management discussion & analysis

INDUSTRY REVIEW

The beginning of 2001 saw a sharp reversal in the economy from the gradual recovery the Asian region enjoyed in 2000. The technology boom driven recovery proved to be a house of cards and as the Internet bubble burst, the fragile local economy ebbed and began a year long decline. The 911 terrorist attack in US destroyed any hope for a recovery in the second half of the year.

The prolonged hardships precipitated in a vicious cycle that resulted in increasingly cautious consumer spending. Economic figures released by the Government's Census and Statistics Department indicated that the total retail sales in December 2001 dropped by 5.4% in value and 3.3% in volume when compared with December 2000, while the Composite Consumer Price Index for December 2001 declined by 3.6% when compared with December 2000. The deflation created increasing pricing pressure that in turn precipitated progressively more difficult retail environment. Hong Kong's economy was more depressed than anytime in recent years. The unemployment rate reached its historic high to 6.1% in the fourth quarter of 2001.

As a result, across many segments in retail and service industries, consolidation took place leaving only those with the requisite economy of scale, efficiency and cost leadership to survive.

FINANCIAL REVIEW

Despite the backdrop of dire market conditions, 2001 was a momentous year for Pricerite. Our Board is pleased to report that for the nine months ended 31 December 2001, the re-engineering efforts that began in April 2000 rewarded us with unabated growth in turnover and net profit attributable to shareholders. The results reflected our increasing ability to enhance our competitive edge with astute market positioning and pricing strategy, the brand recognition and the consumer goodwill we enjoyed, together with the underlying strength we built into our business. In March 2001, Pricerite became a proud member of the CASH Group. To follow the reporting policies of the CASH Group, we changed our financial year end from 31 March to 31 December.

Against such overwhelming odds, we nevertheless recorded satisfactory performance for the nine month period under review with turnover of HK$748.6 million. Our net profit after tax for the nine month period was HK$14.6 million, representing a 6.8% increase when compared with twelve months last year. The combination of our effective marketing and promotion programs, our successful product development and merchandising, our strategic points of presence together with the reduction in operating costs contributed to the growth in the net profit.

During the period under review, we opened 7 new retail outlets in strategic locations including Wong Tai Sin, Taipo, Tin Shui Wai and Sheung Shui on which we had conducted in-depth research to confirm high customer traffic. As part of our strategic plan, we closed 5 retail outlets upon lease expiry. At present, our network boasts a total of 43 retail outlets.

Sales Breakdown

In terms of our product mix, household products and furniture accounted for HK$439.7 million or 58.7% and HK$308.9 million or 41.3% respectively of our total sales of HK$748.6 million for the period under review.

The five largest product categories by sales value for our household products were Self-assembled Furniture, Bathroom, Home Fashion, Tools and Racks, and Electrical Products. According to a recent market survey conducted by ACNielsen, our Self-assembled Furniture, Movable Storage Accessories along with Tools and Racks products enjoyed leading market share in terms of value in Hong Kong. The same study also reviewed that we ranked first in Guest Room Cabinet in the furniture products category by market share in terms of value in Hong Kong.

Financial Position

In 2001, we successfully completed a share placement and a rights issue on 19 July and 22 November, raising a total of HK$163.7 million. This, together with the satisfactory results for the period, further increased our total net assets from HK$133.0 million on 31 March 2001 to HK$309.1 million on 31 December 2001. Our cash and bank balances substantially increased by 1.2 times from HK$76.8 million on 31 March 2001 to HK$165.5 million on 31 December 2001. During the period, our total bank borrowings were reduced by HK$21.8 million to HK$20.3 million and our liquidity ratio improved to 1.7 times. Our working capital further improved as a result of an improvement in inventory turnover, with turnover days dropping from 33 days in the last year to 32 days in the current period under review.

On 31 December 2001, the ratio of total bank borrowings to shareholders' equity was substantially reduced to 6.6% from 31.7% on 31 March 2001. Improvement in our Group's gearing was primarily attributed to better credit terms offered by the suppliers, shortened stock turnover cycle and the funds raised during the last financial period. Our solid financial positions along with continuously improving working capital kept our Group's interest rate exposure to a minimum. In addition, as both our Group's payments and operating revenue were mostly in Hong Kong dollar, our exposure to foreign currency fluctuation was insignificant.

As at 31 December 2001, leasehold properties at their carrying value of approximately HK$71.0 million and bank deposits of HK$8.5 million were pledged to secure general banking facilities granted to a subsidiary. At the end of the period, our Group's contingent liabilities in respect of the long services payments required under the Employer Ordinance of Hong Kong amounted to approximately HK$5.3 million. We have no other material contingent liabilities at the year end.

We believe that our sound liquidity position, steady internal cash generation capability together with the conservative capital structure allow the Group to seize new opportunities in Hong Kong and China as the economic recovery takes place.

Our Group will continue to expand our retail network by opening new shops at strategic locations. At the same time, we are prepared to venture into the China market to tap her phenomenal business opportunities to drive our growth. With our strong financial foundation, we enjoy sufficient funding to finance our strategic expansion in Hong Kong and our ventures into China.

BUSINESS REVIEW

To achieve our financial success during this period, we reviewed and sharpened the five key weapons that any retailers needed to survive and win in the retail world: brand power, product mix, logistical strength, customer service and shopping environment. To ensure quantifiable results in our effort to build a stronger company, we implemented the "Balanced Scorecard Program", a scientific Management By Objective approach, to measure our specific performance in these five key elements.

Mapping Our Strategy

To achieve our mission, we had to be a market innovator rather than a market follower. Sporadic flashes of entrepreneurial insights and inspiration would not bring about a healthy, consistently growing business. To map out our strategy, we continued to engage independent market research agencies to conduct market studies to enhance our appreciation of changing customer needs and expectations in order to review and refine our market positioning and strategy. Ongoing "mystery shopper" surveys at our stores conducted by these agencies helped us monitor and gauge customers' shopping experience and our customer service. To further improve our understanding of our customers, additional feedback channels such as opinion boxes and customer hotlines were installed to link us directly with our customers. A detailed review of our network distribution and consumer demographics together with pedestrian traffic flow helped identify new geographic locations for our expansion.

Strengthening Our Brand Power

Customer promiscuity is the bane of our new retail reality. Last year, we continued our efforts to become the destination shop for value-for-money home improvement products. We aimed to extend our brand promise and become the most preferred retail brand in the sector. Our commitment to build Pricerite into the most endearing household brand continued. We adopted a total brand management approach that synchronised advertising and promotion with product development, improvement in product quality, enhancement in store design as well as shopping experience.

Although our "Everyday-Lowest-Price" initiative enjoyed great success, we needed a campaign which should be more strategic in nature to transform the Pricerite brand name into an enduring and most preferred brand. We worked on a new advertising campaign that better conveyed our significantly enhanced product and service offerings and launched our "New Ideas from Pricerite; New Page for Modern Life" television commercial and print advertisement campaign. The campaign was built around a carefully selected celebrity couple as our role model and ambassadors to convey the warm, fresh quality living that Pricerite represented. Our slogan "Your Lifestyle at Your Price" was further reinforced in this campaign. This tactical focus would be maintained as previous sales and promotional campaigns showed favourable consumer responses.

Enriching Our Product Mix

Our strategy to become the destination shop for value, quality and lifestyle products was built on a dynamic and ever-broadening range of products. We placed great emphasis on new product designs that addressed our modern household needs and quality of life. We also increased our product variety to offer more choices for customers and to cater for the dispersed consumer needs.

To this end, we continued to strengthen our product development function to consolidate our efforts made in 2000. To provide more choices to our customers, we substantially expanded our product categories and ranges with active stock keeping units increased by over 30%. By increasing direct sourcing, we improved the quality of our product range while maintaining competitive pricing. Geographically speaking, we implemented global sourcing with diversified suppliers from Asia, Europe, US, and Greater China. We continued to increase our supply channels and sources of new products by further expanding our logistics partner network and developing relationship with additional export agents overseas.

Our quality assurance team continued their enhancement across our product range. Full compliance to international and local consumer laws was demanded and manufacturers with ISO9000 accreditation were given preferred status. A high level of confidence in our product standard continued to allow us to offer the "7 days return and refund" guarantee to maintain customer satisfaction.

Building Our Logistical Strength

To facilitate timely response to customer needs and demand, we implemented electronic stock replenishment at store level to maintain stock sufficiency and shorten delivery lag. Through this computerised system, optimal order quantities were generated automatically for individual stores to facilitate our ordering processes.

To further enhance stock availability and achieve optimal level of inventory, specialised efforts were made in improving order fulfilment by suppliers. By conducting timely sales forecast and closely monitoring supplier performance, our fulfilment team had managed to increase fulfilment rate by over 10%.

We built on the achievement of our consolidation of all warehouse facilities into our single distribution centre in Sai Kung. By redesigning our stock flow and further enhancing our computerised warehouse system, we implemented a comprehensive reshuffle of warehouse space that resulted in a doubling of our stock handling capacity. To further enhance our distribution efficiency, we introduced night fills to reduce traffic time expended on stock replenishment for our stores. Night fills also minimised interference of consumers' shopping experience during operating hours.

Enhancing Our Customer Service

Despite the increasingly independent culture of our society and the convenience and selections offered by e-shopping, consumers increasingly rewarded those brick-and-mortar retailers who embraced good customer service with their loyalty. To this end, we continued our efforts to enhance the quality of our human interface from our shop-floor staff to our enquiry hotline; and from our in-store information to our service counters.

To complement the "mystery shopper" survey program to drive improvements in our customer service quality, we implemented a performance appraisal system that was linked to sales performance and customer service quality of individual stores. To support and facilitate our appraisal system, we implemented simple and clear guidelines for customer service as well as performance standard. We also adopted a promotion scheme to open greater opportunity for staff to progress their careers internally to further encourage better performance, greater dedication and loyalty.

To supplement our work to create an ideal customer friendly shopping environment in our stores and to achieve higher customer satisfaction at our check out counters, we installed standby facilities to ensure zero down time of our POS system across our entire network.

In addition to our brick-and-mortar operation, our e-commerce channel nonetheless continued to provide convenient, 24-hour shopping channel to serve a specific sector of young, technology savvy, professional clientele. We continued to offer all major product categories carried by the Group's physical stores with over 3,000 products available for ordering. Our number of registered members increased almost by half to 22,000 who generated over a million page-views per month.

We placed high value on human capital which was essential to quality customer service. Our employees were remunerated according to their performance and working experience. In addition to basic salaries and MPF scheme, we also offered staff benefits including medical schemes and discretionary share options, performance bonus and sales commission. As at 31 December 2001, our Group had 738 employees.

Our goal is to upgrade our people to knowledge workers through extensive training that provides them with insights into areas of our business operations beyond their own immediate positions and areas of responsibilities. We aim to further derive improvements in service quality by building an enterprising and interactive workforce. We are certain that through our efforts to empower our people with the necessary knowledge and skills, we shall reach new levels of success.

Improving Our Shopping Environment

We continued to revamp our stores with the design framework laid down by the renowned international designer Rodney Fitch. We set up a specialised visual merchandising team who focused their efforts on improving our shopping environment such as merchandise displays, directional signs, window displays, departmental beacons, floor and wall graphics, banners and posters, staff uniforms and even shopping bags. We also increased the use of showcases and home-setting to better show "mix and match" effects as well as enhanced our store layout to facilitate better shopping experience.

The Beginning of Our New Chapter

Hong Kong

We are determined to maintain our leadership in the furniture and household products retail sector locally. We will continue to sharpen and refine our five key weapons by extending our brand building efforts from advertising and promotion to our points of sales level. We will continue to strengthen our merchandising and product development function so as to improve our product quality and offer more product choices for our customers. To cater for the changing needs of our customers, we are committed to exceeding customer expectations and will strive to improve customer service, product quality, as well as the width and depth of our product categories to excel in the competitive environment.

We intend to increase our market coverage by opening new stores in different strategic locations this year. We will continue to review our store performance to determine our expansion, consolidation or relocation strategy of the stores.

To enhance customer satisfaction, we will provide better training to front-line sales staff, especially as regards customer service and selling techniques. We shall appoint customer ambassadors during the course of 2002 to spearhead our customer service enhancement drive.

Our shopping environment improvement program which utilises our visual merchandising framework will be rolled out in systematic phases. We target to complete our refurbishment of the major stores by the end of this year. We further aim to increase store efficiency by increasing sales per square foot through customer flow enhancements.

On top of cross-selling products and services with our fellow subsidiary CFSG, we will explore means to leverage on the substantial flow of customer traffic we are enjoying by entering into co-marketing programs with other reputable companies.

China

China's entry to the WTO presents a golden opportunity for us to enter the vast China retail market. Work from our China Project Team progressed well and have moved from our initial research to implementation. Target cities for our first foothold include Guangzhou, Shanghai, Beijing and Shenzhen. We expect to open our first store by the middle of the year. We plan to venture into China by opening stores sized around 40,000 square feet each. Our strategy is to develop these stores around a contemporary "home centre" model by combining modern lifestyle products with the needs of the local Chinese communities.

Yet, we will remain cautious in our approach. We shall stay true to our philosophy of developing our business systematically and diligently. This we shall achieve by establishing a network of flagship stores in major cities along the golden coast and simultaneously developing a franchising model to enter second-line cities elsewhere. In addition, we plan to further build logistic centres in Shanghai and Guangzhou to serve the Eastern and Southern China regions respectively to support our China store development initiative. We aim to move forward by combining our expertise in modern retailing with local partners with in-depth local knowledge and appreciation of the differing regional consumer profile as well as operating environment to expand our network of stores together with building the requisite logistic infrastructure.

We are certain that we have indeed passed our darkest days. We emerged through our re-engineering initiatives a strong and modern retailer, well placed to overcome future hurdles. At the same time, we are ready to capitalise on the vast opportunity found in China as well as any new prospects offered by the recovering global economy.