
ArtsGroup

SUMMARY OF RESULTS

The Group's consolidated turnover and net profit increased by 32% and 24% to HK$685.0 million (2003: HK$519.4 million) and HK$102.4 million (2003: HK$82.3 million) respectively in 2004. Basic earnings per share increased by 24% to 27.1 cents (2003: 21.9 cents) in 2004.

Increase in production costs arising from higher raw material prices, labour wages and energy prices had fully offset the positive effects of economies of scale. The gross margin of the Group therefore decreased from 33.9% in 2003 to 33.3% in 2004. Nominal average selling prices remained relatively flat despite the increase in complexity of the products. Substantial capital and human resources investments were also made by the Group in the areas of product design and development as well as the application of new production technology in order to differentiate itself from other optical manufacturers. Net profit margin therefore also decreased from 15.9% in 2003 to 15.0% in 2004.

DIVIDENDS

The Directors have resolved to recommend a final dividend of 9 cents per share for the year ended 31st December, 2004. Subject to the approval of shareholders at the forthcoming annual general meeting to be held on 27th May, 2005, the final dividend will be payable on 7th June, 2005 to shareholders whose names appear on the register of members of the Company on 27th May, 2005.

CLOSURE OF REGISTER OF MEMBERS

The register of members of the Company will be closed from 24th May, 2005 to 27th May, 2005, both days inclusive, during which period no transfer of shares will be effected. All transfers, accompanied by the relevant share certificates, must be lodged with the Company's share registrars in Hong Kong, Secretaries Limited at Ground Floor, Bank of East Asia Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong for registration not later than 4:00 p.m. on 23rd May, 2005 in order to qualify for the proposed final dividend mentioned above.

BUSINESS REVIEW

Original design manufacturing (ODM) division

Sales to ODM customers increased by 34% from HK$460.6 million in 2003 to HK$616.8 million in 2004. The relatively strong performance of this division was due to the rebound in consumer confidence after the war in the Middle East in 2003 and the strengthening of Euro against United States dollars. Europe and the United States remained as the main export markets of the Group's ODM division and sales to these regions increased by 67% and 8% to HK$326.2 million and HK$243.2 million respectively in 2004 (2003: HK$194.9 million and HK$225.1 million respectively). On a geographical basis, sales to Europe, United States, Asia and other regions accounted for 53%, 39%, 5% and 3% respectively of the sales of this division in 2004 (2003: 42%, 49%, 5% and 4% respectively). Sales of prescription frames and sunglasses grew by 16% and 85% to HK$390.1 million and HK$214.4 million respectively (2003: HK$335.4 million and HK$116.1 million respectively). Sunglasses registered a much higher rate of growth as sales of sunglasses was more sensitive to economic performance of the Group's export markets. Sales of metal frames, plastic frames and spare parts accounted for 59%, 39% and 2% respectively of the Group's turnover of ODM business in 2004 (2003: 70%, 28% and 2% respectively).

Distribution division

Sales of the Group's own-branded and licensed branded products (including both spectacles and lenses) increased by 54% to HK$46.5 million in 2004 (2003: HK$30.1 million). Products carrying the house brand of "STEPPER" and licensed brand of "FIORUCCI" were distributed by appointed distributors in more than 30 countries. Sales to Europe, North America, Asia and other regions accounted for 48%, 20%, 14% and 18% respectively of the Group's turnover of distribution division in 2004 (2003: 44%, 13%, 27% and 16% respectively).

Retailing division

Turnover of the retailing division decreased by 24% to HK$21.7 million in 2004 (2003: HK$28.7 million). The Group closed its retailing operations in Nanjing and Shanghai during the year and operated a total of 17 shops (2003: 27 shops) including 11 shops in Beijing and 6 shops in Shenzhen as at 31st December, 2004.

Financial position and liquidity

The current ratio of the Group as at 31st December, 2004 was 3.4 to 1 (2003: 4.1:1) with HK$442.3 million of current assets (2003: HK$432.0 million) and HK$129.8 million of current liabilities (2003: HK$105.8 million). Inventory balance increased from HK$82.5 million as at 31st December, 2003 to HK$119.4 million as at 31st December, 2004 in order to meet the anticipated increase in delivery requirement in the first quarter of 2005. As a result, inventory turnover period (ratio of inventory balance to cost of sales) increased from 88 days in 2003 to 95 days in 2004. Debtors turnover period (ratio of the total of debtor and discounted bills balances to sales) also increased from 99 days in 2003 to 105 days in 2004 due to the extension of trade credit terms to certain key customers of the Group.

Despite the improvement in profitability in 2004, the net cash inflow generated from the Group's operating activities decreased from HK$113.8 million in 2003 to HK$84.0 million in 2004, primarily due to the increase in working capital requirement, with net increase in the level of inventories and debtors less creditors increased from HK$16.4 million in 2003 to HK$54.7 million in 2004. A relatively higher level of capital expenditure of HK$69.8 million (2003: HK$39.1 million) was also incurred during 2004. Payment of the second special dividend for the year 2003 was also made in 2004. As a result of the above factors, the net cash position of the Group (bank and cash balance plus pledged bank deposit less bank borrowing, if any) decreased from HK$192.2 million as at 31st December, 2003 to HK$110.5 million as at 31st December, 2004. The Group did not have any interest bearing borrowings at the end of both years of 2003 and 2004.

As at 31st December, 2004, the Group had 379,130,000 shares (2003: 376,870,000 shares) in issue with a total shareholders' equity amounting to HK$591.8 million (2003: HK$578.0 million). Net asset value per share was HK$1.56 (2003: HK$1.53). Total long term liabilities and debt to equity ratio (expressed as a percentage of total long term liabilities over equity were HK$10.1 million (2003: HK$8.0 million) and 1.7% (2003: 1.4%) respectively.

The Group had limited exposure to foreign exchange rate fluctuations as most of its transactions were conducted in either United States dollars, Hong Kong dollars and Renminbi and the exchange rates movements between these currencies were relatively stable during the period under review.

Contingent liabilities

	The Group	
	2004	2003
	HK$'000	HK$'000
Bills discounted with recourse	**3,922**	3,310

At 31st December, 2004, the Group had given a corporate guarantee in favour of a financial institution to secure general credit facilities to the extent of HK$9,750,000 (2003: HK$9,750,000). The extent of facilities utilised at 31st December, 2004 amounted to approximately HK$9,750,000 (2003: HK$9,750,000).

At 31st December, 2003, the Group had given a corporate guarantee in favour of a minority shareholder of a subsidiary to the extent of RMB1,020,000 (approximately HK$962,000) in consideration of the guarantee given by this minority shareholder in favour of banks to secure general banking facilities to the extent of RMB2,000,000 (approximately HK$1,887,000) granted to this subsidiary. No such facilities were utilised by the aforesaid subsidiary as at 31st December, 2003. The facilities expired during the year ended 31st December, 2004.

At 31st December, 2004, the Company had given corporated guarantees in favour of banks to secure general banking facilities to the extent of HK$120,130,000 (2003: HK$111,130,000) granted to its subsidiaries. Other than the bills discounted with recourse amounting to HK$3,922,000 at 31st December, 2004, (2003: HK$3,310,000) as stated above, there was no outstanding balance of banking facilities utilised by the subsidiaries at 31st December, 2003 and 31st December, 2004.

Pledge of assets

	The Group	
	2004	2003
	HK$'000	HK$'000
Assets pledged to banks in respect of banking facilities granted to the Group		
– leasehold properties with an aggregate net book value	**–**	12,252
– bank deposits	**2,187**	18,037
	2,187	30,289

Employees and remuneration policies

As at 31st December, 2004, the Group employed approximately 7,700 (2003: 6,400) full time staff in mainland China, Hong Kong and Europe. The Group remunerates its employees based on their performances, experiences and prevailing market salaries while performance bonuses are granted on a discretionary basis. Other employee benefits include insurance and medical cover, subsidised educational and training programmes, mandatory provident fund scheme as well as a share option scheme.

PROSPECTS

ODM division

Although the demand for the Group's ODM products remains strong, the challenges facing the Group really lie on the costs side. The performance of this division depends on the ability of the Group to deal with the rising production costs. Any price adjustments to the Group's products will be modest and cannot absorb all the costs increment. Despite the fact that most customers remain bullish about the business outlook, they remain cautious in placing actual purchase orders and keep on demanding shorter delivery lead time, thereby reducing the business visibility of the division. This division currently has 3 months sales orders on hands.

Distribution division

The management expects the sales performance of the "STEPPER" brand will remain strong in 2005. Additional distributors are appointed in certain potential markets (including the United States) for this house brand. The Group has also expanded the distribution rights of the Italian fashion brand "FIORUCCI" from Asia to Europe and new collection of this brand will be launched in the optical fair in Milan in May 2005.

Retailing division

The Group intends to remain focusing on the cities of Beijing and Shenzhen for its expansion of retailing network as the regulatory infrastructure in these two cities are more sophisticated and developed. A few more shops may be added in these two cities in 2005.

Summary

In view of the challenges discussed in the above analysis, the Group will continue to follow its guiding principles of financial prudence, balance sheet management and emphasis on cash earnings. It will also constantly evaluate the impact of gross margin pressure as well as increase in working capital requirement on the Group's profitability and dividend payment capability. Despite the above, the management is cautiously optimistic in reporting a solid financial results to the shareholders in 2005.

APPRECIATION

On behalf of the Board of Directors, I would like to express my sincere appreciation and thanks to our shareholders, customers, suppliers, bankers and staff for their effort and commitment.

Ng Hoi Ying, Michael
Chairman

Hong Kong, 15th April, 2005