

MANAGEMENT DISCUSSION AND ANALYSIS

I MARKET OVERVIEW

In 2005, global economic environment was on a growing track. China not only reported an impressive achievement in terms of economic growth and enhanced efficiency in 2005, but also gained precious experience in the macroeconomic austerity measures and maintained good development trend. Accordingly, the overall economy remained growing healthily at a speedy pace. In 2005, China's preliminary audited Gross Domestic Product (GDP) amounted to RMB 18.2 trillion, increased by 9.9% over 2004. The domestic consumer prices were up by 1.8% over 2004, while the disposable income per capital in urban area increased by 9.6% compared with 2004. With a total commodity retail volume increased by over 12%, China became the country with the fastest growth in terms of the total commodity retail volume. A steady economic growth and an increasing income amongst the domestic citizens represented direct drivers for stimulated consumer spending. It should be noted that a continuous expanding middle to high income classes who are in pursuit of higher quality lifestyle and life tastes added a driving stimulus for an increasing demand for branded products from the high income class. On the side of the watch segment, high-end luxury imported watches enjoyed increasing popularity with an expanding market share and influence in the domestic market. Of which, the prestigious Swiss watches were highly appraised amongst consumers for their high qualities. According to the CCID report, a research report on the Watch and Clock industry in China published by CCID (CCID Consulting Company Limited), sales volume from the imported Swiss watches accounted for 64% of the total sales volume for watches in China.

The Group, as one of the key retailers and distributors of internationally prestigious watches in China, has been enjoying a period of robust development under the prevailing favourable operating environment.

II FINANCIAL REVIEW

Sales

For the year ended 31 December 2005, the Group recorded sales of RMB1,396,531,000, of which sales from wholesale business amounted to RMB745,059,000 and accounted for 53% of the sales. While sales from retail business amounted to of RMB636,725,000 and accounted for 46% of the sales. The Group's sales decreased slightly by 8% over 2004 mainly due to a transfer of the wholesale business of Omega and Rado by the Group to SMH Swiss Watch, a joint venture set up by the Group and Swiss Swatch Group.

MANAGEMENT DISCUSSION AND ANALYSIS

The breakdown of the sales of the Group is as follows:

	For the year ended 31 December			
	2005		2004	
	RMB'000	%	RMB'000	%
Retail business	636,725	46	530,264	35
Wholesale business	745,059	53	974,771	64
After-sales services	14,747	1	13,547	1
Total	1,396,531	100	1,518,582	100

Gross profit and gross profit margin

For the year ended 31 December 2005, the Group's gross profit increased by 18.2% for the last corresponding year to approximately RMB364,162,000. Whereas, our gross profit margin for 2005 was up by 28.6% over the last corresponding year to 26.1%. The increase was mainly attributable to our active expansion into retail business of higher gross profit margin, and diversification into a widened and broadened variety of our wholesale product mix of higher gross profit margin.



Distribution costs

During the year ended 31 December 2005, our distribution costs increased by 6.5% over the corresponding year to approximately RMB96,645,000, representing 6.9% of sales, given that the Group made committed efforts in expanding its retail outlets.

Finance costs

During the year under review, the Group's finance cost amounted to approximately RMB23,353,000, which mainly consisted of interest expense.



MANAGEMENT DISCUSSION AND ANALYSIS



Profit for the year and profit margin for the year
Overall speaking, despite the Group was still undergoing a consolidation period during which we built an operating structure mainly on a retail network oriented basis, we recorded an encouraging year-by-year profit growth in 2005. Profit for the year increased by 24.5% to approximately RMB131,777,000 over last year, while our profit margin for the year was up by 34.3% to approximately 9.4% over last year. The increase was partly attributable to the increased spending from the population group with high consumption power due to a rapid economic growth

particularly arisen from a persistently expanding middle class in the PRC. Another reason was a booming spending on high-end consumer products due to a remarkably growing middle class population in the PRC. In particular, the three important reasons were: (1) our rapidly expanding retail network with an increased retail store number and a higher retail profit margin over wholesale profit margin; (2) a higher gross profit margin for our new agent products; and (3) our improved management quality.

Final dividend

The Board recommends the payment of a final dividend of RMB0.048 per Share for the year ended 31 December 2005 in return for shareholders' support, subject to approval by shareholders at the Annual General Meeting to be held on 8 June 2006. The proposed final cash dividend will be payable on or before 28 June 2006 to shareholders whose names appear on the register of members of the Company on 7 June 2006.

Current assets and current liabilities

As at 31 December 2005, the current assets of the Group amounted to approximately RMB1,191,571,000, including inventory of approximately RMB662,142,000, trade and other receivables of approximately RMB214,110,000, and cash and cash equivalents of approximately RMB142,502,000.

As at 31 December 2005, the current liabilities of the Group amounted to approximately RMB548,788,000, including bank loans of approximately RMB314,000,000, trade and other payables of approximately RMB185,376,000, and current tax payable of approximately RMB49,412,000.

MANAGEMENT DISCUSSION AND ANALYSIS

III BUSINESS REVIEW

Retail business

In 2005, the Group adhered itself to a strategic direction of concerted expansion and consolidation of our retail network. In line with our focused principle of economic effectiveness and strategically oriented synergic development of our wholesale and retail sectors, our domestic retail distribution networks were explored through various means, including acquisitions or co-operations with a large number of retailers through varying means; establishment of brand retail stores in cooperation with brand suppliers; direct investments in the opening of retail stores. At the same time, the Group will continuously upgrade the standard of its retail stores by adjusting the existing network strategy of our retail stores in line with market trends. As at 31 December 2005, the number of the Group's retail stores reached 65, outnumbering our expected stores. All the Group's retail stores were located in prosperous zones, and were strategically located within prime locations in major cities including Beijing, Shanghai, Tianjin, Shenyang, Harbin, Hangzhou, Nanjing and Shenzhen.



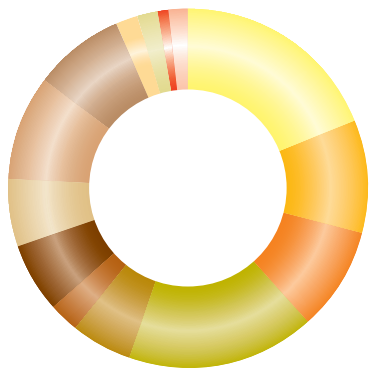
In addition, to cultivate an outstanding corporate image for a reflection of our increasingly upgraded quality of retail stores, the Group was under the process of renovating our retail stores under Xinyu brand namely "PRIME TIME – Xinyu Hengdeli Holdings" (盛時表行—新宇亨得利控股), through which Xinyu Hengdeli will eventually emerge as a unique retail brandname in the operation of international luxury watches.

Over a year of effort, the Group realized a retail sales of RMB636,725,000, representing an increase of 20.1% over last year, and recorded a retail gross profit of RMB221,241,000, which was a 29.9% growth over last year. In 2004, sales from retail and wholesale sectors was in the ratio of approximately 35:64, contrasting a ratio of approximately 46:53 in



MANAGEMENT DISCUSSION AND ANALYSIS

Breakdown by retail area distribution over different provinces and cities:



Beijing 18.52%	Tianjin 5.73%
Heilongjiang 10.62%	Shanghai 10.25%
Liaoning 8.75%	Shandong 8.84%
Zhejiang 18.29%	Henan 2.16%
Shanxi 5.36%	Hebei 1.97%
Guangdong 2.07%	Fujian 1.05%
Jiangsu 4.51%	Guizhou 1.88%

2005. In 2004, gross profit from retail and wholesale sectors was in the ratio of 55:42, contrasting a ratio of 61:37 in 2005. Based on the above comparative figures, it was apparently noted that the Group reported an increasingly booming profit with an expanding weighting of retail sector. In the overall, the Group's operating mode and the actual performance were completely in line with our strategic direction.

Apart from the above, the Group formed a retailing strategic alliance with other three major watch retailers, namely Shanghai San Lian Group Limited (上海三聯(集團)有限公司), Shanghai Oriental Commercial Building Ltd. (上海東方商廈有限公司) and Shenzhen Hengjili World Brand Watches Centre Ltd. (深圳市亨吉利世界名表中心有限公司). With over a hundred of retail outlets within the allied retail network, a market share of approximately 48% was secured in the international luxury watch markets in the PRC. The establishment of the alliance and its gathering of strength progressively represented a crucial factor for a regulated domestic luxury watch market and enhanced corporate profitability.

Wholesale business

With an extensive coverage of a well-established distribution network in the PRC, the Group secured a wholesale customer base of over 300 customers across 40 cities throughout the country during the year ended 31 December 2005.

The Group has maintained a good relationship with world-class watch manufacturers and suppliers, including Swatch Group, Richemont Group, LVMH Group and Desco Group. For the year ended 31 December 2005, out of our 19 brands under the international reputable watch groups, inclusive of the above four big groups, 15 brands were sold under an exclusive agent basis, including Audemars Piguet (愛彼), Jaeger-LeCoultre (積家), Carl F. Bucherer (寶齊萊), TAG Heuer (豪雅), Zenith (真利時), Baume & Mercier (名士), Maurice Lacroix (艾美), Christian Dior (克麗絲汀·迪奧), Fendi (芬迪), Dunhill (登喜路), Hamilton (漢密爾頓) and Certina (雪鐵那). Among which, Dunhill (登喜路), Hamilton (漢密爾頓) and Certina (雪鐵那) were new agent brands acquired in 2005. In addition, the Group established a particularly good relationship with Rolex Group, an international luxury watch manufacturer and supplier.

MANAGEMENT DISCUSSION AND ANALYSIS

The comprehensive wholesale network of Xinyu Hengdeli in the PRC



In 2003, the Group and Swatch Group, the world's largest watches manufacturer and distributor, established SMH Swiss Watch Trading (Shanghai) Co. Ltd. ("SMH Swiss Watch") on a joint venture basis. SMH Swiss Watch, as the first and the only joint venture of the Swatch Group on a worldwide basis, is set to access to exclusive distribution rights of the prestigiously branded watches of Omega (歐米茄) and Rado (雷達) in the PRC.

MANAGEMENT DISCUSSION AND ANALYSIS

Proprietary brands

During the year ended 31 December 2005, the Group's proprietary brand of NIVADA was well-received by the market, as noted from an approximately 45% and 90% growth in sales and gross profit from our proprietary branded NIVADA over the last corresponding figures to RMB30,000,000 and approximately RMB17,735,000 respectively.

To lure a further expansion of our proprietary branded business, during 2005, the Group newly acquired two Swiss famous brands, namely, OLMA (奧爾瑪) and NUMA JEANNIN (龍馬珍). To the Group's belief, our proprietary branded products will represent stronger profit generators for the Group and contributive factors for our prolonged development.

Marketing

In 2005, in order to further enhance our reputation, the Group took an active part in initiating a number of marketing activities, one of them being the "Famous Watches Fair in Three Regions" of Xinyu. With roadshow activities carried out by the Group in three cities including Shanghai, Nanjing and Hangzhou in December 2005, we gained overwhelming market responses by advocating a widespread participation of a large number of reputable brands including Audemars Piguet (愛彼), Baume & Mercier (名士), Cartier (卡地亞), Carl F. Bucherer (寶齊萊), Dunhill (登喜路), Jaeger-LeCoultre (積家), TAG Heuer (豪雅), Vacheron Constantin (江詩丹頓) and Zenith (真利時).



MANAGEMENT DISCUSSION AND ANALYSIS

Customer services

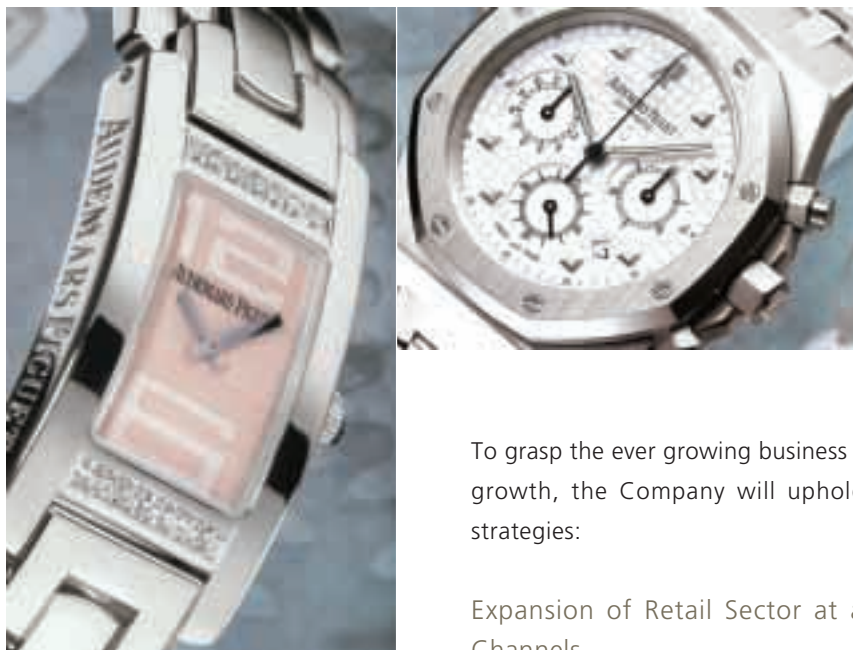
The Group valued quality customer services by offering free-of-charge after-sales services with a warranty period ranging from one to three years to our retail customers. For the year ended 31 December 2005, all retail outlets under the Group are capable of providing instant after-sales services to our customers. The two service centres operated in Beijing and Shanghai by the Group were equipped with a team of experienced technicians and engineers in order to handle technically sophisticated repairs. All of our repair technicians were accredited with professional qualifications, while some of them were in possession of a "Specific Brand Repair Technician", a "Model National Labour" and a "Leading Technically Advanced Technician in the Industry".



IV FUTURE PROSPECTS

Under a rapid surging domestic economy, coupled with an increasing spending power amongst the middle and high income group, all walks of life in our society are increasingly in pursuits of high quality lifestyles and tastes. Given an ever increasing demand for watches, the mid-range and high end watch sectors were embedded with enormous market potentials. In comparison with other developed countries, the PRC's watch market is relatively lagged behind in terms of consumption volume as noted from an average annual purchase of five watches for every 100 people in the PRC which is far below the average annual purchases of 27 and 18 watches in developed countries and developing countries. In this regard, the PRC's watch markets are set to uncover massive development spaces. With a vividly growing economy, the PRC is well positioned to become a huge consuming country of immense market potentials, thereby picturing an extremely bright future for the domestic luxury watch market. As an internationally renowned luxury watch retailer and distributor, the Company will meet the forthcoming market challenges with a stronger competency by steadfastly improving our existing businesses and establishing its leading position in the domestic luxury watch markets. We firmly believe that we will head towards a remarkable result performance by timely keeping abreast of market changes and opportunities.

MANAGEMENT DISCUSSION AND ANALYSIS



To grasp the ever growing business opportunities for flourishing our business growth, the Company will uphold the following business development strategies:

Expansion of Retail Sector at an Accelerated Speed via Different Channels

In 2006, the Company will adhere itself to a strategic direction of providing a quality and extensive distribution platform to a large pool of prestigious international branded watches vendors. In line with our focused principle of economic effectiveness and strategically oriented synergic development of our wholesale and retail sectors, our domestic and external retail distribution networks were further explored through various means. We will strive to increase our retail outlets to 90 by the end of 2006.

Speeding up the Development of Proprietary Brands and Agent Brands

The Group will speed up the establishment of proprietary brands and long term agent brands through its substantial efforts in developing its own brands and equipping with stronger core competitive strengths in order to create higher profit. In the long run, an in-house research and development department will be set up for designing, researching and developing our NIVADA and OLMA branded watches, and for enhancing our long term competitive capacities. We will be more committed to strengthen our long term agent brands, to continuously adjust its operational structure, to reinforce training and guidance to employees, in order to expand its business in the PRC.

MANAGEMENT DISCUSSION AND ANALYSIS

Putting into Place an Ancillary Production System for Principal Business

The ancillary facilities and accessories including renovation and setting of retail shops, elegant watch boxes, brand presentation boards, display boxes and various kinds of tools for watch displays, represent integral parts of luxury watch sales business. We identify considerable profits for such ancillary products. To meet the demand for such products from the proprietary brands, agent brands and outlets of the Group, the Group intends to establish its own production facility for such products and is confident that this will be beneficial to optimizing the ancillary services to luxury watch sales which will in turn effectively increase our profits.

Maintaining and Strengthening the Strategic Alliances of the Group

Xinyu Hengdeli has a vision of setting up an extensive and quality distribution platform for the internationally famous watch brands and of seeking joined forces in business development with other domestic retailers. The Group will work with other suppliers and retailers on a win-win situation basis by entering into and further strengthening close cooperation with our suppliers and strategic alliances with other domestic retailers.

Further Improving Corporate Governance

To boost a sustainable corporate growth and an increasing profit, Xinyu Hengdeli will take a greater leap in strengthening its corporate governance by constantly optimizing our finance and audit systems for a healthy corporate development. To encourage energetic and proactive values amongst our staff, our remuneration and incentive policies will persistently undergo improvements. We endeavour to minimize any potential risks associated with our development with continually optimized rules in respect of business discussions at board meetings.

Looking forward, in light of robustly prosperous growing prestigious watch retail markets in the PRC, as a key retailer and wholesaler in the domestic medium to high end watch market, the Group will leverage on the rapidly growing domestic consumer markets by timely capturing market opportunities in order to deliver the best value for our shareholders and the community at large.



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