Management Discussion and Analysis

TTI recorded a very solid performance in the first half of 2003, with revenue increasing by 21.6% over the same period of last year to HK$4.8 billion and profit rising by 24.1% to HK$210.8 million. Our robust double-digit revenue and profit increases came largely from existing businesses.

During the six months under review, an unprecedented combination of negative factors prevailed. The war with Iraq, together with the outbreak of severe acute respiratory syndrome (SARS), affected the confidence of consumers and retailers. Despite this, there was little impact on TTI's businesses, testifying to our highly competitive position in the home improvement market and the relatively resilient nature of the market itself. Nonetheless, we shifted the timing of several new product launches to the second half of the year, further positioning the Group for even stronger growth in revenue in that period.

Sales were driven by good performances across the board in power tools, outdoor power equipment, floor care equipment and solar powered lighting and electronic measuring products, under both our own growing stable of brands and for our private label customers.

At the same time, we were able to maintain our overall margins despite a slight dilution effect from our recently acquired Royal business and its related acquisition costs. We continue to improve our margins through rationalising our operations, leveraging the economies of scale provided by our higher revenue base, as well as centralisation of functions such as raw material purchasing.

While achieving excellent results from our existing core businesses and successfully concluding the Royal acquisition, we have also developed a new line of professional power tools. This will be an important new growth driver that complements our existing power tool product categories.

In June 2003, we issued a US$145 million fixed rate note. The issue was a great success and has helped the Group to continue to balance its rapid growth with prudent financing structure and strong management control.

Business Review

Power Tools and Outdoor Power Equipment

The power tools and outdoor power equipment division achieved an increase in turnover of 13.1% as compared with the first half of last year to HK$3.7 billion, accounting for 76.7% of Group turnover.

Growth was seen in all key markets and all product segments, despite an inventory adjustment by retailers in the first quarter and, in the case of outdoor power equipment, the negative effect of unusually wet weather. Sales of Ryobi power tools were again satisfactory as we significantly expanded the product line and continued to align the brand in global markets.

We have also successfully developed a range of professional grade power tools that will be available nationally under the RIDGID® brand in industrial supply channels and The Home Depot (the world's largest home improvement specialty retailer) in the United States and Canada beginning in October. Extensive consumer research provided a springboard for developing the tools, which will give us entry to this important market segment in the second half of 2003.

In Europe, significant progress was made in developing a continent wide structure and management processes. This not only creates efficiencies, but also allows improved product introductions and marketing programs across the region, aiming at the high volume consumer retail market.

In outdoor power equipment, we have completed the transfer of manufacturing from Mexico to our facilities in the United States and China. The expanded capacity following the plant relocation enables us to benefit from further increased economies of scale, resulting in improved profitability. New products were introduced, with the "Expand-it" attachment system being particularly well received by the market. Overall, this division continues to move ahead of the industry in its performance.

The solar powered lighting and electronic measuring products business also recorded very outstanding results. Robust sales of portable electronic and laser tools were the main contributors to this impressive performance.

Floor Care Appliances

Turnover at the floor care appliances Division grew by 61.4% over the same period of 2002 to HK$1.1 billion, accounting for 23.3% of Group turnover.

The solid growth reported by this division was mainly driven by healthy OEM sales in the US market. The performance of Royal was in line with expectations and the integration of the acquisition since April has been smooth, with the very effective original management team remaining in place.

The division continued to be aggressive in containing costs. Centralised purchasing on higher volumes reduced average raw material costs. The programme to involve product suppliers in product development began to bear fruit as quality improved and we were able to secure improved terms from suppliers.

Production and Logistics

One of TTI's strengths is its ability to design and manufacture products at competitive costs. During the first half of the year, we continued to ensure that our factories operated at optimum levels of utilisation.

To this end we implemented improved processes in China to accommodate higher volumes, especially following the transfer of production of Homelite products. Our ability to achieve higher volumes on a fixed overhead has been a factor driving our growth in profit.

We have recognised the need to plan for extensive future growth. Accordingly, we have begun construction of a major new manufacturing and R&D complex close to our existing facilities in southern China. This is dedicated space built to our specifications and will come on stream in phases beginning in 2004. Upon completion of the whole project, it will double our existing capacity, enabling us to meet the R&D, engineering and production needs of our branded businesses and OEM clients in the most cost effective manner.

Control of inventory and tighter integration of our inventory management with that of major customers continued, with a particular focus in Europe, where we have begun to put in place new monitoring procedures designed to improve inventory performance.

Outlook

Our current order book remains robust, indicating an even better performance for the second half of 2003. We believe our business to be highly resilient to changes in consumer sentiment and spending patterns, given the nature of the home improvement market and the range of price points our products cover, combined with flexible production processes.

Power tools will remain one of the key growth drivers. We expect continuing strong sales of Ryobi® brand products to be complemented by an aggressive launch of our RIDGID® range of professional tools. These are leading-edge products that by virtue of their design, durability and handling comfort have seen a very enthusiastic response from our retail partner and the trade. Together with the need we already perceive of retailers to rebuild inventory, the usual cyclical pattern of a bias in sales towards the second half of the year will be accentuated in 2003.

Solar powered lighting and electronic measuring products are forecast to repeat their outstanding sales performance of the first half. We expect the rapid momentum to be maintained as we broaden our ODM partnerships, enter into value added new product categories and invest into developing new technologies for the future.

The Royal operation will benefit from a number of innovative items to be launched in the second half, boosting its revenue contributions to the Group. We also expect our Vax operations to gain from the greatly increased economies of scale we now have in floorcare appliances and from the new line of products that we are adapting from the Royal range. Armed with an impressive array of patents and the important, high volume retail distribution channels Royal offers, we expect to build on our leading position in this sector.

Rationalisation of operations is allowing us to achieve much higher volumes on a steady overhead. The shift of production to Asia, especially for floorcare appliances and outdoor power equipment, will continue to drive down manufacturing and R&D costs. The Group expects this will enhance the overall margin.

In summary, short of any major adverse shocks to economic activity, we see our business well positioned to deliver strong growth in the second half, as we continue to build our profile in world markets.