

## REVIEW OF OPERATIONS

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To further strengthen our leading position in the timepiece manufacturing sector, two production setup had been added to our existing production facilities.

Firstly, we have enlarged our design and production capabilities through the establishment of an upscale component manufacturing facility and a design laboratory positioned to cater for the high-end fashion and luxury brand customers. The strategic positioning of this facility is showing signs of early success, as we were able to establish new business relationship with customers from Switzerland and also other major watch brands from around the world. Together with the expertise and the latest machineries from Switzerland, we have strengthened our overall components manufacturing capabilities to pave way for the future of moving toward the upscale market while enlarging our existing customer base. With a view to becoming the model components manufacturing facility for the customers, our team members now strive to leverage the assets within this state of the art facility to its fullest potential.

Secondly, additional production capabilities were also realized within our vertically integrated manufacturing setup through controlling equity participation in a mechanical movement manufacturing plant in Shanghai, China. We strongly believe that China has the potential to become a leader in mechanical watch movement manufacturing given the labour intensive nature of the production process. We began phase one of our renovation works in this newly controlled facility to upgrade its overall standards and imported Swiss skill sets to further improve its overall quality standards. The mechanical movements manufactured by this facility mainly target the PRC market while small amounts are sold to the overseas market through our existing customers.

While progress was made in our new production facilities, the manufacturing segment experienced year on year growth. Factors such as growth in our overseas downstream business and improved market sentiment as compared to 2003 contributed to the surge in our manufacturing business and favorable results were reported during the Basel Fair, Hong Kong Watch & Clock Fair and various trade fairs in the PRC.

Orders on hand from key customers surged double digits and further direct sales business with new customers in Europe and the United States was recorded as the industry trend is for customers to consolidate to a few reliable suppliers. With stronger manufacturing capabilities, we are able to move further upscale to the higher margin manufacturing business.

During the period, prices in various raw materials in particular stainless steel had experienced shortage. To a large extent, we were able to transfer the increase in cost onto the customers of higher-end products. As buying decisions of the end consumers tend to be design driven instead of materials used, customers who were not prepared to absorb the costs were likely to use other alternative materials such as alloy and leather. Material costs have not been the major concern for fashion and design driven products.

## CEPA

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We are currently in the final stage of renovation works within our Hong Kong offices for the two production lines specifically dedicated to the CEPA scheme. These two lines will replace our existing temporary CEPA production lines. So far, we hold the record for the first Hong Kong based timepiece company to manufacture watches within our Hong Kong production lines and to sell directly to our PRC distribution channels in order to enjoy the benefits of CEPA. The incorporation of a wholly foreign owned enterprise with distribution license is progressing towards the final stage. During the period, encouraging results were reported from our own brands like EST that are utilizing our production lines in Hong Kong are sold in China featuring "Made in Hong Kong". Through our participation with the Hong Kong Famous Watch Center in Hangzhou, China, we were able to yield good returns while gather direct feedback from the end consumers confirming that "Made in Hong Kong" watches with attractive designs are well received by the PRC end consumers.