

# Management Discussion and Analysis

## BUSINESS REVIEW

The Group's turnover and loss attributable to shareholders for the year ended 31 December 2003 were approximately HK\$84.0 million (2002: HK\$100.3 million) and HK\$4.6 million (2002: profit attributable to shareholders of approximately HK\$11.7 million), respectively. The Group has also incurred losses arising from the revaluation of properties and write-off of fixed assets of approximately HK\$2.8 million and HK\$3.4 million, respectively, during the year under review. Basic loss per share for the year under review was 0.21 HK cent (2002: Basic earnings per share of 0.53 HK cent). Notwithstanding the above, the Group's financial position remained healthy and recorded a positive cash inflow of approximately HK\$11.3 million during the year under review (2002: cash outflow of approximately HK\$4.8 million). The board of directors of the Company does not recommend the payment of any final dividend in respect of the year (2002: Nil).

### Toys and Gifts Division

During the year under review, the Group continued to engage in the design, manufacture and sale of toys as well as decorative gift items on an OEM and ODM basis and under the Group's own brand names KCARE and KITECH. The global sluggish economy and the SARS outbreak in Hong Kong and the PRC negatively impacted the Group's annual results. The uncertainty and poor consumer confidence due to the SARS had deterred normal business activities from both local and overseas customers during our order placement season. As a result, orders received from our existing and potential customers were severely reduced. During the year under review, revenue from toys and decorative gift items was approximately HK\$52.8 million and HK\$31.2 million, respectively (2002: approximately HK\$60.3 million and HK\$40.0 million, respectively), accounting for approximately 63% of 37% of the Group's total turnover, respectively.

The SARS outbreak has ignited the growing concern for environmental-friendly and anti-bacterial products. To enhance our product competitiveness, the Group has entered into a partnership agreement with U-Right International Holdings Limited to jointly manufacture and distribute the first-of-its-kind nano plush toys processed by the Swedish Texcote Technology. Recent tests have proved that the Texcote treated fabric is anti-bacterial and able to drain away over 96% of Escherichia Coli, Klebsiella Pneumoniae and Staphylococcus Aureus. During the product trial period, the nano plush toys, with the environmental-friendly features of water repellence, stain resistance and anti-bacteria, have received encouraging response from our customers.

The Group's subsidiary in the United States of America has also commenced its operation to offset the negative impact brought by the unexpected regional outbreak of incident and epidemic. The subsidiary was mainly responsible for handling the sales orders from the customers in North America.

### Spandex Division

On 17 December 2003, the Group has entered into an agreement with Sinochem International, Sangyang Textile Co., Ltd. and Harvest City Enterprises Limited to establish a joint venture, Sangyang Spandex Co. Ltd. ("SY Spandex"), in the Jiangsu Province of the PRC. The total investment and registered capital of SY Spandex amounted to approximately HK\$229 million and HK\$94 million, respectively. The Group currently has a 30% equity interest in SY Spandex and has an option to increase its stake in SY Spandex to 47% on or before 12 January 2005.

SY Spandex will be principally engaged in the production, research and development and sale of spandex in the PRC.

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The initial annual production capacity will be 5,000 tonnes of spandex and will be further increased to 10,000 tonnes in the second phase. Construction of the production facilities of SY Spandex in the Jiangyin City of Jiangsu Province is expected to commence in the second quarter of 2004 and be completed before the end of 2004.

The joint venture agreement represents the establishment of Sinochem International's first joint venture in the production of spandex. Sinochem International will provide the joint venture with the most advanced and proprietary technology in spandex production, which will lower the investment and production costs of the joint venture. Sinochem International is the sole PTMEG manufacturer in the PRC, hence guaranteeing a stable and abundant supply of raw materials for spandex production by the joint venture.

Spandex is a kind of highly elastic chemical fibre widely applied in different types of cloths, garments and plush products. The application of spandex can make the plush and cloth become softer and more attractive to enhance the products' value-added features. Its application has also been extended to medical products through the addition of anti-bacteria features. The Group believes that spandex can enhance the variety and quality of the Group's products. Establishing the joint venture also gives the Group an opportunity in vertically integrating its production process.

## FINANCIAL REVIEW

### Liquidity and Financial Resources

The Group generally finances its operations with internally generated cash flow and facilities provided by its principal bankers in Hong Kong and in the PRC. During the year under review, cash generated across the Group remained strong, with approximately HK\$20.4 million being generated from operating activities. The Group recorded a net inflow of approximately HK\$11.3 million during the year, which increased the total cash and bank balances to approximately HK\$49.1 million as at the balance sheet date. The Group's cash and bank balances are mostly held in Hong Kong dollars and Renminbi.

The Group's bank and other borrowings are made in Hong Kong dollars and Renminbi, approximately 74% of such borrowings bear interest at fixed lending rate. At 31 December 2003, the Group's bank and other borrowings amounted to approximately HK\$33.9 million, out of which approximately 61% is repayable within one year. The gearing ratio of the Group at 31 December 2003 calculated as a ratio of total bank and other borrowings to total assets is approximately 14% (2002: 14%). Net current assets at 31 December 2003 was approximately HK\$50.5 million and current ratio was maintained at a healthy level of approximately 166%. The Group had not used any financial instruments for hedging purposes during the year under review.

At 31 December 2003, certain of the Group's leasehold land and buildings with carrying values of approximately HK\$104,637,000, were pledged to secure general banking facilities granted to the Group.

### Employment, Training and Development

At 31 December 2003, the Group has a total of 1,167 employees. The Group always maintains good working relations with its employees and has committed itself to its staff training and development.

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Remuneration packages are maintained at a competitive level and reviewed on a periodical basis. Bonus is awarded to employees according to the assessment of individual performance and industrial practice. Up to the date of this report, no share option had been granted under the share option scheme adopted by the Company.

## OUTLOOK

The Group believes that the unexpected occurrence of SARS and business turmoil in 2003 is not likely to recur again. The gradual recovery of the global economy in 2004 will help giving a boost to the customers' confidence. The Group is highly optimistic towards a turnaround performance in the Group's toys and gifts division in 2004. In addition, the Group had strived to enhance the product competitiveness through the addition of value-added features. The application of nanotechnology will help the Group further upgrade the product quality to meet the discerning need of the customers. While the Group's diversification into the spandex industry is expected to take on increasing importance, its toys and gifts business will continue to provide a stable revenue platform through the Group's excellence in product quality, extensive distribution network and strong brand recognition.

The Group will continue to bolster its sales and marketing force to expand our market, including North America, Europe and the PRC. The Group will also explore collaboration opportunities with prestigious brand names and retail chain stores to underpin our reputation and broaden our customer base. These initiatives will help to further strengthen our foothold in the toys and gifts industry in readiness of the growing demand due to global economic recovery.

The Group boasts a highly qualified and experienced management team, and will continue to recruit professionals with in-depth knowledge and expertise to enable the Group to operate effectively and efficiently. The management is optimistic towards our growth and an improvement in our financial performance in the coming year.

The Group will cautiously monitor the construction progress of the spandex production facilities and plan ahead of the joint venture's future business development strategy. Apart from the application of spandex in the Group's toys and gifts products, the Group will also tap into the well-established textile customer base in the Jiangsu Province and further expand the sales of spandex into other regions of the PRC. SY Spandex will become a leading spandex manufacturer in the PRC when its second phase of production reaches 10,000 tonnes of spandex. The Group is optimistic that the spandex division will turn into a dependable source of revenue growth in the future.