

## MANAGEMENT DISCUSSION AND ANALYSIS

### **Business review and outlook**

For the six months period ended 30 June 2004, the Group recorded a turnover of HK\$6.9 million and a loss before tax attributable to Shareholders of HK\$2.4 millions. The turnover of the Group was substantially decreased by approximately 89.9% as compared to the corresponding period of last year and this reduction was mainly due to the liquidity and uncertain economic conditions which in turn seriously affected the Group turnover and profitability. The negative effect over the change of the Group major distribution product has also contributes significant to the loss of revenue and profit for the business.

The result from ordinary activities attributable to Shareholders was decreased from HK\$1.3 millions in the 2nd half of 2003 to HK\$ (2.4 millions) for the six months ended 30 June 2004 represent a decreased of approximately of 280%. Although the Group has reported gains of approximately HK\$5.3 millions from disposal of properties but the favourable effect was offset by the loss from operation activities. Accordingly, the earning per share was decreased from HK0.1 cents in the 2nd half of 2003 cents to (HK0.20) cents for the six months ended 30 June 2004, but a 92% improvement as compare to the financial result ended 31st December 2003. The Group has reduced its cost of operation by 33% over the corresponding period of last year.

Nevertheless, the Group continued to focus on the existing core business CARPET MANUFACTURING AND DISTRIBUTION and is undergoing restructuring to position itself for future growth and profitability. The restructuring includes inter-alia the sale and divestment of non-core subsidiaries and investment.

### **Carpet manufacturing**

Subsequent to the period ended 30 June 2004, the Company has in principal completed its acquisition of the remaining 49% minority equity interest in Hui Yang Xie Kia Cheng Carpet Company Limited in which the Group already owns 51% equity interest. Out of the total consideration of HK\$62 million, HK\$47 million was already settled last year in the forms of inventory and trade receivables, and the remaining HK\$15 million will be satisfied pending the allotment and issue by the Company of the consideration shares.

### **Carpet distribution**

Over the carpet distribution division, the Group has on September 2004 through an indirectly wholly owned subsidiary entered into a conditional agreement for the acquisition of 51% equity interest in a company incorporated in Hong Kong and engaged in the supply, design, installation, trading and contracting of a wide range of carpet products in Hong Kong and the PRC for a total consideration of HK\$9,500,000 to satisfied by the allotment and issue by the Company of the consideration shares at HK\$0.10 per share under the general mandate granted to the Directors of the Company. The completion of the agreement is conditional upon the Listing Committee of the Stock Exchange granting the listing of, and the permission to deal in, the Consideration Shares.

### **Liquidity and financial resources**

Based on the unaudited management account for the six months ended 30 June 2004, the Group's total current assets were HK\$62.06 millions and its total current liabilities were HK\$41.16 millions. For the six months to 30 June 2004, the Group had been paying down its bank borrowings, consequently total bank borrowings were reduced from HK\$40.02 millions in 31 December 2003 to HK\$8.58 millions as at 30 June 2004. The reduction was in the magnitude of approximately HK\$ 31.44 millions mainly repay from the net proceeds for sale of two properties of the Group situated at Hong Kong.

As at 30 June 2004, the Group cash and bank balances were amounted to HK\$ 1.20 millions (31 December 2003: HK\$ 1.14 millions). On May 2004, the Group has procured a third party loan of approximately HK\$ 14.25 millions utilized to repay trade payables and to provide additional working capital for the Group. The loan is secured by way of first fixed and floating charges on all fixed and floating assets of the Group. The loan is initially repayable within three months after date of the drawdown and bearing interest at the rate of 20% per annum. However, subsequent to the balance sheet date ended 30 June 2004, the Group's has procured an extension to the tenure of the said loan until 31 December 2005 with a revised interest rate of 10% per-annum.

## **Segment information**

During the period under review the Group recorded a substantial decrease in sales and profit margin both in the manufacturing arm based at PRC and trading arm in Hong Kong as a result of the Group's liquidity position and uncertain economic conditions in which the business segment operate. In addition, the negative effect resulted from the change of the Group major distribution product has also contributes significant to the loss of revenue and profit for the trading arm business. The principal market of the Group continues to be the PRC, which accounted for approximately 73% (2003: 83%) of the Group turnover. Sales to the PRC amounted to approximately HK\$5.0 millions, representing a decrease approximately 91.0% compared to the corresponding period of last year. Sales to Hong Kong region amounted to approximately HK\$1.8 millions, representing a decrease of approximately 84.4% compared to the corresponding period last year.

## **Number and remuneration of employees**

The Group total number of employees has reduced to approximately 120 employees (2003: 180) in Hong Kong and PRC for the period ended 30 June 2004. The Group recognized the importance of maintaining good working relationships with its employees and accordingly, strives to maintain remunerations at competitive levels and in line with industry practice. In addition, the Group has adopted a share option scheme of which the Board may, at its discretion, grant options to employees of the Group. The Company has granted no share options during the period under review.

## **Charge on group assets**

As at 30 June 2004, the Group's bank borrowing of approximately HK\$76,000 (31 December 2003: HK\$76,000) was secured by first legal charge on the Group's leasehold land and building in the PRC with open market value of approximately HK\$212,000 (31 December 2003: HK\$300,000); and HK\$8,507,000 (31 December 2003: HK\$40,021,000) were secured by corporate guarantees provided by the Company to certain bankers of approximately HK\$27,000,000 (31 December 2003: HK\$59,710,000).

In addition, the Company third party loan obtained on May 2004 of approximately HK\$ 14.25 millions was secured by way of first fixed and floating charges on all fixed and floating assets of the Group.

### **Current and gearing ratio**

As at 30 June 2004, the Group had total assets of HK\$195 millions (31 December 2003: HK\$221 millions), total liabilities of HK\$55 millions (31 December 2003: HK\$ 76 millions), indicating a gearing ratio 0.28 (31 December 2003: 0.34) on the basis of total liabilities over total assets. The current ratio of the Group for the Period was 1.51 (31 December 2003: 0.78).

### **Foreign currency exposure**

The Group did not have any significant exposure to and did not hedge against risks associated with foreign currency fluctuation.

### **Contingent liabilities**

The Group did not have any significant contingent liabilities at the balance sheet date saved as disclosed under the heading of “charge on group assets”.

### **Corporate Restructuring Exercise**

On July 2004, Prime Orient International Limited make a mandatory conditional cash offer to acquire all the remaining issued shares capital in the Company which its has not already owned at the offer price of HK\$0.03 per share. The offer was closed and lapsed on 23 August 2004 and the shareholding structure of the Company remained unchanged throughout and upon the lapse of the said Offer. As a result of the change in control of the Company, three executive Directors namely Mr. Anthony Henry Serra, Mr. Khoo Chuan Teng and Mr. Chew Kean Eng have resigned from their respective positions with effect from 24 August 2004.