

# Management Discussion and Analysis

## RESULTS

The Group continued to achieve satisfactory results during financial year 2005/06. For the year ended 31 March 2006, the Group reported a turnover of HK\$2,880,037,000, representing a 12.2% growth as compared with HK\$2,566,742,000 last year. Operating profit increased by 35.6% to HK\$189,164,000 (2005: HK\$139,453,000). Profit attributable to shareholders surged 21.3% to HK\$129,607,000 (2005: HK\$106,822,000).

During the year under review, the local retailing sector experienced steady growth thanks to returning consumer confidence. The continual relaxation of the "Individual Visit Scheme" and appreciation of the Reminbi (RMB) also encouraged more Mainland visitors to Hong Kong as well as boosted their purchasing power, which in turn enabled the Group

to report pleasing performance and continuous growth in 2006.

The Group's jewellery distribution and export business remained steady, continuing to contribute as a major income and profit source. The Group's overall gross profit margin was 33.0% (2005: 35.2%) for the year.

Supported by growing turnover, the Group continued to branch out into potential districts and its effort to further enhance the "3D-GOLD" brand also paid off. During the year, the Group has continued to maintain investment in brand promotion as in previous years. Through tighter control of expenses, the selling and marketing costs decreased to 17.5% (2005: 21.2%) of total turnover. To support its expanding operations, the Group's administrative expenses increased from 8.9% of total turnover in 2005 to 9.5% in

the year. Finance costs increased from HK\$26,465,000 last year to HK\$51,148,000, mainly caused by the increase in interest rates during the year.

Geographically, Mainland China and Hong Kong remained as the Group's largest markets, accounting for 92.2% of the Group's total turnover. Sales generated from these markets reached HK\$2,656,314,000, an increase of 15.8% over last year's HK\$2,292,966,000. Overseas sales amounted to HK\$223,723,000 (2005: HK\$273,776,000).

## DIVIDENDS

The Board of Directors proposed to pay a final dividend of HK3.0 cents (2005: final dividend of HK2.8 cents and special dividend HK1.0 cent) per share for the year ended 31 March 2006 in cash with a scrip option for the shareholders to elect to receive such final dividend (or part thereof) in new shares of the Company (the "Scrip Dividend Scheme"). Together with an interim dividend of HK1.0 cent (2005: nil) per share, the total dividend for the year amounted to HK4.0 cents (2005: 3.8 cents) per share.



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“VS Lady” Diamond Jewellery Collection

Subject to the approval by shareholders at the forthcoming annual general meeting, a circular containing details of the Scrip Dividend Scheme together with the relevant election form will be sent to shareholders on or about 1 September 2006. The Scrip Dividend Scheme is conditional upon the granting by the Listing Committee of The Stock Exchange of Hong Kong Limited of the listing of and permission to deal in the new shares to be issued pursuant thereto. It is expected that the relevant dividend warrants and certificates for the new shares will be despatched to shareholders on or about 5 October 2006.

### CLOSURE OF REGISTER OF MEMBERS

The Register of Members of the Company will be closed from 28 August 2006 to 31 August 2006, both days inclusive, during which period no transfer of shares will be effected. In order to qualify for the proposed final dividend and determine the identity of members who are entitled to attend and vote at the forthcoming annual general meeting, all transfer forms accompanied by the relevant share certificates must be lodged with the Company’s branch share registrar in Hong Kong, Computershare Hong Kong Investor Services Limited, at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen’s Road East, Hong Kong not later than 4:00 p.m. on 25 August 2006.

### BUSINESS REVIEW

#### Brand Retailing Business

Brand retailing business continued its growth, benefiting from the further relaxed “Individual Visit Scheme”, appreciation of the RMB as well as marked fluctuation of gold price during the year. The movements of gold price together with other favorable market conditions pushed up turnover of gold products.

#### *Retail network expansion*

During the year, the Group has tailored its retail network expansion strategy to capture the growing number of Mainland visitors to Hong Kong and Macau. It opened three retail outlets in Tsuen Wan, Mongkok and Macau. Anticipating fast-growth for the Macau market, the Group opened its first retail



3D-GOLD Jewellery Shop in Tsuen Wan

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3D-GOLD Jewellery opened its first retail shop in Macau

outlet in the prime district of Macau. As at the end of June 2006, the Group operated 8 retail outlets in Hong Kong. In Mainland China, the Group had around 100 retail stores through franchising and cooperative arrangements.

The Group's successful network expansion strategy has improved its competitive edge by locating new retail outlets in potential districts. With customers in these districts possessing a similar purchasing power as those in popular urban districts, the Group maintained growth for its retail outlet network to leverage on its established brand effect to continue to improve in performance.

### Products

Product strategy has been one of the key factors in successful brand creation and development.

For example, the launch of signature collection "Shàn" diamond jewellery series, which was inspired by the delicate curves of Chinese fan, added to our diverse product range and showcased our advanced technical expertise.

"So Sweet" diamond jewellery collection, sparked by the slimming trend among local ladies, the "Spring Fairy" diamond jewellery collection, which was the seasonal and thematic products, and the "Happy Forever" jade diamond collection, the mother's day series, have effectively aroused consumer interest. The innovative and inspirational product strategies have greatly



"YOUUnique Diamond" Jewellery Collection

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enhanced brand awareness and increased the Group's market share.

Hang Fung Gold Technology introduced the fashionable Modeo Jewellery Italy. Modeo Jewellery Italy is a European brand featuring elegant Italian designs. Using clean and smooth lines conveying romance, the products follow the stringent European standard in colour.

Spotting the potential purchasing power of the children and teenager market, the Group launched a wizard range of wristwatches featuring images from the cinema blockbuster Harry Potter during the showing of "Harry Potter and the Goblet of Fire". The Group also entered the China market through cooperation with China National Publications Import and Export (Group) Corporation ("CNPIEC") to distribute Harry Potter related products in Mainland China. CNPIEC supplies over 10,000 retail outlets and the cooperation with CNPIEC has provided the Group with an effective sales platform to reach a large scale target customers.

### Marketing campaigns

During the year, the Group took a proactive approach in reaching a wider customer base with various media and promotions. Taking a further step in corporate responsibility, the Group paid significant effort in supporting cultural, sports and community events, such as sponsorship of East Asian Games 2009, Chinese New

Year Raceday – 3D-GOLD Cup, 3D-GOLD FIVB World Grand Prix – Hong Kong 2005, uniform sponsor of Hong Kong National Table Tennis Team, 2006 Bun Carnival, sponsorship of Kowloon City District Festival 2006, to name a few.



"Gold Leaf" Collection

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### Distribution and Export Business

Committed to promoting Hong Kong designed products to markets around the world, the Group has actively participated in international jewellery shows. During the year, the Group attended major international jewellery shows in Europe, the U.S. and Asia, including the VicenzaOro 1 & 2, the 37th Bangkok Gems & Jewellery Fair, BaselWorld and Istanbul Show, etc. At these international shows, representatives of the Group meet with overseas buyers and customers directly, which enables the Group to keep abreast of latest design trends and customer preferences. Over the years, the Group has built a strong reputation for its high quality and fashionable jewellery designs. The Group is famous for its innovative products of trendy designs that exemplify the cultures and characteristics of different countries. The Group is

bold with material mix and application of production technologies, which underscore its creative and refreshing designs to appeal customers.

During the year under review, the Group secured production and wholesale orders from prestigious international brand names, which testified to the Group's international standard in production and design capabilities.

### Awards and Achievement

Hang Fung Gold Technology has been relentless in striving for better performance. The Group has over the years received both local, Mainland China and international recognition for its emphasis and efforts in innovation, brand building, service excellence and jewellery designs.

#### Hong Kong

- Hong Kong Q-Mark Service Scheme Certificate
- 2005 Hong Kong Awards for Industries: Innovation and Creativity Awards
- 2005 Hong Kong Premier Brand
- The second prize for the Necklace category, the third prize for the Bracelet category and the "brooch" category in Tahitian Pearl Trophy Asia (4th Edition)

- Five Certificates of Merit of Open Group at the 7th Hong Kong Jewellery Design Competition 2006
- Three winning designs in the Chuk Kam Jewellery Design Competition 2006

#### China

- Silver Award in Brand Management Category of the 7th China Golden Awards for Excellence in Public Relations (第七屆中國最佳公共關係案例大賽—品牌管理類銀獎)
- The Most Influential Brand in Jewellery Chain Industry of China 2005 (2005中國珠寶首飾連鎖行業最具影響力品牌)
- The Top Ten Influential Brand in Jewellery Industry of China 2005 (2005中國珠寶首飾行業十大影響力品牌)
- The Best Selling Brand Award of the 9th Supplier Recognition Summit (第九屆供應商表彰大會—最暢銷品牌獎)
- The Most Popular Retail Brand in Shenzhen 2005 (2005年深圳最受歡迎珠寶零售品牌)
- Award of 3 • 15 Contribution to Culture in China 2005 (2005年度中國三 • 十五文化貢獻獎)



"Virtuosity" Collection

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### Investment in Property, Plant and Equipment

During the year, the Group continued to invest in property, plant and equipment of HK\$356,731,000 (2005: HK\$234,262,000) which serves to strengthen its brand and market competitiveness. These investments provide long-term benefits to the Group and help enhance Hong Kong's attraction as a tourist destination.

### Liquidity and Financial Resources

#### Banking Facilities

As at 31 March 2006, the Group maintained aggregate banking facilities of HK\$1,295,255,000 (2005: HK\$1,099,585,000), of which HK\$337,299,000 (2005: HK\$269,096,000) had not been utilised. The Group finances its operations and business development primarily with internally generated cash flow and banking facilities, and the management believes it has sufficient funds to serve these purposes in the foreseeable future. Interest on bank borrowings is charged at commercial lending rates to the Group. Details of the maturity of bank borrowings as at 31 March 2006 are set out in Notes 28 and 32 to the financial statements.

As at 31 March 2006, the Group's gearing ratio (ratio of aggregate bank borrowings less cash and bank deposits to equity) decreased to 0.63 (2005: 0.84) as a result of effect of rights issue of shares and accumulation of retained earnings in the year.

Certain assets of the Group had been pledged to banks for these banking facilities. Details are set out in Note 36 to the financial statements.

#### Syndicated Loan Facility

The Group successfully obtained a 3-year syndicated loan facility on 16 March 2006. The HK\$500 million term loan facility with an interest margin of HIBOR plus 0.88% per annum was provided by a group of 19 international and local banks. The proceeds from the facility were used to refinance the HK\$300 million syndicated loan extended to the Group in June 2004, and part of the existing short-term borrowings and to finance general working capital requirements. The syndicated loan strengthens the matching of maturity on the balance sheet such that property, plant and equipment are financed by long-term borrowings.

#### Rights Issue

In April 2005, the Group successfully completed a rights issue of 186,931,333 rights shares at a subscription price of HK\$1.01 each on the basis of one rights share for every three existing shares held. Shareholders response was positive resulting in an approximately 1.19 times subscription. The proceeds of the rights issue of approximately HK\$188.8 million was applied for repayment of part of the Group's existing bank borrowings and for further development of the retailing business.

#### Interest Rate Swap

Bank borrowings of the Group are mainly charged at floating rates. The Group manages its interest rate risk by using floating-to-fixed interest rate swaps. Such interest rate swaps have the economic effect of converting borrowings from floating rates to fixed rates. Accordingly, the Group can reduce the impact of unforeseen risen in interest rates by such arrangements.

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### Exchange Rate Exposure

The Group operates mainly in Hong Kong and accepts Chinese Renminbi as a settlement currency of its retail sales in Hong Kong. The Group is exposed to foreign exchange risk arising from the exposure of Chinese Renminbi against Hong Kong dollars. The Group has not hedged foreign exchange rate risk.

### Contingent Liabilities

As at 31 March 2006, the Company had given to banks and other financial institutions corporate guarantees in respect of finance lease obligations and banking facilities granted to its subsidiaries, details of which are set out in Note 35 to the financial statements.

### Investor Relations

The Group values its relationship with investors. Committed to maintaining close relations with international funds, institutional investors, analysts and securities firms, the Group took the initiative to improve transparency of the different aspects of its operation, and has been receptive to investors' opinions. Our goal is to maintain continuous conversations with investors to enable them to understand the Group's management philosophy and long-term development plans.

During the year, the Group arranged one-on-one meetings and visits for fund managers. The Group believes maintaining an open mind to investors' comments is instrumental to strengthening strong investor relations and the Group will continuously pursue service excellence to investors.

### Employees

As at 31 March 2006, the Group had over 2,000 employees. Staff members are rewarded according to industry standards, which will be reviewed annually. Staff remuneration includes a basic salary and bonus. For the year ended 31 March 2006, the Group's employment costs amounted to H K \$ 1 3 8 , 6 8 4 , 0 0 0

(2005:HK\$118,962,000). The Company offers a share option scheme for staff, granting options to employees who have made exceptional contributions to the Group.

### PROSPECTS

In the coming year, the management remains optimistic in the business environment exerted by the continual relaxation of "Individual Visit Scheme" and the increasing spending of the Mainland visitors from the appreciation of RMB and improving per capita income. Mainland China will be the strategic focus in the Group's continuous effort to expand its retail network. Capitalising on the lucrative



3D-GOLD Jewellery Shop in PRC

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business environment in the Mainland China, the Group will continue with its proactive approach in franchising and cooperative arrangement in the potential cities.

To capture the flourishing economy and the retail market opportunities in Hong Kong and Macau, the Group will strengthen its core competence and competitive advantages by leveraging on its proven success in brand retailing and tactical network expansion in suitable locations.

As one of the leading jewellery brands in Hong Kong and the Mainland China, the Group will continue to drive its growth towards reaching 300 retail outlets in the next few years.

With sales tax on watches raised in Mainland China, management believes that more mainlanders will opt to come to Hong Kong to buy brand-carried watches and that will boost the local timepiece retail market. Perceiving bright prospects in watch retailing, the Group had opened its watch retail outlets and made another leap forward by adding two reputable Swiss watch brands "BLITA" and "Swisshorn" to its timepiece portfolio. In the future, the Group will step up efforts to develop its watch business and seek to add more world-class brands to its product line.

With fingertips tapping the pulse of the market, Hang Fung Gold Technology is apt and prepared to serve the changing tastes of consumers. As a major market player, the Group is ready to capitalise on the lucrative opportunities arising from the booming Hong Kong tourism and retail markets in China and overseas. Looking ahead, the Group will continue to expand its business in Hong Kong, Macau and the Mainland China markets and its overseas distribution networks to expand its market share in the jewellery industry worldwide.