THE OPERATING ENVIRONMENT

In 2002, the world economy remained sluggish and the Asian economies were slow to recover, which has been the case ever since the Asian financial crisis. In Hong Kong, where there was no sign of an upturn for the property market and added on top the aftermath of the 911 incident, consumption power continued to be weak and consumer confidence has even become a top social-political concern for the community. As a result, the retail industry in Hong Kong has not yet seen the end of the tunnel, so to speak, and "survival" has become the name of the game for all retailers during the Year.

The only bright spot in Asia lies in Mainland China, which is one of the world's fastest growing economies. In 2002, Mainland China achieved an impressive GDP growth of 8%, the highest in Asia Pacific. The country's accession to the World Trade Organisation has further fuelled consumer confidence. For Hong Kong retailers, Mainland China has indeed become the "land of opportunity".

For the Year under review, the Group's operating results have, to a large extent, reflected the above-described environmental scenario.

OPERATING RESULTS

For the year ended 28 February 2003, the Group's performance in the Mainland China market remained solid and hopeful, whereas in Hong Kong, its performance continued to be adversely affected by the poor consumer climate. Partly because of the cushion of the Mainland China market and partly because of more outlets added in Hong Kong during the Year, the Group managed to achieve a total turnover of HK$312 million, merely a decrease of 7% compared with that of the previous year.

As a result of the Group's margin improvement efforts, gross profit increased from the previous year's HK$131 million to the Year's HK$136 million, a slight improvement of 4%. But such a gross profit gain still could not offset the selling and distribution costs of HK$117 million and the general and administrative expenses of HK$59 million, resulting in an operating loss of HK$19 million (2002: HK$70 million).

Overall, the Group reported a loss attributable to shareholders of HK$24 million (2002: HK$64 million). The improvement in net loss for the Year was primarily because of the following factors:

1. A slight increase of HK$5 million on gross profit as mentioned above;

2. A dividend income from other investment of HK$19 million was received for the Year (2002: nil);

3. For the previous year, a total amount of HK$55 million of "other operating expenses" were incurred due to provisions for inventories of HK$15 million, revaluation deficit on investment properties of HK$21 million and impairment of other properties of HK$19 million. However, there were no such items in the Year;

4. The above gains were, however, mitigated to a certain extent by increases in "selling and distribution costs" and "general and administrative expenses" which went up by HK$28 million in total versus those of the previous year; by reduction of "share of profit of jointly controlled entity" by HK$9 million; by the provision of HK$16 million of additional value added tax payable as mentioned in note 24(a) to the accounts; and by taxation charges which increased by HK$3 million.

Firstly, gross profit improved primarily because of the Group's margin improvement strategies adopted, including expanding its sourcing network to obtain better prices and higher qualities of products, streamlining its procurement processes, and implementing effective inventory and cost controls. Availability of higher-quality products has also allowed us to sell at higher selling prices and less discounts. Secondly, the above-mentioned "dividend income from other investment" of HK$19 million was from its investment in 25% interest of the "Flower Community Country Garden Project" in Mainland China. Finally, "selling and distribution costs" and "general and administrative expenses" increased mainly due to higher staff salaries and commissions and higher rent and rates, both due to more outlets opened in Hong Kong and Mainland China, especially for *CnE*.

BUSINESS REVIEW

The Group's main markets were Mainland China and Hong Kong, accounting for 59% and 35% of the Group's total turnover respectively. Shoes operations, with a turnover of HK$304 million, remained as the Group's core business during the Year.

MAINLAND CHINA

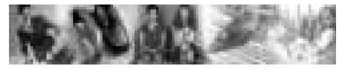
Shoes Operations

The Group's shoes business in Mainland China remained stable. The Mainland China footwear market was highly competitive, and the Group had to adjust its prices to boost sales, resulting in a slight turnover decrease despite a significant volume increase of shoes sold.

After the Group's hard work for a number of years in this market, we have built up a significant market presence and have cultivated significant market recognition of our three brands: *Le Saunda萊爾斯丹* and *CnE* for shoe products, and *Right Angle* for cosmetics.

CnE carrying a Japanese-styled series of shoes and handbags, is a new brand launched in the second half of 2001. With an increasing number of *CnE* outlets in Mainland China to date, the Group intends to target the brand to the mass market, whereas *Le Saunda萊爾斯丹* will be targeting the middle to upper-middle market segment.

Our Mainland China operation also consists of a number of committed and experienced franchised partners in the country. The Group has been relying on franchising as a way of expansion in Mainland China. For the Year, a significant portion of revenues of the Group's shoes business in Mainland China was derived from franchised outlets. It is the Group's intention to continue to rely on its franchisees for rapid network expansion, primarily in the form of sales outlets in second-tier cities, while the Group's own operation will focus on deploying stand-alone *Le Saunda萊爾斯丹* stores in major cities.



Manufacturing

Based in Shunde, Mainland China, the Group's manufacturing facilities occupy an area of 8,262 square metres. With fully vertically integrated production processes, the 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, there were around 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 Mainland China facilities and Italy respectively.

The plant has successfully emerged into a profit centre by engaging in OEM production for external customers from Japan, Europe, etc. Over the long term, the Group hopes to allocate 50% of the plant's production capacity for outside orders. This will not only enhance the economic efficiency of the plant but will also enable the Group to broaden its income base.

Cosmetics

Since mid-2001, the Group has been operating its cosmetics business in Mainland China under its own brand name, *Right Angle*. The Group engages in the sale of colour cosmetics, comprising lipstick, eyeliner, powder, etc. *Right Angle* uses formula adopted by manufacturers of renowned branded cosmetics and raw materials imported from countries such as France and Italy.

During the Year, the Group achieved a turnover of HK$2 million from its cosmetics business. As the business is still in a development stage, an operating loss of HK$3 million was recorded which, however, was a 20% improvement over that of the previous year. It is the Group's plan to further expand the network, to re-focus on colour products and to re-brand its image to target young females in Mainland China.

Property Development

During the Year, the Group's jointly controlled entity in Mainland China, Shunde Shuang Qiang Property Development Company Limited, reported a net profit after taxation of HK$2 million (2002: HK$14 million), of which the Group's share amounted to HK$1 million (2002: HK$7 million).

陽光花園, a residential property developed by the Group's Shunde-based wholly-owned subsidiary, 順德市信達房地產開發有限公司 is under construction and presale was commenced in January 2003. The Group has accounted for the turnover and result in proportion to the actual completion of the residential property in the Year.

Property development is a non-core business of the Group. The Group does not intend to further invest in this business in Mainland China, where it will continue to focus on the shoes and cosmetics operations.

HONG KONG

Amidst a harsh retail environment, the Group recorded a turnover of HK$108 million for the Hong Kong shoes operation, a 23% drop versus that of the previous year. Despite the decrease in turnover, the Group was able to increase its gross profit significantly, primarily through selling more higher-priced quality shoes and adopting other gross margin improvement strategies such as tighter inventory control and shorter replenishment cycles. The latter has succeeded in minimising inventory level at season's end, thus substantially reducing sales of discounted items for disposing of stale stocks.

Overall, the Hong Kong shoes operation made a net loss of HK$25 million, an improvement of 68% over that of the previous year.

During the Year, the Group has opened a number of new stores in the Hong Kong market. While this has enabled the Group to increase sales in newly developed residential and commercial areas, weak initial traffic in these areas and weak consumer sentiment in Hong Kong in general have lowered the cost efficiency of our new stores. The Group is attempting to launch aggressive advertising and promotions, while optimising its shoes inventory in terms of available quantities and styles so as to enable each store to generate substantial sales for each and every promotion campaign. For the future, the Group will streamline its network to fewer, larger stores at key locations.

OTHERS

The Group operates *Le Saunda* stores in Macau and engages in shoes export to other countries including Japan, Russia, Italy, the UK and the USA. Turnover from Macau operation and exports increased from HK$14 million in the previous year to HK$20 million in the Year. The Group also plans to expand to other Southeast Asian markets through franchising and a strategic plan is being drawn.

FINANCIAL POSITION

As of 28 February 2003, the Group's financial position remained sound and healthy, with a current ratio of 2.9 (2002: 2.2) and a quick ratio of 0.9 (2002: 1.0). Cash and bank balances totalled HK$43 million (2002: HK$61 million).

The Group's inventory turnover improved from 95 days for the previous year to 83 days for the Year, with the amount in inventory decreasing from HK$81 million to HK$60 million.

The Group's investment properties and other properties with net book value amounting to HK$43 million (2002: HK$44 million) have been pledged to secure bank loan facilities of HK$124 million (2002: HK$86 million) granted to certain subsidiaries of the Group. Out of such facilities, the Group's total bank borrowings were HK$2 million as of 28 February 2003, compared with HK$51 million as of 28 February 2002. The Group's net worth amounted to HK$346 million (2002: HK$363 million). As a result of substantial decrease in bank borrowings, the Group's gearing ratio stood at 0.01 as of 28 February 2003, as compared with 0.14 as of 28 February 2002. The calculation of the Group's gearing ratio was based on the bank borrowings of HK$2 million and net worth of HK$346 million.

Bank loans and overdrafts were borrowed in Hong Kong dollars, Renminbi, US dollar and Euro. The annual interest rate of the borrowings during the Year ranged from 2.75 per cent. to 6.5 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 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 Mainland China were financed by local bank loans denominated in Renminbi as far as possible for hedging purpose.

The Group believes that its cash holding, liquid asset value, future revenue and available banking facilities will be sufficient to fund the working capital requirements.

During the Year, the Group did not have material acquisitions or disposals of subsidiaries or associated companies. In the coming year, there is no plan for material investments or change of capital assets.

CONTINGENT LIABILITIES

Details of contingent liabilities of the Group at the balance sheet date are set out in note 24 to the accounts.

EMPLOYEES AND REMUNERATION POLICIES

As at 28 February 2003, the Group has a total of 1,666 employees of which 187 are based in Hong Kong and 1,479 are based in Mainland China. Total staff costs including directors' emoluments and net pension contributions for the Year amounted to HK$75 million (2002: HK$60 million). The Group has structured training programmes provided for all employees. Outside consultants are also invited as lecturers to enrich the scope of the programmes.

Competitive remuneration packages commensurate with individual responsibilities, qualifications, experience and performance are structured. In addition, the Group has adopted a share option scheme for eligible employees of the Group.

PROSPECTS

With the outbreak of SARS in March 2003, the retail industry in both the Hong Kong and China markets will be severely affected. The Group does not expect that consumer spending, which was already weak in Hong Kong before the outbreak, will significantly improve in 2003. Starting from mid-May, the Hong Kong government and the community at large have initiated a number of campaigns aiming to restore people's morale and to encourage local spending. Some initial positive results are seen and it is hoped that the worst is over for the Hong Kong economy. In Mainland China, although the epidemic seems to have abated in major cities and provinces including Beijing and Guangdong, it is unsure how long SARS will continue to haunt the country as a whole. Overall, the coming year will be one of the most challenging years for the Group.

Notwithstanding the challenges ahead, the Group will adhere to its core corporate values of Quality, Style, Value and Service, and will aim to provide the best choice of products to its target customers. We will continue to adopt effective market development strategies to expand market penetration and increase sales on the one hand, and to streamline our operations so as to contain costs and enhance gross profit margin on the other hand. While with risks there are always opportunities, we also believe that difficult times are acid test of a fine business operation.

In Mainland China, the Group will strive for ongoing expansion, both for the shoes and cosmetics operations. We will strengthen our franchise network especially in second-tier cities while building more self-operated stores in major cities. Marketing efforts to reinforce our brand names will be actively pursued. A better incentive scheme will be devised to motivate our franchisees, requiring from them a shorter ordering period and offering them better profit margins. The Group will continue its two-brand (*Le Saunda萊爾斯丹 vs. CnE*) strategy in the Mainland China market for its shoes business, while continuing to explore appropriate brand name products for future introduction. Meanwhile, the *Right Angle* cosmetics chain will be further expanded, through re-focusing on colour products which appeal more to the chain's target customers, young females in Mainland China.

The Group will continue to develop its OEM business for the manufacturing plant in Shunde. Apart from broadening the Group's income base, the OEM business will also serve as a springboard for the Group to emerge into a major international footwear manufacturer in its own right.

The Hong Kong market will be the most challenging spot for the Group. The Group will take advantage of the large network and substantial brand awareness that it has built up all these years, and exploit the Group's economies of scale by launching cost efficient advertising and promotions campaigns so as to stimulate sales. Meanwhile, inventory management will be another key tool for the Group to weather through difficult times. How to provide strong inventory to reap the benefit of each advertising or promotion campaign but to minimise stale stocks at the same time will be a key to success for the coming years.