

# Management Discussion and Analysis



**Bankee P KWAN**

*Chairman*

# Management Discussion and Analysis

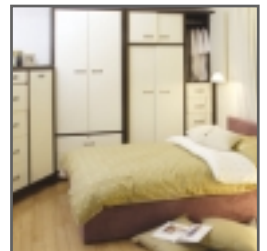
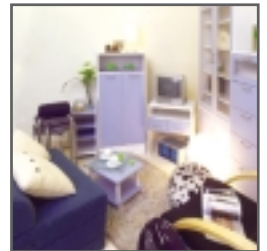
## REVIEW OF THE ECONOMY

The beginning of 2004 had seen a sustained economic revival from the previous year. A sharp contrast from the temporary depression caused by the SARS epidemic in early 2003 was reflected in the improvement in most 2004 economic indicators. The 2004 whole year GDP grew by 8.1% in real terms over a year earlier, with private consumption expenditure alone surged by 6.7% in real terms during the same period.

Despite the fact that tourism industry accounted for only 2.5% of Hong Kong's GDP in the year 2003, its strong performance in 2004 was an important contributing factor to the improving economy. Consumer confidence and sentiment continued to grow against the backdrop of a 40.4% increase in tourist arrivals in 2004, inducing new demand in various sectors, including retail.

Reflecting the fairly broad-based economic recovery, the Composite Consumer Price Index (Composite CPI) reverted its downtrend and showed a positive sign since July 2004, ending a sixty-eight-month long period of deflation. The stabilising of prices laid a more predictable ground for investments. In all, the investment sentiments restored.

Under this backdrop in the general economy, the retail industry also benefited. According to the Census and Statistics Department, the total retail sales value increased by 10.8% in 2004. However, despite improvements in the general economy, we continued to combat the residue effect of the poor economic fundamentals during the past few years as consumer price sensitivity continued to hamper efforts to improve gross profit margins. This was reflected in the specific years-long decline in durable goods item in Composite CPI for the year 2004.



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### BUSINESS REVIEW

In the midst of a stabilising market environment, Pricerite continued to sharpen our business edges to deliver better products and services to our customers.

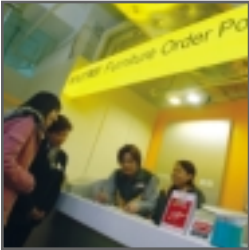
#### Improving Customers' Shopping Experience

We continued to improve the shopping environment in Pricerite stores. We completed upgrading our in-store shopping environment. Works included the standardisation of corporate and visual identities, a more logical planning of customer flows inside the stores, and the planning and spacing of racks and merchandise. Overall, the new look of Pricerite stores was well received by customers to be a more spacious and better-displayed shopping environment.

Following the well received "room setting" in-store display of furniture and associated household products, we extended the "room setting" display to all furniture-carrying stores.

#### Re-engineering Our Merchandise

To meet the ever demanding needs of our customers for better selection of products, Pricerite introduced wider and deeper ranges of merchandise mix during 2004. We reviewed and refined our range within each product category. On the whole, Pricerite started migrating towards a more focused retailer in product groupings that are highly identified with our customers. Within each of such product categories, we introduced a deeper range of product offering to enhance customer choice.



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### Sharpening Our Tools

We continued to enhance our operating efficiency and the scalability of our supply chain management. During the year, we conducted a comprehensive review in our operations, system and management reporting processes. A professional team was assigned to conduct a re-engineering project in our household section to study, evaluate, measure and improve the various components of our business. New operations workflow and system were established, trial run and implemented for all functional areas within the purchase and sales cycle and the related inventory management. As part of the re-engineering project, we also reviewed and re-defined the Key Performance Indicators ("KPIs") of various components in our household retailing business. New KPIs were adopted as the standard means of performance measurement, communication and evaluation.

We continued to invest in and deploy IT to provide a more accurate and robust system for our management and operations. Further to winning the Intelligent 20 Award in 2003, our IT application in inventory management, the Wireless Warehouse Management System (WMS), won the MIS Innovation Award 2004 organised by MIS Asia magazine. The award was presented to recognise innovative use of technology in enhancement of productivity in Asian business enterprises.

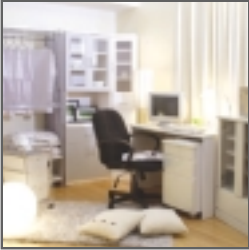
Our collaborative efforts in re-engineering our household business reported initial success in enhancing our operating efficiency during the year, with remarkable results in raising the vendor fulfillment rate by 12% and improving our stock-out ratio to below 5%. This encouraging result boosted our confidence to re-engineer our furniture business in 2005.

### Enhancing Our Customer Service

Our commitment in enhancing our service quality continued and culminated in two Distinguished Salesperson Awards and one Outstanding Young Salesperson Award being presented to our frontline staff in the 36th Distinguished Salesperson Award Programme as organised by the Hong Kong Management Association in June 2004. Participants of the said programme mainly came from the service sector like banks, insurance company, airlines, telecommunications companies and property agencies. We are glad that our investment in nurturing our staff was recognised. During the year under review, we invested in more than 2,000 training hours on improving our staff's skills in areas such as customer service and product knowledge.

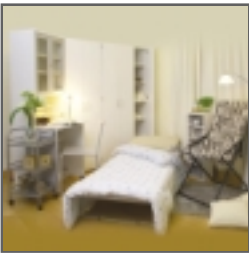


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### Fine Tuning Our Network

As part of our strategy to constantly improve our overall profitability, we continued to regularly review our store network. Stores below performance targets were replaced with new stores that are better located with higher customer traffic. As of 31 December 2004, our store network comprised a total of 38 stores.



### Building Strength in the Greater Pearl River Basin

To serve the growing operation needs in the PRC markets, in September, Pricerite started an operations support centre in Shenzhen, the PRC, employing more than 70 staff to provide cost effective and timely back office support to serve the markets in Hong Kong and the Guangdong Province. The operations support centre will also include a procurement centre to support our global distribution business.



To further strengthen our presence in Guangzhou, we relocated our store from the southern region to the Tian He area in the northern region. The new store in this Northern Guangzhou is favourably located at a popular shopping area with proximity to excellent customer traffic and easy access to the subway network. In Shenzhen, our fourth outlet was opened in the new B&Q home decoration and building materials mall. To date, we have a total of four outlets in Shenzhen.

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### Materialising Our International Business Model

In 2004 Pricerite made significant advancements in international business. Our international expansion strategy consists of two components: licensing of the Pricerite operation, and provision of supply chain management services for international retailers.

Our business in the Middle East continued to made significant progress. Pricerite and ARTAR, our Saudi business partner, built operation teams in Riyadh and Hong Kong to work on the opening of the Saudi operation and the associated work in supply chain operations. The Riyadh store boasts 50,000 square feet shopping space and is expected to open in 2005.

In November we completed the acquisition of Cosmos Global Limited, a brand management and distribution specialist from our parent company. Cosmos Global had a track record in the introduction of consumer product brands from Europe into the Asian markets including Mainland China. Upon acquisition of Cosmos Global, Pricerite gained a head start for the accelerated development in brand management and international distribution business.

### Catering for Growing Market Demand

In view of the booming demand for the most up-to-date digital products from both local and tourist customers, we launched a new retail chain named "3C Digital" in Hong Kong last year. 3C Digital aims at providing customers with trendy digital products to enjoy life. Four shops were initially opened, including a flagship store at Langham Place, Mongkok and three "shop-in-shop" operations in Pricerite stores. All four stores are strategically located at high customer traffic shopping area in Mongkok, Shatin and Yuen Long.



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### MOVING FORWARD TOWARDS A NEW PRICERITE

#### Capturing Opportunities in the Changing Retail Market Environment

The Pricerite board of directors is of a view that 2004 was a period in which the Group strengthened our basic elements in management and steered the strategic direction towards a more internationally based operation platform. While the year 2004 represented an improvement in the operating environment for Hong Kong retailers, it also exemplified the limitations of the Hong Kong retail markets in locally consumed products.



In 2004, we conducted a comprehensive market analysis of recent retail market trend in local Hong Kong economy. In all, the improvement in retail landscape comprised of two elements: a rebound in consumer demand following the revival of economy, and a fundamental change in consumer behaviour of both Hong Kong people and inbound tourists.



The change in consumer behaviour implied that nowadays consumers are more selective and focused on well-chosen ranges of specialised goods. In view of this, we will continue to increase our efforts in re-engineering our merchandise, so as to provide well-chosen ranges of furniture and household products to enhance our customer satisfaction. On the other hand, to meet the ever-increasing demand of customers for quality digital products, we will continue to build coalitions with our vendors, so as to further develop value-added services, such as free-downloads and infotainment related services, to our customers. Joint marketing programmes with merchants and credit card companies will also be launched. We are planning to expand the retail network of 3C Digital into prime shopping areas in 2005.

Moreover, to capture the growing business opportunities emerged in the international arena, Pricerite board of directors will continue to re-engineer the Group in order to migrate Pricerite into a global player in the furniture and household product supply chain market.

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### Leveraging and Further Sharpening Our Competitive Edges

In our twenty years' of operation, Pricerite is well recognised as a leading retailer that delivers the best product selection and value. Down the road we will further our expertise in providing well-selected and value-for-money products to satisfy our customers' home improvement needs.

In order to offer the best value to our customers and at the same time to enhance our shareholder value, Pricerite will continue to streamline our operations and rationalise our operating costs. In the next five years, this will be achieved by consolidation of sourcing and back office support activities in our operations support centre in Shenzhen. Upon full function of our Shenzhen operations support centre by end of 2005, we will be able to further enhance our supply chain functions and smooth away operating wastage and non-essential cost elements. We will also be able to leverage on this operations support centre to further develop our international supply chain business.

