

MANAGEMENT DISCUSSION AND ANALYSIS

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Bankee KWAN
Chairman & CEO



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In the first two quarters of the year, the general business environment continued to slow down following the five-year long deflation. The spread of severe acute respiratory syndromes (SARS) epidemic since March had caused further adverse impact as a whole and the retail business in particular. As reported by the Government's Census and Statistics Department, retail sales value as a whole had declined by 6.7% in the first half of the year. For the first six months of 2003, total sales of Pricerite amounted to HK\$388.3 million, representing a 16.7% decline from the same period in 2002.

During the year, deflation had deepened to an annual rate of 3.1% in June. Furthermore, the lack of investor confidence had led to a worsening of the business condition. In May to July, unemployment had reached the record level of 8.7%. Consumer sentiments had hence declined to a new low.

Since July, the Hong Kong economy started to recover fairly rapidly. Among other developments, the Central Government announced to grant HKSAR the Closer Economic Partnership Agreement (CEPA), granting Hong Kong produced products free of import duties from January 2004. The Central Government also announced to lift certain restrictions on the travelling of Mainland visitors to Hong Kong, which led to a significant increase in visitor flow.

The property market also showed signs of improvement in the fourth quarter with prices stabilised and transaction volumes steadily going up. Such improvements reflected the increase in consumer and investor confidence.

The business of Pricerite had been recovering since then, particularly in the furniture division. In December, furniture sales had recovered to exceed the December sales in 2002 by 36.2%.



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As a summary to the overall performance of the year's business, the sales revenues have been maintained at HK\$836.0 million, as compared to the 2002 level of HK\$889.9 million.

Amid the ups and downs in the economy, Pricerite continued to sharpen our business edges to provide the best value and quality lifestyle and basic home improvement solutions to customers.

Fast and Timely Response to Customer Needs

During the early SARS period, we envisaged the significance of on-line shopping and promoted our on-line shopping channel, www.pricerite.com.hk, to boost sales. As a result, our on-line sales increased by 6.9% in 2003. In response to increasing customer demand, we had strengthened our cleaning and sterilising products to capture the increasing health and hygiene awareness of our customers.

Enriching our Product Mix

We further extended our product mix to cater for customer needs as they emerged. We saw an increasing trend in product specialisation and hence we opened the IT Corner, and expanded the Small Office, Home Office (SOHO) Division in our flagship stores. We also started to provide professional and personalised customer service in choosing these products.



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Strengthening our Brand with the Relationship of our Customers

To further associate our brand with our “customer-caring” motto, we continued to provide quality products to meet with customers needs. Furthermore, we joined with major merchants and credit card companies to provide promotional offers to our customers. Such merchants included the Bank of China, the Standard Chartered Bank, the Dao Heng Bank, Epson, MacDonald’s, and Kentucky Fried Chicken. To instil more “lifestyle” element into our “value for money” products, we launched a new corporate identity in June 2003 to further strengthen our brand power.



Enhancing our Customer Service

With an aim to constantly improve our customer service, we launched the interactive voice recording system in April 2003. To better equip our staff and to enhance their morale, we continued to invest in the “Service with Hearts” training programme to improve the product knowledge and communications skills of our staff.



Improving Customers’ Shopping Experience

We continued with the “room setting” visual merchandising strategy in our flagship stores. To further improve our store layout and product display, we had finalised our specifications and planning in the Planogram, which will allow visual planning of retail space utilisation and in turn maximise its efficiency. We also worked with Octopus Cards Limited to install the Octopus payment system in all of our stores to offer customers convenience and to improve our customers’ shopping experience.



REFOCUSING AND RE-ENGINEERING OF PRICERITE

With a view to maximise shareholder value, the board of directors made the effort to redefine the business model of Pricerite so as to build on our strengths and to capture the emerging business opportunities.



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Refocusing and Re-Engineering of Pricerite

Over the course of the year, the Pricerite board of directors had undergone an in-depth re-examination of the business model of Pricerite to focus on the following key performance indicators to improve overall performance: (1) category sales performance; (2) optimal mix and match of merchandising; (3) asset conversion cycles; (4) profitability analysis; and (5) financial performance.

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Bob CHAN
Managing Director



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Redefining our Strength

The Pricerite board of directors had engaged Ernst and Young to conduct a strategic diagnosis of our business model and to advise the board of directors on defining the strategic direction of future business growth. Mr Anthony Troughton, a veteran retail expert, had conducted an in-depth examination with our management team to redefine our strengths. Such strengths had enabled Pricerite to build on its retail business model and extend to an international supply chain management (SCM) business model focusing on furniture and household products.

Strategic Refocus of the Pricerite Business Model

The board of directors had also identified two critical factors pertinent to our strategic refocus: (1) the Hong Kong retail business and the international SCM business have significant complementary effects; and (2) the emergence of China as a major economic power and its strength in the manufacturing sector offer significant business opportunities in sourcing, merchandising, and the logistic setup of products.

Investment in IT

To support the strategy of migrating Pricerite into a global player in the furniture and household product markets, the board of directors had provided persistent support to re-engineer Pricerite.



In 2003 we had engaged in a major overhaul of the management information system. The first major component built and installed was the Pricerite warehouse management systems (WMS) that provided better performance control in the logistics of merchandising from the warehouse to the stores. The Pricerite WMS was a winner of the Intelligent 20, a regional information technology award that recognises outstanding business technological applications in the Asia Pacific region.

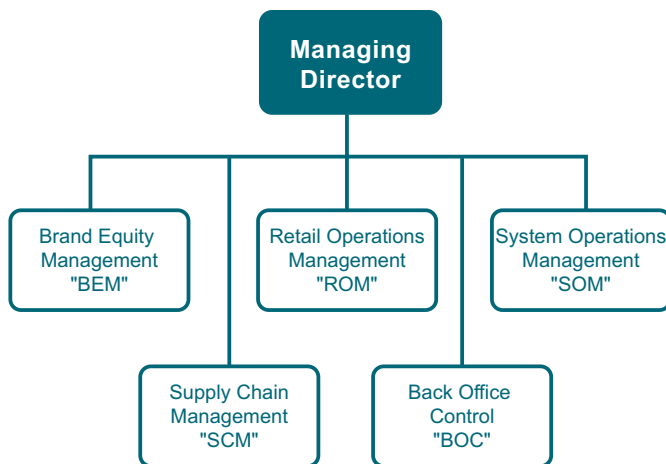
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Building the Structure for Long-term Growth

To ensure the success of our strategic refocus, the board of directors had made changes in the management organisation structure so as to further clarify management responsibilities and reinforce expertise in each of the functional areas. Pricerite operations are divided into five functional divisions: (1) brand equity management responsible for marketing, customer services and e-commerce; (2) supply chain management responsible for product sourcing, merchandising, quality assurance and vendor relations; (3) retail operations management responsible for retail network planning, store operations and staff training; (4) back office control responsible for the administrative functions, including accounting, human resources, information technology, loss prevention, and warehousing and logistics management; and (5) system operations management responsible for system design and enhancement (headed by the newly appointed chief operating officer, who is also responsible for spearheading the building of relevant management and control systems, and the continual examination of the Pricerite management systems to assure that the operation is consistent with the state of development of business.).



Management Organisation Structure



OUTLOOK

Our mission is to leverage on our unique strength in sourcing and supply chain management in the furniture and household products categories to scale up the sales of our products globally.



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CAPTIALISING ON GROWTH OPPORTUNITIES

Continual Growth of the Mainland Economy

The Pricerite board of directors is in a view that the Mainland economy will continue to be strong with a high growth rate in the next 3 to 5 years. Given the strong Mainland economy, the board of directors envisages substantial business opportunities for Pricerite.

The Mainland property market is expected to remain strong despite consolidation in certain geographical areas. The increase in household income will create significant demand for furniture and household products with higher levels of quality and styling. With our long operating history in the Hong Kong market, Pricerite is in a good position to tap into the fast growing market for quality furniture and household products.

Also, the manufacturing base in the Mainland will gain further strength and more global buyers will shift their purchase to the Mainland. Leveraged on the strong sourcing and merchandising platform we have built, Pricerite is in a good position and will aggressively move to develop our merchandising services for international clients in furniture and household products.

Business Opportunities under CEPA

The Pricerite board of directors is in a view that CEPA will bring significant business opportunities which will begin to take shape in 2004. Catered for the increased number of Mainland visitors, Pricerite is in the process of adjusting our product mix, especially in the household sections, to provide for the demand for quality and stylish household products for visitors, including products from overseas markets such as Japan, Korea, and the South East Asia. In addition, Pricerite will increase the lines of information technology products which are in high demand from Mainland visitors.

CEPA provides a favourable environment for Hong Kong companies to invest directly in the Mainland. Pricerite is actively seeking to capitalise on this advantage and speed up our investments in the Mainland market.



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Pricerite China

The board of directors expects to speed up our development for Pricerite China in 2004. Our first store in Guangzhou had recorded satisfactory results in 2003. Despite the SARS influence, the business had quickly picked up and returned to normal. Both sales and transaction count had experienced a remarkable growth in the second half of the year. Customer loyalty programs, including the Pricerite VIP card, had been launched. The feedback had been extremely positive as evidenced by the continuous increase of repeated purchases and average ticket value.

Besides our retail model, Pricerite China is actively negotiating with suitable business partners which have the local business network so as to shorten our time to market in the appropriate markets. Pricerite has the strategy to develop our operation in major cities such as Beijing and Shanghai. We also plan to expand our presence in Guangzhou given our improved understanding of customer taste and demand.

Growth of International Business

We began in earnest our international business development strategy this year. Our mission is to leverage on our unique strength in sourcing and SCM in the furniture and household products categories to scale up the sales of our products globally. Our Group is ideally located to leverage on China's growing low cost manufacturing base and our ability to mate this strength with our ability to develop products as well as work with international designers to produce world class products at competitive quality and prices.



We are currently reviewing and pursuing multiple distribution models in our international initiatives. These include buying agency service for European brand owners, FOB trading into European and north American territories, franchising as well as Build Operate and Transfer (BOT) models to develop Pricerite branded outlets abroad.

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We kicked off 2004 with two programmes. The first, our collaboration with the ARTAR Group of Saudi Arabia to develop both a Pricerite branded retail network as well as wholesale business in the Middle East region. The first Pricerite store is targeted for launch in Riyadh by the end of 2004. Our second initiative focused on the exploration and development of the European market. We exhibited a limited range of our product assortment at the Birmingham Spring Fair in February 2004 together with our sister companies Cosmos Global and Halo. Responses from potential buyers have been encouraging and we are in active pursuit to convert enquiries into FOB sales into the UK. We are also reviewing and refining the execution plan to enter the European market with a trade fair based FOB export model based on buyer feedbacks.

While we are not planning to build substantial international infrastructure in the near term, we are reviewing and considering market entry into Europe and North America by way of acquisitions.

