# Management Discussion and Analysis

## RESULTS AND BUSINESS REVIEW

The Group reported a net loss of HK$7.0 million, compared to a net profit of HK$10.1 million last year. The Group recorded a turnover of HK$192.2 million, representing a decrease of 20% compared with last year. Sales orders for the current year were HK$195.8 million, versus last year of HK$245.3 million. The gross profit margin decreased from 20% last year to 12% this year.

On the business side, the slow down in the sales orders was mainly caused by the following:

- Many months of lackluster demand affected the economies in both the United States and Germany;

- Many eyewear companies in the United States and Europe were extremely conservative in re-ordering of products or were having too much inventories in their pipeline; and

- Owing to the outbreak of Severe Acute Respiratory Syndrome epidemic in Hong Kong, our sales staff deferred various overseas customers visit plans and thus delayed product development programs with customers.

Downward price pressure in the market and low capacity utilization as a result of the decrease in sales orders decreased our gross profit margin during the year. This adverse impact on the profit margin was partially offset by the benefits derived from continuous cost reduction. Although there was the loss from operations, the Group continues to provide positive contribution in terms of operating cashflows.

Selling and administrative expenses had also dropped by HK$2.2 million from HK$41.4 million in 2002 to HK$39.2 million in 2003 due to stringent cost control. Such cost-saving was partly offset by the additional provision of specific and general doubtful debts, amounted to approximately HK$5 million. The increase in the other operating expenses was mainly attributed to the additional provision for slow moving inventories caused by cancellation sales orders and the slow-down in the forecast sales orders.

## RESULTS AND BUSINESS REVIEW (cont'd)

Finance costs maintained the same level as that of last year. Following completion of a share sale agreement and a loan settlement agreement on 4 November 2003, the accrued interest of HK$26.5 million since 1 March 2002 up to the completion of the above two mentioned agreements, included HK$13.5 million provided in current year, was waived by Probest and reported as exceptional income in the account.

Income of an exceptional nature also included HK$3.1 million earned from disposal of the Company's 30% interest in its operating subsidiaries and 30% of the loan due from the subsidiary to the Company pursuant to the above share sale agreement and loan settlement agreement.

The shared profit before tax, from the Group's 50 percent-owned associate, Dongguan Yueheng Optical Company Limited, was HK$1.7 million versus HK$9.4 million recorded last year. The decrease in the profit was mainly due to the sluggish demand for lenses.

## FUTURE OUTLOOK

In 2003, the Group's ophthalmic products business unit awarded 2003 Hong Kong Awards for Industry: Productivity Certificate of Merit. This achievement is recognized by the optical industry and demonstrated that the Group is one of the market leaders in the field.

In order to maintain this competitive marketing position, the Group continues to add value to our customers with the one-stop service for sunglasses, optical frames and lenses, from the functional and stylish designs, to the moulds and toolings, rational production, packaging and brand building.

In 2004 the Group will focus on the following improvement plans:

– Restructuring the manufacturing plants in Shenzhen and Dongguan in respect of the operating flows so that the new streamlined organisation will increase the productivity. The momentum comes from the new management team of optical professionals with both commercial and technical talents, experienced operations managers, and the Group's high caliber and loyal executive committee members.

## FUTURE OUTLOOK (cont'd)

– Upgrading the manufacturing facilities with high quality and sophisticated functions to enhance the technical capability for manufacturing processing and developing of new products so as to fit into the market trend and fashionable lifestyle.

– Implementing the aggressive business development plan with the international brand-named customers.

– Implementing the continuous improvement programme for cost-savings and reduction of wastage.

As a key player in the industry, the Group will keep abreast of the rapid change in the market. The Group will implement an effective and efficient supply chain management to lower cost of procurement, which in turn will improve gross margin and our competitive positioning. Our high quality team of designers and technicians will continue to provide lots of value-added services to customers. To counteract the downward price pressure exerted by customers and the increase in costs of raw material, our strategy is to work with international brand-named customers to increase the market share and enhance business growth amid the keen competition so as to increase our bargaining power. The management will put all efforts to ensure the best return to our shareholders and to keep our position to be the market leader in optical industry.

## LIQUIDITY AND FINANCIAL REVIEW

The Group mainly finances its day to day operations with internally generated cash flow. As at 31 December 2003, the current ratio of the Group, measured as total current assets to total current liabilities, was 1.31: 1.

During the year, the Group recorded a cash inflow from operating activities of HK13.4 million. As at 31 December 2003, the Group has recorded an accrued overdue interest of HK$1.5 million on promissory note due to Probest.

## LIQUIDITY AND FINANCIAL REVIEW (cont'd)

The Group conducts its business transactions mainly in Hong Kong dollars, US dollars, Euros and Renminbi. The Group did not arrange any forward currency contract for hedging purposes. Whilst most of the Group's cash is denominated in currencies directly and indirectly linked to the US dollars, the exposure to exchange fluctuation in gains and losses is minimal. The Group's promissory note and Profitown Loan due to Probest bear interest at a rate equivalent to 1% over Hong Kong prime rate per annum. The Group's borrowings are mainly denominated in Hong Kong dollars.

The gearing of the Group, measured as total debts to total assets, with 124% as at 31 December 2003, comparing to 134% as at 31 December 2002.

## CAPITAL STRUCTURE

On 4 March 2003, the Company, Probest and Tomorrow entered into a conditional asset disposal agreement and a conditional loan restructuring agreement to restructure the principal loan of HK$250 million and the accrued loan interest due to Probest (collectively, the "Previous Transactions"). Further details of the Previous Transactions are set out in a circular to shareholders dated 7 April 2003. The Previous Transactions were subsequently terminated on 27 August 2003.

On 4 March 2003, the directors also proposed a capital reorganisation including share capital reduction, increase of capital and share consolidation (the "Capital Reorganisation"). The Capital Reorganisation was completed on 29 July 2003. The authorized share capital of the Company after the Capital Reorganisation was HK$3,000,000,000 comprising 300,000,000,000 shares of HK$0.01 each, of which 223,204,481 shares of HK$0.01 each were issued and fully paid or credited as fully paid.

On 3 September 2003, the Company, Probest and Tomorrow entered into a conditional share sale agreement pursuant to which Probest would acquire a 30% equity interest in Profitown, which is a wholly-owned subsidiary of the Company, and 30% of loan owing by Profitown to the Company at an aggregate consideration of HK$3 million (the "Share Sale Agreement"). Profitown is the intermediate holding company of all the operating subsidiaries and associates of the Company.

## CAPITAL STRUCTURE (cont'd)

In addition, the Company and Probest entered into a conditional loan settlement agreement pursuant to which Probest agreed to waive the repayment of the outstanding principal loan of HK$47 million due by the Company and the accrued loan interest thereon since 1 March 2002 up to the effective date of the loan settlement agreement which amounted to approximately HK$26.5 million (the "Loan Settlement Agreement").

Moreover, the Company also proposed to raise not less than HK$37.7 million before expenses by way of an open offer to issue not less than 2,901,658,253 offer shares at HK$0.013 each on the basis of 13 offer shares at HK$0.013 each for every existing share of HK$0.01 each in the issued share capital of the Company held by the qualifying shareholders on the record date (the "Open Offer"). Net proceeds from the Open Offer of approximately HK$37.0 million was used to repay partly the loan due to Probest. On 3 September 2003, the Company, Probest and Tomorrow also entered into an underwriting agreement in relation to the underwriting of the Open Offer.

Upon the Share Sale Agreement, the Loan Settlement Agreement and the Open Offer became unconditional, the outstanding principal loan due to Probest was reduced from HK$250 million to HK$163 million and will be repaid by three instalments in accordance with the terms of the promissory note with maturity date on 1 June 2006. The promissory note is unsecured and bears interest at a rate equivalent to 1% over Hong Kong prime rate per annum. Further details of the Share Sale Agreement, the Loan Settlement Agreement and the Open Offer are set out in a circular to shareholders dated 30 September 2003.

After the completion of the Share Sale Agreement, the Loan Settlement Agreement and the Open Offer were completed on 4 November 2003, the total number of issued shares of the Company was 3,124,862,734 shares.

## CHANGE OF SHAREHOLDINGS

Upon completion of the Open Offer, the shareholding of Probest in the Company increased to 83.21%. In order to restore the minimum public float requirement of 25% of the Company's shares, on 16 December 2003, Probest entered into a placing agreement with Kingsway Financial Services Group Limited, a wholly-owned subsidiary of SW Kingsway Capital Holdings Limited ("SW Kingsway"). Pursuant to the placing agreement, 412,794,000 shares, representing 13.2% of the entire issued share capital of the Company, were placed to independent investors.

On 16 December 2003, Probest also entered into a sale and purchase agreement with Rich Global Investments Limited ("Rich Global") and Kingsway Lion Spur Technology Limited ("Kingsway Lion"), both being wholly-owned subsidiaries of SW Kingsway, pursuant to which, Probest agreed to sell and Rich Global and Kingsway Lion agreed to purchase a total of 593,724,000 shares, representing approximately 19.0% of the entire issued share capital of the Company, at a total consideration of approximately HK$15,971,000 or approximately HK$0.0269 per share. Out of the 593,724,000 shares, 312,486,000 shares, representing approximately 10.0 % of the entire current issued share capital of the Company, were purchased by Rich Global, and 281,238,000 shares, representing approximately 9.0% of the entire current issued share capital of the Company, were purchased by Kingsway Lion.

Upon completion of the placing agreement and the sale and purchase agreement, shareholding of Probest in the Company decreased to 1,593,599,230 shares, representing approximately 51.0% of the entire issued share capital of the Company.

On 16 December 2003, Fortune Dynamic Group Corp. ("Fortune Dynamic"), a wholly-owned subsidiary of Tomorrow, and Tomorrow (as warrantor of Fortune Dynamic) entered into an option agreement with Rich Global, pursuant to which, Fortune Dynamic agreed to grant the option to Rich Global to purchase 50.0% of the entire issued shares of Probest at the time of exercise of the option within a period of 15 months from the date of the option agreement at a consideration of HK$15,666,000 or approximately HK$0.0197 per share of the Company based on the shareholding of Probest in the Company of 1,593,599,230 shares immediately upon completion of the sale and purchase agreement and the placing agreement.

## CHANGE OF SHAREHOLDINGS (cont'd)

If upon the exercise of the option, Rich Global and parties acting in concert with it acquire the shares such that their aggregate holding of voting rights in the Company is increased to 30% or more, Rich Global and the parties acting in concert with it (including Probest) will be required under Rule 26 of the Code on Takeovers and Mergers to make a mandatory general offer to acquire all the shares other than those already owned/agreed to be acquired by Rich Global and the parties acting in concert with it.

Further details are also set out in the announcement dated 30 December 2003.

## SIGNIFICANT INVESTMENTS, MATERIAL ACQUISITIONS AND DISPOSALS

Save as the Company disposed 30% of the entire issued share capital of Profitown and 30% of the entire amount of shareholder's loan due from Profitown to the Company to Probest at an aggregate consideration of HK$3 million in pursuant to the Share Sale Agreement, there was no other material change on the investment held and also no other material acquisition or disposal of any subsidiary and associate of the Group during the year.

## CAPITAL COMMITMENT, CHARGE ON GROUP ASSETS AND CONTINGENT LIABILITIES

As at 31 December 2003, the Group had no material capital commitment, no charge on the Group's assets and no material contingent liabilities.

## HUMAN RESOURCES AND SHARE OPTION SCHEME

As at 31 December 2003, the Group had 2,036 employees. The Group's remuneration policy is primarily based on the individual performance and experience of employees, prevailing industry practice and market rates. In addition to the basic salaries, the Group provides staff benefits including medical insurance and contributions to the provident fund. Discretionary bonuses are also available to the Group's employees depending upon the overall performance of the Group. The Group also provides appropriate training programmes for benefits to employees' better personal development and growth.

Mr. Lim Huat Joo resigned as an executive director of the Company with effective from 28 June 2003 and Mr. Cheung Wah Hing was appointed as an executive director of the Company with effect from 30 June 2003. Mr. Lau Tai Ming was removed as an executive director of the Company with effect from 15 December 2003. Mr. So Shan Do was appointed as a chief executive officer by the Group with effect from 1 November 2003.

Pursuant to the Company's share option scheme adopted on 28 May 2002 for a period of 10 years, the Company may offer to any employee of the Group options to subscribe for shares in the Company. During the year, 5 share options were granted to an employee who had already exercised the share options at an exercise price of HK$0.20 per share. No share options was outstanding as at 31 December 2003.

On behalf of the Board
**Tam Wing Kin**
Executive Director

Hong Kong, 26 April 2004