MANAGEMENT DISCUSSION AND ANALYSIS

Results of Operations

The Group's consolidated turnover for the financial year ended 31 December 2003 amounted to HK$1,238 million, representing an increase of 4.5% over the HK$1,185 million annualised consolidated turnover recorded in the previous year. Although the Group's interim results reported a 2.1% drop in turnover, sales momentum was quickly restored in the second half of the year with 11.6% growth, resulting in a net increment for the full year consolidated turnover.

Gross profit for the year was HK$705 million (2002 annualised: HK$713 million), representing a gross profit margin of 57.0% (2002: 60.2%). In the interim report, the gross profit margin was only 56.2%. For the second half of the year, the gross profit margin increased 1.6% and went up to 57.8% and the resultant gross profit margin for the full-year was 57.0%.

As a result of maintaining a stable gross profit level while reducing in selling, distribution and administrative expenses by 13.7%, the Group's operating profit for the year increased 9.5% to HK$241 million from 2002's annualised figure of HK$220 million. Together with a reduction of 37.0% in its finance costs due to the low interest rate environment in 2003 and a lower effective tax rate this year, profit attributable to shareholders for the year reached HK$182 million against an annualised figure of HK$135 million for 2002, a significant increase of 34.8%.

The Group's earnings before interest, tax, depreciation and amortization (excluding interest income) for the year amounted to HK$301 million, a rise of 7.5% over the annualised 2002 figure of HK$280 million, showing a very strong operation capability and cash-generating power of the Group.

Returns on average equity increased from 9.4% in 2002 to 10.5% in 2003. Based on the profit attributable to shareholders of HK$182 million and the weighted average number of 429,236,296 ordinary shares issued during the year, basic earnings per share were HK42.31 cents (2002 annualised: HK33.45 cents), an increase of 26.5%. The Board recommended payment of a final dividend of HK4.8 cents. Together with the interim dividend of HK7.0 cents, total dividend for the year was HK11.8 cents. The dividend payout ratio was 27.9%

Segmental Information

The Group's business has customarily been divided into three segments, namely, integrated manufacturing-distribution, OEM/ODM and the PRC integrated operations.

The integrated manufacturing-distribution segment continued to experience stable growth of 2.8%, with turnover reaching HK$983 million for the year ended 31 December 2003 (2002 annualised: HK$956 million). Revenue from this segment accounted for 79.4% of the Group's consolidated turnover, which is in line with the Group's long-term development strategy.

Turnover in the OEM/ODM segment increased 5.6% from 2002 annualised HK$161 million to HK$170 million for the year ended 31 December 2003, representing 13.7% of the Group's consolidated turnover. The Group intends to keep the contribution from this segment at the current level as it is a cash-cow business.

With the PRC economy still booming, turnover of the Group's PRC integrated operations grew 23.2% from 2002 annualised HK$69 million to HK$85 million for the year ended 31 December 2003. All OEM/ODM, distribution and retailing businesses in the PRC contributed to this growth. During the year, the Group increased the retail stores in the PRC from 29 to 34. It is the Group's target to open a further 16 self-opened stores by the end of 2004.

Placing of Existing Shares and Subscription for New Shares

Pursuant to the placing and subscription agreement dated 14 May 2003, KFL Holdings Limited, a substantial shareholder of the Company, placed 40,000,000 shares of HK$0.5 each in the capital of the Company at HK$3.5 per share to over 20 independent professional investors and on 27 May 2003 subscribed for 40,000,000 new shares at HK$3.5 per share. The net proceeds received by the company under the subscription were approximately HK$136 million and were used to expand the Group's distribution business in Europe.

Pursuant to the placing and subscription agreement dated 3 December 2003, KFL Holdings Limited, a substantial shareholder of the Company, placed 54,000,000 shares of HK$0.5 each in the capital of the Company at HK$5.6 per share to over 20 independent professional investors and on 16 December 2003 subscribed for 54,000,000 new shares at HK$5.6 per share. The net proceeds received by the company under the subscription were approximately HK$295 million and will be used to expand the business of the Group in the United States.

The above two exercises have further broadened up the Company's shareholder base with the inclusion of more institutional investors.

Financial Position

The inventories of the Group were HK$412 million at 31 December 2003, the inventory level increased by 4.6% when compared with the inventories of HK$394 million at 31 December 2002. At October 2003, the Group acquired a German distribution company and its inventories amounted to HK$26 million were consolidated into the Group at year end. Without this acquisition effect, the Group's inventories were HK$386 million. The stock turnover period for the year based on sales was 121.5 days, quite comparable with last year 121.4 days. Since only one quarter result of the acquired German distribution company was accounted for in 2003, if the inventories and the quarter turnover were excluded, the computed stock turnover period without acquisition effect was 117.1 days. In view of the special task force in handling the inventories and a better communication between procurement, design, marketing and sales teams across subsidiaries worldwide, management believes that the inventory level will be continuously reduced along with its existing extensive distribution network.

The trade receivables, net of provision, of the Group were HK$507 million at 31 December 2003, representing an increased of 3.9% when compared with the trade receivables, net of provision, of HK$488 million at 31 December 2002. Similar to the situation in inventories, there were HK$36 million trade receivables in the acquired German distribution company consolidated into the Group at year end. Without this acquisition effect, the Group's trade receivables, net of provision, were HK$471 million. The trade receivables turnover period for the year was 149.5 days, slightly lower than 150.3 days last year. Without the acquisition effect, the computed trade receivables turnover period was only 143.0 days. The management reviews the trade receivables level regularly and strikes to improve it through both internal close monitoring and external financing arrangement such as negotiation for factoring without recourse in the near future.

The appreciation of the Euro had an inevitable adverse impact on inventories and accounts receivables. By the end of the year the Euro-HKD exchange rate stood at 9.7, considerably higher than the 8.2 rate at 31 December 2002. If the 18.3% Euro inflation effect was excluded, both the inventories and the accounts receivables would be further reduced.

MANAGEMENT DISCUSSION AND ANALYSIS

Financial Position *(continued)*

As a result of strong operating cash inflow, liquidation of short term investment and certain receivables, together with two placements of new shares over the course of the year, the Group had approximately HK$890 million in cash on hand as at 31 December 2003. This compares with a total of around HK$265 million on the same date in the previous year. The HK$890 million figure represents a strong investment base for future activities. The total bank overdrafts and loans of the Group at 31 December 2003 was HK$1,160 million (31 December 2002: HK$1,151 million). The amount of bank overdrafts and loans repayable within one year was HK$610 million (31 December 2002: HK$500 million) and long-term bank loans was HK$550 million (31 December 2002: HK$651 million). The Group's gearing ratio of net interest-bearing borrowings over equity also improved over the year, from 0.62 at 31 December 2002 to 0.39 at 30 June 2003 to 0.13 at 31 December 2003. The ratio was calculated by dividing net interest-bearing borrowings (including convertible notes) of HK$270 million (31 December 2002: HK$901 million) by the total shareholder's equity of HK$2,011 million (31 December 2002: HK$1,448 million). With the sound operating results and strong capital base, management believes that the current gearing ratio is unusually low, and planned future investment on the part of the Group should see it rise moderately over time.

In addition to its strong cash position, the Group has undrawn bank facilities to provide future capital expenditures, investments and working capital requirements. The established bank facilities are adequate for the short term requirements.

As at 31 December 2003, the Group had contingent liabilities amounted to HK$16 million for guarantees given in lieu of deposits for licensing arrangement.

Liquidity and Capital Resources

The Group generally finances its operations with internally generated cash flow and facilities provided by banks in Hong Kong.

During the year ended 31 December 2003, the Group recorded net cash inflow from operating activities of HK$284 million (year ended 31 December 2002: net cash outflow of HK$53 million). Together with net cash inflow from financing activities of HK$290 million (year ended 31 December 2002: HK$4 million) and net cash inflow from investing activities of HK$44 million (year ended 31 December 2002: net cash outflow of HK$56 million), the cash and cash equivalent significantly increased by HK$618 million for the year. The Group's strong cash-generating ability and excellent liquidity position make the management feels comfort to prepare for the next downstream investment phase.

The current ratio of the Group also improved from 2.28 at 31 December 2002 to 2.31 at 31 December 2003, showing a strong yet improving liquidity position of the Group.

Taking into consideration the anticipated internally generated funds and the available unutilized banking facilities, the Group believes that it has sufficient resources to meet its foreseeable capital expenditures and working capital requirement.

Acquisition

The Company acquired one-hundred per cent of NiGuRa Optik GmbH from Optische Werke G. Rodenstock, Munich, Germany, a company internationally renowned for its expertise in optical and ophthalmic products and services. The acquisition positions the Group as one of the largest suppliers of optical frames and sunglasses in the German market, and adds four reputed brands, namely Reebok, Féraud, NiGuRa and Enjoy, to further enrich its portfolio.

Capital Expenditures

Capital expenditures for the year ended amounted to HK$165 million, and principally comprised of production facility, plant and machinery, computer equipment and licenses for brands and the Enterprises Resources Planning System. The Group will further enhance its production capability, through know-how transferred from European subsidiaries, to produce higher added value products with its own brands and licensed brands. By means of controlling the production process and increased coverage of the distribution network, the Group will maximize the profitability and the shareholders' return.

Interest Rates and Foreign Currency Exposure

The Group's funding reflects the capital structure of each business. All its financing and treasury activities are monitored by a Central Treasury at the corporate level of the Group. The Group structures to match the tenure of its borrowings with its corporate functions and manages its interest rates exposure in relation to the interest rates level and outlook. The Group continues to do most of its business in US dollar, Euro and Renminbi. Payments to vendors are mainly in Renminbi, Euro and HK dollar. That, together with a policy of keeping the majority of our assets also in these currencies, ensures that our exposure to exchange rate fluctuation is minimal.

Employees

At 31 December 2003 the Group had some 5,000 employees around the world. The Group's policies governing employee remuneration and other benefits are based on individual performance, experience, and more broadly on the current conditions prevailing in the industry generally. The awarding of any discretionary bonuses, merit payments and the granting of share options to eligible staff is made according to the Group's financial results and is based on the performance of individual employees. The Group's employees are also provided with opportunities for training to enhance their personal development and contribution to the Company.