BUSINESS REVIEW

Following China's entry into the World Trade Organization ("WTO") in November 2001 and the subsequent lowering of import tariffs, market competition in China has intensified. With the increasing number of overseas players entering the China market, entrepreneurs in China are facing threat and competition of magnitude they never ever encountered before.

Despite the adverse economic situation in 2002, the Group was able to improve the sales performance of various products. Besides strengthening the hardware sales, the Group has put more emphasis on Value-Added Technical Services. Sales of certain hardware products were even bundled with Value-Added Technical Services such as the provision of customized software and turnkey solutions. This strategy not only enabled the Group to enjoy a higher profit margin, but it also improved customer loyalty.

Turnover analysis by operations:

	2002	2001	
	HK$ million	*HK$ million*	%
			+/(-)
Manufacture and Distribution			
Business (by major products)			
Industrial controllers	**403.5**	368.3	9.6
Stone-OKI printers	**163.2**	195.4	(16.5)
Gold Tax products	**27.5**	18.9	45.5
UPS equipment	**91.7**	75.8	21.0
Digital graphic products	**44.1**	27.9	58.1
Computers	**152.9**	105.0	45.6
Others	**69.5**	130.4	(46.7)
	952.4	921.7	3.3
Fee income from Value-Added Technical Services	**42.3**	19.7	114.7
Media Related Business	**1.3**	—	100
	996.0	941.4	5.8

ELECTRONIC PRODUCTS MANUFACTURE AND DISTRIBUTION

Industrial Controllers

Because of the ferocious market competition, PRC's industrialists have been striving to raise their productivity and automate their production lines as far as possible in order to enhance production efficiency and competitiveness. In this regard, the demand for industrial controllers, automation equipment for production and process engineering, remained high despite the keen competition.

The turnover for industrial controllers increased by approximately 9.6% from HK$368.3 million in fiscal 2001 to HK$403.5 million in fiscal 2002. This is attributed mainly to (i) increase in market demand and (ii) bundling of consultancy and application solutions services with the sale of hardware which appealed to customers.

The Group is one of the principal distributors in China for many famous brand name industrial control and automation products. The principal controller and automation products brands distributed by the Group include Siemen, Fuji, Omron and Allen Bradley. For more information, please visit www.stone-automation.com. To more closely and effectively monitor inventory and logistic control systems, the Group has adopted an ERP system for its distribution operation which serves several thousand customers. The new system is helping the Group to achieve better cost control and customer relations management.

Invoice Printers

Stone-OKI printers are dot matrix printers. They are principally for processing Chinese text invoices and bank passbooks and are well received by corporate customers such as banks, post offices and securities companies in China. Each dot matrix printer is downloaded with customized software developed by the Group. For more information, please visit www.printertec.com.

During the year, as a result of reduction in import tariffs, prices of the products were reduced by approximately 9.0%. In addition, the Group launched upgraded printer models to gradually replace old models. These changes led to a slowdown in sales with a decrease of 8.9% in terms of sales volume. Sales of Stone-OKI invoice printers decreased by approximately 16.5% from HK$195.4 million in fiscal 2001 to HK$163.2 million in fiscal 2002.

ELECTRONIC PRODUCTS MANUFACTURE AND DISTRIBUTION *(Continued)*

Uninterruptible Power System ("UPS") Products

The Group is one of the principal distributors of Invensys plc, which is a global leader in production technology and energy management. It resells Powerware UPS equipment, management software and systems.

Sales of UPS products increased by approximately HK$15.9 million or 21.0% to HK$91.7 million for fiscal 2002 as compared with HK$75.8 million for the prior year. The increase in sales was attributable to (i) changes in product mix, (ii) the strengthened sales teams with higher caliber, and (iii) the increase in marketing activities.

Digital Graphic Products

The Group is the exclusive distributor of Roland DG Corporation's digital graphic products in China. The products distributed by the Group include wide format inkjet printers, cutters, 3D scanner etc ("DG products"). For more information, please visit www.stonedg.com.cn. Roland DG Corporation is one of the global leaders in graphic arts and 3D modeling industries with innovative hardware and software. Its comparable competitors are Epson and Hewlett Packard.

Sales of DG products increased by HK$16.2 million or 58.1% from HK$27.9 million in fiscal 2001 to HK$44.1 million in fiscal 2002. The significant increase in sales was the outcome of: (i) the decrease in selling price as a result of obtaining price deduction from the supplier, (ii) the strengthened caliber of the sales team, and (iii) the increase in marketing activities.

Stone Computer Products

In March 2002, the Group formed a joint venture with Achieva Investment Pte Ltd ("Achieva"), a listed company in Singapore, with the total investment cost of approximately Rmb50 million for the production and distribution of "Stone Collaborative" brand computer products in China. The joint venture, in which the Group holds a 51% interest, will concentrate on brand name management and product design. Computer products will be produced on an OEM basis. The principal products include personal computers, servers, notebook computers, etc. For more information, please visit www.stone@stc.net.cn.

Although China's corporate computer market slowed down in 2002 as compared with 2001, the Group believes that the market will go up in 2003 as China's entry into WTO has added pressure on Chinese entrepreneurs to computerize their businesses and enhance management efficiency and competitiveness. In addition, with computer products still having a low penetration rate in China, the Group sees ample room to develop and expand the sales of "Stone" and "Stone Collaborative" brands computer products.

ELECTRONIC PRODUCTS MANUFACTURE AND DISTRIBUTION *(Continued)*

Stone Computer Products *(Continued)*

With the strategic alliance with Achieva, the Group is able to make use of Achieva's advanced marketing and management skills to consolidate, promote and uplift "Stone" and "Stone Collaborative" brands in China.

Non-branded Computers

Despite the significant increase in the sale of non-branded computer products, the profit margin of the products was very thin. The Group did not get much economic benefit from this operation. It has therefore decided to terminate this operation and shifted resources to Stone computer products.

Gold Tax Products

Gold Tax products include sales tax-control cashiers ("STC Cashiers") and anti-counterfeiting tax control machines ("ACT Machines"). STC Cashier is for small enterprises with annual turnover of less than Rmb2 million; and ACT Machine is for value-added-tax ("VAT") taxpayers. The product designs, built-in software and IC cards of these two products for launching into market purpose have to be reviewed and approved by State Tax Bureau ("STB"). It was previously expected that the products would be approved for open sales by the end of 2002, but the approvals have been postponed for technical reasons. The Group expects STB to finalize the approval by the end of 2003. The Group believes that, by then, a steady growth in the sales of the products will be achieved.

During the year, the Group was allowed by STB to commence pilot sales of STC Cashiers in 20 designated cities in over 8 provinces in China. For ACT Machines, STB has not yet approved the products for open sales as the security control programme of the IC Card has not yet been fixed. Nevertheless, the Group was allowed to provide training service to VAT taxpayers to use the machine.

Other Products

The turnover of other products decreased by HK$60.9 million or 46.7% to HK$69.5 million in fiscal 2002 from HK$130.4 million in fiscal 2001. Other products included semi-conductors, electrical lighting products, starters, fluorescence tubes and other electrical products.

VALUE-ADDED TECHNICAL SERVICES

By bundling Value-Added Technical Services and the hardware sales, the Group believes that the two businesses can compliment each other and create added value to the customers. This strategy allows the Group to differentiate its products from its competitors, staying well ahead of market competition.

The fee income increased by HK$22.6 million or 114.7% to HK$42.3 million in fiscal 2002 from $19.7 million in fiscal 2001.

MEDIA RELATED BUSINESS

Through Sun Stone New Media Limited ("Sun Stone"), a subsidiary, the Group began to tap media related business in China. Since the China media market is still immature, the Group experienced difficulties in developing this business. The Group decided to cease the development in this media related business during fiscal 2002 and incurred approximately HK$9.1 million net loss after minority interest.

The Group currently holds an indirect equity stake of 20.6% in SINA Corporation ("Sina"). As the Group was no longer able to exert significant influence over Sina, and the dividend policy of Sina is not expected to be attractive, the Group decided to hold the investment in Sina for profit in the short run.

In respect of an equity investment in China Cable Information Network Company Limited ("China Cable"), the Group's equity interest was diluted from 25% to 9.51% in fiscal 2002 as a result of a series of organization restructuring steps undertaken by China Cable. An impairment loss of approximately HK$79.4 million was recorded in fiscal 2002.

OTHER INVESTMENTS

Mitsubishi Stone Semiconductor Company Ltd. ("MSSC")

During the year, MSSC contributed a profit of HK$4.9 million to the Group in fiscal 2002 as compared with HK$3.5 million in fiscal 2001 despite the global slowdown of the semi-conductors market. The Group's equity interest was diluted from 25% to 21.7% as MSSC issued new shares in 2002. The gain on deemed disposal was HK$2.6 million.

OTHER INVESTMENTS *(Continued)*

Shanghai Centek Communication Industry Company Ltd. ("SCCT")

In April 2002, the Group established SCCT, a PRC's company, in which the Group owned 52% equity interest. SCCT was principally engaged in the provision of satellite positioning services in Shanghai. As there was cultural difference in running the business with other joint venturers, the Group decisively terminated the business and disposed of its equity interests in SCCT in December 2002. Although it incurred a loss of approximately HK$12.1 million in this project, the management obtained valuable experience, which would be beneficial to the Group's future business development.

Censoft Company Ltd. ("Censoft")

During the year, the Group invested in 30% equity interest in Censoft, a PRC company, in which Beijing Centergate Technologies Co., Ltd. owns 51% and Microsoft Corporation owns 19%. Censoft is a software development company focusing on platform software development for e-government, e-commerce, e-banking projects, etc. For more information, please visit www.censoft.com.cn.

Dalian F.T.Z. Huaqing International Engineering & Trading Co., Ltd. ("Dalian Huaqing")

The Group acquired 51% equity interest of Dalian Huaqing for an amount of Rmb11.0 million (HK$10.4 million) during the year. Dalian Huaqing is established in the PRC and will be engaged in the provision of e-commerce and one-stop logistics management services.

FINANCIAL REVIEW

Gross Profit

The Group's gross profit margin increased by 1.5 percentage point to 11.7% in fiscal 2002 from 10.2% in the prior year. This was principally attributable to (i) the increase in Value-Added Technical Services with higher profit margin and (ii) the clearance of slow moving inventories during the year, provision against which had been made in prior years against these inventories. Complementing the increase in turnover, gross profit increased by HK$20.6 million or 21.5% to HK$116.3 million for fiscal 2002 as compared with the prior year.

Distribution Costs, Administrative Expenses and Other Operating Expenses

Distribution costs increased by HK$9.1 million or 18.0% to HK$59.3 million for fiscal 2002 as compared with HK$50.2 million for the prior year. As a percentage of the turnover, distribution costs increased from 5.3% to 6.0%. This was principally attributable to the increase in marketing, selling and promotion expenses.

FINANCIAL REVIEW *(Continued)*

Distribution Costs, Administrative Expenses and Other Operating Expenses *(Continued)*

Administrative expenses increased by HK$20.9 million or 30.7% to HK$89.1 million for fiscal 2002 as compared with HK$68.2 million for the prior year. As a percentage of the turnover, administrative expenses increased from 7.2% to 8.9%. The increase was mainly resulted from the administration and business development expenses incurred by (i) the Media Related Business, (ii) Stone brand computer business and (iii) Value-Added Technical Services in their early development stage.

Other operating expenses decreased by HK$22.2 million or 50.8% to HK$21.5 million for fiscal 2002 as compared with HK$43.7 million for the prior year. This was principally attributable to the decrease in provision for obsolete inventories by HK$3.5 million to HK$7.7 million and the decrease in provision for bad and doubtful debts by HK$8.9 million to HK$1.8 million in fiscal 2002.

Operating Loss

The Group recorded an operating loss of HK$44.8 million during the year, up by HK$21.5 million as compared with the operating loss of HK$23.3 million the prior year. The significant increase in operating loss was principally attributed to (i) a one-off gain of HK$22.6 million from the termination of the distribution rights of Matsushita products was recognised in the fiscal 2001, (ii) a loss of HK$13.0 million incurred in Media Related Business, and (ii) the increase in administrative expenses in new business operations.

Liquidity and Capital Resources

The Group's primary liquidity needs are to fund daily operations and direct investments. At 31st December, 2002, the Group had a working capital of HK$858.5 million, which included a cash balance of HK$217.0 million (including restricted cash of HK$3.4 million). The working capital and cash balance at 31st December, 2001 was HK$479.1 million and HK$338.4 million (including restricted cash of HK$53.4 million) respectively.

The current ratio was 4.4 times in fiscal 2002 as compared with 2.7 times in fiscal 2001. This was principally attributable to the increase in fair value of investment in Sina which was reclassified as current investment at 31st December, 2002. This investment was accounted for as an associate in fiscal 2001. The decrease in cash and cash equivalents by HK$71.3 million was principally due to (i) cash used in financing the 30% equity interest in Censoft, (ii) the acquisition of 51% equity interest in Dalian Huaqing, and (iii) general working capital requirement.

FINANCIAL REVIEW *(Continued)*

Liquidity and Capital Resources *(Continued)*

Inventories decreased by HK$21.3 million to HK$164.4 million at 31st December, 2002 when compared with 31st December, 2001 and the inventory turnover in terms of month improved from 2.9 months at 31st December, 2001 to 2.4 months at 31st December, 2002. Better inventories and procurement controls account for the improvement.

The Group had available banking facilities of a total of HK$116.7 million with various banks at 31st December, 2002. Of the total facilities, HK$96.7 million was for letter of credit arrangement, overdraft and other facilities commonly used by manufacturing and distribution companies, and HK$20.0 million was a term loan. The working capital facilities bear interest at floating rates generally based on prime lending rates and are subject to periodic review. The term loan is on HIBOR basis and repayable semiannually for 5 installments from 29th June, 2003 onward. At 31st December, 2002, the Group utilized approximately HK$46.7 million of its credit facilities.

The Group believes that funds generated from internal operations and the existing banking facilities will enable the Group to meet anticipated future cash flow requirements.

Use of Proceeds

The Group raised approximately HK$234.0 million, net of related expenses, from the issue of 115,000,000 new shares of the Group under a private placement in 1999. After using the proceeds of approximately HK$84.0 million for various acquisitions as disclosed in 2000's annual report and approximately HK$20.0 million for general working capital in fiscal 2001, the remaining balance of the proceeds as of 1st January, 2002 was HK$130.0 million.

During fiscal 2002, an amount of approximately HK$28.3 million was invested in 30% equity interest in Censoft, and the remaining fund of approximately HK$101.7 million will be applied in future investments.

Financial Position

At 31st December, 2002, the Group's cash and cash equivalents was HK$213.7 million, while bank borrowings stood at HK$46.7 million. Gearing ratio was approximately 5.0% (2001: 8.5%). This reflects a strong financial position for the Group.

FINANCIAL REVIEW *(Continued)*

Details of Charges on Group Assets

At 31st December, 2002, properties with carrying value of HK$14.2 million (2001: HK$2.5 million) were pledged with a bank as collateral against a banking facilitiy and a term loan to subsidiaries of the Group. In addition, fixed deposits amounting to HK$3.4 million (2001: HK$3.4 million) were pledged in respect of a bank guarantee issued to a customer of a subsidiary. At 31st December, 2001, bank deposits of HK$50.0 million and certain investment properties with a carrying value of HK$4.8 million were pledged as securities for bank loans granted to the Group.

Contingent Liabilities

As at 31st December, 2002, the Company had provided a counter guarantee for a bank loan of approximately HK$52.9 million (2001:HK$57.9 million) granted to an associate.

Hedging

As the Group makes its purchases substantially from overseas, it is the Group's policy to enter into foreign exchange forward contract to hedge against foreign exchange fluctuation whenever necessary.

Employees

At 31st December, 2002, the Group employed a total of 913 (2001:1,305) employees, of which 884 (2001:1,264) were employed in the PRC and 29 (2001:41) in Hong Kong. Out of the 884 employed in the PRC, 43 were temporary staff.

In addition to receiving salaries and bonuses, employees are also entitled to other benefits, including medical subsidies and employer's contributions to mandatory provident fund for Hong Kong staff, and Central Pension Scheme and supplementary defined contribution retirement plans managed by independent insurance companies for PRC staff. Certain employees are also given share options as incentives.