Management Discussion and Analysis of Results of Operations and Financial Condition

Results

- **Turnover**

Group turnover the year at HK$565.8 million, increased by HK$179.0 million (+46.3%) over that recorded last year.

The main contributory factor to this increase was the re-acquisition of a controlling interest in the motor vehicle and car accessories business (principally the "Ferrari" and "Maserati" brands) such that once again it becomes a subsidiary operation of the Group. Last year the business was treated as an associate, the profits from which were accounted on an equity basis only and turnover was not taken to account.

Turnovers from the other businesses at HK$322.5 million were HK$64.4 million (-16.7%) below those of the previous year. Given the difficult economic conditions and special conditions affecting the markets, all other business segments recorded lower turnovers than last year.

- **Attributable loss**

The Group loss attributable to shareholders was HK$99.5 million which was HK$14.1 million (+16.4%) higher than the comparable figure last year. However a significant positive factor in the results was that the underlying loss from operations was much lower than last year being reduced by HK$18.7 million (41.1%), after adjusting for three exceptional, non-recurrent items which do not result from trading, being a loss of HK$8.0 million booked on the sale of a property surplus to requirements in Singapore and two items involving one-time write-offs for HK$30.6 million. The proceeds from the sale of the Singapore property were used to reduce bank indebtedness.

Although there was a signification reduction in the loss from continuing trading operations, it was decided by management to be prudent this year and to make any further substantial provisions and write-offs considered appropriate, and mainly in respect of properties, intangible assets and goodwill. Such provisions included a write-down on revaluation of investment properties of HK$11.2 million (2000: HK$8.4 million); a write-down on the valuations of properties held for resale of HK$10.6 million (2000: nil); a total write-off of intangible assets of HK$20.0 million (2000: nil); and a HK$3.5 million write-off of goodwill in connection with both the acquisition of an increased shareholding, in the year, in the motor vehicle group (HK$2.8 million); and also with the acquisition of the minority interests of the Mega Warehouse direct marketing operation (HK$0.7 million) and of ebuystore.com (an e-commerce and sales support facility), both of which companies became wholly-owned subsidiaries.

The total of these provisions and write-offs amounted to HK$45.3 million and compared with a figure of only HK$8.4 million last year.

Results *(continued)*

- **Attributable loss** *(continued)*

  A loss of HK$4.0 million was booked from the results of associated companies which compared with a HK$3.4 million profit last year. The reasons for this were firstly, that the two manufacturing joint-venture companies in which the Group has an equity interest in the PRC, recorded a combined profit this year of HK$0.8 million (2000: HK$2.6 million), but a special provision of HK$5.0 million, against potential losses which may arise on collection of receivables, was considered prudent by the Group, although the PRC joint-ventures did not themselves consider such provisions necessary. There was no such special provision last year. Secondly, the associated company results last year included a small profit from the motor vehicle distribution business, which business is treated as a subsidiary this year.

Liquidity and Financial Resources

As in recent years, the Group in FY2001, continued to be financed by a combination of internal cash flows; trade creditor support; and bank borrowings involving both short and longer-term maturities. The Group continued to meet its bank liabilities upon due dates and the position of actual bank loans and overdrafts improved significantly in the year which at balance sheet date were HK$95.6 million (compared with HK$131.6 million at balance sheet date 2000). However, the cash being generated by the businesses was being used to pay down debt and not being re-cycled in the businesses and this did adversely affect operations in the year in limiting business levels. As a percentage of total shareholders' funds, total bank borrowings at year end were 32.5% compared with 34.2% last year.

Group net current liabilities at December 31, 2001 were HK$124.8 million which compared with HK$87.3 million at the previous year end. The primary reason for this continued to be the reclassification as short-term debt of an unsecured loan from Mitsubishi Heavy Industries Limited ("MHI") which loan became due for repayment on December 31, 2001. **However, as was announced at the end of November 2001, in friendly and constructive negotiations between MHI and Group management, a Conditional Agreement was made between the parties. Details of this Conditional Agreement and the financial implications are given in this Annual Report headed "Post Balance Sheet Events and Pro-forma Summary Balance Sheet".**

Also, given the requirement for the Group to increase its financial resources to partly repay short-term debt and also to provide additional working capital to meet the needs of the businesses, **it was decided in February 2002 to undertake a capital reorganisation exercise which was allied to a Rights Issue and Bonus Issue. A circular and prospectus were prepared for shareholders on February 20 and March 15, 2002 respectively, and the arrangements were approved by shareholders on March 15 and completed on April 11, 2002. Again, the entire capital reorganisation exercise and the financial implications, are detailed under the section headed "Post Balance Sheet Events and Pro-forma Summary Balance Sheet" of this Annual Report.**

Business Reviews

- **Air conditioning products**

The business consists of marketing and distribution of the range of products from Mitsubishi Heavy Industries of Japan ("MHI") for which the Group holds exclusive distribution rights for Hong Kong and Macau (all products) and the mainland China markets. MHI provides a full range of air-conditioning products both for the packaged commercial systems and the consumer markets. Similarly, the Group also markets and distributes a wide range of air-conditioning products supplied under the "LG" brand ("LG Electronics Inc." of Korea). Both are pre-eminent global brands.

Total sales to third party customers at HK$176.1 million were 8.1% lower than the HK$191.7 million recorded in FY2000. The entire shortfall in sales, and therefore the impact on profits earned from this business which were significantly reduced, was outwith the management control. During the year, a trade dispute developed between China and Japan on an wholly unrelated area of business, but which led to an arbitrary impost of a 100% import penalty duty, imposed by the Chinese customs office on Japanese-made air-conditioning products. This lasted a full six months and wholly affected deliveries for the major selling season of this business from June 2001 onwards. The penalty tariff was lifted in December 2001. Without this disruption, sales would have been much higher.

However, the markets throughout 2001 were difficult. In Hong Kong and Macau the economies remained depressed and sales were slow. New construction projects were at low levels, reducing product demand. Nevertheless, due to the Group's multi-channel distribution and networking, allied to the excellent support from both the MHI and "LG" principals, brand building and market support increased and the products were very competitive. Given their accepted high quality position, this enabled total market shares to be maintained or increased, in some sectors. Increased distribution efforts in mainland China are now beginning to show more business. A main office for China business was established in Dongguan, Guangdong Province to co-ordinate and integrate the functions of marketing, sales, after-sales support, and sales/product training. The project side of the business is expanding through networking and channel management of project design, contractors and tenderers.

Operational efficiencies increased and lower unit costs were achieved through streamlined organisation, after-sales service and warehousing operations. Working capital efficiencies were also made in respect of both inventories and receivables. However, total gross margins were somewhat lower than FY2000 given the competitive market situation, and total profit contributions were only half of those achieved last year.

For FY2002 management are now more optimistic. Sales opportunities are increasing in both Hong Kong and the mainland PRC markets; the tariff impost is no longer a factor; and the market stimulus of China's accession to the World Trade Organisation ("WTO"), will be a further positive factor. Given the operational improvements made and the commitment to increased market coverage and distribution, this business segment is forecast to grow both sales and profit contribution in the year 2002.

Business Reviews *(continued)*

- **Audio-visual and other electrical products**

The audio-visual business is now largely focused upon marketing and distribution of a range of products developed for the Group's own brands of "Rogers" (from the UK) and "Bodysonic" (from Japan). The business segment also includes sales from "LG" branded domestic electrical appliance products which are now well established in the market. And finally, sales also include a post-production services business, to the film and entertainment sector, known as Best and Original Production Limited ("B&O").

Total sales decreased 13.6%, compared with FY2000, to HK$59.6 million given a stagnant domestic market. The audio-visual products sector of the business remains extremely competitive especially given the range of innovative products offered to the market; the constantly reduced market pricing; and gross margins are narrow. Nevertheless, the range of products marketed increased in the year to include CD, VCD, DVD players and mini hi-fi systems; speakers, surround sound and home theatre systems; and Plasma display televisions. Sales of "LG" domestic appliances increased satisfactorily in the year. Distribution channels were expanded and sales and promotional campaigns were organised in a cost effective manner. Operational efficiencies and cost controls were effectively implemented with the result that, despite the lower sales compared to last year, losses were almost halved after adjusting for the write-off of intangible assets of HK$20.0 million.

Looking at 2002, the consumer markets will still be highly competitive given a sluggish economic outlook; changing consumer tastes; and increased competition from mainland Chinese brands. Nevertheless, launch of a competitive range of products; increased distribution efforts and particularly in the markets of Hong Kong, mainland China, Singapore and Malaysia; and the increasing brand awareness of "Rogers" and "Bodysonic" following continuous marketing efforts, will all be positive. At the end of 2001 the Group sold its interest in B&O, the post-production services business, which will reduce the sales but will not affect the profitability of this business segment.

- **Car audio and electronic products**

The business consists of marketing and distribution of products largely under the "Alpine" brand (from Japan) which is one of the leading brands in the market, together with products developed under the Group's own "Rogers" brand of motor vehicle speakers and power amplifiers. Products are distributed in Hong Kong, Macau, Singapore and Malaysia.

Total sales were HK$52.5 million, which was an HK$21.8 million (29.4%) decline in FY2001. Across the markets, business was affected by the drop in sales of automobiles. There was intense competition on products and new product innovations, and pricing and margins were affected. The economic environment forced operational and cost efficiencies and despite the significant drop in sales, losses recorded from the business were small.

Business Reviews *(continued)*

- **Car audio and electronic products** *(continued)*

In FY2002, "Alpine" is offering an exciting range of products with car audio and audio-visual features which are targetted at the growing larger cabin vehicle sector. "Alpine" is also a leader in products featuring integrated navigation systems and these will stimulate sales once this technology is available in the markets we serve. The business is forecasting a growth in sales and a profitable year in 2002.

- **Direct marketing**

This business involves direct retailing in consumer electronic and electrical products, in the Hong Kong market under "Mega Warehouse" branded outlets.

Sales to customers in the year were lower than FY2000. However, the business has been refocused in the year. At the beginning of FY2001, a large outlet in the Wo Kee Hong Building was closed and re-sited to Tsing Yi in April. Since then, a chain-store type strategy to cover Hong Kong, Kowloon and the New Territories, on a cost effective basis, has been implemented. The contributed loss in the year was significantly reduced from that recorded in FY2000 and based upon the increased number of retail outlets, Mega Warehouse is now operating profitably.

By the end of FY2001 there were four sales outlets in Tsuen Wan, Sai Wan, Tsim Sha Tsui and Tsing Yi. In the first quarter of 2002, two further outlets have been opened in Tuen Mun and Yuen Long with another opened in North Point in April. The business model is based upon competitive warehouse retail concepts with regular promotional and key product category sales, to provide value-for-money products to customers.

This strategy is increasing business levels, and new stores have already and will continue to be opened in FY2002 to a conservative plan. Despite a weak retail environment, there is latent consumer demand for products providing innovation and value for money. Mega Warehouse outlets are becoming recognised for providing these values. There will be an increased number of stores in differing locations throughout Hong Kong in the year; a wider range of product categories offered; increased marketing and promotion efforts; and possible sales outlets in mainland China to be considered later in the year. All of these activities will be undertaken cautiously, with a view to increasing sales, utilisation of cost and capital efficiencies; and both sales and profits are forecast to increase.

- **Motor vehicles and car accessories distribution**

The business is the marketing, sales and parts supply and after-sales servicing of the "Ferrari" and "Maserati" vehicle franchises. The Group is the sole distributor for these two unique premier luxury sports marques in Hong Kong, Macau and mainland China. In FY2001 the Group repurchased a controlling interest in the business, which interest was further increased during the year upon a recapitalisation, such that at year end the operation was an 86% controlled subsidiary.

Business Reviews *(continued)*

- **Motor vehicles and car accessories distribution** *(continued)*

  Total sales for the year were HK$243.4 million which was 9.8% higher than the sales achieved in FY2000, although last year the sales were not consolidated, as this business was then an associate. The pre-tax profits were stable at similar levels to the previous year.

  "Ferrari" continues to be the premier luxury sports car available in the world today and demand for the models generally outstrips supply. Demand for the 360 Modena/Spider was high, as was demand for the 550 Maranello/Barchetta. With the introduction of the new 575M Maranello, with the popular F1 gear shift, sales are expected to continue strong in FY2002.

  The "Maserati" marque is increasing brand awareness in Hong Kong and unit deliveries increased 14% over FY2000. Exciting new "Maserati" models are lined-up for 2002 and already in February the new "Maserati" Spyder began deliveries to customers. A new Coupe was also announced for introduction from April 2002. The new Spyder GT/Cambiocorsa marks a radical shift in "Maserati" technology, incorporating a 4.2 litre engine with F1 gear shift.

  The product line-up therefore from both marques, is extremely strong and increased sales are expected in FY2002, notwithstanding a flat total market in Hong Kong for passenger vehicles (actually down 1.7% in 2001, compared with 2000). Total units delivered in FY2001 were up almost 6.5% on those delivered in 2000.

  In the year, a dedicated "Maserati" workshop was opened, as was another showroom facility dedicated to the sale of quality used cars, an important facet of the business in support of new car sales. The personnel employed in the business increased in the year especially in the parts, service and bodyshop facilities, where demand is increasing as the road population of "Ferrari" and "Maserati" grows in Hong Kong.

  China remains a difficult and small market for unit sales for high performance vehicles at this time. However, entry into the WTO has already seen a dramatic import tariff reduction from pre-WTO levels in 2001 of 80%, to 50.7% effective from January 1, 2002. Sales and service activities in key strategic cities will be established or consolidated from 2002 onwards, and we look to the mainland China market to be solid, albeit incremental business, to the Hong Kong base market operation, for a number of years.

Personnel

At the year end 2001 the total number of employees of the Group, excluding associates, was 338 (the comparable number last year, including the motor vehicle group employees, was 377 people). It was essential, as part of the profit restoration program, to further review our personnel employment contracts and to carefully review the staff required in each business and function, within the Group, as we moved into 2002. Regrettably, it has been necessary to reduce the employee headcount further with redundancies already announced, given closure or consolidation of some small business units; implementation of a retirement scheme at age 55 years; implementation of Group wide reduction in remuneration packages including the elimination of automatic Chinese New Year bonuses.

These measures are painful, but the Group is determined to restore profitability, to be competitive and ensure the Group is able to grow profitably from 2002 onwards. The Group recognises the importance of its employees and has been extremely fortunate to retain a core of loyal, experienced and dedicated people. The management team has remained stable and committed throughout the year and together, from this point on, we are confident that the businesses and the employees, will grow together for the benefit of all in subsequent years.

Prospects

Despite the tough market environment, for reasons explained for each business segment in which the Group is involved, it was really pleasing to see that the recurrent operating loss in 2001 was significantly reduced compared with the previous year.

Looking to 2002, management are of the view that the year 2001, and considering the further actions taken early in 2002, mark a turning point for the Group. The prospects for each business segment in which the Group is involved look much brighter. The Group has a long history and an established name and reputation in its markets which it cherishes. It is a market leader in marketing and distribution of consumer products in Hong Kong, Macau, mainland China and certain other markets in South East Asia. These markets are at last recovering in different ways, from the effects of the global economic downturn and we see signs of a good recovery and growth. The actions management has taken on costs and the further rationalisation measures and strategic positioning in each business, should facilitate and stimulate profitable growth. The measures taken on the supplier debt restructuring and the recently completed capital reorganisation and Rights Issue will also dramatically improve the balance sheet and financial standing of the Group and further reduce finance costs.

For all of these reasons the Board is cautiously optimistic that 2002 will at last allow the Group to both record increased revenues and mark a return to profit, after the work of recent years in difficult circumstances.

Barry John BUTTIFANT
Managing Director

Hong Kong, April 24, 2002