management's discussion and analysis

RESULTS ANALYSIS

The Group recorded 38.9% growth in turnover to HK$13.18 billion for the year, boosted by strong organic growth and contributions from acquisition. Net profit, despite a slight dilution effect from the newly acquired operation, surged by 63.2% to HK$674 million. Earnings per share were HK$1.03, an increase of 56.1% as compared to HK$0.66 in 2002. Return on shareholders' funds improved to 26.8% as compared to the restated 22.6% in 2002.

Gross Margin

Gross margin improved by 3.6% points in 2003 to 29.6%, translating into a gross profit of HK$3.90 billion for the year. The improvement in gross margin was the result of our growing economies-of-scale and efficiency gains, reflecting the Group's ability to improve its manufacturing costs by leveraging higher business volumes. A more favourable sales mix together with the newly acquired operation also contributed to the gross margin gains.

Selling, Distribution, Advertising and Warranty Expenses

Total selling, distribution, advertising and warranty expenses increased by 54.5% over 2002 to HK$1,575 million. The increase in the expenses was due to expanded volume of business and the acquisition of Royal, which has a higher cost structure than the Group. Advertising and warranty expenses remained in line with the revenue growth. A series of cost rationalisation programmes will be implemented to improve the cost structure. Incremental sales from the current cost base will also improve cost efficiencies.

The contribution of the Group's branded businesses, following the Royal acquisition, increased to 68.0% of total revenues from the 52.0% reported in 2002, while the contracted business remained at 32.0%, levels we regard as strategically appropriate.

Research and Development Expenses

The design and development of innovative, high quality products at competitive prices is vital to the Group's long-term growth. The Group spent HK$268 million on R&D in 2003, representing 2.0% of total Group turnover and an increase of HK$156 million over 2002. In addition to the continuing new product programmes at our business divisions, the increase was attributable to the development of a new and comprehensive line of professional power tools, which was launched to the market under the Ridgid® brand in the second half of 2003.

Administrative Expenses

Following the integration of the newly acquired Royal operation, administrative expenses for the year increased by 50.9% to HK$1,247 million, representing 9.5% of total turnover. Stripping out the impact of the acquisition, the Group's administrative expenses as a percentage to sales improved as compared to 2002.

Taxation

In 2003, our internal restructuring and relocation of manufacturing activities contributed to the reduction in the effective tax rate from 14.2% in 2002 to 8.7%. Deferred tax credits at overseas subsidiaries also contributed to the lower effective tax rate.

LIQUIDITY AND FINANCIAL RESOURCES

Shareholders' Funds

Total shareholders' funds amounted to HK$2,513 million as at 31st December, 2003, representing an increase of 37.5% from HK$1,828 million as reported last year. Book value per share, despite the increase in number of shares issued from the exercise of options during the year, rose 33.9% to HK$3.79, as compared to HK$2.83 reported in 2002.

Financial Position

As at 31st December, 2003, the Group was in a net cash position of HK$740 million as compared to HK$520 million in 2002. This was after the settlement of the Royal acquisition, which was fully funded by internal resources and the additional working capital required for a much expanded operation. The improvement from a gearing level of 53.1% as reported as at 30th June, 2003 to net cash demonstrated the high cash generating capabilities of the Group, particularly in the second half of the year. Free cash flow increased from HK$612 million to HK$1.26 billion in 2003.

Net interest expenses amounted to HK$79 million for the year as compared to HK$70 million reported in 2002. The increase was relatively small taking into account the acquisition early in the second quarter of the year and the increased scale of operations. The Group continued to benefit from the low interest rate environment and its efficient working capital management. Interest cover, expressed as a multiple of profit before interest and tax over total net interest expenses, was at 10.4 times as compared to 7.9 times reported in 2002.

Bank Borrowings, Notes Issue

Taking advantage of the low interest rate environment, the Group arranged its debut issue of fixed interest rate Notes on 30th June, 2003, through its wholly-owned entity in the United States. The Notes were issued in two fixed-rate tranches, of US$120 million for 10 years at 4.7% per annum, and US$25 million for 7 years at 4.09% per annum, with an aggregate principal amount of US$145 million. The proceeds of the Notes were used to refinance existing medium-term debts and for general working capital. The Group now has a better loan portfolio structure to support its long-term growth. As at 31st December, 2003, the split between short-term and long-term bank borrowings stood at 27.0% and 73.0% respectively (2002: 58.5% and 41.5%).

The issue of the Notes and the inclusion of debts from the Royal acquisition have resulted in total borrowings increasing by HK$520 million to HK$1.87 billion as at 31st December, 2003. Compared with the HK$2.37 billion in debt reported at the interim, the Group has managed to reduce total borrowings by over HK$500 million during the second half of 2003. Bank balances and cash were at a very healthy level of HK$2.59 billion, an increase of over HK$700 million compared to 31st December, 2002.

The Group's major borrowings are in US Dollars and HK Dollars. Other than the fixed interest rate Notes issued during the year, all borrowings are based on LIBOR or Hong Kong best lending rates. As the Group's revenues are mainly in US Dollars, and major borrowings and payments are in either US Dollars or HK Dollars, there is a natural hedge mechanism in place and currency risk exposure is relatively low. However, the Group will continue to monitor and actively manage its currency and interest rate exposures.

Working Capital

The Group's working capital position remained healthy. Net current assets as at 31st December, 2003 was at HK$1,985 million (2002: HK$1,155 million), an increase of 71.9% and current ratio at a healthy level of 1.35 (2002: 1.29).

Inventory level increased by 56.6% to HK$2.49 billion (2002: HK$1.59 billion) and overall inventory turnover days were at 57 days (2002: 46 days). The increase was mainly due to the Royal acquisition during the year and additional finished products built at the end of the year with delivery scheduled in early January, 2004. As a result, finished goods turnover days increased to 39 days from 28 days in 2002. Raw material and Work in Progress turnover days remained stable at 18 days (2002: 18 days). The Group remains focused on controlling the inventory level to manage its working capital more efficiently.

Trade receivables turnover days increased from 33 days in 2002 to 45 days in 2003 with the inclusion of the receivables from Royal, whose credit arrangements differ from those of the Group.

Although the Group is comfortable with the current receivables turnover days, it will work on improving payment arrangements with customers. The Group did not experience any material bad debts that required writing off during 2003.

Trade and other payables turnover days were at 49 days as compared to 51 days in 2002. Bills payable turnover days increased from 43 days in 2002 to 61 days. As its business volume expanded, the Group received more favourable payment terms from its suppliers. In addition, capitalising on the low interest rate environment, we extended our financing arrangements through banks.

Acquisitions

The Group completed the acquisition of Royal Appliance Mfg. Co. ('Royal') on 23rd April, 2003 (US time). The total consideration was US$109 million (approximately HK$852 million), financed by internal resources. Upon completion of the transaction, Royal began operating as a wholly owned subsidiary of TTI.

The integration of the Royal operations is substantially complete and has benefited from management continuity. The Group is now working to achieve efficiencies for the Royal operations by migrating production to its cost-effective Asian manufacturing base.

Capital Expenditure

Capital expenditure for the year, apart from acquisitions, amounted to HK$242 million and was in line with the Group's guideline to match the depreciation charges for the year of HK$304 million.

Capital Commitment and Contingent Liabilities

During the year, the Company entered into an agreement for the acquisition of a piece of land in Dongguan PRC that amounted to approximately HK$50 million. As at 31st December, 2003, the capital commitment not provided on the cost of land amounted to approximately HK$43 million. Total capital commitment in 2003 amounted to HK$89 million (2002: HK$68 million).

As at 31st December, 2003, there were no material contingent liabilities or off balance sheet obligations other than trade bills discounted during the ordinary course of business.

Charges

As at 31st December, 2003, the Group has pledged certain freehold land and building having an aggregate net book value of HK$14 million to secure general banking facilities granted to the Group. The pledge has been released after year end upon the mortgage loan being paid off.

MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31st December, 2003:

i. The Group's largest customer and five largest customers accounted for approximately 39.0% and 65.4% respectively of the Group's total turnover.
ii. The Group's largest supplier and five largest suppliers accounted for approximately 4.2% and 18.5% respectively of the Group's total purchases (not including purchases of items which are of a capital nature).

According to the knowledge of the directors, none of the directors, their associates or any shareholders who owned more than 5% of TTI's share capital had any interest in the five largest customers or suppliers.

HUMAN RESOURCES

Following the expansion of the Group's operations and the acquisition of Royal, as at 31st December, 2003, the Group employed a total of 16,000 employees in Hong Kong and overseas (2002: 12,000 employees). Total staff costs for the year amounted to HK$984 million (2002: HK$625 million).

The Group continues to provide job-related training to all level of staffs to improve their skills and competencies as it believes that human capital is vital to its continuous growth and profitability.

The Group also offers competitive remuneration packages, discretionary share options and bonuses to all eligible staff based on individual and Group performances.

INVESTOR RELATIONS AND COMMUNICATIONS

The Group understands the importance of maintaining effective communication with our shareholders and the investment community. Regular meetings with analysts and institutional shareholders were conducted to promote investor relations and communications. The Company also maintains a website which is updated on a timely basis to ensure all parties receive our latest corporate information.

PURCHASE, SALES OR REDEMPTION OF SHARES

There has been no purchase, sales or redemption of shares of the Company by the Company or any of its subsidiaries during the year.

AUDIT COMMITTEE

The Audit Committee is composed of a majority of independent non-executive directors. The Audit Committee has reviewed with management the accounting principles and practices adopted by the Group and discussed internal controls and financial reporting matters including a review of the audited final financial statements for the year ended 31st December, 2003.

CLOSURE OF REGISTER OF MEMBERS

The Register of Members of the Company will be closed from Monday, 14th June, 2004 to Friday, 18th June, 2004, both days inclusive. In order to qualify for the final dividend to be approved at the Annual General Meeting, all transfers accompanied by the relevant share certificates must be lodged with the Company's Share Registrars, Secretaries Limited, at G/F, BEA Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong not later than 4:00p.m. on Friday, 11th June, 2004.