

### INDUSTRY REVIEW

2003 was a challenging year for the manufacturing industry in China. The outbreak of the SARS epidemic in China in the first half of the year dealt a severe blow to the manufacturing industry, as domestic traffic was held up and the delivery of goods was delayed seriously. As a result, marketing and sales activities were affected. In many trade fairs (including the Canton Fair held in Guangzhou), the number of exhibitors participating was affected and transactions were scarce. Individual trade fairs were even cancelled. Many customers from the United States and Europe postponed their schedules of plant visits and products inspections in China.

After the accession of China into the World Trade Organisation, its role as the World's Factory is further strengthened and many industries have started to transfer their production procedures into China. The power tool and air tool industry is one of the most representative industries among them. There are two aspects in the transfer of production procedures. Firstly is the transfer of productivity. Renowned overseas manufacturers of power tools and air tools seek appropriate production partners in China. Second, there is the transfer of brand names. Large overseas chain operators launch products of their own brands while selling international brand name products. In order to enhance the competitiveness of their products, most of the chain operators tend to procure in China and outsource production in order to reduce production costs. Leveraging on its research, design, production and sales capabilities and its competitive edge in offering one-stop services, the Group is well positioned to benefit from the bright prospect of the power tool and air tool industries.

DC and AC power tools and air tools have wide applications. Such tools include electric drills, electric hammers, electric cutters, electric saws, electric grinders, staplers, bench tools and gardening tools, and are used in construction, carpentry, installation, grinding and cutting. Such tools are for commercial as well as household use. The growth of the global power tools industry is satisfactory and its market potential is enormous. According to statistics from the power tool magazine, the global demand for power tools grows by 5% annually. It is expected that the demand will increase to USD 25 billion by 2005. Currently, China accounts for approximately 10% of the global production of power tools and most of its products are for export. It is expected that the value of power tools exported by China will amount to approximately USD 1.38 billion in 2004, representing an annual growth rate of 16%. In view of the continuous strong growth of China's economy, the sales of power tools in China will be increased. This, coupled with the fact that professional power tools are still mainly imported, illustrate the fact that there is enormous room for development in the domestic market.

Air tools mainly refer to air staplers and also air manual tools and air spray guns, which are used in making wooden furniture, construction and decoration work, leather box packaging and renovation projects. As DIY is a common practice in North American countries and wooden houses are comparatively more common, air tools are more frequently used. The major markets of air tools include the United States, Canada, Europe and South East Asia. The global sales of air staplers alone amounted to USD 768 million in 2003. The largest market is the United States, followed by the European and Japanese markets. Demand for air staplers grows steadily annually.

### **INDUSTRY REVIEW** (continued)

The sales of power tools and air tools are less affected by the overall economic environment because of their product nature. The optimistic economic outlook will stimulate consumption. Consumers will purchase power tools or air tools as gifts or for personal use. When the general economic outlook is uncertain, DIY will become an increasingly popular option and the demand for tools will also increase. Hence, the demand for power tools and air tools will be steady in both good and bad economic environment.

Although the DIY markets in Europe and the United States are becoming more mature, the market demand continues to grow steadily every year. The strong performance of Euro last year helped to stimulate consumption sentiment in Europe and created favourable market conditions for DIY in the United States and Europe. In regard to the Mainland China market, as the living standard improves gradually, the Chinese DIY market grows rapidly and there is huge room for further development.

### **DIVIDEND**

The Board of Directors recommended to declare a final dividend of HK0.5 cent per share for the year ended 31 December, 2003, which will be subject to the approval by the shareholders of the Company at the forthcoming annual general meeting. Taking into account the interim dividend of HK1 cent per share for the year under review, the annual dividend per share for the year under review is HK1.5 cents.

### **BUSINESS REVIEW**

The Group is principally engaged in the production and sales of AC and DC power tool and air tool products. The results for 2003 fell short of market expectations, mainly because the Group implemented various measures to adjust the business model. Besides, due to the outbreak of SARS in the first half of the year, the time required for the development of 14 types of new products by the Group is longer than expected, thereby affecting the application for professional certifications of the products and the time for the products to be launched to the market. The sales of the Group were directly affected. Nevertheless, we made thorough preparations in 2003 for the future business development, some of them are starting to demonstrate positive results. Thus, we are confident that the Group will achieve satisfactory results in the future.

We have made various changes to the business model and our marketing strategy in 2003. Instead of selling to the middleman and exporters, we sell our products directly to famous brands and large chain stores. It normally takes longer time to negotiate with big chain stores on new product development projects. The effort we have made in this aspect is beginning to bear fruit. Several large-scale European and American clients have placed orders with us and we have signed a letter of intent on cooperation with a world renowned power tool brand, and we are now setting the targets for future sales and production. We expect to see more encouraging results in the future.

### **BUSINESS REVIEW** (continued)

Moreover, we always maintain a balance between outsourcing and self-manufacturing activities to reduce the risk arising from outsourcing and to maintain product quality. The Golden Harbour, new plant in Hai An County, Jiangsu Province commenced operation in 2003 but since the new plant is still in an early consolidation stage, and the imported production moulds and accessories were not delivered in time, the full operation of the plant was delayed and the production failed to attain economies of scale. However, it is expected that when the plant is fully-equipped, the utilisation rate is increased and horizontal production is further expanded, the production efficiency will be reflected in the future results.

The Group made substantial investments on R & D of new products, but the plan was delayed for various reasons. The development of the series of 14 types of new power tools was not completed and put into commercial production until September 2003. The delay from the original plan has adversely affected the results of the Group.

In the first half of 2003, the outbreak of SARS epidemic hindered the delivery of goods, the time between the placement of orders and new product delivery was prolonged, as a result, the delivery of 14 types of newly developed products was also affected. The spread of the SARS epidemic in China also prevented overseas customers from visiting plants, carrying out product inspection and confirming orders, which affected the overall annual income of the Group. The usual marketing and promotion activities were postponed or cancelled, the Group initiated to cancel its booths in the Canton Fair in April. The ordinary business activities were significantly affected during the period of the SARS epidemic and the number of orders received by the Group also decreased.

Although the results during the period under review were inevitably affected and failed to meet our expectations, we kept on expanding our business for the future growth of the Group.

The Group continued to develop its existing power tool business, and with its extensive experience and technological edge, the Group successfully acquired an air tool business (of which HK\$9,319,000 was intangible assets and HK\$3,176,000 was raw materials) at consideration HK\$12,495,000 during the year and developed a five-in-one multi-functional product which was well-received by the market and widely recognised by the customers. We also acquired "Airy", the famous air tool brand in Taiwan. "Airy" has been established in the United States and Japanese markets for more than 20 years. Its product quality is frequently praised and compared to other brands in US tool magazines. As power tools and air tools are complementary, the acquisition of air tool business will broaden the Group's product portfolio, enhance its competitiveness and introduce another revenue source and consequently increase the economic benefits of the production and operation of the Group.

### **BUSINESS REVIEW** (continued)

The Group is the only large-scale professional air tool manufacturer in China. We have a total of thirty-four patents in air tools. Air tools are mostly sold to chain stores and distributors in the United States and Japan. The market potential is huge as demand exists in different sectors. The product has a higher margin than power tool because it is technologically more advanced. During the year, we succeeded in forming cooperation alliances with US professional air tool brands in developing various competitive air tool products. Such cooperation is an evidence of our strength in R & D and helps to further consolidate our leading position in the air tool industry.

In 2003, the Group expanded the power tool and air tool market and made significant accomplishments. Europe is the major market of power tools while air tools are mainly sold to the United States and Japanese markets. Although the contribution from the sales of air tools is insignificant in 2003, it is beginning to contribute to the results of the Group. The Group has more than 20 long-term customers, including renowned chain operators such as Praktiker, Leroy Merlin and TIP and major European power tool distributors. After relentless efforts made in 2003, we have succeeded in attracting clients from the United Kingdom, Australia and the United States and obtaining bulk orders from OEM air tool customers. We expect the air tool business to achieve significant growth in 2004 and 2005, evidencing the fruitful results brought about by the change in the Group's marketing strategy in 2003.

In order to further expand our presence in the European market, we acquired 50% equity interest in SBW Technische Gerate GmbH ("SBW"), a German associated company, which commenced its operation from January, 2003 at consideration EUR 1,500,000. SBW is the Group's platform for providing quality products to its European customers and from which we gather updated information of the European market, to help us keep abreast of the market development and make corresponding modifications to our products. SBW has developed steadily since its establishment. Its sales performance is encouraging and it is making new profit contribution to the Group.

In respect of the production capacity of production facilities, the annual production capacity of the production bases Hai An County, Jiangsu Province Golden Harbour and Suzhou Dongxin reach 3,000,000 sets. Golden Harbour's new plant commenced production in early 2003 and the utilisation rate reached 50% by the end of 2003. The progress is encouraging. The proportion of self-developed product sales increased last year, mostly attributable to the expansion of sales to chain store customers. This is a testimony that our self-developed products are being well-received and recognised by the market and this is encouraging for our R & D team.

During the year, we succeeded in developing a series of 14 new products and launched a five-in-one multi-functional air tool product. By the end of 2003, we employed a total of 93 engineers who are responsible specifically for the research and development of new products and the improvement of products so as to strengthen the competitiveness of our products in the market.

### FINANCIAL REVIEW

#### Turnover and Profit Analysis

For the year ended 31 December 2003, the Group recorded an audited turnover of approximately HK\$242,738,000, decreased by 29.36% as compared to 2002. Profit attributable to shareholders was HK\$12,095,000, representing a decrease of 52.89% as compared to 2002.

The decrease in turnover and profit is mainly due to the implementation of several business adjustment measures. The outbreak of SARS in the first half of the year also affected the sales of the Group.

#### Turnover Breakdown by Products and Geographic Locations

In terms of products, power tool is still the major source of revenue of the Group. On the other hand, the Group has succeeded in diversifying its product portfolio by acquiring air tool business. The new business began to make contribution for the Group and we expect it will account for a larger share of the turnover in the future.

Geographically, Europe remains the major market of the Group. In addition, the Group successfully taps into the United States, Australia, and Japanese markets with its power tool and air tool products.

#### Gross Profit and Profit Margin Analysis

For the year ended 31 December 2003, the Group's gross profit decreased from approximately HK\$50,723,000 for the year ended 31 December 2002 to approximately HK\$32,527,000. The decline in gross profit is mainly attributable to the decrease in turnover and increase in cost due to the inability of the new factory to attain economies of scale.

Although the Group has succeeded in expanding into the air tool business which has a higher gross profit margin, the development of the business is still at its early stage. This, coupled with the fact that the new production plant failed to attain economies of scale, have led to a decline in gross profit margin.

### **FINANCIAL REVIEW** (continued)

#### **Debt Analysis**

As at 31 December 2003, the Group's total short term bank loans amounted to HK\$68,685,000. The loans were mainly used to finance the infrastructure investment project and pay for the new machines and laboratory equipment at the new Golden Harbour plant. As at the end of 2003, the Group's gearing ratio (bank loans/equity) was 41% and the current ratio was 1.09 times. The Group considers the current gearing ratio to be at a reasonable level and expects it to drop to even lower level as the production capacity of the Golden Harbour plant increases.

The Group exercised a share placement in January, 2004 to strengthen its financial resources, the net proceeds from placement were HK\$77,300,000 which were mainly used to purchase additional equipment for air tool production and used as ordinary working capital.

#### **Debtors Analysis**

For the year ended 31 December 2003 and the year before, the debtors' turnover days were 61 days and 72 days respectively.

#### **Inventories Analysis**

For the year ended 31 December 2003 and the year before, the inventory turnover days were 36 days and 24 days respectively.

#### **Shareholding Structure**

The Group was actively looking for institutional investors to broaden our shareholder base. The shareholding of the major shareholder has been decreased from 75% to 51.43% up to the date of the report. This can increase the transparency of the Company's operation and enhance the effectiveness of corporate governance.

#### **Pledge of Assets**

As at the year ended 31 December 2003, the Group has pledged bank deposits amounting HK\$9,997,000 comparing HK\$288,000 of last year.

#### **Exposure to Foreign Exchange Risks**

The Group's revenues and expenses are mainly denominated in US dollars. In the year under review, our working or operating capital was not significantly affected by the fluctuation of exchange rates.



### PROSPECTS

The Group has paved the road ahead with much preparation in 2003 to establish an excellent platform for its future business development. The Group's new factory is well-equipped with the most advanced production facilities and a product testing center. We also endeavour to implement horizontal production management to enhance production efficiency.

Looking ahead, while consolidating and expanding the power tool business, the Group will continue to nurture the development of the air tool business and promote both businesses at the same time. The Group will also seek opportunity to form strategic alliances with large chain stores to develop its business. In order to reduce its reliance on the European market to lower market risk, we will explore other markets and expand our business to the United States, Australia and the United Kingdom, etc. While exploring the European and American markets, we will also consider tapping into Mainland China market. In addition, we endeavour to seek more potential clients, including chain stores and famous tools brands, in order to enlarge our customer base to provide impetus for the further growth of the Group.

The Group will continue to enhance its production capacity, improve products quality, strengthen its competitiveness and consolidate its leading position in the market. The Group will invest more resources and adjust the proportion between self-manufacturing and outsourcing in order to further increase the utilisation rate of the new factory in 2004. The Group aims at adjusting the proportion between self-manufacturing and outsourcing to 80:20 in 3 to 5 years' time. We stick to the strategy of manufacturing medium to high-end and higher margin products by ourselves and outsourcing old and lower margin products with an objective of increasing cost effectiveness and enhancing profitability for the Group.

The Group will continue to strengthen our R & D capabilities. We plan to establish a R & D center in Taiwan to satisfy the requirements of world renowned brands for manufacturers, collect the latest information and keep abreast of the market changes. Moreover, by conducting researches on its own and seeking strategic partners, the Group wishes to expand product portfolio to include gardening tools so as to diversify its product mix.

### **PROSPECTS** (continued)

To strengthen our management capability, an operational management committee comprising of members with extensive experience in production, technological research and sales was set up in early 2004. The committee is committed to improve the system, operational efficiency and management standard of the Group. We understand that human resources is one of the crucial factors supporting our rapid growth. Therefore, a series of training courses are organised for our employees to provide them with comprehensive on-the-job trainings. Internal promotion opportunities are also abundant. At the same time, we are considering granting share options to the management as a gratitude for their continuous dedication to the Group.

Meanwhile, we are searching for mergers and acquisitions opportunities to further expand the Company's business and enhance our market position. In the long term, we endeavour to improve product quality, tighten cost control, enhance economies of scale, increase the transparency of the Group's operation and strengthen corporate governance in order to become one of the leading power tool and air tool manufacturers in China.



# Competitive Advantage



