



Management Discussion and Analysis



Sewco's directors and senior management (from left to right): Mr Ho Kam Chuen, Ms Cheung Man, Catherine, Mr Kung Ka Pang, Mr Cheung Po Lun (Chairman), Mr Hui Kwok Chu and Ms Lo Suk Yee Roxanna

Industry Overview

Hong Kong is famous for producing high-quality toys. A large proportion of our toy exports are derived from licensing and contract manufacturing for overseas manufacturers. In particular, production in the People's Republic of China (the "PRC") has facilitated good supportive industries and services. Despite the economic slow down, basic toy is still regarded as a high essential of our life and represents a huge market.

Analysis of Operating Environment

The Group is principally engaged in the manufacturing and trading of a wide range of hard toys and stuffed toys on an original equipment has manufacturing (the "OEM") basis. Over the years, the Group has manufactured more than 500 types of hard toys and 100 types of stuffed toys with different features according to orders and specifications of its customers and these products are principally sold to

Japan and North America including U.S.A. and Canada.

For the year ended 31 December 2001, sale of hard toys accounted for approximately 76.4% of the Group's turnover, while the balance of 23.6% was attributable to the sale of stuffed toys and there was no material change in turnover by geographical segment.

Solid Clientele

A number of factors contributed to the encouraging results of 2001. The Group has three major customers, namely Bandai, Mattel and TMSW, which are either toy specialist companies or agent of internationally well-known fast food chain stores. The Group has established itself as a reputable OEM toy manufacturer in Hong Kong and the PRC. With its commitment to product quality, the Group has gained the confidence and trust of its customers to establish the business relationship for over 14 years. During the



Management Discussion and Analysis

year under review, sales to the three major customers accounted for approximately 99% of the Group's turnover.

Production

Headquartered in Hong Kong, the Group operates three principal production facilities in Zhongshan Shi, Guangdong Province, the PRC with a total gross floor area of approximately 72,800 sq.m. equipped with 39 production lines of hard toys, 80 injection moulding machines, six electronic assembly lines and 11 production lines of stuffed toys. The utilisation rate of these production facilities is almost 100%.

Staff

The Group has a dedicated and highly skilled workforce of over 5,000 workers in the PRC. The Group believes that its expertise has grown alongside with the society to capture the taste, style and needs of the present and future. What the Group offers to its client is not only price competitiveness, but also quality and extensive knowledge of the toy industry.

Strict Quality Control

The Group's quality assurance procedures are undertaken throughout the whole production process to ensure the quality of the products is maintained according to the specifications and requirements of its customers. The Group's quality control team comprises an aggregate of 75 inspection supervisors, technicians and assistants. The Group is well-equipped with testing facilities which enable it to handle all these tests by itself. The Group's commitment to maintaining a high standard of quality control in the manufacture of toys was recognised by ISO9002:1994 accreditation of its production facilities located at Gangkou Zhen. The Group was also recognised by The Chinese Manufacturers' Association of Hong Kong as a certified laboratory in 2001.



Sewco's production facilities





Management Discussion and Analysis



Sewco's production facilities in Zhongshan Shi, Guangdong Province, the PRC.

Liquidity and financial resources

The working capital of the Group was generally financed by the internally generated cash flow from its sales. As at 31 December 2001, the Group's cash on hand and bank balances totalled HK\$20.3 million with net current asset amounted to HK\$60.8 million. The Group had a mortgage loan of HK\$3 million as at 31 December 2001. In respect of its gearing position, the Group's gearing ratio, which is calculated by dividing the Group's total bank borrowings and finance lease payable by its total tangible assets, was approximately 1.3% for 2001 (2000: 2.2%). Generally speaking, the Group had a solid financial position and this will benefit future business developments.

Future Prospects

As customer satisfaction is the key to our success, the Group is synonymous with reliability, quality products, production capability, competitive prices and punctuality.

In view of the growing demand of the toy industry, especially the demand for basic toy, the Group has identified several important steps to capture the upcoming opportunities.

Beside continuing to manufacture toy and novelty products to internationally renowned customers, the Group will pro-actively introduce new clients and product lines into its already enviable portfolio. At the same time, through strengthening sales and marketing network, new customers will be acquired while strengthening existing client relationship. The Group will keep itself fully aware of current market trends. Participating in toy fairs and other industry exhibitions will help in this end.

With the continuous support of its suppliers, the capability of scalable production and effective cost controls, the Group will continue to manufacture top quality products to cater to the customized needs of its customers.

In the future, the Group will enhance its production capacity to fulfil the increase of the existing client orders through construction of a new factory complex and acquisition of additional plant and machinery. Evidently, this will also prepare the Group for more new clients requesting services and cooperation.

Contingent Liabilities

As at 31 December 2001, neither the Group, nor the Company had any significant contingent liabilities.



Management Discussion and Analysis

Charge on Assets

As at 31 December 2001, certain of the Group's leasehold land and buildings situated in Hong Kong with an aggregate value of HK\$2.6 million (2000: HK\$3.8 million) had been pledged to banks in Hong Kong as security in respect of banking facilities of approximately HK\$25 million (2000: HK\$26.7 million) granted to the Group.

Foreign Exchange and Currency Risks

Since most of the revenue generated from the sale of products and the payment for purchases of materials, components, equipment and salaries are either made in HK dollars, US dollars or Renminbi, the Group is not exposed to significant foreign exchange risk. For each of the two years ended 31 December 2001 and 2000, the exchange losses incurred by the Group were about HK\$0.1 million and HK\$0.3 million, respectively.

Employees and Remuneration Policy

As at 31 December 2001, the Group had approximately 6,100 employees (2000: 5,300 employees). The Group remunerates its employees based on their performance and the prevailing industry practice. The remuneration policy and package are reviewed by the Board on a periodical basis. Bonus and share options may be awarded to

employees based on performance evaluation. These are drives and encouragements for personal performance.

Use of Proceeds of the Public Offer

The net proceeds of the Share Offer (as defined in the Prospectus), after deduction of related expenses, amounted to approximately HK\$36 million. The Company has disclosed in the Prospectus the proposed application of such proceeds as follows:

- as to approximately HK\$18 million for construction of a new factory complex on a parcel of self-held land in Guangkou Zhen to engage in the manufacture of hard toys;
- as to approximately HK\$6 million for acquisition of additional machinery and equipment and upgrading of its existing production facilities to enhance the Group's production efficiency and productivity;
- as to approximately HK\$2 million for expansion of the sales and marketing team of the Group to solicit new customers; and
- as to the balance of approximately HK\$10 million as additional general working capital of the Group.

Currently, the above net proceeds of approximately HK\$36 million remains unused and is placed in short term deposits with licensed banks in Hong Kong. Such proceeds will be applied in the coming years to their intended uses as set out above.

