

# MANAGEMENT DISCUSSION AND ANALYSIS



Pursuit of trueness  
through perfect rendition

# Management Discussion and Analysis

## I MARKET OVERVIEW

The PRC economy maintained its impressive growth trend in 2006 with the gross domestic product (GDP) growing by 10.6% and total retail consumption in the community reached RMB8 trillion, representing an increase of 13.5% year-on-year. On top of that, the Central Government had also introduced a series of policies favorable for an continuous increase in people's income, such as the upward adjustment in the personal income tax exemption threshold, the agricultural tax exemption, and the rise in salaries of civil servants etc., leading to the increase in household's actual disposable income and substantially enhance consumers' purchasing power. This creates enormous demand for luxury goods such as watches of high-end brand names. As the market leader in the retail and distribution of internationally prestigious brand watches in the PRC, the Group had seen its business leap under such favorable market conditions.

## II FINANCIAL REVIEW

### Sales

For the year ended 31 December 2006, the Group recorded sales of RMB2,404,699,000, of which sales from wholesale business amounted to RMB1,024,507,000 and accounted for 42.6% of the sales; sales from retail business amounted to RMB1,362,863,000 and accounted for 56.7% of the sales. The increase in sales was mainly attributable to the Group's ability to leverage the enormous demand in the PRC's luxury watches market, enhancement of the operating performance together with the brand name effects through a strong sales network, the Group's business performance therefore moving forward.

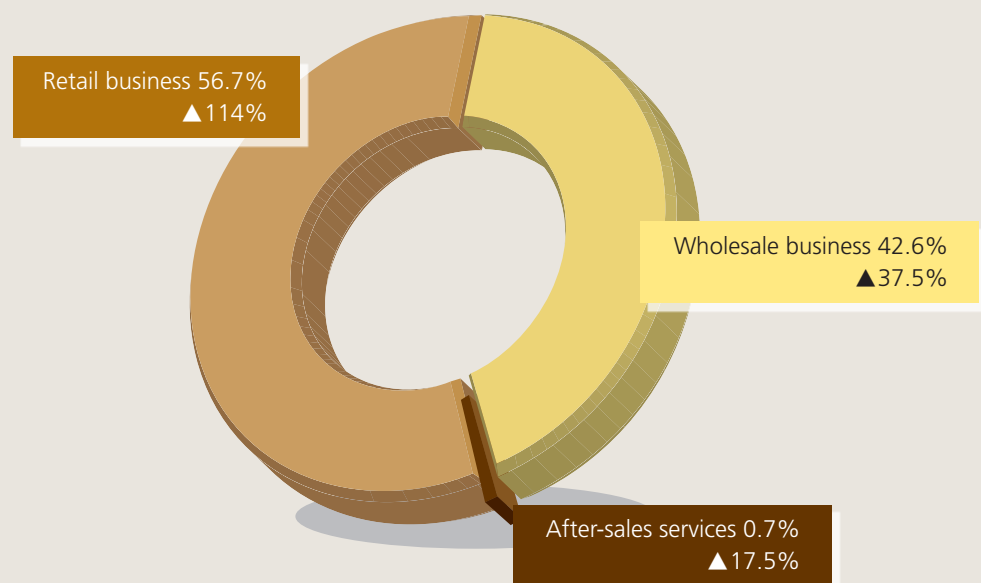


## Management Discussion and Analysis

Sales breakdown of the Group (for the year ended 31 December 2006):

	2006		2005		2004	
	RMB'000	%	RMB'000	%	RMB'000	%
Retail business	<b>1,362,863</b>	<b>56.7</b>	636,725	45.6	530,264	34.9
Wholesale business	<b>1,024,507</b>	<b>42.6</b>	745,059	53.4	974,771	64.2
After-sales services	<b>17,329</b>	<b>0.7</b>	14,747	1.0	13,547	0.9
<b>Total</b>	<b>2,404,699</b>	<b>100.0</b>	1,396,531	100.0	1,518,582	100.0

# 2006



## Management Discussion and Analysis

### Gross profit and gross profit margin

For the year ended 31 December 2006, the Group's gross profit increased by 54.6% from last year to approximately RMB562,904,000, whereas our gross profit margin was down 2.7 percentage points over last year to approximately 23.4%. The increase was mainly due to the consolidation of sales and gross profits of the Elegant Group into the Group for the current year, while the gross profit margin in the Hong Kong market was lower than the market in Mainland China.



### Profit for the year and profit margin

Profit for the year increased by 62.1% to approximately RMB213,598,000 over last year.

### Distribution costs

During the year under review, the Group devoted to expand its retail network with 31 new outlets being opened. As a result, the Group's distribution costs was approximately RMB175,889,000, representing 7.3% of the Group's sales. The increase in distribution costs of the Group is in line with the growth of its business.

### Final dividend

The Company recommends the payment of a final dividend of RMB0.028 per share for the year ended 31 December 2006 in return for shareholders' support, subject to approval by shareholders at the Annual General Meeting to be held on 1 June 2007. The proposed final cash dividend will be paid on or before 26 June 2007 to shareholders whose names appear on the register of members of the Company on 31 May 2007.

### Current assets and current liabilities

As at 31 December 2006, the current assets of the Group amounted to approximately RMB1,968,560,000, including inventory of approximately RMB1,262,382,000, trade and other receivables of approximately RMB330,995,000, and cash and cash equivalents of approximately RMB298,275,000.

As at 31 December 2006, the current liabilities of the Group amounted to approximately RMB832,996,000, including bank loans and other interest bearing liabilities of approximately RMB387,814,000, trade and other payables of approximately RMB370,698,000, and current tax payable of approximately RMB74,484,000.

# Management Discussion and Analysis

## III Business Review

### Expansion of retail outlets

The Group's enormous retail network in the PRC provides an expressway for internationally renowned watch brands to enter the China domestic market. As at 31 December 2006, the Group has established 92 retail outlets across 30 cities throughout the PRC, representing an increase of 27 retail outlets to the same period in the previous year, that outnumbered our expected number of 20 stores.



In terms of our operating model, the Group owns 82 integrated retail outlets under Xinyu's brand portfolio and 14 individual brand boutique shops. Not only do different operating models help promptly establishing retail network for the Group, but also accelerate market penetration at the same time. Furthermore, they help the Group focus on various customer segments, cognize market positions with different retail brands and cope with customers' needs by providing suitable products and appropriate services.

All of the Group's retail outlets are located in prosperous zones which are strategically opened at prime locations in major cities including Beijing, Shanghai, Tianjing, Shenyang, Harbin, Hangzhou, Nanjing and Shenzhen.

While the Group has been driving hard for expanding the retail network in the PRC, speeding up the expansion of retail business in Hong Kong and other overseas markets is also one of the major tasks of the Group during the period. During the period under review, the Group succeeded in acquiring Elegant International (三寶集團) which have been engaged in retailing business of international branded watches in Hong Kong for 36 years with 4 luxury watch retail shops in which 2 at Tsimshatsui, 1 at Causeway Bay and 1 at Central. The acquisition would not only enhance profitability, but also leave a glorious chapter in the Group's quest to implement its overseas retail strategy, bolster our foundation for a steady development in the future. Since joining our Group, Elegant International had achieved rapid business growth, with both turnover and gross profit margin increased more than 30% from the corresponding period prior to the acquisition.



## Management Discussion and Analysis



During the period under review, the Group set up Anhui Sanxin Watch & Clock Ltd. jointly with a well-reputed retailer in Hefei, Anhui and acquired 70% shareholding of Henan Fuhao Watch Ltd. With these two projects, the total number of retail shops of the Group increased by 10, with a market share of 85% and 90% in the high and middle end watch retail market in Hefei and Zhengzhou respectively. In addition, the Company and a

famed retailer in Wenzhou entered into an agreement in relation to the establishment of Wenzhou Xinyu Watch & Clock Co., Ltd., boosting the marketing share of middle and high end watches market in Wenzhou up to 90% and the number of retail outlets of the Group in the Mainland China to 92.



Retail network in both domestic and overseas markets have been growing in a fast pace, generating a strong driving force to the Group's development. During the reporting period, retail revenue grew 114% from last year, in which turnover from newly opened outlets accounted for four-fifth of turnover growth in the retail business. Sales from existing outlets had also been satisfactory, which registered a one-fifth of turnover growth in the retail business from last year.

At present, in order to standardize image & categorize operation, the Group's retail shops is basically divided into 3 categories: luxury shops, high to middle end integrated shops and fashion stores. As to the high to middle end integrated shops, they will gradually be promoted under a unified brand name of "PRIME TIME" (盛時表行).

### Watch distribution business

The Group believes that the development of retail and distribution businesses is of equal importance and both are complementary to each other. Hence, while developing the retail business, the Group also stresses on expanding the distribution business and strives to set up an extensive distribution network. For the year ended 31 December 2006, the Group developed a distribution network spreading over 40 cities throughout the nation with a customer base of over 300 wholesale customers, most of whom are branded watch retailers of the PRC.



# Management Discussion and Analysis

## Reinforce co-operations with brand suppliers

During the period under review, the Group has co-operated with various internationally renowned brand suppliers and jointly opened 6 new brand franchised shops, which include the cooperation with Richemont Group in the opening of two exclusive brand boutique shop under the brand name of Cartier in Huayu International Exquisite Commodities Building in Taiyuan, Shanxi province and Dannisi Shopping Center in Luoyang, Henan Province. 4 other brand boutique shops include the Beijing Grant Hyatt Zenith Boutique, Shenzhen Huaqiang Sunshine TAG Heuer Flagship Shop, Grand Hyatt Beijing TAG Heuer Flagship Shop and Shenyang TAG Heuer Flagship Shop. These 6 shops are all located in the prosperous and sumptuous business districts in Beijing, Shanxi, Shenzhen and Henan.

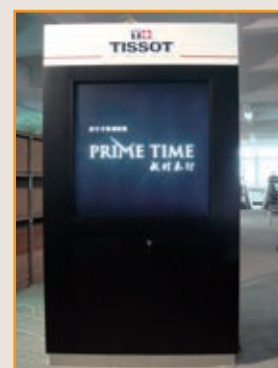


The Group has maintained good relationships with numerous brand suppliers of internationally-famous watches, namely the Swatch Group, the Richemont Group (曆峰集團), the LVMH Group, the Desco Group (達昌集團) and the Rolex Group (勞力士集團). As at 31 December 2006, the Group was the wholesalers of 19 internationally renowned watch brands, of which 17 brands were distributed under an exclusive basis, including Audemars Piguet (愛彼), Jaeger-LeCoultre (積家), Carl F. Bucherer (寶齊萊), TAG Heuer (豪雅), Zenith (真力時),

Baume & Mercier (名士), Maurice Lacroix (艾美), CK, Christian Dior (克麗絲汀·迪奧). During the period under review, the Group also entered into a three-year and five-year renewable long-term exclusive agency agreements with Audemars Piguet and Maurice Lacroix respectively, These cooperation lay a strong foundation for both parties' business development in the PRC market in the long run.

## Strengthen ancillary production development

During the year, the Group completed the acquisition of Artdeco Decorating & Packaging Co., Ltd., a professional company engaged in the design and manufacture of package boxes for watches, jewellery, cosmetics, premium gifts etc., as well as manufacture of brand presentation boards, specialized props and outlet fixtures for marketing, furnishing etc. for retail outlets of high-end consumer products. At present, it mainly produces watch boxes, presentation boards and marketing props for renowned international watch brands. Upon the completion of acquisition of Artdeco Decorating & Packaging Co., Ltd., the Group could further expand its capacity in accessories production which complement to its principal business. It could also facilitate the enhancement in upgrading store image within the network and provide a strong foundation for product packaging design. The Group can also explore new business opportunities in manufacture of decorative packaging products at the same time.



## Management Discussion and Analysis

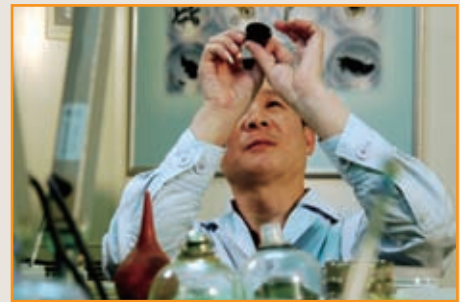
### Marketing

In 2006, the Group actively participated in and implemented a number of marketing activities in order to promote the Group's image.

In order to achieve synergy effect in brand promotion, the Group collaborated with various brands to launch extensive marketing campaigns, one of which is to sponsor the promotion campaign of Ferrari. Besides, the Group also joins hands with China Merchants Bank Co., Ltd. to allow customers purchase products by credit card under installment so as to bring quick sale effects. Meanwhile, the Group has held road shows in selected clubhouses of four cities, during which guests were invited to take part and purchase luxurious watches exhibited thereof.

### Customer services

The Group has always focused on the provision of premium and quality customer services. Apart from establishing two sizeable repair and maintenance centers in Beijing and Shanghai, immediate repair and maintenance services are also provided with comprehensive after-sales service systems at each retail shop in order to all-rounded satisfy the needs of our customers. With the inauguration of our nationwide joint repair and maintenance services, the Greater China interactive customer services network covering Hong Kong and the PRC has also been duly launched, thereby serving our customers with best assurance in product quality.



### Future prospects

Given the increasing spending power of consumers and the rise of high income groups in the PRC, the purchasing power of the PRC will surge significantly, bringing about constant growth of demand for high end watches. It is expected that in 2007, the high-end watch market will undergo rapid and continuous development. In line with the enormous consumption market in the domestic and overseas markets, the Group will adhere itself to different approaches to expand sales network, so as to set forth a firm foundation for our development. In the coming years, the Group are expected to open 20 retail outlets to face the huge market opportunities ahead.

In addition to maintaining and fostering our close collaborative relationships with the brand suppliers of internationally renowned luxury watches, the Group will also actively develop ancillary products related to watch sales to boost profitability growth. Moreover, the Group will reinforce marketing efforts to raise the brand awareness for our new retail outlets. The Group will also foster higher operating efficiencies and improve resources allocation through optimized enterprise resources planning and management systems. The Group will continue to uphold its advantages to achieve larger market share, further improve service quality and assure the undertaking of providing premium quality service to our customers.