

# MANAGEMENT DISCUSSION AND ANALYSIS

## DIVIDENDS

The Board of Directors recommends a payment of a final dividend of HK12.0 cents per share for the year ended 31 December 2003. Together with the interim dividend of HK6.0 cents per share, the total dividend for the year ended 31 December 2003 is HK18.0 cents per share.

## MANAGEMENT DISCUSSION AND ANALYSIS

Driven by the fast growing domestic furniture industry and rocketing consumer market in China, the Group again enjoyed record-breaking annual business results with turnover reaching HK\$300.7 million, a surge of 45.3% from 2002. Operating profit also rose 73.4% to HK\$89.0 million while net profit increased 73.5% to HK\$77.2 million as compared to HK\$44.5 million in 2002. The Group was also able to sustain healthy margins supported by brand ownership and stringent cost controls. In addition, the cost of wood as a raw material was also stable during the year. For the year ended 31 December 2003, we recorded a gross profit margin of 35.8% as compared to 35.3% in 2002. At the same time, net profit margin improved from 21.5% last year to 25.7% this year.

As the Group targets at the medium to high-end home furniture markets where we already have an established presence, we have, despite intense competition in the overall furniture industry in China, maintained our leading status in the apex of the home furniture industry under our high-return business model. The Group owns the brand and distributes our products through an extensive franchisee network.

During the year, the Group marketed four series of medium to high-end modern style home furniture - "Light Walnut", "Ebony", "Black Walnut" and "Glossy" - under the brand names "Royal" and "Knight". The Group was pleased to have received overwhelming responses from the market during the year. Among them, "Light Walnut" contributed the highest sales while "Glossy" was launched in October 2003. The Group's strong product design and development team normally develops two new product series each year. In recognition of its achievements in product design, the Group was ranked first in 2003 by "Modern Furniture", a leading furniture magazine in China, in a number of award categories, including product quality, service and management.

The Group's core competency is to focus on product design and manufacturing while outsourcing the distribution model through a franchise system. The Group maintained close business partnerships with our distributors and we have 600 specialty outlets in 29 provinces in China as at 31 December 2003. The franchisees nationwide conformed to the Group's required product and store layout while the Group was responsible for branding, marketing and advertising. To enhance brand image, the Group appointed celebrity Ms. Rosmund Kwan as the spokesperson for the Group. In November 2003, TV commercials featuring the celebrity were launched on main media channels such as CCTV and Phoenix Satellite. These marketing efforts helped the Group promote and extend our brand recognition to potential franchisees and end-users throughout China.

During the year, the Group's other revenues include the service fee generated from sourcing non-wooden furniture accessories for our franchisees and have become another key income stream for the Group, contributing HK\$12.6 million this year. At times, the franchisees sourced lower-end quality non-wooden products to complement the Group's branded furniture. In order to maintain consistency with our overall image and style, the Group is now sourcing the majority of furniture accessories for our franchisees, and this has also broadened our revenue stream.

With regard to our production, the Group has established a new three-storey facility, a new storage and a distribution terminal adjacent to our existing site. Currently, the Group has a maximum monthly production capacity of 10,000 sets of furniture with a total production floor area of 70,000 sq.m. as well as 100,000 sq.m. factory site area in Guangzhou, China. In view of the potential growth in demands for our branded furniture products, the Group has also rented a factory in Dongguan during the year. A total capital expenditure of HK\$30 million will be financed by internal resources. The new facility will increase the existing monthly production capacity by about 30% to 40%. These investments will sharpen the Group's competitive edge in terms of efficiency and flexibility to meet the escalating demands for quality home furniture in the market.

### PROSPECTS

The thriving China economy backed by the country's entry into the WTO and our competitiveness as an international production hub will continue to boost consumer spending. The Group believes that as the rate of urbanization increases and living standards improve, the furniture market will become one of the fastest growing consumer goods categories in China. Thus, the Group is optimistic about the prospects of the domestic furniture market and expects to achieve promising growth in the next few years.

Building on the established reputation of the Group's brands, "Royal" and "Knight" Furniture, the Group is committed to further strengthening our product design capabilities. It is also crucial for the Group's long-term development to protect our intellectual property. To date, the Group has already obtained over 100 patents on our product designs. With strong support from the local government, the Group is confident that infringements will be curbed and that our intellectual property will be well protected. The Group recently launched two new furniture series, "Light Oak" and "Glossy", which are targeted at the younger and more mature generations respectively. The new product series have received positive market feedback from distributors and customers.

As the Group's specialty outlets are already widely distributed in major cities in China, the Group is positioned to actively pursue market diversification in the county cities. As these cities develop, our growth in these county cities will be strong with their relatively smaller economic structures and wide existence in China. The Group targets to reach a total of 1,000 specialty outlets by the end of 2005. To accelerate growth, the Group will continue to launch extensive marketing and promotional activities to potential distributors and consumers around the country.

With reference to our production facilities, we will continue to maintain an efficient and flexible operation. Production efficiency is expected to be improved as the Group enjoys economies of scale with larger production volume. The newly established storage and distribution terminal will also enhance logistics in support of the Group in meeting customer requirements.

As one of the leading home furniture brand names in China, the Group is creating value for our investors and business partners. Through the integration of market driven products, superior design capabilities, quality and efficient production, solid branding strategies and an extensive distribution network, the Group is paving the way for sustained growth in the future.