Management Discussion and Analysis

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FINANCIAL PERFORMANCE

This year Peace Mark reported a consolidated turnover of HK$1,434.5 million representing a year-on-year growth of 28%. The increase was mainly attributable to full year operation of Omni Watch & Clock Co., LLC., the Group's marketing and distribution arm in USA, commencement of China distribution and retail businesses for Citizen watches since November 2003 and the other brands such as Montana, Pierre Cardin, Fiorucci, Umbro and Victorinox Swiss Army. The manufacturing business also showed strong performance due to volume growth and better product mix.

Regarding margin enhancement, its gross margin has been improved from 17% in FY2003 to 24% this year. The increase reflects the better margin from our downstream business in USA and in China, the result of the cost saving from the higher production efficiency and reduced components outsourcing. The gradual business transformation also gave rise to improved margins.

As a sign of strong operating income and cashflow, earnings before interest, tax, depreciation and amortization ("EBITDA") reached HK$151.5 million. Given the above positive contributory factors, the combined effect was a profit attributable to shareholders of HK$80.0 million. In short, the well-planned business plans execution translated to the surge of bottom line.

SEGMENT INFORMATION

To facilitate the analysis of its business model, the business was divided into three main segments, namely, OEM and ODM; OBM and licences; and distribution and retailing.

The proportion of manufacturing and retail and distribution contribution to the Group's turnover were 83% and 17% respectively for FY2004 and 97% and 3% respectively for FY2003.

Within the manufacturing business, the proportion of OEM and ODM and OBM and Licences are 74% and 9% respectively.

The increase in distribution and retailing business was mainly attributable from the full year operation of Omni Watch & Clock Co., LLC., our distribution arm in USA.

In terms of geographical segment, the Americas market, representing 55% of the turnover, was the largest market of Peace Mark. For this market, Peace Mark's target segment was mass market merchandize. Its products were sold to major retail and drug chains stores. US direct sales turnover represents 21% of the total US sales.

Turnover in Asia included OEM orders from Japanese customers and sales of licensed products through over 10 appointed distributors and distribution subsidiaries across the region. Sales in the China market contributed approximately HK$61.0 million in FY2004. Although its contribution was insignificant in this year, the potential of this market should not be ignored. The Group has substantially set up the infrastructure and the logistics support for the distribution and retail operation for the fashion brand agreement after the year end. This market will be a significant market of the Group in the years to come. The management will exercise strict operational and financial controls in order to reap the benefits of selling in this market while monitoring the execution risk at its lowest level.

PLACING OF EXISTING SHARES AND SUBSCRIPTION FOR NEW SHARES

Pursuant to the placing and subscription agreement dated 30 March, 2004 and supplementary agreement dated 2 April, 2004, A-ONE INVESTMENTS LIMITED and United Success Enterprises Limited, substantial shareholders of the Company, placed 93,500,000 ordinary shares of HK$0.10 each in the capital of the Company in total at HK$1.63 per share to some independent institutional investors and on 13 April, 2004 subscribed for 126,500,000 new shares in total at HK$1.63 per share. The net proceeds from subscription of approximately HK$202.0 million were used as follows:

- HK$60.0 million for expansion of the Group's production facilities;

- HK$80.0 million for the development of the Group's distribution network and expansion of its sales channels in the PRC; and

- the remaining balance for the use as the general working capital requirements.

The above placing exercise further broadened the Company's shareholder base with the inclusion of more institutional investors.

FINANCIAL POSITION

Property, plant and equipment increased from HK$357.1 million in FY2003 to HK$383.7 million in FY2004. Peace Mark had further improved its production facilities in Bienne, Switzerland and China. A new factory was established in Longhua, China for the purpose of better serving upscale customers including but not limited to international fashion and luxury brands.

The Group's inventories stood at HK$309.9 million as at 31 March, 2004, the inventory level increased by 36% when compared to the inventories of HK$227.7 million as at 31 March, 2003. This year, inventories of the distribution business were consolidated into the Group at the year end. The inventory turnover increased from 90 days in FY2003 to 104 days in FY2004.

The increase was a result of longer production cycle arising from vertical by integrated set up and higher level of inventory for distribution.

Trade and other receivables, net of provisions, were HK$397.5 million as at 31 March, 2004, increased by 16% when compared to HK$342.5 million last year in which HK$37.6 million was deposit paid for the acquisition of a watch movement factory and additions of new production facilities in the PRC. The trade and other receivables turnover was 92 days which was shorten by 20 days than last year. The improvement in trade receivables was due to stronger credit control over the customers.

LIQUIDTY AND FINANCIAL RESOURCES

The cash and bank balances of the Group maintained at approximately HK$467.5 million (FY2003: HK$207.6 million) while total financial indebtedness was approximately HK$809.9 million (FY2003: HK$463.5 million). The total financial indebtedness was approximately HK$809.9 million, consisted of term loans and a syndicated loan of approximately HK$641.7 million, trade and other facilities of approximately HK$161.8 million and obligations under finance leases of approximately HK$6.4 million. Regarding the maturity of this financial indebtedness, approximately HK$385.2 million will mature within one year, HK$189.8 million after one year but within two years and HK$234.9 million will mature after two years but within five.

As at 31 March, 2004, the gearing ratio of the Group, calculated by dividing the financial indebtedness (excluding the acquisition deposit of HK$37.6 million) net of cash and bank balances over shareholders' equity, was approximately 39%, increased of from 38% in FY2003.

Taking into account the placement of new shares on April 2004, the gearing ratio was improved to approximately 13%.

During FY2004, the Group recorded net cash inflow from operating activities of HK$96.5 million (FY2003: HK$115.4 million) and cash generated from operations of HK$104.0 million (FY2003: HK$118.1 million).

The current ratio of the Group as at 31 March, 2004 was 2.2 (FY2003: 2.0). The increase in the ratio shows a health liquidity position of the Group.

In view of the Group's ability to generate operating cash flow, the level of internally generated funds and available banking facilities, the Directors are of the opinion that the Group has adequate cash resources for working capital requirements and its capital expenditure commitments.

FUNDING AND TREASURY POLICIES

The Group's treasury policy is to manage the Group's assets and liabilities to reduce its exposure to fluctuation in foreign exchange and interest rates. During the normal course of business, the Company enters into certain derivative contracts to hedge its exposure to fluctuations in interest rates and foreign currencies. These instruments are executed with creditworthy financial institutions. Gains and losses on these contracts are applied to offset fluctuations that would otherwise impact the Company's financial results. Costs associated with entering into such contracts are not material to the Company's financial results. Over 80% of the Group's borrowings were in Hong Kong Dollars with the balance in Renminbi and US Dollars. It is the Group's treasury policy to manage its foreign currency exposure whenever there is material financial impact to the Group.

MATERIAL ACQUISITIONS

An agreement dated 30 October, 2003, pursuant to which China Regal Holdings Limited, a wholly-owned subsidiary of the Company agreed in a consideration of RMB30.0 million to acquire 60% of equity interests of a PRC incorporated company and to participate in the distribution and retailing timepieces business in the PRC carrying Citizen brands.

The Group invested HK$15.6 million in the equity stake of a Japanese watch company. This company advises and assists Japanese brands in identifying and coordinating with PRC manufacturers, distribution partners and acquisition targets. This company also assists the Group to serve its Japanese customers.

The Group acquired a PRC marketing and distribution company for a consideration of HK$12.0 million which assist the Group to further penetrate the PRC distribution network and to provide overall brand management and points of sale set-up services for the PRC market. The PRC Company also owns the PRC distribution rights of a famous international brand.

EMPLOYEES AND THE REMUNERATION POLICY

As at 31 March, 2004, the Group employed a total of approximately 3,000 employees worldwide. The Group remunerates its employees based on their performance, experience and prevailing industry practices. In addition, the Group has established discretionary bonuses and employee share option schemes, to motivate and reward employees to achieve the Company's business performance targets.

CONTINGENT LIABILITIES

As at 31 March, 2004, the Group had contingent liabilities in respect of bills discounted with recourse amounting to approximately HK$19.4 million.

The Company has given corporate guarantees to banks in respect of general banking facilities granted to subsidiaries amounting to HK$1,483.2 million.