Management discussion and analysis

Techtronic Industries (TTI) achieved a record profit of HK$168 million for the six months ended 30th June 2002 with impressive growth of 77.8% as compared to the HK$94 million recorded for the same period last year. Basic earnings per share grew 67.2% to HK28.01 cents from HK16.75 cents in the comparable 2001 period. Turnover increased by 71.0% over the first half of 2001 to HK$3,959 million.

This significant growth was due to strong order flows in the core power tools, floor care appliances, solar-powered and electronic products businesses. The European and Australasian Ryobi and Homelite businesses acquired in the second half of 2001 and the first half of 2002 also contributed to the robust turnover and profit increases. These acquisitions are strategic components in the Group's transition to a global Own Brand Manufacturer (OBM). TTI achieved turnover and profit growth in all geographic markets and business segments.

The Group's strong performance in the challenging economic period was achieved by increasing demand for it's recognized brands with effective advertising and promotion activities, and by providing the customer with a value-positioned product range. These elements, plus a strategy to work closely with volume customers in the home-improvement and related industries have driven TTI to outperform the market and deliver 68.5% turnover growth in North America, representing 83.5% of the Group's business.

In addition to the strong gains made in North America, sales to Europe increased by 101.9%, and sales to other countries, including Australasia, were up 42.2%. The Ryobi acquisitions are providing an infrastructure in Europe and Australasia that will form the foundation for the Group's future market penetration in these markets.

The acquisition of Homelite adds a leading brand to the portfolio and expands the Group's presence in the outdoor products category. The outlook is exciting for Homelite as the first six months of ownership delivered better than expected results and has positioned TTI solidly in the outdoor tools category, which has similar potential to the power tools business for the Group.

BUSINESS REVIEW

Power and Outdoor Products Division

The Power and Outdoor Products Division, which includes the Homelite business, delivered an aggressive 96.2% growth over the corresponding period last year, to HK$3,140 million, representing 79.4% of Group turnover.

Turnover of Ryobi power tools posted an impressive growth of over 100% for the first half. Investments in brand promotion and marketing campaigns have improved Ryobi brand awareness and created strong demand from the market. The quality of the Ryobi product, combined with its value-price positioning, has allowed the Group to increase comparative turnover and improve profitability. The Original Design Manufacturing (ODM) and Original Equipment Manufacturing (OEM) businesses also remain healthy growth.

Performance of outdoor products in the first six-month period was ahead of plans. Homelite's integration with Ryobi is leveraging logistics strengths and streamlining distribution and marketing programs. Additionally, the Group's Ryobi outdoor products are benefiting from Homelite's product technologies and production capabilities. The expansion of the outdoor products business also helps to offset the seasonal factors inherent in the power tools industry providing a more even level of orders, in turn strengthening the consistency of the revenue stream and benefiting the supply chain.

Floor Care Appliances Division

The Floor Care Appliances Division recorded a 17.7% gain in turnover to HK$617.8 million, which accounted for 15.6% of the Group's turnover in the first half. The growth was driven by new product introductions and from demand-generating retail price adjustments made by our OEM customers in North America. Product development programs remain vibrant with a growing OEM customer base. In the United Kingdom, a successful promotion with a major retailer dramatically increased consumer demand and demonstrated the strength of the Vax brand. New product initiatives that will expand the Vax product range are underway.

Solar Powered and Electronic Products Division

The Solar Powered and Electronic Product Division, which features products such as solar powered lighting, electronic and laser measuring devices, and electronic health care products also posted strong turnover, increasing by 20.4% to HK$123.8 million, which represented 3.1% of the Group's turnover. Divisional profits rose during the period as a result of a disciplined and focused product-development program targeted at high value-added items, the launching of a new range of products, and a strict overheads control and pricing policy.

OPERATIONS

TTI continues its efforts to add value throughout the supply chain by integrating customer's inventory and purchase systems, and implementing tight cost controls. The Group has aggressively leveraged its purchasing power, moved to capitalize on manufacturing synergies, and systematically implemented continuous improvement programs to upgrade quality and eliminate waste. As a result, gross margins improved in the first half of 2002 and gross profit increased 96.2% to HK$964.1 million as compared to HK$491.5 million in the first half of last year.

To facilitate the increasing business in bench power tools, the Group continues its in-house expansion and has formed a new joint venture with a bench tool manufacturer in the Peoples Republic of China. The joint venture allows TTI to acquire immediate production capacity and technology know-how on bench tools with very low capital expenditure, further strengthening its market-leadership in the bench and stationary tools category.

TTI will invest in a combustion engine plant in the Peoples Republic of China to add capacity and further improve cost competitiveness. The plant will supply combustion engines and finished goods for the Group's Homelite and Ryobi outdoor products, plus potential opportunities with ODM and OEM customers. The capital investment is approximately HK$156 million (US$ 20 million) and will be financed by the proceeds from the share placements on 28th April 2002. The majority of outdoor products final assembly production will remain close to the largest market in North America, keeping the time-to-market and logistic costs at a minimum.

OUTLOOK

With customer orders secured for the third and fourth quarters, the outlook for the second half of 2002 is bullish and the Group is confident there will be a continuation of the first half-year's high-growth performance. The robust turnover growth will be driven by innovative new products, an expanding product mix, a bright outlook for the outdoor products brands, and further penetration of the Ryobi market presence in North America, Europe and Australasia.

The healthy performance in the first half year reflected only the initial growth of the soundness and execution of TTI's global brand building strategy. Looking ahead, TTI will continue to invest in brand building, market expansion, customer-focused product development and cost improvement, which will drive the business further forward.

FINANCIAL REVIEW

Acquisitions and Investment

As a further step to the Group's global brand building strategy, in November 2001, TTI entered into an agreement with Deere & Company to acquire its Homelite brand of consumer outdoor products, including a manufacturing plant in Mexico. In March 2002, the Group acquired two power-tools companies in Australasia from Ryobi Limited, together with the perpetual rights for the "Ryobi" brand name in Australia and New Zealand. In July 2002, TTI's 40.8% associated company, Gimelli Laboratories Company Limited ("Gimelli") arranged an 18.8% investment in a German brand name company, Medisana AG ("Medisana"), at a consideration of Euros 1.98 million and financed by Gimelli's internal resources. The price was referenced to the market share price of Euros 2.15 at end of June, and based on Medisana's net equity per share of Euros 3.00 as at 31st December 2001. Medisana is a health-care product distributor and manufacturer listed on the Frankfurt Stock Exchange. This strategic alliance allows Gimelli to capitalize on the Medisana brand name and its sales channels across Europe to further expand its OEM health-care business.

Placing of New Shares

On 28th April 2002, the Group announced the placing of 60 million new shares to independent professionals and investors at the price of HK$6.275 per share. The net proceeds of the placement were approximately HK$367 million. The new shares issued represented approximately 10.3% of the Group's issued share capital immediately before the placing and approximately 9.34% of the enlarged issued share capital. The placing provided the Group with sufficient funding, and strengthened its financial position, to enable the Group to aggressively expand its global branding strategy.

Results Analysis

Strong core business growth together with the successful acquisitions of the Ryobi and Homelite businesses, resulted in a turnover growth of 71% and net profit rising of 77.8%, as compared to 2001's first half. During the period under review, Group operating expenses also increased. This increase was mainly due to the inclusion of expenses from operations acquired during the second half of last year and beginning of the current year. The Group is implementing various cost rationalization programs to improve cost efficiencies.

New product development and marketing remain the key growth drivers of the Group's business. For the six months ended 30th June 2002, the Group spent approximately HK$46 million in research and development, representing 1.2% of the Group's turnover, as compared to HK$43 million last year, which represented 1.9% of the Group's turnover. The Group invested about 2.2% of the Group's turnover (HK$88.1 million) on marketing and advertising to promote its brands and products, as compared to 1.2% (HK$28.6 million) in the first half of 2001.

Cash Flow

Increase in cash and cash equivalents for the six months period amounted to HK$527.7 million was principally the cash from the placing proceeds and increase in borrowings.

Net cash used in operating activities for the period amounted to HK$182 million, mainly due to the increase in inventories and trade and other receivables as a result of the various acquisitions and substantial increase in sales. Also, inventory levels are usually higher in the first half of the year in preparation for the peak shipment season in the second half. Compared with the same period last year, the number of days for inventory turnover improved from 65 days to less than 60 days, while the number of days for receivables improved by over 20 days.

Financial Resources

Total shareholders' funds increased to HK$1.6 billion as compared to HK$1.1 billion as at 31st December 2001. The improvements are mainly due to the share placement during the period and profit retained for the first half year. Despite the increased number of shares in issue, total net tangible assets per share stood at HK$2.38 per share as compared to HK$1.81 per share as at 31st December 2001.

Total bank borrowings amount to HK$1.53 billion, represented an increase of $637 million as compared to the 31st December 2001 balance of HK$893 million. Borrowings are normally higher in the first half year in preparation for the peak production period commencing during the third quarter of the year. Furthermore, the Group had arranged financing arrangements for the Homelite acquisition and taken over certain loans from the acquired businesses during the period. Bank balances, deposits and cash, however also increased by $568 million during the period under review.

The Group's trading activities and borrowings are mainly denominated in United States Dollars and Hong Kong Dollars, and carry interest rates with reference to US or HK best leading rates. The Group is actively evaluating various financial instruments on both interest rates and currency exposure to capitalize on current low interest rate levels and favorable currency fluctuations.

The gearing ratio as at 30th June 2002, expressed as a percentage of Total Net Bank Borrowings to Total Tangible Net Worth improved to 21.3%, as compared to 54.9% as at 31st December 2001.

Interest coverage, expressed as a multiple of profit before interest and taxation to total net interest expenses was 6.38 times, as compared to 3.55 times for the same period last year and 4.46 times for the full year ending 31st December 2001.

Capital expenditure for the period, apart from various acquisitions, amount to HK$124 million and was matched by depreciation for the period of HK$128 million.

The Group believes that it has a very healthy financial position and is in a very competitive position to obtain financing on favorable terms should opportunities requiring additional working capital or financing arise.