Management Discussion and Analysis

Business Review

With its continuous commitments on product quality and competitive pricing policy, Sewco was able to maintain a steady increase in its turnover under such difficult economic condition in 2003. Being established as a reputable OEM manufacturer in Hong Kong and Mainland China, Sewco was able to secure steady orders from its existing customers and attract new customers during the year under review.

With the change in market demand for hard toys and stuffed toys, sales of hard toys and stuffed toys for the year ended 31 December 2003 were 88.9% (2002: 68.9%) and 11.1% (2002: 31.1%) of the Group's turnover respectively.

Geographically, although sales to USA/Canada remained the largest segment through which 82.2% (2002: 86.2%) of the Group's turnover for the year was generated, the Group had recorded sales in other countries/cities, such as United Kingdom and Hong Kong, as a result of the new customers secured. Therefore the balances of 14.9% (2002: 13.8%) and 2.9% (2002: Nil) were attributable to the sales to Japan/others and Hong Kong/Mainland China, respectively. The Group did not record any material change in the rate of contribution to operating profit in terms of geographical segments.

Following the military action in Iraq and the continuous cutting of the production of oil by the Organisation of Petroleum Exporting Countries, the price of oil had remained at a high level during the year under review. The price of plastic, a by-product of oil, had also increased significantly as compared with that of last year. During the year, Sewco had experienced an average increase of 11.2% in the price of plastic , a major raw material used in the manufacture of its products. This adverse price change had put much pressure on the Group's profit margin and therefore pressed the Group's gross profit margin from 23.1% in 2002 to 14.6% in 2003.

The selling expenses and administrative expenses remained relatively stable for the year ended 31 December 2003 as compared with those of the last year. Selling expenses remained at 4.1% (2002: 4.1%)

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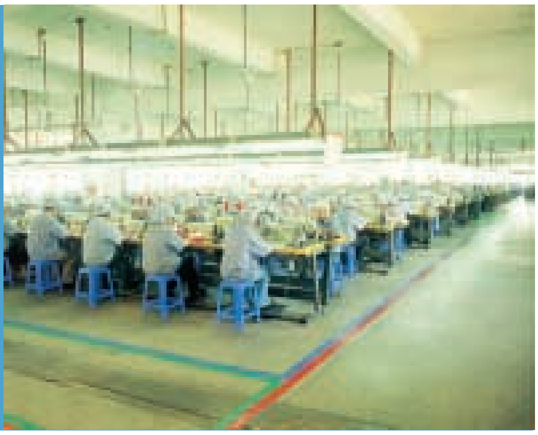

Sewco's production facilities

of the turnover for the year and the administrative expenses were controlled at HK$35,753,000 (2002: HK$36,734,000).

With its target in maximising the shareholders' return, Sewco continued to explore suitable development opportunities. During the year under review, Sewco had acquired 20% interests in two companies at a consideration of HK$6,440,000. These two companies are mainly engaged in the design and trading of toy products and Sewco had recorded share of profits and losses of associates of HK$4,000 (after netting the amortisation of goodwill on acquisition) for the year ended 31 December 2003.

In order to meet the expected increase in customer orders in the forthcoming years, the Group had started the construction of a new factory complex in Gangkou Zhen, Zhongshan Shi, Mainland China in 2002. This factory complex comprises a gross floor area of approximately 70,000 sq.m. and as at 31 December 2003, the total construction cost was approximately HK$55,304,000, which had been financed by part of the net proceeds of the initial public offer of 80,000,000 shares in March 2002 and the issue of 48,000,000 shares in June 2003 and the term loan facility offered by a bank. The construction of this factory complex had been completed in early 2004 and the production had also been commenced therefrom.

Except for the balancing payments of approximately HK$4,607,000 for the construction of the new factory complex, the Group did not expect to incur material capital expenditure in the coming year.

Liquidity and Financial Resources

During the year ended 31 December 2003, the Group principally financed its operating and investing activities by its internal resources, proceeds received from the initial public offering and the placement of new shares and bank borrowings.

As at 31 December 2003, the Group's cash and bank balances, which were mainly dominated in Hong Kong Dollars, US Dollars and Renminbi, amounted to approximately HK$56,349,000 (2002: HK$87,029,000).

During the year under review, the Group had accepted a term loan facility of HK$35,000,000 and a revolving loan facility of HK$20,000,000 made available to the Group for a term of four years and one year respectively (collectively, the "Loan Facilities"). As at 31 December 2003, the Group has utilised the term loan facility of HK$20,000,000 for the construction of the new factory complex. This loan facility is a clean loan without any charges or securities required and is subject to floating interest rates.

In June 2003, 48,000,000 new shares of the Company were issued to Great Victory International Inc. ("GVII"), the Company's controlling shareholder, at a price of HK$0.57 per new share, after GVII's placing of the same number of shares held by it to certain independent third parties at a price of HK$0.57 per share. Such issue of new shares by the Company had raised net proceeds of approximately HK$26,240,000. The said net proceeds had been used for the construction of new factory complex.

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Contingent Liabilities

The Group had a contingent liability in respect of possible future long service payments to employees under the Hong Kong Employment Ordinance, with a maximum possible amount of HK$590,000 as at 31 December 2003 (2002: HK$674,000). The contingent liability has arisen because at the balance sheet date a number of current employees have achieved the required number of years of service to the Group, in order to be eligible for long service payments under the Employment Ordinance if their employment is terminated under certain circumstances. A provision has not been recognised in respect of such possible payments, as it is not considered probable that the situation will result in a material future outflow of resources from the Group.

At the balance sheet date, the Group had provided corporate guarantees of HK$500,000 (2002: Nil) to a bank in respect of banking facilities granted to one of its associates. As at 31 December 2003, such banking facilities were fully utilised.

In addition, it is one of the conditions of the Loan Facilities that Mr. Cheung Po Lun, the Chairman of the Board and the controlling shareholder (as defined in the Listing Rules) of the Company, his family members, close relatives, related trusts or companies controlled by him, his family members, close relatives or related trusts must beneficially own not less than 51% of the issued voting share capital of the Company throughout the life of the Loan Facilities. A breach of the aforesaid condition will constitute an event of default under the Loan Facilities and no further advance will be allowed and all amounts outstanding under the Loan Facilities will immediately become due and payable. As at 31 December 2003 and up to the date of the approval of these consolidated financial statements, Mr. Cheung beneficially owns, through GVII (a company wholly-controlled by him), approximately 66.96% of the issued share capital of the Company.

Charge on Assets

The Group did not have any charges on assets as at 31 December 2003 and 31 December 2002.

Exchange Risk

Most of the Group's transactions are conducted in Hong Kong Dollars, US Dollars and Renminbi. As the exchange rates of these currencies were relatively stable during the year under review, the exposure to fluctuations in exchange rates was minimal.

However, in view of the possible appreciation of Renminbi in the coming year, the Group had entered into a series of forward contracts pursuant to which approximately US$9,300,000 can be exchanged into Renminbi at fixed rates for the period up to 25 September 2004.

Employees

As at 31 December 2003, the Group had approximately 7,320 (2002: 8,250) employees in Hong Kong and Mainland China. The Group's remuneration packages are generally structured by reference to market terms and individual merits. The management considers that the pay levels of the employees of the Group are competitive and employees are rewarded on a performance-related basis within the general framework of the Group's salary and bonus system. In addition, share options under the Company's share option scheme may be awarded to the Group's employees based on performance evaluation. All these measures are drives and encouragements for personal performance. Up to now, no share option has been granted by the Company.