

# Management Discussion and Analysis of Results of Operations and Financial Condition

## Results

- Turnover

Group turnover dropped 48.7% to HK\$386.9 million. There were two major business segments that were reorganised in the year 2000 causing a reduction in the group sales figures, which together accounted for almost 87.0% of the shortfall.

The first and largest factor was the disposal of a 67.0% interest in Corich Enterprises Inc. ("Corich") to an independent third party, in December 1999. Corich is the company which controls the interests in the motor vehicle and accessories sales and service business and is primarily the "Ferrari" and "Maserati" marques. This meant that in the year 2000, the Group's interest in the business was treated as that of an associate, whereby the turnover of the business was not consolidated into the Group and only a proportion of the results derived therefrom, were taken into account on an equity accounting basis and shown as a share of results of associates. The loss of sales to the Group from this disposal accounted for 48.1% of the recorded fall in turnover in 2000 compared to last year.

The other major contributory factor to the fall in turnover was the downsizing of the direct marketing business which was proving to be an extremely competitive, high volume narrow margin activity. The reduction in sales brought about by the deliberate refocus of the business to a more periodical and promotional sales activity, was the second major factor and accounted for 38.6% of the shortfall.

Finally, the sales of all other largely consumer related business segments in the year continued to be affected by the economic downturn which has adversely effected the economies of Hong Kong and the other countries and markets in Asia. All businesses, without exception, therefore recorded sales lower in 2000, than in the previous year.

- Gross profit

Gross profit for the year amounted to HK\$106.0 million which was a gross margin of 27.4% on turnover. The gross margin improved significantly over last year when only 22.8% on turnover was recorded. The margin improvement was achieved through a combination of management action to focus on higher margin business, particularly in the commercial air-conditioning systems, and the change in sales mix of business in the year.

- Other revenue

Other revenue for the year mainly comprised of rental and commission income. Gross rental income for the year amounted to HK\$12.3 million, down 21.5% on rentals achieved last year, with the continuing decline due to lower rentals fixed on rent reviews and on re-lettings. Commissions in the year at HK\$5.8 million, compared with the HK\$8.9 million achieved in 1999 which was a 35.1% decrease as a result of the increasing competition in the room air-conditioners market of PRC.

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- Distribution costs, administrative and other operating expenses

Such expenses for the year amounted to HK\$178.1 million which was a 22.3% reduction on the HK\$229.2 million recorded in the previous year. Despite significant cost reduction achieved in the year principally by way of staff costs (down by 34.8% or HK\$31.2 million) and rental expenses (down by 55.7% or HK\$12.8 million), total expenditures remain too high for the level of business and further cost reductions are being effected in the new financial year.

- Loss from operations

Operating losses increased over last year to HK\$54.0 million. Losses occurred in all business segments except the Group's traditional core air-conditioning products distribution business. The business environment in Hong Kong and China for sales of consumer products remains sluggish and affected by the uncertain economic climate. In such circumstances, markets also have become more competitive, which has compounded the difficult trading conditions.

- Other income and expense items

- Finance costs

These increased to HK\$18.2 million, from HK\$13.6 million in the previous year. This was primarily due to the interest payments amounting to HK\$6.3 million to a major supplier for its financial support to the Group whilst it was interest free in the previous year.

- Provision for repurchase of a controlling interest in an associate

Owing to the untimely demise in May 2000 of the independent party who had purchased 67.0% of the Group's interest in Corich Enterprises Inc. ("Corich") in December 1999, the Group has exercised its buy-back option. As a result of which, a provision of HK\$22.6 million was made against the outstanding amount receivable from the independent purchaser. The purpose of this provision, allied with the write-back of provisions for the amounts due from Corich and its subsidiaries, of HK\$5.6 million, was to recognise the accounting adjustments to the Group necessitated in exercising the option rights which become effective in 2001. The transaction is expected to be completed in the new financial year, and this does mean that in 2001 the motor vehicle dealerships, of "Ferrari" and "Maserati", will revert to the Group as subsidiaries.



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- Associated companies

For fiscal 2000, profit before taxation shared from associates declined to HK\$3.4 million from HK\$18.8 million one year earlier. This was principally attributed to a bad debt provision amounting to HK\$19.0 million being made by Jin Ling Electrical Company Limited in recognising problem debtors in fiscal 2000. Furthermore, Mitsubishi Heavy Industries-Jinling Air-Conditioners Company, Ltd. also suffered from an exceptional loss due to write-off of fixed assets HK\$2.8 million and additional customs duties of HK\$5.9 million for exceeding the approved domestic sales limit.

## Liquidity and Financial Resources

As with previous years, the Group continues to be financed through a combination of internal cash flows; trade creditor support; and bank borrowings with both short and long-term maturities.

The Group continued to retire its trade and bank liabilities upon due dates, although the net cash and cash equivalent balances were reduced to HK\$1.0 million at 31st December, 2000.

Group working capital employed was a negative balance of HK\$87.3 million at 31st December, 2000 compared with a positive balance of HK\$94.9 million at the previous year end. The principal reason for this is the movement in short-term borrowings which increases year-on-year by HK\$135.7 million, primarily relating to the reclassification as short-term debt of an unsecured loan of HK\$131.0 million from a supplier with whom the Group has a long-term joint venture partner trading relationship, which loan falls due for repayment in December 2001. The future financing and repayment arrangements of this unsecured loan are currently under negotiation in the new financial year. The management is confident that a favourable agreement can be reached between the parties.

Total bank borrowings in the year were again reduced, and year-on-year by HK\$21.1 million or 13.8%, such that at 31st December, 2000 they amounted to HK\$131.6 million. As a percentage of total assets, bank borrowings at the year end were 15.1% and which showed continuing improvement over the level of 15.7% recorded at the end of the last financial year.

The total net borrowings of the Group continue to be reduced and at 31st December, 2000 were HK\$350.2 million compared with HK\$371.0 million at 31st December, 1999.

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## Business Reviews

- Air-conditioning products

Generally sluggish market conditions ruled throughout the year affecting product sales to both the mass consumer market and to the property developers' market. The Group was successful in maintaining market shares, although the total market and our total sales were slightly down. However, product prices were highly competitive especially in the mass consumer sector. Nevertheless, the Group's strategy to increase focus on commercial products and decrease reliance on the mass consumer market for window and split-type units, was successful with continuous improvement in overall margins. The year saw a strengthening of the project business with an expanded sales network through contractors and tenders.

"MHI" (the range of products from "Mitsubishi Heavy Industries" of Japan), for which the Group holds exclusive distribution rights for Hong Kong, Macau, (all products) and the mainland China markets, provides a full range of air-conditioning products for the packaged commercial systems and the consumer markets.

Satisfactory sales continue to be achieved by the other brand which the Group markets being "LG" of Korea.

Looking to 2001, prospects appear more encouraging at this time, as there is expected to be gradual improvement in both the Hong Kong and mainland China markets. The general recovery of the Hong Kong economy continues, with lower interest rates and better affordability ratios for property, with the market slowly improving, and in China the continued growth of the China market and the potential further stimulus of the entry of China into the WTO is encouraging. Given also, the continued excellent support of principals with improved new products, the prospects are for increased sales volumes and profit growth.

- Audio visual products

The Hong Kong and China markets were not good in the year and overall business was reduced. However, the total audio visual business is now more focused upon the Group's own brands of "Rogers" (from the UK) and "Bodysonic" (from Japan). Products have been developed under these brands in different product categories, and the range extension of product offerings, will continue to establish a wider distribution network for the brands. The growth being achieved in the new year is encouraging.



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- Car electronic products

The “Alpine” brand (from Japan) is one of the leading brands in the market, which the Group distributes, together with the developing products under the Group’s own “Rogers” brand of motor vehicle speakers. The business out-turn was similar to last year on sales turnover which was ahead of last year. Greater emphasis has been placed in providing products in the region in the OEM market, as the after-sales market has been fairly static, becoming largely a replacement market. Greater emphasis in the next year will be given to the brands by supplying higher-end product offerings.

- Other electrical and electronic products

Sales were maintained at a satisfactory level and the Group intends to add to the range of products and markets. “LG” remained the main brand in this business group with Hong Kong as the major market.

- Direct warehouse outlet marketing

This business, under the “Mega Warehouse” outlets, was cut-back further in the year, following extremely keen competition in the Hong Kong market for consumer electronic and electrical products. Trading was further re-focused in the new year, with the major outlet being relocated to Tsing-Yi, Hong Kong and a greater market concentration being given to special promotional sales. E-commerce has not become a significant marketing tool in the business as expected, and is unlikely to be a significant factor in any new future marketing programmes.

- Motor vehicle and car accessories distribution

In the year, this business was treated as an associate because of the sale of a controlling equity stake to a third party in December 1999. As noted elsewhere in the report, the person acquiring the Group’s interest has since passed away and, under the terms of sale, the Group is exercising its option to repurchase the shares, such that from the beginning of 2001 the business will once again become a 73.6% controlled subsidiary of the Group.

Trading in 2000 was very satisfactory and sales were increased by over 25.0%. As expected, the vehicles offered to the market under the “Ferrari” marque in the year, have been supplied to order to valued customers. The first new “Ferrari” 360 Modena Spider vehicles were supplied and orders are excellent. Similarly, the limited edition “Ferrari” 550 Barchetta was launched mid-year, with all units for delivery in 2001 being pre-sold.

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Sales of vehicles under the relaunched "Maserati" marque, showed remarkable increases and the two models available to the market, the "Maserati" 3200 GT and the "Maserati" Quattroporte have been well received by customers. A special edition "Maserati" 3200 GT Assetto Corsa will also become available in 2001 and the Group is confident that an increasing loyal group of customers will be established for the unique "Maserati" brand vehicles.

2001 is expected to be yet another year of increased sales and business for the two premier, luxury brands of "Ferrari" and "Maserati" and the Group is also excited by the potential prospects for these marques in the China market, more especially after China gains WTO status.

## Personnel

At the year end 2000 the total number of employees of the Group, excluding associates, was 293 (1999 was 423 people). This was a 30.7% reduction in headcount whilst total staff costs decreased by 34.8% and this was mainly due to the change in status to associated company of the motor vehicle distribution business. It is of increasing importance to the business that operating and staff efficiencies improve further. However, the Group recognises the importance of its employees and has been fortunate to retain a core of loyal, experienced and dedicated people and a management team that has remained stable and committed throughout the year.

## Prospects

The year of 2000 proved disappointing for the Group. Revenues in all business sectors were under pressure and the direct marketing and e-commerce businesses did not contribute as expected.

Looking to 2001, the prospects appear better for virtually all the business segments in which the Group operates. The Group has an established name and reputation in its markets and is positioned to be one of the market leaders in marketing and distribution of consumer products in Hong Kong, Macau, mainland China and certain other markets in South East Asia. There is still some rationalisation of the business to be completed, but the Board is cautiously optimistic that 2001 will turn out to be the year which marks the re-establishment of the business on the track of sound growth in revenues and profits.

**Barry John Buttifant**

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Hong Kong, 28th May, 2001

