK$2 million in fixed assets depreciation.

BUSINESS REVIEW

Shoes operations, with a turnover of HK$334 million, remained as the Group's core business during the year under review. In the same year, the Group's principal markets were Mainland China and Hong Kong, which accounted for 54 per cent and 42 per cent of the Group's total turnover, respectively.

Shoes operations

Mainland China

The Group's shoes business in Mainland China achieved a modest improvement in turnover as a result of escalating consumption power, particularly in second-tier cities, and growing domestic interest in fashion and brand-name products. Turnover of the Group's mainland shoes operations amounted to HK$180 million, representing a slight increase of 1 per cent from that of the previous year.

To enhance its market penetration and profitability, the Group had been exploiting the booming second-tier cities through franchising. Revenue from its franchised outlets accounted for 36 per cent of the Group's shoes retail business sales in Mainland China for the financial year under review. During the year, the Group had also successfully launched a new brand name, Comfort & Easy **(CnE)**, a ladies' shoes and handbag line in Japanese style. However, market competition and the overstocking pressure from its mainland operations had forced the Group to lower its prices to boost sales and to reduce its output volume during the year. As a result of the price cut and rise in average unit cost of sales, the operating profit before inventory provision and revaluation deficit of the Group's shoes business in Mainland China for the year under review amounted to HK$21 million, down by 42 per cent from that of the preceding year.

Hong Kong

Under the rigorous retail market conditions in Hong Kong, the Group's turnover from its Hong Kong shoes operations was HK$140 million for the year, representing a decline of HK$28 million as compared with that of the previous year. The decline was mainly attributable to the continued economic slowdown and the 911 events, which had worsened consumer sentiment. As a result, the Group had to lower price to boost sales. In addition, the Group launched warehouse sales, where prices of slow-moving items were significantly reduced, to ease the pressure of overstocking. Owing to the price-cutting measures and warehouse sales, the operating loss before provision for inventory and diminution in property value from the Group's Hong Kong shoes operations for the year was HK$35 million, increased by 61 per cent from that of the previous year. However, the resulting lower inventory is expected to improve the Group's liquidity and help pave the way for greater flexibility in developing and launching new products.

BUSINESS REVIEW *(Continued)*

Shoes operations *(Continued)*

Manufacturing

During the year, the Group produced about 841,257 pairs of shoes, and 86,702 pieces of handbags, representing a decrease of 33 per cent and an increase of 149 per cent respectively from those of the previous year. The sales to production ratios of shoes and handbags were 1.25 and 0.97 respectively for the year, reflecting the Group's substantial effort in reducing its inventory.

Based in Shunde, the PRC, the Group's production facilities occupy an area of 8,262 square metres. With fully vertically integrated production processes, the production plant has an annual capacity of 1.56 million pairs of shoes and the capacity of 93,600 pieces of handbags per year. During the year under review, there were about 700 skilled labourers, working under the guidance of experienced Italian footwear engineers. The Group had engaged a team of engineers in product research and development and designers in its PRC facilities and Italy respectively.

Other businesses

Cosmetics

Since September 2001, the Group has been operating its cosmetic business in Mainland China under its own brand name **Right Angle**. The Group is engaged in the selling of colour cosmetics, which comprise lipstick, eyeliner, powder, etc. The well reception of **Right Angle** is mainly attributed to the formulae and raw materials used to make its products. **Right Angle** uses formulae adopted by manufacturers of renowned branded cosmetics and raw materials imported from countries such as France and Italy. During the year under review, the Group's turnover and operating loss from its cosmetics operations was HK$1 million and HK$4 million respectively.

Property development

During the year under review, the Group's jointly-controlled entity in Mainland China, Shunde Shuang Qiang Property Development Co Ltd ("Shuang Qiang"), reported a net profit after taxation of HK$14 million, of which the Group's share amounted to HK$7 million. As at 28 February 2002, the Group's cumulative share of profit from the jointly-controlled entity amounted to approximately HK$30 million.

BUSINESS REVIEW *(Continued)*

Other businesses *(Continued)*

Property development (Continued)

The following table sets out the net profit after taxation generated by each of the property development project since the establishment of Shuang Qiang:

Project	**Net profit after taxation For the year ended 28/2/2002** HK$ million	**Net profit after taxation From 21/4/1994 to 28/2/2002** HK$ million
Nanyuan Business Street	1	18
Fu Li Hua	8	20
Xingye Lou	–	2
Yuejin Lu	–	2
Dongji Lu	–	10
Shuangqiao Lu	–	1
Nanyuan Garden	3	4
Fengying Lou	2	2
TOTAL	14	59

Apart from Shuang Qiang, the Group also owns 25 per cent interest in the "Flower Community Country Garden" project in Guangdong Province, the PRC. As at the end of February 2002, about 78 per cent of Flower Community Country Garden have been sold for RMB1.2 billion. However, since no dividend from the "Flower Community Country Garden" project had been distributed during the year under review, there had been no record of dividend income for the year. As at the end of the year under review, the Group's cumulative share of profit from the "Flower Community Country Garden" project was estimated to be not less than HK$9 million.

In November 2001, the Group purchased a plot of land in Shunde, the PRC, for residential property development. The site area and gross floor area of this project is 30,000 square metres and 75,000 square metres, respectively. The project will be developed in two phases, with construction work scheduled to commence in the second half of 2002.

Property development is a non-core business of the Group. The Group intends to maintain the activity of property development with financial return from the property operations, and has no intention to have a fresh capital injection into this line of business.

MANAGEMENT DISCUSSION & ANALYSIS

FINANCIAL POSITION

As of 28 February 2002, the Group's financial position remained sound and healthy. Its current ratio and quick ratio were 2.2 and 1.0 respectively as of 28 February 2002, against 2.4 and 0.5 respectively as of 28 February 2001. Cash and bank balances were HK$61 million as of 28 February 2002, compared with HK$24 million as of 28 February 2001.

The Group's inventory turnover improved from 229 days in the year ended 28 February 2001, to 95 days in the year under review. The adjustment of 134 days in inventory turnover period and 154 per cent increase in cash and bank balances from those of the previous year were mainly due to substantial decline in inventories from HK$178 million as of 28 February 2001, to HK$81 million as of 28 February 2002. The sharp reduction in inventories was largely attributed to the Group's price-cutting measures and strategic warehouse sales.

The Group's total bank borrowings were HK$51 million as of 28 February 2002, compared with HK$40 million as of 28 February 2001. The Group's net worth amounted to HK$363 million as of the end of February 2002, representing a decrease of HK$72 million over that of the previous year. The change was mainly due to the loss incurred for the year under review. As a result of the substantial decrease in net worth and slight increase in total bank borrowings, the Group's gearing ratio stood at 0.140 as of 28 February 2002, as compared with 0.093 as of 28 February 2001. The calculation of the Group's gearing ratio was based on the bank borrowing of HK$51 million and net worth of HK$363 million.

Bank loans and overdraft were borrowed in Hong Kong dollars, Renminbi, Italian Lire and Euro. The annual interest rate of the borrowings at the current financial year end ranged from 3 per cent to 6 per cent. Forward contracts were used, if necessary, for hedging of purchases from overseas, related debts and bank borrowings. With regards to Renminbi currency exposures on revenues generated or assets located in the Mainland China, surplus cash was remitted to Hong Kong and converted to Hong Kong dollars, our base currency, as soon as possible. In addition, working capital requirements for business in the Mainland China were financed by local banks loans denominated in Renminbi as far as possible for hedging purpose.

FUTURE PLANS

In the current financial year, the Group will implement its new supply chain management to enhance cost-effectiveness and deepen market penetration. To achieve these objectives, the Group will introduce new shoe models to the market on a regular basis.

Design

In view of the continued demand for new designs, the Group will commission design houses in Italy, in addition to its in-house designers. This will not only allow the Group to enhance its ability in innovation, but will also lower fixed overheads.

FUTURE PLANS *(Continued)*

Manufacturing

With the trend for short product life cycle and the Group's focus on new product launch, the Group will start to outsource some of its production activities to select contractors in 2002. The Group will evaluate factors such as cost-effectiveness, order deliverability and techniques to meet special requirements, to determine whether to outsource or to produce shoes by its own manufacturing unit. Such an arrangement will not only increase the Group's flexibility in responding to market changes, but will also stimulate its own manufacturing unit to increase competitiveness in terms of efficiency and cost-effectiveness.

During the current year, the Group's manufacturing unit will, for the first time, be transformed into a profit centre by taking intra-group orders and providing original equipment manufacturing ("OEM") services to outside shoe producers from Japan and Europe, etc. Established for more than a decade, the Group's manufacturing unit is well equipped with sophisticated imported machinery and housed about 700 skilled labourers, which are under close supervision of seasoned Italian footwear engineers. The Group intends to strengthen its manufacturing quality to become comparable with international advanced level, and thus enhance the Group's edge in extending OEM services to more overseas producers.

In addition, the Group will continue to implement the just-in-time procurement programme to ensure timely delivery of raw materials and effective control on stock and cash outflow. The Group will also streamline its procurement processes and expand its sourcing network in a bid to secure steady supply of quality materials at competitive prices. All this is expected to further reduce the Group's operation costs.

Marketing

The Group will accelerate the promotion of its brand name awareness and market penetration through expanding retail network and appointment of new franchisees. In Hong Kong, the Group plans to open at least 13 new stores during the current year, and to achieve the target of more than 40 shops in two years. In Mainland China, the Group will continue to look for new franchisees, particularly in the second-tier cities of Mainland China. By increasing its franchise network, which now comprises more than 70 franchisees, the Group expects to benefit from economies of scale. Meanwhile, the Group also plans to set up additional counters and self-operated stores in major cities of Mainland China to capitalise on the relatively affluent population.

FUTURE PLANS *(Continued)*

Sales training and services

During 2002, the Group will intensify sales training and implementation of incentive scheme across all departments in an attempt to improve sales services and overall performance. Since early this year, the Group has commenced a sales incentive scheme, which has been proved highly effective with satisfactory sales results achieved since its introduction. The Group's incentive schemes, which include bonus distribution policy, commission programme and share options plan, are expected to further boost staff morale. In addition, the introduction of the bonus distribution policy will not only serve as a stimulus, but will also help the Group reduce fixed overheads via lower basic salaries, while achieving monthly sales targets. The Group intends to complete implementation of incentive schemes throughout the entire organisation by the end of 2002. In addition, the Group will continue to reinforce its sales training to provide value-added services. Such training includes footwear knowledge and the composition of different footwear.

Cosmetic

The Group will continue to strengthen the promotion of its brand name **Right Angle** and market penetration in Mainland China in 2002 through expanding its product range and market coverage. During the current year, the Group may introduce a full line of skin care and spa products under **Right Angle** to tap in the burgeoning beauty care market in Mainland China.

PROSPECTS

Given that the slow recovery of the Hong Kong's economy and the intensified market pressure resulting in shorter product life span and demand for higher quality services, the Group will continue to explore new measures to weather the aforesaid challenges and further improve its gross profit margin.

The Group intends to take advantage of the local sluggish economy to expand its market shares. With relatively lower rental and stable wages, the Group plans to open more new shops in Hong Kong. Besides, the Group will tap into the "fad" characteristic of the Hong Kong market by introducing new products on a regular basis.

PROSPECTS *(Continued)*

With respect to the shoes business in Mainland China, the Group expects to achieve continued growth in sales, given that the enormous market and consumer's willingness to spend on fashion items there. The Group will continue to look for opportunities to open more franchise shops in the booming second-tier cities to enlarge its PRC market shares.

The Group's cosmetic business is also expected to experience steady growth. The Group has launched colour cosmetics since September 2001 in collaboration with a well-established cosmetic OEM manufacturer. Leveraging the OEM and **R&D** capabilities of its business partner, the Group is in the process of developing new cosmetic products. The Group may launch a skin care and spa products by the end of 2002.

The Group aims at becoming a multi-brand operator for various fashion products, including shoes, handbags and other accessories, and cosmetics etc, which allows the Group to cater to the various needs of individual customers. The Group envisages its strength in brand name products will expand its market share in Hong Kong and Mainland China, and will enhance its profitability in the long run. To this end, the Group will continue to explore appropriate brand-name products for introduction in the Hong Kong and Mainland China markets.

With the transformation of its manufacturing unit into a profit centre, the Group is not only broadening its income base, but is also paving way for the development of OEM business. In the long run, the provision of OEM services, which require continued quality enhancement, will serve as the springboard for the Group to move to a major international footwear manufacturer in its own right.