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## Management Discussion and Analysis

### (I) Market Review

Inheriting the strong economic performance in year 2005, China's economy has continued to grow in a rather fast pace and a stable manner in the first half of 2006. According to the government statistics, the GDP for the first quarter reached RMB4,331.3 billion, representing a year-on-year growth of 10.02%, with total retail consumption in the community also reached RMB1,844 billion, representing an increase year-on-year of 12.8%.

The continuing economic development and increasing domestic income had resulted in substantial growth in consumers' demand, which in turn had contributed to the enormous development in the watches' retail market.

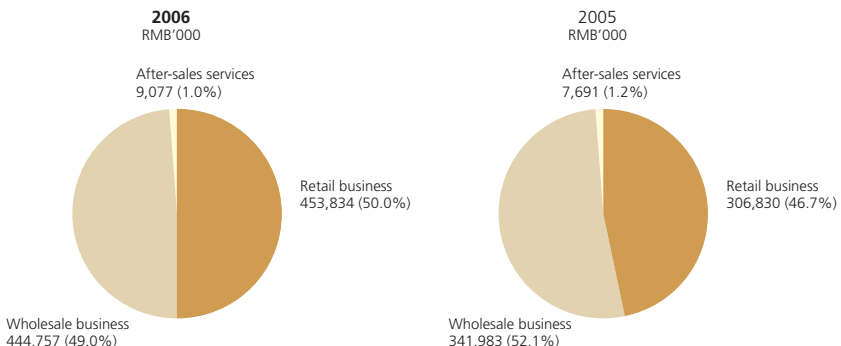
Under such favourable conditions, the Group had been developing its business with tremendous success as a major player in retail and distribution of internationally prestigious brand watches in the PRC.

### (II) Financial Review

#### Sales

For the six months ended 30 June 2006, the Group recorded sales of RMB907,668,000, representing a growth of 38.3% from the corresponding period of last year. 50.0% of the sales was attributable to the retail operation, which amounted to RMB453,834,000, or a growth of 47.9% from the corresponding period of last year.

Breakdown of the Group's sales: (six months ended 30 June 2006)



### *Gross profit*

For the six months ended 30 June 2006, the Group's gross profit increased by 36.0% to approximately RMB224,366,000 as compared to last year. The increase was mainly attributable to our active expansion in the retail business which enjoys a higher gross profit margin.

### *Profit and net profit margin for the period*

During the period under review, the Group has recorded a remarkable profit growth, profit for the period amounted to approximately RMB70,147,000, or 41.5% higher than that of the corresponding period of last year. Net profit margin for the period stood at 7.7%. This was mainly attributable to the Group's continued expansion of its sales network and broadening of its earning base, as well as its effort in maintaining good corporate governance practices. The strong performance in profit could also be attributable to the fact that the high-spending population in the PRC had kept on growing in line with the country's booming economy, creating significant demand for the high-end consumer goods market in the PRC.

### *Distribution costs*

During the period under review, the Group had invested heavily in developing its retail business. Distribution costs amounted to approximately RMB76,034,000, which represented 8.4% of the Group's turnover.

### *Finance costs*

During the period under review, the Group's finance costs amounted to approximately RMB9,336,000, representing a decrease of approximately 19.0% compared to the corresponding period last year.

### *Contingent liabilities*

As at 30 June 2006, the Group did not have any material contingent liabilities.



### *Current assets*

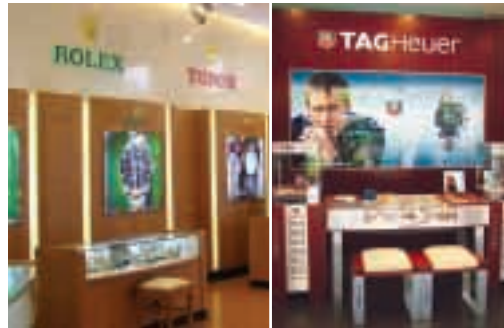
During the period under review, the current assets of the Group amounted to approximately RMB1,227,915,000, including inventories of approximately RMB742,707,000, trade and other receivables of approximately RMB236,733,000, and cash and cash equivalents of approximately RMB194,633,000.

## (III) Business Review

### *Retail Business*

Constant expansion of sales network is the Group's principal strategic direction of the year. During the period under review, the Group dedicated to expand its sales and distribution network through various means, including acquisitions and co-operations with retailers through various ways, collaboration with brand suppliers, co-opening brand franchised shops and direct investment in opening retail stores. Moreover, we made concerted efforts in strengthening good cooperative relationship with brand suppliers during sales network expansion in order to capture the tremendous demand for high end watches in the PRC market.

Speeding up the expansion of the retail business of Hong Kong and other oversea markets is one of the main tasks of the Group this year. During the period under review, the Group entered into a provisional acquisition agreement with Elegant International Holdings Limited in relation to the acquisition of the entire share capital of that group and a formal acquisition agreement was entered into July. Elegant International is mainly engaged in the trading and retail business of internationally branded watches in Hong Kong with four high end watch retail shops in Tsimshatsui, Causeway Bay and Central, Hong Kong. Its management has extensive and rich experience in the horizon of high end watch retail sector. The Group believes that this can bring material effect to the Group's development in the long run.



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Over the period under review, two companies were added by the Group in provincial capitals like Hefei and Zhengzhou through the acquisition of 70% shareholding of Henan Fuhao Watch Ltd., and the setting up of Anhui Sanxin Watch & Clock Ltd. in joint hands with a well-reputed retailer in Auhui respectively. With these two projects, the overall retail shops of the Group were increased by 10, with the share of 85% and 90% in the high end watch retail market in Hefei and Zhengzhou respectively.

To persistently upgrade our group's retail image and to establish a strong foothold for our long term growth, the Group made great efforts in expanding our sales network, and at the same time continuously strengthen internal controls through a standardising image and operate by categories. At present, the group's sale business was basically divided into: high and middle end comprehensive shops, brand franchised shops and lifestyle stores. As to the high and middle end comprehensive shops, they will be gradually promoted under a unified brand name of "PRIME TIME" (盛時表行). Through constant adjustments, the Group now owns 87 retail outlets in China, distributed over 50 internationally renowned watch brands. In addition to the brands wholesaled by the Group, Rolex (勞力士), Omega (歐米茄), Rado (雷達), Vacheron Constantin (江詩丹頓) and Cartier (卡地亞) were also distributed by the Group.

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## The Comprehensive Retail Network of Xinyu Hengdeli



The Group recorded a realized retail sales of RMB453,834,000, representing an increase of 47.9% over the corresponding period last year. Gross profit amounted to RMB152,488,000, representing an increase of 43.7% over the corresponding period last year. The ratio of retail and wholesale sales amounted to 50.0:49.0, contrasting a ratio of 46.7:52.1 for the corresponding period of the last year. The retail development was completely in line with the Group's strategic directions.

### *Close Co-operations with Brand Suppliers*

The Group has an extensive coverage of distribution network spreading over a geographic extent of 40 cities throughout the nation and a customer base of over 300 wholesale clients in the PRC.

The Group has maintained good relationships with numerous brand suppliers of internationally-famous watches, namely The Swatch Group, LVMH Group, Richemont (曆峰) Group, Rolex (勞力士) Group and The Desco (達昌) Group. The Group was the wholesalers of 19 internationally renowned watch brands under the above groups, of which 16 brands were distributed under an exclusive basis, including TAG Heuer (豪雅), Jaeger-LeCoultre (積家), Carl F. Bucherer (寶齊萊), Baume & Mercier (名士), Maurice Lacroix (艾美), Christian Dior (克麗絲汀·迪奧), Zenith (真力時) and Audemars Piguet (愛彼).

The Swatch Group was one of the strategic shareholders of the Company. The LVMH Group also acquired the Company's shares in the market and declared its intention to increase its shareholding of the Company.

The Group has always reinforced our co-operations with brand suppliers. During the period under review, 5 brand franchised shops were opened. Currently, there were 14 brand franchised shops under the Group, including Beijing Grand Hyatt Jaeger – LeCoultre Boutique (北京君悅積家專賣店), Beijing Grant Hyatt Zenith Boutique (北京君悅真力時專賣店), Beijing Grand Hyatt TAG Heuer Boutique (北京君悅豪雅專賣店), Beijing Oriented Plaza Rolex, Tudor Boutique (北京東方廣場勞力士·帝舵專賣店), Nanjing Deji Omega Boutique (南京德基歐米茄專賣店), Hangzhou Building Omega Boutique (杭州大廈歐米茄專賣店), Wuxi Oriental Plaza Cartier Boutique (無錫東方商廈卡地專賣店). All these shops are located in Beijing, Shanghai, Hangzhou, Nanjing and Shenzhen which are economically the wealthiest and the most prosperous places in China.

During the period under review, the Group marked a brand new epoch for our co-operation with Audemars Piguet by entering into a three-year renewable long-term exclusive agency agreement with Audemars Piguet.

### *Customer Services*

Quality customer services represent good after-sales assurance for customers. Premium services are of particularly crucial for high end products. In view of this, the Group has always stressed on the provision of customer services. Apart from providing immediate repair and maintenance services at each retail shop, two sizeable repair and maintenance factories in Beijing and Shanghai served to assure our clients of full confidence. The two large repair and maintenance factories are equipped with strong technical capabilities by a pool of senior repair technicians and authorized repair technicians from high end watch brands like Jaeger-LeCoultre (積家). With an established customer service network, the Group is capable of offering repair and maintenance services on a nation-wide basis.

#### (IV) Future Plans

Given to the robust domestic economic growth and the increasing income level and purchasing power of the people, the watch retail market in China is set to be embedded with a more promising operating environment, and benefiting the Group's business development eventually.

The Group will adhere itself to a diversified approach of developing domestic as well as overseas sales network in order to set forth a firm base for our development. The retail outlets of the Group are expected to exceed 90 by the second half of the year.

The Group will continue to maintain and foster our close collaborative relationships with the brand suppliers through the joint promotion of brands in the China market and the establishment of brand franchised stores so as to cultivate an upgraded branding image as a flagship arm.

The Group will upgrade customer services to a higher and brand new level by setting up sound customer service hotlines and comprehensive service systems. Upon the completion of the acquisition of Elegant International, an interactive customer service network will be established between Hong Kong and China on basis of our nationwide joint repair and maintenance services.

To the Group's belief, ancillary production related to watch sales will be a new profit growth driver for enterprises. The Group will complete the construction of the relevant production bases promptly in order to achieve synergies from scale of economies as soon as practicable.

The Group will also foster higher operating efficiencies and improve resource allocation through optimized enterprise resource planning and management systems. At the same time, standard of the corporate management will be enhanced progressively to ensure the Group's decision made are in line with the overall interest of our shareholders.

The Group will dedicate greater effort to the development and promotion of its proprietary brands in order to foster the continual growth of its business. Meanwhile, through strengthening internal management and reinforcing marketing efforts, the Group will proactively enhance the brand awareness of "PRIME TIME" (盛時表行), the retail brand name of Xinyu Hengdeli.