Management Discussion and Analysis

INDUSTRY REVIEW

The PRC Government suppressed the overheated investment activity through the implementation of a series of macro-economic austerity measures to ensure a continual steady development of the overall economy. Other than the tightening of bank credit, the implementation of macro-economic austerity measures also brought about sharp rises in raw material prices such as steel, aluminum and copper since the measures had not completely taken into effect. In addition to the increase in transportation costs, the product price and gross profit were also suppressed, constituting pressure on manufacturing industries. Power and air tool industries were to a certain extent unavoidably affected which became a big challenge to the industry in 2004.

The worldwide power and air tool markets were blooming continually in 2004. According to the statistic from power tool magazine, the global demand for power tools will grow by 5% each year. As per a 2003 market research prepared by a well known market research company, there will be a steady growth in the US tool market, which will amount to US$15.4 billion in 2007 and US$16.6 billion in 2012. The demand for power tools in the mature markets of North America and Europe will be driven by the demand for replacement of tools and new products, representing approximately 50% of the expected aggregate sales of the global power tool market up to 2007. In regards to the developing countries of Asia, Latin America, Eastern Europe, Africa and Middle East region, there is a trend that the sales of power tools will grow rapidly. The industrialization process is going well in these regions. With the increase of infrastructure projects and improvements in people's living standards, sales of power tools will benefit. Global investment projects are increasing. The users of professional tools need a wide range of products to cope with their needs. It is expected that professional power tools will continue to take the leading role in the global markets.

The three major markets of air tools are the US, Europe and Japan. Air stapler is one of the major air tool products. It is widely used in the industries like wooden furniture making, construction and decoration, leather box packaging and furnishing. In 2004, the global sales of air tools was approximately US$2.7 billion with continuing appreciation for growth.

The improved living standards and the launch of new products stimulated the sales of user markets. The DIY markets in Europe and the US are becoming more mature, the market demand continues to grow steadily each year. The strong performance of Euro last year helped to stimulate consumption sentiment in Europe and created optimistic conditions there and in the US DIY market. In regards to the PRC market, as the people's lifestyles are becoming more westernized, the PRC DIY market grows rapidly and there is huge room for future growth.

INDUSTRY REVIEW (continued)

After China's accession into the WTO, it continued to keep its role as the World's factory to attract quite a large number of foreign brands and manufacturers to relocate their production to China. The power and air tool industry is among one of them. Renowned foreign power and air tool manufacturers seek for suitable production partners in the PRC and outsource the production. The relocation of the production procedure reduces production costs. Moreover, while the big chain store operators are selling internationally renowned power and air tools, they also launch their own products at the same time. They do the procurement in China and the transfer of production in order to enhance their market competitiveness. Therefore, one-stop power and air tool manufacturers have become the best business partners of renowned foreign tool manufacturers and big chain store operators.

Different from other industries, power and air tools need a great deal of capital investment and time to research and develop product and obtain certifications. High degree of quality control is required. The suppliers must be in a specific scale and have the strength to meet their requirement. Since product quality is the very main concern of the international renowned customers, suppliers have to perform various tests and examinations on products to obtain the customers' trust. Generally speaking, it needs to take more than one year or even two to three years for negotiation, product design and application for quality assurance certifications. The entry barrier for the industry is very high. Despite that there are strict requirements imposed by the internationally renowned customers on suppliers, once a cooperative relationship is reached, the customers will not shift to another supplier easily. It helps the supplier to establish goodwill within the industry and obtain orders successfully from other famous brands.

BUSINESS REVIEW

The Group is principally engaged in the production and sale of AC and DC power tool and air tool products, focusing on the manufacturing of mid-priced quality tool products. In 2004, the price of raw materials continued to rise. The implementation of macro-economic austerity measures led to the increase of transportation and even the overall costs. However, the Group further strengthened the enterprise management, especially cost management and quality management that efficiently reduced wastage of human resources and raw materials during the production, which helped maintain the growth of business. At the same time, the Group also strived to strengthen its product sales to a greater extent and launch new products to enhance economies of scale. The turnover for the year ended 2004 and profit attributable to shareholders was approximately HK$317,569,000 and HK$18,182,000 respectively, representing an increase of approximately 30.8% and 50.3% respectively over 2003.

Management Discussion and Analysis

BUSINESS REVIEW (continued)

Despite the challenging operating environment in 2004, the Group recorded satisfactory growth in results. It was mainly due to the successful transforming of the business model from the cooperation with middleman to the direct cooperation with renowned brand names and chain stores, which resulted in positive results; as well as the successful launching of the Group's self-developed new series of complete-range products, establishing new customer base and the timely delivery of products. The Group's air tool business also ran smoothly. The Group obtained orders placed by the largest renowned US air compressor brand name Campbell Hausfeld Air Power Company ("Campbell Hausfeld"). During the year, the operation scale of the production plants experienced the enhancement of economies of scale and projects were undertaken according to schedules that brought about steady and encouraging results for the Group.

For the year ended 31 December 2004, the Group launched various new products which were well received by the market. Sales grew steadily with aggregate sales of 3.6 million pieces (2003: 2.97 million). During the period under review, while further strengthening its power tool business, the Company also took an active role to expand its air tool business. It was also the first year that the air tool production business came into full scale. During the year, the sales of power tools, and air tools and other products represented 91% and 9% (2003: power tools 95%, air tools and others 5%) respectively to the aggregate sales. Our business is further diversified.

Since the power and air tools are technologically complimentary, they share basically the same pool of customers. Certain suppliers have a wide customer base of power and air tools with considerable synergy that established a solid customer platform. In 2004, the Group was successfully in obtaining orders placed by a new customer, Campbell Hausfeld, for air tools. The first batch of products was the order for Christmas delivery. During the period, the Group's air tools also attracted several customers of renowned brand names and manufacturers. Those customers are currently negotiating with us on product development. In late 2004, there were over 50 customers including global famous chain stores, brand names and manufacturers such as the world's sixth biggest chain store, Leroy Merlin Group in France and Praktiker in Germany.

The Group is currently developing power tools with customers, aiming at creating more new products to cope with the needs of the market and customers. During the year under review, the proportion of ODM and OEM business was 58:42. As for the capacity of the production facilities, the Group has over 50 production lines. The utilization rate of the production bases in Jiangsu Golden Harbour and Suzhou Dongxin was increasing in 2004, at an average rate of 60%-70% (2003:50%), with the highest annual capacity amounting to 5 million sets.

BUSINESS REVIEW (continued)

As the capacity of our production plants is becoming more mature, the proportion of self-production for the Group is increasing accordingly. In 2004, the proportion of the Group's self-production and production outsourced was 55:45 (2003: 40:60). The Group will increase the proportion of self-production as well as to seek for opportunities to outsource production for the sake of fully utilization our strengths and for enhancing the Group's development. The Group's production strategy is to maintain the self-production of mid-high end new products with high gross profits. It will also outsource the production of old products with low gross profits to achieve better economies of scale. The long term goal is to maintain the proportion between self-production and outsourcing at a level of 80:20.

In regards to new product development, the Group successfully developed 22 types of new power tools and launched 6 types of new air tools. The Group is currently producing five series of power tool products totaling 48 models with 118 different features and 50 models of air tool products. The Group also has over 46 world patents and 3 registered trademarks.

In 2004, the performance of SBW Technische Gerate Gmbh ("SBW"), a German company which the Group interested in 50%, was steady with the share of result of an associate of HK$5,301,000, which is comparable to last year. SBW is mainly engaged in the ODM or OEM product development and cooperating with the Group to develop new products. With the increase of direct sales of the Group to the European customers, SBW will gradually transform from the Group's platform providing European customers with quality products to a representative for the Group to develop the European market and carry out the referral work to serve European customers. Leveraged on the industry position of SBW in Europe and its industry knowledge, SBW will provide the Group with the latest market information, which will help the Group to develop and grasp more business opportunities and increase the income sources for both parties.

As for the development progress of the R&D centre in Taiwan, the preparation work was almost completed in late 2004. Part of the R&D work commenced in the first quarter of 2005. There are currently five professional technology R&D employees in Taiwan. During the year under review, the Taiwan R&D centre made steady progress. It is expected that the R&D work will commence to a full scale in 2005 and will employ totally ten R&D employees to further strengthen the Group's R&D capacity and accelerate the development of the Group's sales business. In late 2004, the Group employed 98 R&D staff specializing in the product R&D and carrying out research on product improvement to enhance overall market competitiveness of products.

Management Discussion and Analysis

FINANCIAL REVIEW

Turnover and Profit Analysis

For the year ended 31 December 2004, the Group recorded an audited turnover of approximately HK$317,569,000, an increase of 30.8% as compared to 2003. Profit attributable to shareholders was approximately HK$18,182,000, an increase of 50.3% as compared to 2003.

The increase in turnover and profit was mainly due to the successful transformation of the business model during the year from the cooperation with middleman to the direct cooperation with renowned brand names and chain stores, which resulted in positive results; as well as the successful launching of the Group's self-developed new series of complete-range products, establishing new customer base and the timely delivery of products.

Turnover Breakdown by Products and Geographical Locations

In terms of products, power tool were still the major income source for the Group. The Group's air tool business also ran smoothly and grew steadily during the year. In 2004, the sales of power tools, and air tools and other products represented 91% and 9% (2003: power tools 95%, air tools and the others 5%) respectively.

Geographically, Europe was still the major market of the Group. In addition, the Group succeeded in taping Australia as one of its major markets. In 2004, the turnover proportion for the Group in Europe, Asia, Australia, North America and other markets was 72:9:14:5 (2003: 76:14:6:4).

During the year under review, the European markets grew steadily while the proportion occupied by the Asian markets decreased. It was due to the increase of sales in other markets, the Group's direct cooperation with foreign customers and less cooperation with middleman. In addition, the Group also explored new markets including the US and Eastern Europe. It also established offices and representative agents to expand its business in Latin America so as to strengthen the market intensity in America.

Gross Profit and Profit Margin Analysis

For the year ended 31 December 2004, the Group's gross profit increased from approximately HK$32,527,000 to approximately HK$47,191,000. The increase in gross profit was mainly due to the launch of new products and the successful securing of new customers.

During the year under review, the Group's gross profit margin improved as compared to last year to 14.9% (13.4% in the corresponding period last year). The profit margin of power tools was approximately 14.2% while it was approximately 21.8% as for air tools and other tool products. The steady gross profit margin was mainly due to the enhancement of the Group's overall production efficiency in 2004 and the efficient intensifying of internal cost controls which led to the decline in costs. However, the increase of the cost of raw materials suppressed the increase of gross profit margin during the year.

FINANCIAL REVIEW (continued)

Structure of Costs

For the year ended 31 December 2004, raw material, salary, power and manufacturing overheads amounted 91.25%, 4.33%, 1% and 3.42% respectively, (2003: raw materials: salary: power: manufacturing overhead: 90%:4%:2%:4%). Raw materials were still the major portion of production costs.

Dividend

The Board of Directors recommended a final dividend of HK1.3 cents per share for the year ended 31 December 2004 subject to the approval of the shareholders of the Company at the forthcoming Annual General Meeting. Together with an interim dividend of HK1.2 cents was declared during the year under review, the total dividend for the year under review of the Group is HK2.5 cents per share. The Group will remain dedicated to maintaining a stable dividend distribution policy as feedback to the shareholders' support for the Group.

Capital Expenditure

The Group's capital expenditure in 2004 was approximately HK$15 million, of which R&D expenses amounted to HK$2.2 million and development of mould expenses amounted to HK$4.0 million.

The major infrastructure of the Group's PRC production base was completed. There is no need to inject a great deal of capital for the construction of production plants in the short term. The expected general expenditure of the Group in 2005 will be approximately HK$25 million, of which R&D expenses will amount to HK$15 million, which will be applied to develop moulds of new products and carry out product tests to enhance the capacity of the Nanjing and Taiwan R&D centers.

Account Receivables Analysis

For the year ended 31 December 2004, the account receivables of the Group were HK$50,452,000. The Group's debtors' turnover days improved from 61 days last year to 71 days.

Account Payables Analysis

For the year ended 31 December 2004, the account payables of the Group were HK$104,119,000 (2003: HK$82,752,000).

Management Discussion and Analysis

FINANCIAL REVIEW (continued)

Debts Analysis

For the year ended 31 December 2004, the long term and short term debts of the Group were HK$53,381,000 (2003: HK$68,685,000) in aggregate.

Inventories Analysis

For the year ended 31 December 2004, the inventories of the Group were HK$38,054,000 (2003: HK$20,798,000) while the inventory turnover days were 51 days (36 days last year). The increase as compared to 2003 was due to the increase in the proportion of self-production which led to corresponding increases in raw materials and inventories.

Gearing ratio

For the year ended 31 December 2004, the gearing ratio of the Group was 0.24. As compared to 0.41 of last year, it maintained at a healthy level.

Cash on Hand

For the year ended 31 December 2004, the cash on hand for the Group was HK$60,823,000. It was sufficient to be general working capital. (2003: HK$35,338,000)

Shareholding Structure

The Group continued to enlarge the shareholder base. For the year ended 31 December 2004, the shareholding of the major shareholder decreased from 64% in late 2003 to 55.61%, while the second largest shareholder, Arisaig Greater China Fund Limited held 10.47%.

Pledge of Assets

For the year ended 31 December 2004, the Group pledged bank deposits amounting HK$16,318,000. (2003: HK$9,997,000)

Exposure to Foreign Exchange Risks

The Group's income and expenses are mainly denominated in US dollars and partly in Euro and RMB. During the year under review, the Group's working or operating capital was not significantly affected by the fluctuation of exchange rates.

Management Discussion and Analysis

FINANCIAL REVIEW (continued)

Corporate Governance

In September 2004, the Group invited one more independent non-executive director to join the Board of Directors and Audit Committee. During the period, the Board of Directors and the Audit Committee had several official and non-official meeting and discussion in response to the Group's operating environment, collecting professional opinions from different aspects to seek for the direction of development. They keep close contact to exchange information, ensuring that the Group's business meets the requirement of the Listing Rules and endeavors to safeguard the investor and public interests.

During the period, the Group implemented various measures to strengthen the corporate governance, including the establishment of several independent monitoring committees responsible for the internal review, the monitoring of ordinary operation and the formulating of resolutions to optimize the internal system. At the same time, the Group enhanced the operation efficiency through the strengthening of the integration of and the rational distribution of human resources. Through the internal promotion, training and external employment, the Group proactively enlarged the management team and enhanced its professional management to a international standards to cope with its rapid development.

The Group endeavored to enhance its transparency. During the year under review, the Group kept close contact with customers, external investors and internal staff to provide them with the latest updates on the enterprise through different channels including the Company's website, email, press release and the participation to the domestic and foreign exhibitions.

Employee Benefits and Training

For the year ended 31 December 2004, the Group had approximately 1,600 employees, of which, 236 employees were management staff while there were 107 and 98 technicians and R&D staff respectively.

The Group has focused on the enhancement of the quality of staff and training. During the year under review, the Group organized various types of civil education training courses at the PRC office and production base. The Group also invited speakers to those courses including police from Nantong City and Haian County and well-known authentic persons from the legal and labor department to provide the Group's staff with moral training other than knowledge of production plant, enhancing their civil awareness and making them to be responsible and committed citizens

It has been three years since the establishment of the Group's production plant at Golden Harbour since then hundreds of on-the-job training programs have been held there. The Group invited technical and management professionals from Taiwan to provide intensive training for the mid-high graded management to enhance their work awareness and professional conduct. In addition, in order to strengthen the team spirit, and to enhance the communication, mutual understanding, mutual support and mutual trust between the Group and staff through various talks, seminars, and recreational activities including ball games and Mid-Autumn night fair.

Management Discussion and Analysis

PROSPECTS

During the year, the Group formulated series of development strategies, making arrangements to lay a solid foundation for the future business development. In terms of production facilities and capacities, the Group is much stronger than the other PRC manufacturing suppliers. At the same time, the Group is continuing its improvement and optimization of its production facilities and management practices. The Group is currently negotiating with several international brand names or chain stores for cooperative opportunities and project developments. Under such favorable circumstances, it is expected that there is still huge room for growing. As the capacity of our production plants is becoming more mature, the proportion of self-production for the Group is increasing accordingly. The Group will increase the proportion of self-production as well as to seek for opportunities to outsource production for the sake of fully utilization of our strengths, promoting of the Group's development.

Other than to increase the self-production proportion, the Group will also speed up the development of new products. In 2005, the Group will focus on the development of mid-priced quality power tool products and high-end professional air tool products. The Group intends to launch 30 new power tool products and 10 new air tool products in 2005. With our full-scale operation of Taiwan R&D centre and the strengthening of the Nanjing R&D centre, we are confident that the Group can complete the above development projects in 2005. In order to expand our business and enlarge the customer base, the Group will proactively carry out research to develop new business related to the existing products.

With the abundant capital investment in the previous few years, the production capacity of the Group is currently sufficient to cope with the future development. It is expected that there will be no need to invest a great deal of capital for the construction of infrastructure in the coming few years. If there is a demand for the increase of production, the Group will install additional assembly/production lines in the existing plants or increase the working shifts to meet the need of order placement. However, the Group will also consider installing necessary accessories in response to the development pace in US market to enhance the production capacity.

Leveraged on premium product quality, a solid business base, renowned goodwill and its well known brand name, the Group is full of confidence about the future. Overall, the Group will inherit the development direction of 2004 to achieve the fruitful rewards resulting from the successful transformation of our business. While stabilizing our business development in Europe and Australia markets, we will also develop the US market to a greater extent. As the world's demand for power tools is so strong, the Group expects that there is still room for the growth of the power tool business. As for the air tool business, the Group had a good start during the period. The Group will facilitate the sales and endeavor to exploit new markets and enlarge the customer base in 2005, so as to optimize the synergy of power tools and air tools. In addition, the Group will develop varieties of products to cope with the market demand and also tap into a larger customer base.

PROSPECTS (continued)

With the effort made in the last two years, the Group's production base and management have stepped into a steady development period. Looking ahead, apart from the proactive development of the existing business, the Group will also seek for suitable opportunities of acquisitions and merges to further develop its business, expand the market share and consolidate its market position. Leveraged on its stringent cost control measures and excellent management over cost and quality, the Company will dedicate itself to the enhancement of economic efficiency, optimization of product portfolio, and the strengthening of enterprise competitiveness and profitability, aiming to become one of the leading power and air tool manufacturers in the PRC.