Management Discussion and Analysis

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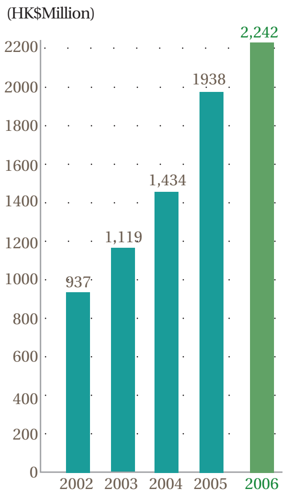
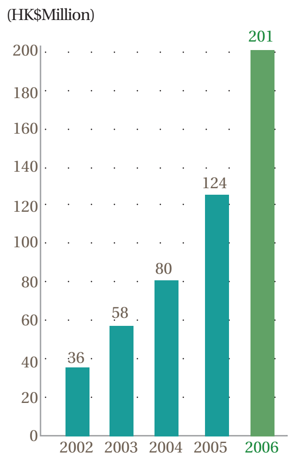
"Leveraging our balanced business portfolio to generate stronger cash flow and better return."

MANAGEMENT DISCUSSION AND ANALYSIS



TURNOVER



PROFIT ATTRIBUTABLE TO SHAREHOLDERS

Financial Reviews

Turnover and Profits

Peace Mark continued to grow strongly during 2006, with excellent performance from all core businesses.

The Group turnover was HK$2,242 million, up 15.7% compared to last year. The turnover growth was a result of organic growth and accounted for full year contribution of results of the China subsidiaries acquired last year. The US distribution business increased by 47.2% to HK$310 million.

The margins have been improved at all levels. Gross margin continued to improve to 31.1% as compared to 27.8% reported last year. EBITDA was HK$342 million and margin was 15.3%, an improvement of 37.3% year-on-year. The improvement was a result of an increased share of China business of the total turnover, which commanded higher margin.

Net profits was HK$201 million, up 61.9%, representing a margin of 8.9%. The basic earnings per share were at HK22.13 cents after taking into account the dilution effect of 90 million new shares issuance in February 2006.

Selling, Distribution and Administration

Selling, Distribution and Administration expenses was stabilized at a level of 19.9% of turnover. Selling and Distribution expenses were increased due to increased turnover of distribution and retailing businesses but the administrative expense as a percentage of turnover was reduced from 9.7% to 8.3% due to economies of scale. Further integration of the US distribution and manufacturing contributed to a lower level of operating expenses. Management had focused on integrating various China businesses acquired last year and removed overlapping resources. This highly scalable platform enabled the Group to further control the level of operating expenses.

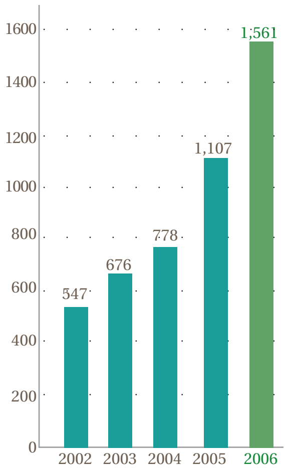
Taxation

The effective tax rate before deferred tax for the year was 14.5%. China distribution and retail businesses in general had a higher tax rate than the manufacturing export business.

Liquidity and Financial Resources

Shareholders' Funds

Shareholders' Funds increased from HK$1,107 million to HK$1,561 million. No significant acquisitions were done during the year and the new share placement completed in February 2006 had increased the Shareholders' Fund by approximately HK$286 million. Net Asset Value per share was HK$1.58 per share.



SHAREHOLDERS' FUNDS

Financial Position

At the year end date, the cash and bank balances stood at HK$1,186 million and the borrowings were at HK$1,159 million. The net cash, expressed as a percentage of total net borrowings to equity attributable to shareholders, was 1.7%. The improved financial position from net gearing to net cash was a result of additional cash generated from operation and raised from the share placement proceeds.

The year-end borrowings were split into 47% short-term and 53% long-term. The structures of the borrowings were mainly term and trade finance facilities. The Group continued to refinance the existing borrowings by cheaper financing. The major financings were: a 4-year syndicated term and revolving facilities of HK$630 million completed in April 2005 and a share placement of HK$286 million in February 2006. Subsequent to the balance sheet date, the Group also completed a 3-year syndicated term loan facility of HK$600 million. This syndicated loan is extendable to 7-years under certain conditions. The purposes of the fund raising activities were to finance the China distribution and retail network expansion plan and to refinance part of the higher costs short term debts.

More than 70% of the carrying amounts of the year-end borrowings are denominated in Hong Kong dollar.

The interest coverage, expressed as a multiple of EBITDA over the interest expenses, was 5.7, which remained at a comfortable level.

Syndicated Loan

Working Capital

The Group's current ratio was 2.5. The improved ratio was due a combination of increased level of current assets from HK$1,575 million to HK$2,456 million and the longer maturity profile of the borrowings.

The improved financial position and current ratio will enable the Group to further leverage on the balance sheet and take on mergers and acquisitions opportunities.

The management continued to focus on the working capital management. Net working capital, expressed as the net of accounts receivables of HK$479 million, inventory of HK$654 million and accounts payable of HK$385 million as a percentage of turnover, was 33.4%, which improved from 35.5% last year.

Total trade and other receivables increased by HK$204 million to HK$600 million. Included in this amount, was a non-recurring deposit of HK$76 million paid for the capital of joint venture and a receivable of HK$45 million from the partial disposal of a subsidiary The trade and other receivables, net of the above two non-recurring items, were HK$479 million.

Inventory level was at HK$654 million. The Group started the China luxury watch business in the second half of the year. Inventory of approximately HK$114 million was maintained for new store openings at the balance sheet date and a large part of the sales will be reflected in the next financial year. Excluding that amount, the inventory turnover days improved by 6 days for the established business. It is imperative to control the inventory level at lower turnover days given the fact that the business cycle of a vertical integrated manufacturer and distributor, in particular for the US market, have trended towards longer inventory days. The lower inventory turnover days of the China mid-range business attributed to the overall improvements. The accounts payable increased from HK$220 million to HK$385 million as a result of more favorable sales terms obtained from suppliers.

As part of the working capital management, the Group also utilized working capital loans for the financing of its purchases. The costs of trade financing have been much lower than the suppliers' credit in general. Net working capital of the Group after working capital loans was HK$557 million and was 24.8% of the total turnover.

Capital Expenditure

Capital expenditure for the year was HK$78 million. The deployment of capital expenditure for the year was slower than the original forecast as the refurbishment of existing points of sales and new stores roll out plans have been postponed to the next financial year.

Capital Commitment and Contingent Liability

As at 31 March 2006, there were no material capital commitment and contingent liability.

New Shares Placement

In February 2006, the Company placed 90 million shares to independent investors at a price of HK$3.25 per share. The new shares placed represented approximately 9.09% of the enlarged share capital of the Company at the date of placement. The net proceeds of HK$286 million were intended to be used for the China expansion plans and repayment of certain borrowings.

Financial Risk Management

The Group manages its financial resources and liquidity as well as financial risk management according to a set of policies and procedures approved by the Board of directors.

The overall objectives is to act prudently to ensure that the Group has adequate cash flow and access to funding sources, both debt or equity, to fund the operations and the potential investments. Hedging arrangement of currency and interest rate risks will be entered into with consideration being given to the hedging costs and the risk level.

The risk is managed through prudent treasury policies, which include the following:

1. The Group closely monitors the cash-resources. We maintain a conservative cash reserve and review our position regularly to ensure that cost-efficient funding is available for operating expenses, capital expenditure needs and business expansion;

2. Our policy is to deposit surplus cash with creditworthy financial institutions or invest in low risk and liquid instruments; and

3. To the extent possible the financing and cash management of the subsidiaries have been managed by the centralized treasury functions for the efficient allocation of capital, lower funding costs and control purposes

During the year 2006 and post balance sheet significant financing activities were as follows:–

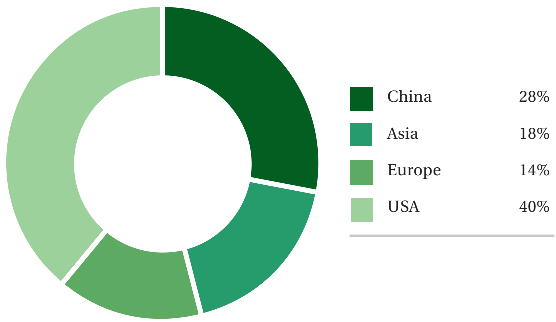
In April 2005, the Group completed a 4-year syndicated term loan and revolving credit facility of HK$630 million;

in February 2006, the Group placed 90 million new shares at a price of $3.25 per share and raised approximately HK$286 million in order to broaden the shareholder base; and

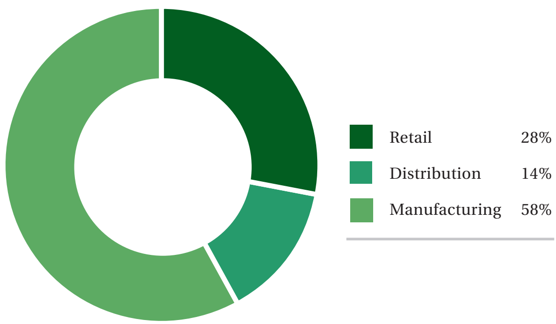
in June 2006, the Group obtained a 3-year syndicated term loan facility with an extendable feature for up to 7 years under certain conditions.

The Group will continue to maintain sufficient liquidity and further diversify the funding sources and extend maturities profile, if necessary, to meet business requirements.

Turnover by Geographical Market



Turnover by Business



Interest Rate Exposure

The Group manages its interest rate exposure with a view to increasing the predictability of the interest payment and lower the overall cost of debt. It is the Group's policy to mitigate interest rate risk through the use of appropriate interest rate hedging instruments that mitigate current and future interest rate volatility.

As part of balance sheet management, we have matched the maturity of the assets and liabilities to the greatest possible extent. Certain shorter-term tenor bank borrowings have been refinanced by longer term debt with flexible interest rate reset. This enabled the financial flexibility of the Group. Interest rate movement and hedging advices are provided from time to time by leading banks to the Group.

After taking into consideration of interest rate swap, the Group's fixed rate debt was at an effective interest rate of approximately 5% as a percentage of total debt was approximately 70%.

Foreign Currency Exposure

The Group manages its foreign currency exposure by entering into currency hedging instruments, like currency forwards, to hedge currency exposure at an optimal level. Operating exposure of currency movement will be closely monitored. Currency derivatives (e.g. EUR, GBP and CHF) will be entered into to hedge the change of expected cash flows arising from an unexpected change in exchange rates. For RMB, the Company tends to naturally hedge its RMB denominated liabilities and expenses by the RMB denominated assets and revenue.

Currency transaction loss was HK$10 million and was expensed, while the currency translation charge of HK$5 million was reflected as reserve movement during the year.

Credit Exposure

The Group deals with the credit exposure according to the risk management policies. Credit extended to business associates are based on the credit analysis provided by credit agencies and trade intelligence sourced through industry participants.

All finance-related hedging transactions and deposits are made with counter-parties with high credit ratings.

Risk Factors

There are several risk factors pertaining to the core businesses that the Group considers that may adversely its results of operations and financial position. There may be other risks in addition to those listed below which are not known to the Group or which may not be material now could turn out be material in the future.

Industry Trends

Intense competition in the watch industry

China retail

The Group faces competition from both domestic and overseas watch distributors and retailers. Domestic companies have dominated the watch distribution and retail industry in China. After China entered into WTO, more foreign brand owners may operate a distribution business by themselves to better control the sales channel. New market entrants entering into this market also cause higher competition. In the face of such risks, the Group sped up its business plan for the retail network expansion to raise the barrier to entry; establishing a vertical integrated platform from manufacturing, distribution, retail to after-sales services; and formed strategic alliances with foreign and domestic companies for leveraging the resources.

Manufacturing

Manufacturing business has been highly competitive and the industry is fragmented. The Group, through participating in industry association involved in the industry strategy and policy formulation; improved the quality of its products; made considerable efforts in product development and design; and formed strategic partnership with major industry players combining the respective strength.

Changes and uncertainties in PRC policies

Regulatory environment including the tax regime in China may change and adversely affect the operating environment and consumer market. These risks can be addressed through establishing and maintaining a good relationship with relevant authorities for updating the regulatory changes.

Increase in raw materials prices

The increase in raw materials price may adversely affect the margin of the manufacturing business if the Group is not able to pass the increased costs to the customers. Satisfactory level of hedging is not possible given the uncertainty of the volume and kind of materials for OEM manufacturing. We manage the margin of the this business by advising alternative or mixed materials in substitution of the more expensive one.

Human Resources

The Group employed over 4,000 employees mainly in China, Hong Kong, the USA and Europe. The total staff costs amounted to HK$140 million as compared to HK$110 million of last year.

The remuneration packages for the senior executives and marketing staff are performance linked. Share and option schemes as well as bonus scheme are in place to ensure the employees and shareholders goals are congruent.

Share Incentive Scheme

On 31 March 2006, the Company adopted a share incentive scheme (the "Scheme") which will enable selected eligible persons to purchase shares of the Company (the "Shares") at a 5% discount to the market price. The selected eligible persons have the option of paying for their Shares in one lump sum, or by monthly instalments. Where Eligible Persons choose the latter option, they will pay an additional finance charge to cover the Company's finance costs.

Eligible Persons will not be able to dispose Shares purchased under the Scheme immediately following their purchase. Those selected Eligible Persons who opt to pay for their Shares in one lump sum will be able to dispose their Shares after one year, while those who opt to pay for their shares in instalments will be able to dispose their Shares over a period of time commencing after one year and ending when they make their final instalment payment.

The Company has obtained a loan in the amount up to HK$150 million from a bank for the purpose of financing the operation of the Scheme. Shares to be purchased pursuant to the Scheme will be purchased on behalf of the Eligible Persons by the Custodian. The Custodian will hold the Shares on behalf of the Eligible Persons until they are permitted under the rules of the Scheme to dispose of their Shares.

The aggregate number of Shares to be offered under the Scheme shall at all times be less than 5% of the issued share capital of the Company from time to time and the aggregate acquisition cost of all Shares purchased under the Scheme shall not exceed HK$150 million.