Management Discussion and Analysis

REVIEW OF RESULTS

The Group's consolidated turnover for year 2002 was HK$667,000,000 (year 2001: HK$709,200,000), representing a decline of 6% as compared to that of year 2001. Average gross profit margin increased slightly to 34% (year 2001: 33%).

Loss attributable to shareholders for year 2002 decreased by 10% to HK$38,600,000 (year 2001: HK$42,800,000). The main reasons for the loss were:

1. Since the "911" terrorist attack, consumer sentiments in the United States have not recovered as anticipated. Customers are still taking very conservative procurement strategies;

2. The strike of dock workers on the West Coast in the United States at the end of year 2002 affected the Group's delivery process and some deliveries were unable to reach customers in time to meet the peak retail season; and

3. Some subsidiaries of the Group are yet to fully function and thereby have caused financial burdens to the Group.

Notwithstanding the difficult operating conditions in year 2002, the Group has adopted actively the following measures to minimise losses:

1. Endeavoured to obtain more favourable procurement terms from suppliers; and

2. Strived to reduce unnecessary manpower and operating processes through a simplified corporate structure.

In year 2003, the Group will further reinforce these measures and expects to achieve better results.

For year 2002, the United States and Europe remained the Group's largest markets.

Sales to the United States declined by 18% to HK$326,700,000 (year 2001: HK$399,400,000), representing 49% of the Group's total turnover (year 2001: 56%). Since the "911" terrorist attack, the United States economy had sunk to a low trough, with rising unemployment rate and drastic drops in consumer sentiments. Despite the repeated downward adjustments of interest rates by the Federal Reserve Board of the United States, the economy remains sluggish and shows no substantial recovery. In the peak delivery season in the second half of year 2002, orders received by the Group increased significantly. However, negative impacts caused by the strike by dock workers on West Coast in the United States and the Middle East crisis directly slowed down the recovery of the Group.

After injecting substantial resources into the European market in the last three years, the Group has strengthened the local sales network. In spite of the difficult operating environment, sales to the European market recorded a growth of 3% to HK$251,800,000 for the year under review (year 2001: HK$245,100,000), representing 38% of the Group's total turnover (year 2001: 35%).

Overview of Sales Network

For year 2002, loss of the Group was mainly due to overseas subsidiaries. In the last few years, the Group injected substantial resources in the United States, Europe and Australia to establish a comprehensive sales network.

Silkroadgifts, Inc. (USA)

Subjected to the weak economy and high unemployment rate in the United States, Silkroadgifts continued to record losses for the year under review, albeit the extent was smaller than that in year 2001. In the middle of year 2002, the management of the subsidiary actively implemented several measures to trim costs, including transferring product research and development and after-sales services to the PRC to minimize operating costs, and preliminary results have been achieved. The management believes that with the improving operating conditions, the subsidiary is expected to breakeven in year 2003.

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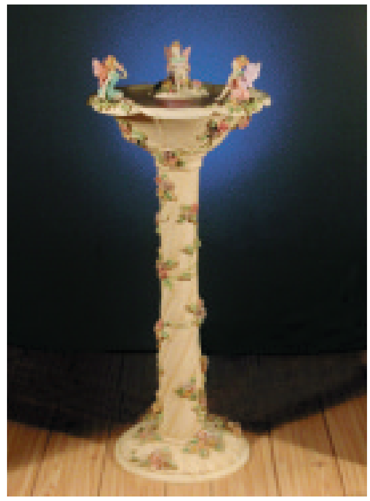

Sunterra, LLC (USA)

Sunterra is a joint venture company established at the end of year 2001 by the Group with L.R. Nelson Corporation, a market leader in gardening products in North America. Sunterra positions itself primarily in the market for outdoor gardening products and targets at Nelson's existing customer base of major chain stores such as Lowe's, Home Depot, Wal-mart and Sams, while the products are manufactured by the Group's state-of-the-art manufacturing technology.

During the year under review, Sunterra was still in the set-up stage of operation and therefore losses were sustained. However, the management expects that the operation of the joint venture company will gradually reach maturity and the losses will be reduced.

Heissner AG (Germany)

After two years of reorganisation, loss sustained by Heissner has been greatly reduced during the year under review. Loss for the year included an amount of over HK$3,000,000 which was spent on professional consultancy fee and accounts' clean up. With the technology transfer from Heissner, the Group has successfully developed a number of high-quality water pumps and related products in the PRC, in order to achieve the Group's production goal of "high quality at low costs".

Peaktop Technologies Italy s.r.l. (Italy)

Since the beginning of year 2002, the Group has endeavoured to transform Peaktop Technologies Italy s.r.l. from a service centre to a sales centre, and a small factory was established mainly to engage in assembly of aquarium and water pumps and related research and development activities. It coordinates with local manufacturers to manufacture bulky products in Italy, thereby lowering the transportation cost and shortening delivery lead time. During the year under review, Peaktop Technologies Italy s.r.l. recorded slight loss.

Waterwerks Pty. Ltd. (Australia)

During the year under review, the performance of this subsidiary was very encouraging. In addition to substantial profit, the sales volume was also increasing significantly. Looking ahead, the subsidiary will continue to focus on the sale of water gardening products in Australia and New Zealand. It is envisaged that the subsidiary will sustain satisfactory growth.

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FINANCIAL AND MANAGEMENT REVIEW

Cost Control

Notwithstanding the undesirable operating environment in year 2002, the Group continued to endeavour to minimize cost of sales. Through bulk purchase and effective utilization of production technology, the Group's gross profit rose steadily from 27% in year 1999 to 34% in year 2002.

Selling, General and Administrative and Other Operating Expenses

Total selling expenses of the Group in year 2002 was HK$111,600,000, representing 17% of the total turnover (year 2001: HK$127,600,000, representing 18% of total turnover). The main reasons for the decrease in selling expenses were the decrease in total turnover and reduction in costs.

Total general and administrative expenses of the Group for year 2002 was HK$136,300,000 (year 2001: HK$132,100,000). The increase in general and administrative expenses was principally due to the Group's actions in streamlining the operations of overseas subsidiaries, hence leading to expenses in professional fees and certain one-off expenditure such as redundancy payment and contract termination costs.

Other operating expenses of the Group in year 2002 was HK$3,700,000 (year 2001: HK$8,700,000), mainly consisting of write-off of accounts receivable. The Group has implemented a series of effective credit control measures to minimize provisions for accounts receivable.

Share of Loss of An Associate

During the year under review, for the first time the Group had to share a loss of HK$3,500,000 attributable to Sunterra, LLC, a joint venture company in the United States.

Liquidity, Financial Resources and Finance Costs

The Group finances its operations with internally generated cash flows, banking facilities and issue of new shares. As at 31 December 2002, the Group had aggregate available banking facilities of HK$330,100,000, of which HK$274,400,000 was utilized and subject to floating market rates. The Group's cash and bank balance at that date amounted to HK$34,800,000, denominated in United States dollars, Hong Kong dollars, Euros and Renminbi. This together with unutilized banking facilities will enable the Group to fund its operational needs.

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As at 31 December 2002, the Group's current ratio and quick ratio were 86% and 45% respectively (As at 31 December 2001: 81% and 46% respectively). At that date, the Group's total borrowing amounted to HK$281,800,000 (As at 31 December 2001: HK$225,400,000), which included short-term borrowing and long-term borrowing of HK$204,900,000 and HK$76,900,000 respectively. The increase in total borrowing was due to the long-term mortgage loan obtained by the Group on the pledge of the property in the PRC as collateral and the additional imports trade financing to deal with the peak production period at the end of year 2002. As at 31 December 2002, the Group's gearing ratio, defined as total borrowing as percentage of total assets, was 43% (As at 31 December 2001: 38%).

Following the lowering in interest rates and prudent financial management, the total finance costs incurred by the Group during year 2002 decreased by 10% to HK$19,500,000 (year 2001: HK$21,700,000). The Group continues to implement prudent financing policy to reduce short-term borrowing as far as possible in order to ensure that the Group will not be affected by short-term uncertainties.

Capital Expenditure

The Group incurred a total capital expenditure of HK$41,900,000 in year 2002, which included: HK$13,300,000 for expanding the manufacturing plants in the PRC, HK$10,900,000 for acquiring machinery and equipment in the PRC, HK$10,000,000 for acquiring machinery, office and production equipment in Europe, and HK$7,700,000 for acquiring other fixed assets.

Placement of New Shares

In order to reinforce its financial resources, the Group made three new shares placements in year 2002, generating a total of HK$65,900,000 before deduction of related expenses. The proceeds would be used for the following purposes:

(1) HK$14,000,000 for investment in new projects in the PRC and the United States;
(2) HK$21,000,000 for the expansion of the Group's production facilities in the PRC and Italy;
(3) HK$8,000,000 for research and development of new products;
(4) HK$16,900,000 as additional operational funds for the Group; and
(5) HK$6,000,000 for repayment of the Group's short-term borrowing.

As at 31 December 2002, an amount of HK$13,300,000 from the proceeds generated from the placements was not utilized and deposited in the bank account. This amount would be used for the following purposes:

(1) HK$2,000,000 for research and development of new products;
(2) HK$5,300,000 as additional operational funds for the Group; and
(3) HK$6,000,000 for repayment of the Group's short-term borrowing.

Proceeds obtained from the aforesaid placements of new shares will directly and effectively increase cash flow, enhance the capital base and lower the debt ratio. In the long run, the Group will strive to diversify financing channels through banks and the capital market and maintain an appropriate gearing ratio to ensure stability of its capital structure.

Foreign Exchange Exposure

For the year 2002, the Group's major revenue was denominated in the United States dollars and Euros, while banking facilities repayment and purchase were made essentially in the corresponding currencies and Renminbi, thus establishing a natural hedge. During the year under review, the Group was exposed to relatively low risks of exchange fluctuations. To further reduce exchange risks, the Group has utilized foreign exchange hedging tools and will continue to closely monitor exchange rate movements.

Contingent Liability

As at 31 December 2002, the Group had contingent liability of HK$6,500,000 (As at 31 December 2001: HK$13,500,000) for bills discounted with recourse.

Charge on Assets

As at 31 December 2002, certain assets of the Group with aggregate carrying value of HK$234,800,000 (As at 31 December 2001: HK$174,300,000) were pledged to secure loan facilities utilized by the Group.

EMPLOYEES

As at 31 December 2002, the Group had a total of 6,800 employees. Total staff costs incurred during the year 2002 amounted to HK$153,500,000. The Group offers a comprehensive remuneration and benefit package to its employees, and remuneration policies are reviewed by the management on a regular basis.

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The Group also adopts a share option scheme which is reviewed and revised periodically in accordance with the latest statutory requirements. The Group has already taken into account the comparable remuneration level of the market when structuring the scheme.

Product Development Strategy

The Group will continue to focus on the development of its giftware business:

(1) Development of Functional Giftware Products

The Group will focus on the development of more advanced technology products that comprise of mechanical structure and electronic components, such as rotatory motion and lighting.

(2) Development of Composite Material Giftware Products

The Group will develop technically advanced and yet aesthetic products by combining the use of materials such as plastic, metal, glass, and wood.

In addition to the aforesaid direction relating to the giftware business, the Group will pursue the following directions in order to transform its business gradually:

(1) Industrialized Production of Artistic Products

Based on our existing artistic concepts on a large industrialized production, the Group will develop automated production techniques utilizing both resin and plastic materials in order to achieve the goal of "high value at low cost".

(2) Industrialized Products Made Artistic

The Group will combine artistic concepts in the production of common industrial products, such as plastic, stationery, and household items, to enhance the aesthetic image and discard the impression of low value merchandise.



PROSPECTS

As the global situation gradually stabilises, the Group anticipates orders from customers to grow steadily. According to sales statistics in the latest three months, a growth rate of 20% to 25% (as compared with the same period in year 2002) has been recorded for the Group. To prepare for the peak sales season in the second half of year 2003, the Group will launch new products and expect to be able to penetrate into the market successfully.

In view of overseas sales network, the Group believes that the related investments have begun to show fruition and no further substantial investment is expected in the short-term. Meanwhile, the Group will continue to proactively streamline and reorganise its overseas subsidiaries. The Group strongly believes that certain loss-making overseas subsidiaries will be able to turnaround in year 2003. As the performance of overseas subsidiaries gradually improves, the Group is highly confident in the coming year.

With the continuous support of our shareholders, the Group's management and the staff will continue to do their best to seek and maximize long-term and stable return on investment for the Group and its shareholders.