Management Discussion and Analysis

LIDS stores

Liquidity and Financial Resources

The Group continues to enjoy financing for its operations by internally generated cash flows.

As at 31 December 2004, the Group had cash and bank balances of approximately HK$101.7 million (2003: HK$109 million). About 72% and 23% of these liquid funds were denominated in US dollars and HK dollars respectively and the remainder in Renminbi. In addition, the Group has also maintained a portfolio of liquid investments of a total market value of approximately HK$61.4 million (2003: HK$42.7 million) at the end of the year under review.

As at 31 December 2004, the Group had banking facilities of HK$94.8 million (2003: HK$84.6 million), of which HK$93.1 million (2003: HK$83.4 million) was not utilised. Banking facility in the amount of HK$46.7 million (2003: HK$62.4 million), of which HK$1.2 million (2003: HK$1.2 million) was utilised, is secured by inventories and trade receivables of a subsidiary amounting to HK$27 million (2003: HK$27 million) and HK$64 million (2003: HK$39 million) respectively as at 31 December 2004.

The Group continued to maintain its gearing ratio (being the Group's net borrowings over its shareholders' equity) at zero. In view of the strong financial and liquidity position, it is evident that the Group will have sufficient financial resources to meet its commitments and working capital requirements.

Management Discussion and Analysis

Diversified products offering value added service

Capital Expenditure

During the year, the Group spent approximately HK$28 million (2003: HK$27 million) on additions of machinery and equipment and the construction of dormitory buildings for senior staff. As a result, the production capacity of the Group increased by about 30% in 2004. In addition, the Group also spent about HK$2.3 million on building the retail platform and opening of LIDS stores.

For the year 2005, the Group has budgeted approximately HK$25 million for capital expenditure. About HK$21 million will be for the additions of plant and equipment, including the construction of the first phase of a logistics centre. These are expected to increase the production capacity by 20%. The remaining HK$4 million is earmarked for the opening of LIDS stores.

In addition, on 31 March 2005, the Group injected HK$30,000,000 into the joint venture for the operation of the SANRIO licence, which includes the amount of HK$10,000,000 for the subscription of the share capital and a shareholder's loan of HK$20,000,000. These will be used to open shops as well as to finance the working capital of the joint venture.

The above capital expenditure are expected to be financed by internal resources of the Group.

Management Discussion and Analysis

Contingent Liabilities

As at 31 December 2004, DPM, a subsidiary of the Group, was involved in a patent dispute in which a preliminary injunction was entered in November 2004 by a competitor against an accessory product to be launched by DPM in the US market. Legal costs incurred up to 31 December 2004 were charged to the income statement for the year. Based on legal opinion, the Directors consider that the product has not infringed any of the competitor's patents. The parties to the dispute are currently in negotiations with each other with a view to settle the dispute. The cost of the related inventory included in the consolidated balance sheet as at 31 December 2004 amounted to HK$2,858,000.

Save as disclosed above, the Group had no contingent liabilities as at 31 December 2004.

Exchange Risk

The Group's manufacturing operations are based in the PRC with sales mainly made to the USA. All assets and liabilities of the Group are denominated either in HK dollars, US dollars or Renminbi.

Employees and Remuneration Policies

At 31 December 2004, the Group employed a total of 102 (2003: 99) employees in the USA, 93 (2003: 57) employees in Hong Kong, and 2,520 (2003: 2,098) workers in the PRC. The expenditures for employees during the year were approximately HK$105 million (2003: HK$84 million). The increase of staff costs for the year ended 31 December 2004 was mainly in line with the growth in business. The Group ensures that the pay levels of its employees are competitive and employees were remunerated based on their position and performance. Key employees of the Group, including Directors, are also granted share options under the share option schemes operated by the Company.