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## BUSINESS

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### OVERVIEW

We are the leading jeweller by market share in the PRC as well as in the Hong Kong and Macau jewellery markets, with a market share of 12.6% and 20.1%, respectively, in 2010, according to the Frost & Sullivan Report. We have an extensive retail network, with 1,421 jewellery POS and 85 watch POS as at 30 September 2011. Our largest market is the PRC, accounting for 56.0% of our turnover for 1HFY2012, followed by Hong Kong, Macau and other Asian markets, which accounted for 44.0%. Our principal products are mass luxury and high-end luxury jewellery products, including gem-set jewellery, platinum/karat gold products, gold products and watches.

### COMPETITIVE STRENGTHS

#### **Iconic and trusted brand in the Greater China region with over 80 years of heritage**

“Trust” is one of the most valued virtues in the Chinese community and is also a key attribute that customers look for when they choose their jeweller. As a pioneer in the industry, we started our operations in Guangzhou in 1929 and opened our first POS in Hong Kong in 1939. We believe we were one of the first in Hong Kong and Macau to launch 999.9 gold jewellery products in 1956. In 1990, we implemented the “一口價” (Fixed Price) Policy. With over 80 years of heritage and our corporate values of “sincerity • eternity”, our customers’ trust in our brand has stood the test of time. We believe our brand has come to symbolise the authenticity and premium quality of our products.

We were ranked along with “Tiffany” and “Cartier” as the “Top Three Brands Most Likely to be Purchased in 2010” in the PRC according to an independent market survey on jewellery brands conducted by Bain & Company in November 2010. In addition, according to the Frost & Sullivan Report, the “周大福” (CHOW TAI FOOK) brand was ranked first in jewellery brand awareness in the PRC, Hong Kong and Macau. We believe these rankings are testaments to our brand’s iconic position and market leadership.

#### **Loyal, experienced and dynamic management team**

Our core management team is loyal to our Company. The trust which our Company places on our core management team, the bond and comradeship built amongst the team members and their loyalty to our Company set important cultural tones and corporate values for the rest of our workforce. These inspire allegiance towards the Company amongst new and existing management members and employees. With a number of our core management team members having worked their way up through the ranks, they have built a deep knowledge and a thorough understanding of every facet of our business and operations. As a result, our core management team, which has cooperated for over 20 years, is able to work efficiently and seamlessly as a team and execute, using modern corporate management methods, many of our development and expansion plans successfully over the years.

Our management team spans three generations of “the old, the middle-aged and the young (老、中、青)” and by working closely together, they have been the driver of the growth and success of our Company. We believe the unique dynamics of our core management team give us a competitive edge in the management and continuing expansion of our business, allowing us to capture the growth of the jewellery market in the Greater China region.

#### **Extensive retail network with deep access to rising consumer spending in the Greater China region**

We have an extensive retail network in the Greater China region with over 1,500 POS (of which 1,421 were jewellery POS and 85 were watch POS as at 30 September 2011). We opened a net average of 179 new POS per year from 1 April 2008 to 31 March 2011, representing a CAGR of

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18.3%, and another 148 POS from 1 April 2011 to 30 September 2011. Since the opening of our first batch of POS in Tier III cities and Tier IV cities in the PRC in 2000 and in 2002, respectively, our retail network has now expanded to cover over 320 cities (including municipalities, prefecture-level cities and county-level cities) in the PRC. According to the Frost & Sullivan Report, from 2010 to 2015, the CAGR of the overall jewellery retail sales in the PRC is expected to reach 38.6%, and, in particular, the CAGR of the jewellery retail sales in Tier III cities and other lower tier cities is even expected to reach 45.3%.

Our extensive footprint, particularly in the fast growing Tier III cities and Tier IV cities in the PRC, has given us direct, deep and strategic access to the PRC market and created synergies with our POS in Hong Kong and Macau, both popular destinations for Mainland Chinese tourists. We believe we are strongly positioned as a market leader to benefit from the expanding Mainland Chinese middle class with rising income and the surging demand for luxury goods in the PRC.

### **Broad product portfolio on the mass luxury segment with an increasing focus on higher value products**

We manufacture a very broad range of classic and contemporary jewellery products made from diamonds, gemstones, platinum and gold to cater to the ever-evolving needs and tastes of our large and diversified customer base. We have focused on the mass luxury segment of our market and have over the years gained a well-established and stable customer base in this segment. According to the Frost & Sullivan Report, the mass luxury segment accounted for approximately 56.7% of the overall jewellery market of the PRC in 2010, with retail sales amounting to HK\$171.4 billion and is expected to grow at a CAGR of 39.1% from 2010 to 2015 to reach HK\$891.6 billion by 2015.

We are also strong in the high-end luxury jewellery segment, particularly in our POS in Hong Kong, Macau and Tier I cities and Tier II cities in the PRC, in order to meet an increasing appetite of affluent customers looking for higher value, exclusive or unique jewellery pieces in the Greater China region.

### **Vertically integrated business model giving us effective operation control and efficiencies**

Our experience of over 80 years has enabled us to build an effective vertically integrated business model that gives us centralised and tight control over our processes from raw material procurement, design, production and marketing to sales through our extensive retail network. Our vertical integration allows us to monitor and control the quality of our products, gives us the ability to respond quickly to our customers' needs and preferences, and serves as the backbone for our future growth. We also benefit from operational efficiencies that often translate into more competitive pricing for our products, which benefits our customers as well as attracts more customers, both new and repeat customers, to buy our products.

### **Strong growth underpinned by favourable macro and industry backdrop**

According to the Frost & Sullivan Report, the forecast CAGR of the PRC's nominal GDP for 2010 to 2015 is 13.5%. During the same period, the retail value of the PRC jewellery market is forecasted to grow at an even faster CAGR of 38.6%. We focus on the mass luxury segment in the PRC which, according to the Frost & Sullivan Report, represented approximately 56.7% of the total jewellery market in the PRC in 2010. The mass luxury segment in the PRC is also forecasted to exhibit the strongest growth prospect (forecasted CAGR for 2010 to 2015 of 39.1%) relative to the rest of the jewellery retail industry in the PRC.

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During the Track Record Period, our turnover growth had been higher than that of the jewellery and watch markets in the PRC, and in the Hong Kong, Macau and other Asian markets.

<u>Growth rate comparison</u>	<u>FY2010</u>	<u>FY2011</u>	<u>Six months ended 30 September 2011</u>
<b>The PRC</b>			
The Group .....	26.2%	54.2%	77.8%
Jewellery and watch markets <sup>(1)</sup> .....	24.3%	37.9%	44.7%
<b>Hong Kong, Macau and other Asian markets</b>			
The Group <sup>(2)</sup> .....	22.6%	51.1%	81.3%
Jewellery and watch markets <sup>(1)</sup> .....	16.9%	39.1%	48.8%
<b>Total</b>			
The Group <sup>(2)</sup> .....	24.6%	52.8%	79.3%
Jewellery and watch markets <sup>(1)</sup> .....	22.6%	38.1%	45.5%

Source: Data of jewellery and watch markets from the Frost & Sullivan Report as at November 2011.

Notes:

(1) Industry data calendarised to March year end.

(2) The Group's turnover for FY2010 and FY2011 included turnover contribution from our self-operated Taiwan POS which was insignificant. Our POS in Singapore and Malaysia are franchised POS and the corresponding wholesale turnover was recorded in Hong Kong.

We achieved Same Store Sales Growth of 33.8% and 61.9% in FY2011 and 1HFY2012, respectively. We also recorded a net increase of 179 POS on average annually from 1 April 2008 to 31 March 2011, representing a CAGR of 18.3%, and a net increase of 148 POS from 1 April 2011 to 30 September 2011.

## BUSINESS STRATEGIES

### Continue to recruit, develop and retain talent

We actively pursue a strategy to recruit, develop and retain talented employees across all aspects of our integrated operations, which we believe is central to our business success and reputation. We intend to continue providing our employees with tailored training programmes and instilling our corporate values of "sincerity • eternity" into them. In addition, we seek to retain our valuable and talented employees by aligning their compensation and incentives with their performance and by providing them with a clear career path with opportunities for additional responsibilities and promotions. We will continue to strengthen our employees' sense of belonging through our strong corporate culture and give them opportunities to maximise their potential.

### Increase Same Store Sales and continue to encourage repeat customer purchases

For FY2011 and 1HFY2012, the Same Store Sales Growth achieved by our POS in the PRC, Hong Kong, Macau and other Asian markets were:

- Tier I cities and Tier II cities in the PRC: 35.2% and 44.6%, respectively
- Tier III cities and Tier IV cities in the PRC: 35.1% and 49.6%, respectively
- Hong Kong, Macau and other Asian markets: 32.4% and 78.5%, respectively

We believe that increasing Same Store Sales will generate higher levels of profit for our POS network. We target to achieve this objective by further strengthening our customer loyalty programme through (i) expanding our member coverage to attract more customers to join as members, (ii) enhancing membership benefits to encourage spending and (iii) upgrading our database to analyse

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members' preferences to aid us in formulating more effective marketing strategies. This is because sales to our customer loyalty programme members in the PRC in our self-operated POS as a percentage of total retail turnover in the PRC has risen from 27.0% for FY2009 to 27.5% for FY2010 to 30.5% for FY2011, and to 33.0% for 1HFY2012. For FY2011 and 1HFY2012, over 80% of the top 500 customers (by transaction value) in the PRC were our customer loyalty programme members.

We will also continue to optimise our product mix at our POS and step up efforts to promote higher value products to match the spending profiles of consumers in the locality of the POS and to reinforce our corporate values of "sincerity • eternity" through personalised customer service to strengthen customers' confidence in the "周大福" (CHOW TAI FOOK) brand and encourage repeat customer purchases.

### **Further expand our jewellery POS network and geographical footprint in the Greater China region**

We believe that continuing to expand our retail network and geographical footprint will further solidify our leadership position in the Greater China jewellery market. We expect that Tier II cities, Tier III cities and Tier IV cities in the PRC will become the key target cities in our business development in the future. Currently, we have penetrated into only less than half of the 712 cities (including municipalities, prefecture-level cities and county-level cities) in the PRC and envision huge potential in the Greater China market. With plans to reach over 2,000 jewellery POS by 2016, we aim to open a net of approximately 200 jewellery POS per year. We aim to achieve this growth by opening wholly-owned POS as well as joint-venture POS and franchised POS by leveraging on the local relationships of our joint-venture partners and franchisees. We believe this rate of expansion is achievable as it is consistent with our historical expansion rate.

### **Focus on diversifying our sales channels to broaden our customer base**

We intend to continue to focus on diversifying our sales channels to enhance our brand awareness and broaden our customer base through our e-commerce channels, jewellery auctions and strategic distribution partnerships with prominent companies. With the increasing use of the Internet in the PRC and the continuing development of e-commerce channels, we believe that we will be able to significantly extend our customer reach and increase our sales with relatively small amounts of investment due to the strong scalability of an online product offering. In addition, we believe that we can enhance our brand awareness among Internet users. Our e-commerce channels would also enable us to collect customer consumption data and feedback more systematically. In addition, we believe we are able to attract jewellery enthusiasts by organising jewellery auctions of products with exquisite craftsmanship. We also plan to further expand our customer base, increase our brand awareness and enhance our corporate image by establishing partnerships with premium Chinese commercial banks in the PRC.

### **Further enhance our upstream vertical integration business model**

We believe that a stable supply of raw materials and first-rate production capabilities are very important to us in maintaining our competitive advantage. We plan to continue to strengthen our status as a preferred business partner with key suppliers such as the DTC and Rio Tinto, which will allow us to ensure a large, stable supply of high quality rough diamonds. At the same time, we will continue to explore additional opportunities in procuring high quality raw materials. We also intend to invest further in and expand our research, design and production capabilities to meet the expected growth in market demand for our products, and to achieve greater operational efficiencies and cost savings in production. We are in the process of building a new PRC headquarter office building in Shenzhen, PRC and identifying a new production site in the PRC to expand our production capacity in preparation for our POS expansion plan.

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### Further enhance the synergy between our jewellery business and our watch business

We believe that there is potential for significant growth in the luxury watch market in the PRC. We have well-established business relationships with reputable watch suppliers, including affiliates of LVMH Group, Richemont Group, Rolex group and Swatch Group, and are authorised to retail a large number of mid- to high-end brands of watches. We intend to expand our watch brand portfolio through further cooperation with international watch suppliers and brands to retail additional mid- to high-end watch brands. In the PRC, we intend to continue to expand our network of watch POS, which will also increase our brand awareness. In Hong Kong and Macau where it is common to retail both jewellery and watches in the same POS, we intend to increase the number of watch brands we retail at each of these POS so as to increase cross-selling in order to maximise Same Store Sales.

### OUR POS

The following table gives a breakdown of our jewellery POS and watch POS as at the dates indicated:

	Number of POS								
	As at 31 March						As at 30 September		
	2008	Net change	2009	Net change	2010	Net change	2011	Net change	2011
Jewellery POS	821	144	965	150	1,115	172	1,287	134	1,421
<i>PRC</i> <sup>(1)</sup>	752	143	895	139	1,034	172	1,206	129	1,335
Tier I cities	146	20	166	8	174	14	188	11	199
Tier II cities	405	65	470	66	536	75	611	66	677
Tier III and other cities	201	58	259	65	324	83	407	52	459
<i>Hong Kong, Macau and     other Asian     markets</i> <sup>(2)</sup>	69	1	70	11	81	—	81	5	86
Watch POS	—	—	—	64	64	7	71	14	85
<i>PRC</i>	—	—	—	60	60	8	68	14	82
Tier I cities	—	—	—	18	18	—	18	(1)	17
Tier II cities	—	—	—	27	27	8	35	15	50
Tier III and other cities	—	—	—	15	15	—	15	—	15
<i>Hong Kong, Macau and     other Asian markets</i> ...	—	—	—	4	4	(1)	3	—	3
<b>Total</b>	<b>821</b>	<b>144</b>	<b>965</b>	<b>214</b>	<b>1,179</b>	<b>179</b>	<b>1,358</b>	<b>148</b>	<b>1,506</b>

*Notes:*

- (1) Included 5, 7, 10, 14 and 14 POS that retailed both jewellery and watch products as at 31 March 2008, 2009, 2010, 2011 and 30 September 2011, respectively.
- (2) Included 26, 28, 33, 33 and 32 POS that retailed both jewellery and watch products as at 31 March 2008, 2009, 2010, 2011 and 30 September 2011, respectively.

### OUR JEWELLERY BUSINESS

We have a wide range of jewellery products encompassing jewellery made from different raw materials and spanning mass luxury to high-end luxury. Our product designs range from classic designs, such as gold dowry for weddings, to contemporary designs, such as jewellery that incorporates diamonds and gemstones in platinum or 18-karat gold setting. Such a broad product range caters to the needs of our customers at all stages of their life cycle. Certain of our products have relatively lower selling prices and target the younger generation, which we believe helps to expand our customer base and cultivate our relationship with the next generation of customers.

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We believe that in addition to allowing us to capitalise on the growth opportunities arising from a wide spectrum of products, offering products at different price levels and catering to customers at different life stages have also contributed to the overall resilience of our business.

Our jewellery products are segmented into (i) gem-set jewellery, (ii) platinum/karat gold products and (iii) gold products. Raw materials used in our jewellery products include diamonds, gemstones (which include coloured stones, jadeite and pearls), gold and platinum. All our jewellery products that include diamonds and gemstones are categorised as gem-set jewellery products. Our range of gem-set jewellery products includes earrings, rings, pendants, necklaces, bracelets and bangles. Diamonds and gemstones jewellery are usually inlaid and set in 18-karat gold or platinum.

The following table provides an analysis of the turnover of jewellery products by product types during the Track Record Period:

	Year ended 31 March						Six months ended 30 September			
	2009		2010		2011		2010		2011	
	HK\$million	% of total	HK\$million	% of total	HK\$million	% of total	HK\$million	% of total	HK\$million	% of total
Gem-set jewellery . . . . .	5,488.5	31.8%	6,625.7	31.1%	8,962.9	27.5%	3,526.4	29.0%	5,642.7	25.6%
Platinum/karat gold products . . . . .	2,688.3	15.6%	3,574.5	16.8%	4,869.4	15.0%	2,125.3	17.5%	3,713.9	16.8%
Gold products . . . . .	9,077.9	52.6%	11,124.7	52.1%	18,724.7	57.5%	6,517.5	53.5%	12,690.4	57.6%
Total . . . . .	17,254.7	100%	21,324.9	100%	32,557.0	100%	12,169.2	100%	22,047.0	100%

### **Product design and development**

#### *Design and development for retail products*

Our Research and Development Department (“**R&D Department**”), has over 40 designers. Our designers possess the necessary qualifications and training and attend ongoing design training programmes. They come from a diverse background and include designers educated and trained locally and internationally.

Generally, we plan in advance the design project schedule for the following year. Our designers visit jewellery exhibitions to increase their exposure to current trends and design concepts. At meetings amongst our designers, Product Management Department and Sales Management Department, the sales report, style and market insights are reviewed and discussed so that the design direction is aligned. Turnover data derived from our extensive POS network is also analysed to assess consumer preferences. This process greatly assists us in anticipating market trends which we then take into consideration in our product design and development process. For example, our “福星寶寶” (Bao Bao Family) collection was very well-received by the PRC customers when we launched the initial collection. In response to its popularity, we introduced versions that reflect their unique ethnic traditions and culture.

The first stage of our product development is hand-sketching. Specialised design software is used to complement hand-sketching. Designs then proceed to the modelling stage after the approval of hand-sketches. Modelling can be conducted in a variety of methods including cad-cam modelling, wax modelling and goldsmithing. In particular, cad-cam modelling is widely used by us as it produces both resin and wax models with precision and efficiency. The design process is completed upon the prototype receiving collective approval from our head of the R&D Department. Our Product Management Department and Sales Management Department will determine the order size after considering the expected market demand and our marketing strategy.

We usually select popular products from our existing collections for promotional purposes, in particular, for special occasions such as Valentine’s Day and Mother’s Day. For certain festivals that

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may have special significance in the Greater China region, we roll out specially designed items. For instance, for the upcoming Year of the Dragon, we intend to sell products and jewellery with dragon motifs or elements.

### *Design and craftsmanship awards*

We have won a number of awards for our design and craftsmanship, including the 2011 International Jewellery Design Competition — Aesthetic Award and the 2011 International Jewellery Design Competition — Craftsmanship Award.

### *Customised products*

We provide customised product design and production service for customers who wish to own unique and exclusive products. Our charges for the customised design and service depend on the complexity of the design.

### *The “Danseuse de Ballet” collection*

We have introduced a pink diamond jewellery collection known as the “Danseuse de Ballet” collection, designed and produced by our in-house designers, gemologists and craftsmen. This premium collection features a selection of more than 200 custom-designed jewellery pieces, including bejewelled rings, bracelets and necklaces, decorated in rare pink and yellow diamonds. All jewellery pieces in the “Danseuse de Ballet” collection are one-of-a-kind, and will only be offered to an exclusive group of customers.

### *The Perfect Mark collection*

Our Perfect Mark jewellery collection features only diamonds with triple excellence, namely excellent cut, excellent polish and excellent symmetry. These diamonds are subject to strict specifications from the inlay to the shape and size of each claw which, combined with the triple excellent characteristic, highlights the radiance and sparkle of each diamond for our Perfect Mark jewellery collection.

### *Licence agreements with The Walt Disney Company (Asia Pacific) Limited and The Walt Disney Company (Shanghai) Limited*

We have entered into a non-exclusive licence agreement with The Walt Disney Company (Asia Pacific) Limited in respect of the Hong Kong and Macau markets and a non-exclusive licence agreement with The Walt Disney Company (Shanghai) Limited in respect of the PRC market under which we have been granted a license to use certain Disney characters and still scenes from Disney motion pictures designated in the respective licence agreements to design, create and manufacture Disney-licensed jewellery products. We pay a royalty fee to The Walt Disney Company (Asia Pacific) Limited and The Walt Disney Company (Shanghai) Limited in consideration for the licences granted to us under the respective licence agreements. Our licence agreement with The Walt Disney Company (Asia Pacific) Limited in respect of the design, manufacture and sale of Disney-licensed products in Hong Kong and Macau became effective on 1 December 2010 and expires on 30 November 2012, and our licence agreement with The Walt Disney Company (Shanghai) Limited in respect of the design, manufacture and sale of Disney-licensed products in the PRC came into effect on 1 November 2010 and expires on 31 October 2012. Under the licence agreements, either party may terminate the licence agreements if a breach is not remedied within a specified period of time after written notice is provided. In addition, The Walt Disney Company (Asia Pacific) Limited and The Walt Disney Company (Shanghai) Limited have the right to terminate the respective licence agreements under certain circumstances, including if we are placed in liquidation or if, due to material changes in our financial position, we are unable to meet our obligations under the licence agreements.

Under both licence agreements, our designs are approved by The Walt Disney Company (Asia Pacific) Limited and The Walt Disney Company (Shanghai) Limited before being put into production. However, prices are determined solely by us. Our range of Disney-licensed products includes rings, earrings, pendants, necklaces, bracelets, brooches, cuff links, charm sets and statuettes made from gold, platinum, silver or gemstones. We are licensed to sell different products of Disney characters in Hong Kong, Macau and the PRC, subject to the particular customer demands in the relevant markets.

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### *Forevermark diamond products*

Forevermark is a trading name of De Beers UK Limited and we are an authorised jeweller of Forevermark. We have entered into an agreement with Forevermark Limited which came into effect on October 2008 and expires on 31 December 2013 and is renewable upon mutual agreement at least one month before the expiry date. Under the agreement with Forevermark Limited, the Company may terminate the agreement by giving written notice and in addition, Forevermark Limited also has the right to terminate or suspend the agreement if the Company breaches any terms of the agreement and such breach is not remedied within the specified period of time from the notice of the breach. We pay a commission to Forevermark Limited in consideration for the right to retail Forevermark diamond products in a number of our POS in the PRC as well as Hong Kong and Macau. We provide a monthly turnover report to Forevermark Limited and settle our accounts and commissions payable to Forevermark Limited on a quarterly basis.

### **Procurement**

We have two major procurement departments, namely, the Diamond Department and the Procurement (Gemstones) Department, comprising experts with substantial industry and gemology experience. Through regular communications with our Production Management Centre and Sales Management Department by monitoring the turnover of our raw materials, our procurement departments are able to determine the jewellery components that are required by us and procure jewellery components suitable in quantity and quality for our purposes.

We are able to secure a stable raw materials supply and procure raw materials at competitive market prices as our excellent trade reputation, significant retail presence and long-term relationships with our suppliers make us one of their preferred business counterparties. We are able to purchase flexibly as we do not enter into any long-term contract with any supplier. Our suppliers are promptly notified of any shortcomings in the raw materials they supply to us. We may return materials that do not meet industry standards, and may also cease procuring from any supplier whose raw materials do not meet our requirements.

We have well-established relationships with our existing suppliers of diamonds, gemstones, and precious metals. Due to the large scale of our operations, excellent relationships and reputation, a number of our suppliers often allow us to make our selections from their available stock. Save in respect of our relationships with the DTC and Rio Tinto, we believe we are not dependent on any single supplier for any raw materials to any material extent. We evaluate potential new suppliers based on their operational scale and infrastructure, reputation, capacity and their ability to meet our specific quality requirements. Prior to placing our orders with suppliers, we carefully inspect sample raw materials provided to us by the suppliers. We also conduct a quality control inspection upon delivery of our orders to ensure that they meet our quality standards. Before the raw materials enter our production line, they are re-inspected and graded according to their quality and attributes, such as colour, cut, weight and clarity.

### *Diamonds*

Approximately 60% of the polished diamonds used by us are purchased from trade dealers and wholesalers. The remaining approximately 40% are produced from rough diamonds polished at our three diamond cutting and polishing factories. Two of such factories are located in South Africa and the third in Shunde, PRC.

We are a DTC Sightholder through Zlotowski's which was previously our related party and now a subsidiary of our Group pursuant to the Reorganisation. Zlotowski's has been a DTC Sightholder since 1973. Our wholly-owned subsidiary, CTF HK, also became a DTC Sightholder in 1993. We also became a Rio Tinto Select Diamantaire in 2009. We recently renewed the agreement with the DTC for a further three year term from 2012 to 2015. Our agreement with Rio Tinto has just been renewed for



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a further one year term with effect from December 2011. Both the DTC and Rio Tinto agreements may be terminated with written notice and in addition by DTC and Rio Tinto under certain circumstances, such as in the event of material breaches of the agreement or the Company is in liquidation. Under the respective supply agreements with DTC and Rio Tinto, they agree to supply us with rough diamonds meeting pre-agreed specifications, up to a stipulated value and for a specified period, thereby ensuring that we have access to quality rough diamonds. The actual carats we receive vary from time to time depending on the market price of diamonds. The rough diamonds supplied by the DTC and Rio Tinto account for a significant portion of our demand for rough diamonds. The rest of the rough diamonds used by us are purchased from other trade dealers and wholesalers.

As a reputable jeweller in the industry, we are invited to participate in auctions to bid for rare and unique diamonds from time to time. For example, Zlotowski's successfully bid for the 507 carat Cullinan Heritage rough diamond in 2010 for US\$35.3 million, which is the highest sale price on record for a rough diamond. The Cullinan Heritage was transported to our own diamond cutting and polishing factories, where experts analysed the stone and formulated what we believe is the best way to cut it. The Cullinan Heritage rough diamond was cut into 24 polished stones, the largest of which was named Cullinan Heritage I. Cullinan Heritage I is a Round Brilliant Cut and D colour polished diamond weighing over 100 carats.

### *Gemstones*

We purchase our coloured stones from over 50 vendors, stone cutters and mine owners. Most of our jadeite is purchased from various jadeite suppliers in the PRC and Hong Kong and to a much lesser extent, directly from private sellers at jadeite auctions organised by the Myanmar government. Our freshwater pearls and South Sea pearls are purchased directly from pearl farms as well as through wholesalers or at major trade auctions. We have approximately 15 regular pearl suppliers. On 10 June 2011, Techni Development Investment Limited ("**Techni**"), a subsidiary of our Group, entered into a convertible note agreement (the "**Autore Convertible Note Agreement**") with one of our pearl suppliers, Autore Holding Pty Limited ("**Autore**"), a company based in Australia. The Autore Convertible Note Agreement matures on 31 December 2014 and helps strengthen the financial position of Autore, which in turn assists us in ensuring the supply of pearls from Australia. Pursuant to the Autore Convertible Note Agreement, Autore issued convertible notes (the "**Autore Convertible Notes**") with a principal amount of AUS\$3,000,000 to Techni. Interest is payable on the Autore Convertible Notes at the rate of 8% per annum, payable annually in arrears on each anniversary of the issue date of the Autore Convertible Notes before the same are converted, redeemed or matured. Further, Techni has an option under the Autore Convertible Note Agreement to convert the Autore Convertible Notes into shares in the event that the shares in Autore Pearling Pty Limited, a company incorporated in Australia, are listed on the Australian Securities Exchange or the assets of Autore Pearling Pty Limited have been transferred to a company listed on the Australian Securities Exchange in exchange for securities in this listed company.

### *Precious metals*

We purchase our precious metals from companies in the precious metals business in Hong Kong and the Shanghai Gold Exchange in the PRC.

### **Production**

We continually develop, upgrade and expand our production facilities and recruit skilled craftsmen and technicians to keep pace with the rapid increase in the demand for our products and the expansion of our business. As part of this initiative, we are in the process of pilot testing the automation of certain aspects of our production line in one of our Shenzhen factories, and once the pilot test is satisfactorily completed, we will roll out the automation to cover a greater proportion of our jewellery production. We also intend to build a research and development facility in Shenzhen on the land we purchased, which will focus on the research and development of new materials, production technology and the automation of production.

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As at 30 September 2011, we have a total of 12 factories (consisting of nine jewellery factories and three diamond cutting and polishing factories). The nine jewellery factories together employ over 3,500 employees and occupy a total area of over 42,000 square metres. The nine factories comprise one factory in Hong Kong that produces gem-set jewellery products, four factories in Shenzhen that produce gem-set jewellery, karat gold and gold products and four factories in Shunde that produce gem-set jewellery, platinum/karat gold and gold products. Given that we have in-house production capabilities, the flexibility to outsource production and optimise our production through our product mix, we believe that we are, and will continue to be, able to meet consumer demand for our products.

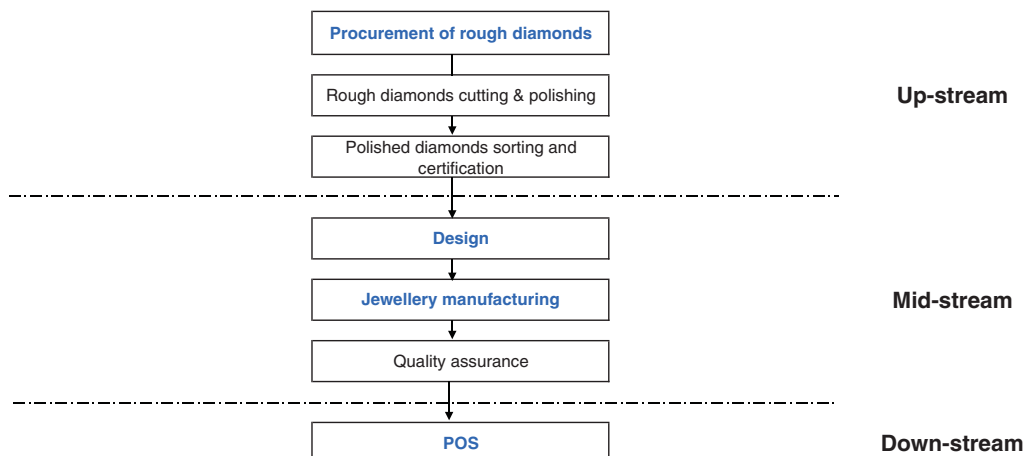
### *Jewellery production*

We maintain our high product quality by producing in-house approximately 80% of our gem-set jewellery products during the Track Record Period. The production of the remaining jewellery products are outsourced to external producers under our strict quality control. The overall percentage of outsourced production was approximately 50% during the Track Record Period. Using external producers for easy-to-make or lower value jewellery products offers us the opportunity to focus our production capabilities on gem-set jewellery products and results in greater cost efficiency. The proportion of production that we outsource may vary from time to time depending on the overall number and complexity of jewellery produced in-house by the Company and peak seasons such as Chinese Lunar New Year. Operating history, reputation and scale of operations are taken into account when selecting contractors. Samples of the contractors' products are required to be submitted to us for assessment of their production quality. The finished products are subject to our strict quality control standards and procedures including sample checking on physical characteristics and chemical composition. Defective products would be returned to the contractors for rectification. Payment would only be made upon receipt of finished products with satisfactory workmanship and we typically do not place any deposit with or make any or advanced payment to the contractors. Site checking or audit is randomly conducted on their production facilities to ensure their production process complies with our standards.

Our Production Management Centre plans our production schedule by considering (i) anticipated sales, (ii) our POS expansion plans, (iii) production lead-time and (iv) raw material procurement plan. The ability of our Production Management Centre to take into consideration such factors is aided by our advanced IT system, which enables them to monitor the turnover of our raw materials and jewellery products. Our production is order-driven. From order-to-POS delivery, the production lead time typically ranges from 30 to 50 working days. We believe our relatively short production lead time demonstrates our ability to replenish our POS inventory on a timely basis.

### *Production process*

Production process of our gem-set jewellery products is as follows:



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### Quality control

Our precious metal testing laboratory, which was established in Shenzhen, PRC in 2004, has 20 professional inspectors and advanced machineries and specialises in testing precious metals, including gold and platinum as at 30 September 2011. This Shenzhen laboratory has been certified by China National Accreditation Service for Conformity Assessment (CNAS) (中國合格評定國家認可委員會) and its quality control system has been accredited with ISO17025 certification. The precision of the equipment in this laboratory is nationally recognised, enabling us to test both the physical integrity and chemical composition of our jewellery products.

Our jewellery products are subject to strict in-house quality control monitoring. We conduct sample tests of the chemical composition of the finished products produced by such outsourced producers to ensure that they meet our quality standards.

Our jewellery components are sourced from suppliers of good reputation. In general, diamonds that weigh over 1.0 carat are enclosed with certificates issued by the GIA or HRD. Our jewellery products sold in the PRC are enclosed with certificates issued by the National Gem Testing Centre of the PRC in accordance with applicable PRC rules and regulations.

### Distribution of our jewellery products

For FY2009, FY2010, FY2011 and 1HFY2012, turnover attributable to our jewellery business amounted to approximately HK\$17,254.7 million, HK\$21,324.9 million, HK\$32,557.0 million and HK\$22,047.0 million, respectively, representing approximately 93.7%, 93.0%, 92.9% and 92.3% of our total turnover for each of the corresponding years and period. We experience seasonal fluctuations in our turnover. Our sales for October and from December to February are usually higher than those for the remaining months of the year mainly due to the Golden Week, the Christmas holiday season, Chinese New Year holidays and Valentine's Day. See the section headed "Financial Information – Principal factors affecting our results of operations – Seasonality" for information on seasonal fluctuations in our turnover.

The following table shows an analysis of our turnover of jewellery products by geographical locations during the Track Record Period:

	Year ended 31 March						Six months ended 30 September			
	2009		2010		2011		2010		2011	
	HK\$million	% of total	HK\$million	% of total	HK\$million	% of total	HK\$million (unaudited)	% of total	HK\$million	% of total
PRC .....	9,999.8	58.0%	12,455.5	58.4%	18,929.0	58.1%	7,190.5	59.1%	12,698.6	57.6%
Hong Kong, Macau and other Asian markets .....	7,254.9	42.0%	8,869.4	41.6%	13,628.0	41.9%	4,978.7	40.9%	9,348.4	42.4%
<b>Total .....</b>	<b>17,254.7</b>	<b>100%</b>	<b>21,324.9</b>	<b>100%</b>	<b>32,557.0</b>	<b>100%</b>	<b>12,169.2</b>	<b>100%</b>	<b>22,047.0</b>	<b>100%</b>

### Our Jewellery POS

We have established and operate an extensive distribution network in the Greater China region and continue to expand our jewellery POS network and geographical footprint. Our jewellery POS network comprises both retail and wholesale channels through which we distribute our jewellery products. As at 30 September 2011, we had a total of 1,421 jewellery POS comprising 1,335 POS in the PRC and 86 POS in Hong Kong, Macau and other Asian markets. The gross floor area of our POS in Hong Kong and Macau is typically around 170 square metres and the gross floor area of our POS in the PRC is typically around 80 square metres. However, our flagship stores are significantly larger than our typical POS—our flagship stores in Hong Kong and Macau are around 400 square metres and our flagship stores in the PRC are around 1,000 square metres.

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The following table gives a breakdown, by geographic segment, our number of jewellery POS as at the dates indicated:

	Number of POS								
	As at 31 March						As at 30 September		
	2008	Net change	2009	Net change	2010	Net change	2011	Net change	2011
PRC — self-operated .....	547	87	634	98	732	83	815	69	884
<i>Wholly-owned</i> .....	462	79	541	63	604	45	649	46	695
<i>Joint-venture</i> <sup>(1)</sup> .....	85	8	93	35	128	38	166	23	189
PRC-franchised .....	205	56	261	41	302	89	391	60	451
Hong Kong, Macau and other									
Asian markets <sup>(2)</sup> .....	69	1	70	11	81	—	81	5	86
<b>Total</b> .....	<b>821</b>	<b>144</b>	<b>965</b>	<b>150</b>	<b>1,115</b>	<b>172</b>	<b>1,287</b>	<b>134</b>	<b>1,421</b>

*Notes:*

- (1) Joint-venture POS are controlled and operated by us, and the financial results of such POS are consolidated in our financial statements.
- (2) Included one franchised POS in Malaysia as at 31 March 2010 and one franchised POS in Malaysia and one franchised POS in Singapore as at 31 March 2011 and 30 September 2011.

We began our penetration into Tier III cities in 2000 and Tier IV cities in 2002. We believe we were one of the first Asian large-scale jewellers to enter into a number of those cities, thereby giving us first-mover advantage. We have established good business relationships with business partners, including leading department stores and franchisees, which give us strategic and preferred access to prime POS locations. We maintain POS in 18 out of the “Top 20 Gold Jewellery Department Stores” as listed in the study of The Monitoring Report on the Operation of and the Major Products Sold by the Leading Retail Enterprises in the PRC (全國大型零售企業經營與主要商品銷售監測報告) in 2010.

Our POS consist of self-operated stores and franchised stores, which generally operate as standalone stores or concessionaire counters. Except for our Concessionaire Counters which are typically located within department stores, we generally lease the premises of our self-operated stores, with a small number of our self-operated stores occupying self-owned properties.

### *Joint-venture POS*

Approximately 21% of our self-operated jewellery POS in the PRC are joint-venture POS set up through our joint-venture companies. As at 30 September 2011, we had 189 joint-venture POS. Our joint-venture agreements are typically for a period that ranges from 10 years to 30 years, and in some cases, for an indefinite term, and may be extended by mutual agreement six months before expiry.

We control all aspects of the management of our joint-venture jewellery POS including store design concept, turnover strategy, product mix and inventory levels, daily operations, and branding and marketing activities. The staff at the joint-venture jewellery POS are our employees and the jewellery products sold at our joint-venture jewellery POS are provided exclusively by us. The joint-venture partners are not actively involved in the day-to-day management of the joint-venture companies and joint-venture POS. They are involved in the POS site selection process and initial start-up logistics as they are familiar with the local geography, retail network and regulatory environment and may provide their views on general management of the joint-venture at board meetings of the joint-venture companies from time to time. The profits of the joint-venture POS are shared in accordance with the respective equity share of the Company and the joint-venture partner in the joint-venture company. Use of joint-venture POS in the PRC allows us to maintain control over the daily management and operation of the POS while giving us the option to utilise the local knowledge of our joint-venture partners as necessary.

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The joint-venture agreements generally provide that (a) any transfer of the stake in the joint-venture company requires the consent of the other joint-venture partner; (b) we are responsible for recruiting management personnel, technicians, workers and other staff for the joint-venture company; (c) the chairman of the board of the joint-venture company is to be nominated by us and (d) the general manager of the joint-venture company is, depending on the joint-venture agreement itself, either nominated by us or by the board of the joint-venture company.

We had 14, 15, 23 and 25 joint-venture partners as at 31 March 2009, 2010 and 2011 and 30 September 2011, respectively. The backgrounds of our joint-venture partners and franchisees are diverse and include partners who are involved in the retail (including department stores) or jewellery industries. Our existing joint-venture partners do not have any past or present relationship with us, our Shareholders, Directors, senior management and their respective associates, save for ordinary business relationships including our relationship as joint-venture partners. We became acquainted with our joint-venture partners through day-to-day business dealings and ordinary commercial relationships.

### *Franchisees*

We started entering into franchise arrangements in 1998 and as at 30 September 2011, we had over 150 franchisees, of which almost all operate in the PRC. Our sales to our franchisees are recorded as wholesale revenue in our Group's financial statements. Our franchise agreements normally have an initial term of two years and a renewal option by mutual agreement. Renewal of a franchise agreement is subject to mutual agreement and we consider a number of factors including turnover performance and whether the franchisee had complied with our brand policies and operation guidelines.

We select our franchisees carefully, and in considering their suitability, we take into account a number of factors including their reputation, background, credibility, industry experience and the value of their local knowledge and expertise they are able to bring to the franchise arrangement. We had 74, 91, 134 and 159 franchisees as at 31 March 2009, 2010 and 2011 and 30 September 2011, respectively. As at 30 September 2011, we have strong working relationships with our franchisees as may be evidenced by a 2.4 years of relationship on average, with the longest relationship spanning 12 years. In addition, more than 69% of our franchised POS are operated by our franchisees who have at least three franchised POS. We intend to further utilise the franchise model to expand our retail footprint, especially in Tier III cities and Tier IV cities in the PRC. We believe that the franchise model enables us to leverage on the local knowledge and premises of our franchisees and provides us with a flexible and faster rollout strategy that requires minimal capital commitment from us.

Staff members at the franchised POS are subject to the same training programme as our own employees and their salaries and incentive programmes are generally in line with our standards. The store design, storefront presentation, purchasing and sales activities and promotional materials of the franchised POS follow our specifications, policies and guidelines. Our franchisees are required to operate the franchised POS according to our standards and consistent with the perception of our brand, adhere to marketing guidelines to give the franchised POS the uniform “周大福” (CHOW TAI FOOK) brand characteristics and participate in promotional and marketing activities organised by us. We conduct routine checks and inspections at the franchised POS to ensure that it is being operated in accordance with our operation manual, standards and policies and we are able to monitor their inventory level through our information system and database. We also regularly communicate with the franchisee to ensure that we are kept abreast of the operation status of the franchised POS. This ensures that our customers enjoy the same “周大福” (CHOW TAI FOOK) experience whether they patronise our standalone stores and concessionaire counters operated by us or our franchised POS.

Our franchisees are typically responsible for finding suitable store locations that meet our requirements and are responsible for paying rent, utilities and store management fees. We also require our franchisees to maintain adequate insurance coverage.

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The products sold at our franchised POS are supplied exclusively by us and we typically receive cash on delivery for the products we sell to them. We do not accept returns from our franchisees unless there are quality issues or unless the inventory requires our service capabilities such as maintenance care for jewellery products and polishing. Generally, the royalty fee we receive from our franchisees depends on the turnover of the franchised POS. As at the Latest Practicable Date, there was no minimum purchase requirement for the franchised POS. In the event we or the franchisee decides not to renew or terminate the franchise agreement, we will consider to repurchase the inventory from the franchised POS, in the case of gold products, at the prevailing gold prices at the time of such repurchase and in the case of other products, at the original price at which the products were sold to the franchised POS. We prefer to repurchase the inventory as that allows us to maintain control over the whereabouts, sale strategy and sale prices of our products.

In general, under the terms of the franchise agreements, (a) we are entitled to grant the same franchise rights to any third parties even in the same territory; (b) the franchisee needs our prior consent to open up new stores, and is strictly forbidden from selling goods other than the goods franchised by us at the franchised POS; (c) in addition to payment for the intellectual property license, the franchisee has to pay us in advance (i) a start-up service fee, since we provide employee training, computer software technical support and auxiliary items for the POS and (ii) a security deposit. Notwithstanding that employee training is provided by us, the employees at the franchised POS are the employees of the franchisees and their salaries (including compliance with any social welfare requirements required under applicable laws) are the responsibility of the franchisee, in addition to other expenses of the POS such as decoration or renovation works, insurance, utilities, rentals, repair and maintenance.

We have the right to, among other things, set, subject to certain conditions, the purchase price at which the franchisee is to buy the products from us, as well as the retail price at which the franchisee is to sell those products, formulate overall the business strategy of the franchised POS and supervise and inspect the POS and its operations. The franchisee has the obligation to, amongst others, (i) comply with an operation manual we provide and operate the franchised POS according to our standards and policies; (ii) keep a specific monthly minimum stock level and (iii) seek our consent before decorating or renovating the franchised POS, or launching any advertising or promotional campaigns.

We have the unilateral right, with written notice, to terminate the franchise agreement in the event the franchisee breaches its obligations under the franchise agreement, including failure to comply with our operation manual, renovate the franchised POS according to our specifications, comply with our marketing and branding strategies, provide us with information promptly or in the event they transfer or subcontract their rights under the franchise agreement without our prior written consent. The franchisee has the right to terminate the franchise agreement within seven days after entering into the franchise agreement and if so terminated, all fees paid to us by the franchisee will be forfeited and the franchisee is also obliged to reimburse the losses incurred by us as a result of the termination.

Two franchised POS which were operated by NWDS were converted into our self-operated POS during FY2010. There were no special arrangement related to this conversion and NWDS was neither a joint-venture partner nor a franchisee as at the Latest Practicable Date. Save as disclosed in this paragraph, our existing franchisees do not have any past or present relationship with us, our Shareholders, Directors, senior management and their respective associates, save for ordinary business relationships including our relationship as franchisees. There were no incidents of material non-compliance by our franchisees of the key terms and conditions of the franchise agreements and no franchise arrangement was terminated prior to the expiry of the franchise agreement during the Track Record Period.

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### Concessionaire Counters

As at 30 September 2011, 862 out of 1,053 of our self-operated POS are operated as Concessionaire Counters. Generally, our Concessionaire Counters are located within department stores. We have strong working relationships with our department store partners which is evidenced by a 3.2 years of relationship on average and with the longest relationship spanning 11.9 years as at 30 September 2011. In addition, more than 50% of our self-operated Concessionaire Counters have been operated for more than three years.

The following table gives a breakdown of self-operated Concessionaire Counters that are self-operated jewellery POS and watch POS at the dates indicated:

	Number of self-operated Concessionaire Counters								
	As at 31 March						As at 30 September		
	2008	Net change	2009	Net change	2010	Net change	2011	Net change	2011
Jewellery POS .....	485	72	557	93	650	73	723	64	787
<i>PRC</i> .....	475	72	547	90	637	76	713	65	778
<i>Hong Kong, Macau and     other Asian markets</i> .....	10	—	10	3	13	(3)	10	(1)	9
Watch POS .....	—	—	—	56	56	6	62	13	75
<i>PRC</i> .....	—	—	—	56	56	6	62	13	75
<i>Hong Kong, Macau and     other Asian markets</i> .....	—	—	—	—	—	—	—	—	—
<b>Total</b> .....	<b>485</b>	<b>72</b>	<b>557</b>	<b>149</b>	<b>706</b>	<b>79</b>	<b>785</b>	<b>77</b>	<b>862</b>

The staff at our self-operated Concessionaire Counters are our employees. In consideration for maintaining our Concessionaire Counters within the department stores, the department stores will receive a commission determined with reference to our turnover from such Concessionaire Counters.

For our Concessionaire Counters, payment of our jewellery products and/or watches are received by the department stores and the amount due to us less the commission and other related management fees and agreed shared fees for promotional events organised by the department stores are settled and transferred to our account once or twice a month. The inventory database of our Concessionaire Counters are linked to our information database which allows us to monitor the inventory turnover and the revenue since the sale price of each item is itemised in the inventory database. After we issue the invoice to the customers at our Concessionaire Counters, the customers are required to pay at the department stores' cashiers (the customers are often accompanied by our staff to the cashiers as part of our customer service) and are only allowed to collect the merchandise from our Concessionaire Counters upon showing a valid receipt from the department store indicating that payment has been made. This allows us to reconcile the sales and inventory records of our Concessionaire Counters with those of the department stores when we settle our accounts with them.

Our agreements with respect to our Concessionaire Counters are typically renewed every one to two years. The form and terms of our concessionaire agreements vary considerably as they are generally based on the standard forms provided by each individual department store. However, in general, the agreements broadly state the nature of the products and for POS retailing watches, the brand(s) of the watches that are to be sold at the relevant Concessionaire Counters. As at 30 September 2011, less than 10% of our Concessionaire Counters have sales targets and the department store has the right to terminate the concessionaire agreements in the event we are unable to meet the stipulated sales targets. No concessionaire agreements have been terminated by department stores for failing to meet stipulated sales targets during the Track Record Period.

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We voluntarily terminated less than 35 concessionaire agreements for each of FY2009, FY2010, FY2011 and 1HFY2012 due to less than satisfactory sales performance of the Concessionaire Counters. We continually review the opening, renewal and closing of our Concessionaire Counters to ensure that our portfolio of Concessionaire Counters are in line with our overall business and strategies.

### ***Sales management and review***

Through our advanced IT system, our sales and inventory information are updated on a real-time basis. Our management is therefore able to receive automated daily sales report and is able to retrieve information broken down by markets and even by the sales and inventory situation of an individual POS. At the store level, the store manager conducts a daily review of sales, operation and inventory. Our senior management has a monthly meeting to review the overall sales, operation and inventory of our Group.

### ***Our distribution strategy and network***

We select sites for POS based on certain key criteria that include macroeconomic metrics such as GDP and per capita income growth, local market demand for our products, operating environment and availability of business partners. We also, among other things, evaluate the customer base of target department stores and interview management of target department stores.

#### *Our jewellery distribution strategy and network in the PRC*

We believe we have a well-balanced proportion of self-operated POS and franchised POS in the PRC. Our self-operated POS, which comprise our wholly-owned POS and joint-venture POS, accounted for 884, or 66.2%, of our total of 1,335 jewellery POS in the PRC as at 30 September 2011. This percentage was higher than 32.0%, being the percentage of self-operated POS in the PRC jewellery market as at 31 December 2010, according to the Frost & Sullivan Report. The remaining 451 jewellery POS in the PRC were franchised POS. Leveraging our franchisees in the PRC allows us to expand our POS network at minimal costs and not divert our management resources to their daily management, while still allowing us to maintain control over our brand and marketing strategies. However, a majority of our POS is still self-operated, giving us greater operational control and access to our end customers. In addition, compared to implementing the franchising model, operating self-operated POS allows us to capture the retail margin. Our gross profit margin of our retail channel was higher than the gross profit margin of our wholesale channel during the Track Record Period.

Of our 884 self-operated jewellery POS in the PRC, 778, or 88.0%, were Concessionaire Counters which are typically located within department stores as at 30 September 2011. The department stores where Concessionaire Counters are located provide us with convenient access to prime shopping districts, pedestrian traffic and shoppers. The department stores also allow us to leverage on their marketing activities. The use of Concessionaire Counters in department stores also enables us to penetrate Tier III cities and Tier IV cities in the PRC more easily and rapidly as it is relatively easy to set up Concessionaire Counters in department stores that are already occupying prime sites and have operating infrastructure in place.

#### *Our jewellery distribution strategy and network in Hong Kong and Macau*

Hong Kong and Macau are both popular tourist destinations, especially for PRC tourists. Most of our POS in these areas are located in prime tourist and shopping districts. For example, in Hong Kong, we have 31 POS in Causeway Bay, Tsim Sha Tsui and Mongkok and most of them are either situated on streets with heavy pedestrian traffic or in department stores popular with PRC tourists such as SOGO, Times Square and K11. In Macau, we also have POS located in key shopping destinations for PRC tourists, such as Venetian Macau, City of Dreams and Avenida De Almeida Ribeiro. The Company does not pay any commissions to tour operators who bring tourists to our



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POS. In addition to benefitting from the increasing purchasing power of PRC tourists, our POS in Hong Kong are also patronised by local customers who generally have high purchasing power.

We expect to open an average of three to five jewellery POS per year in Hong Kong and Macau. We believe there is an increasing number of PRC customers patronising our Hong Kong and Macau POS as evidenced by the rise in the proportion of payment through China UnionPay or in RMB (cash) as a percentage of our retail turnover in Hong Kong, Macau and other Asian markets from 31.4% in 2009 to 49.3% in 2011.

### *Our distribution strategy and network in other Asian markets — Malaysia, Singapore and Taiwan*

We take a flexible approach to our distribution strategy in Malaysia, Singapore and Taiwan and will open new POS as appropriate depending on local market conditions.

### **Pricing**

We adopt a uniform pricing policy which is applicable to all our jewellery products. All our jewellery products are subject to our “一口價” (Fixed Price) Policy but from time to time, we launch sales and promotional discounts in respect of certain jewellery products for short periods of time. Certain of our sales staff also have minimal discretion to give discounts to our customer for our jewellery products. We determine the price of our jewellery products primarily based on our costs (which includes the cost of the jewellery components and the cost of design and production) and local taxes as well as market demand and price trends. The prices of our non-gold jewellery products are reviewed by our management on a monthly basis and the prices of our gold jewellery products are reviewed by our management on a daily basis.

### **OUR WATCH BUSINESS**

Our watch business in Hong Kong and Macau started during the 1960s. We have well-established business relationships with reputable watch suppliers including affiliates of LVMH Group, Richemont Group, Rolex group and Swatch Group. The watches we retail are mainly mid- to high-end luxury brands and target the middle to high income group of customers.

We have letters of authorisation and agreements with terms ranging from one year to an indefinite length of time with certain watch suppliers and watch brands which authorise us to retail their watches at selected POS. Where we do not have written agreements, we purchase from these suppliers on an order-by-order basis. As authorised dealers or retailers, we are required, under standard market practice, to comply with the pricing policies, discount policies and minimum stock levels stipulated by the watch suppliers from time to time.

For FY2009, FY2010, FY2011 and 1HFY2012, turnover attributable to our watch business amounted to approximately HK\$1,156.2 million, HK\$1,608.7 million, HK\$2,485.5 million and HK\$1,827.5 million, respectively, representing approximately 6.3%, 7.0%, 7.1% and 7.7% of our total turnover for each of the corresponding years and period. We experience seasonal fluctuations in our turnover. Our sales from December to February are usually higher than those of the remaining months during the year mainly due to the Christmas holiday season, Chinese New Year holidays and Valentine’s Day. See the section headed “Financial Information — Principal factors affecting our results of operations — Seasonality” for information on seasonal fluctuations in our turnover.

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The following table shows a breakdown of our turnover of watches by geographical locations during the Track Record Period:

	Year ended 31 March						Six months ended 30 September			
	2009		2010		2011		2010		2011	
	<i>HK\$ million</i>	<i>% of total</i>	<i>HK\$ million</i>	<i>% of total</i>	<i>HK\$ million</i>	<i>% of total</i>	<i>HK\$ million (unaudited)</i>	<i>% of total</i>	<i>HK\$ million</i>	<i>% of total</i>
PRC .....	5.4	0.5%	173.5	10.8%	542.8	21.8%	330.3	28.8%	672.8	36.8%
Hong Kong and Macau .....	1,150.8	99.5%	1,435.2	89.2%	1,942.7	78.2%	815.5	71.2%	1,154.7	63.2%
<b>Total</b> .....	<b>1,156.2</b>	<b>100%</b>	<b>1,608.7</b>	<b>100%</b>	<b>2,485.5</b>	<b>100%</b>	<b>1,145.8</b>	<b>100%</b>	<b>1,827.5</b>	<b>100%</b>

### Purchases and supplies

The process of initiating and placing the order and the inventory turnover varies from brand to brand. Through our information system which is linked to all our POS, each of our POS retailing watches is able to submit a sales report and place orders for watches with our watch departments in Shanghai and Hong Kong. Our watch departments will review the orders and after the orders are approved, they will be placed with the watch suppliers. Our processing time for each order from submission of the sales report to placing of orders is approximately one business day.

### Our watch retail strategy

Our watch retail strategy is determined by the market and the requirements of the suppliers. For example, in Hong Kong and Macau where the markets are more mature and customers are accustomed to a one-stop-shop culture, we generally offer watch brands in POS which also sell our jewellery products. This enables us to offer products to satisfy the needs of, and attract, a wide range of customers who may have different price points and preferences. In the PRC, it is more common for a POS to retail watches only. This is reflective of the general culture of the watch retail market in the PRC as well as the overall branding strategy of watch brands in the PRC with which we, as retailers, are required to comply. As at 30 September 2011, we had 85 POS retailing only watches, of which 82 POS were in the PRC while the other three POS were in Hong Kong and Macau.

### Quality Control

In general, each watch retailed by us has its own serial number provided by the watch brand owners or authorised watch suppliers to prevent the purchase of any counterfeit products. All purchases are inspected by our experienced salespersons and/or quality controllers when delivered to us from the suppliers to avoid any possible counterfeit items.

### Delivery of watches and credit policies

Generally, the watch distributors deliver the watches directly to the POS which originated the order, although in certain circumstances where the orders are large, the watches are delivered to our watch departments for our onward distribution to the POS. Our staff at our watch departments and POS are trained to conduct the necessary quality checks on delivery. The credit policy is dependent on the policy of the relevant watch brand and distributor, typically ranging from seven days to 60 days from the date of delivery.

### Pricing and discounting policies

The retail prices and the discount policies are determined by each watch brand based on its marketing strategy. We do not have the flexibility to deviate from these prescribed pricing and discounting policies.

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### SUPPLIERS

For each of FY2009, FY2010, FY2011 and 1HFY2012, purchases from our five largest suppliers amounted to HK\$8,259.1 million, HK\$10,015.7 million, HK\$18,040.7 million and HK\$15,529.9 million, respectively, representing 51.6%, 50.8%, 50.3% and 50.9% of our total purchases. Purchases from the largest single supplier for each of FY2009, FY2010, FY2011 and 1HFY2012 amounted to HK\$4,778.2 million, HK\$6,021.5 million, HK\$10,511.7 million and HK\$8,191.1 million, respectively, representing 29.8%, 30.5%, 29.3% and 26.9% of our total purchases. Our largest single supplier is the Shanghai Gold Exchange, which supplies us with gold and platinum in the PRC. Most of our purchases were settled in HKD, RMB or USD by way of cheques and telegraphic transfers. None of our Directors, their associates or any Shareholder (which to the knowledge of the Directors owns more than 5% of our share capital) has any interest in any of our five largest suppliers during the Track Record Period.

### CUSTOMER SERVICES AND RELATIONSHIP

Customer service has always been important to us and to the success of our business. As entrenched in our corporate values of “sincerity • eternity”, our goal is to deliver personalised customer service and to build on our relationship with our customers. Our sales staff are trained to handle all aspects of a shopping experience from the moment a customer enters a store to the eventual purchase of products by customers. Our sales staff are supported by our customer ambassadors in delivering personalised customer service. We regularly assess the performance of our sales staff to uphold the high quality and consistency in our customer service.

In addition, we have set up a customer service centre in selected POS and a customer service hotline which directs calls from our customers to our call centre operators who are trained to assist our customers. Our website also provides a channel to our customers for providing service feedback. We conduct monthly reviews of feedback submitted by customers to prevent any reported problems from recurring.

#### ***After-sales and maintenance service***

##### *Jewellery*

For jewellery products, we offer a number of after-sales services such as resizing of rings and polishing of bracelets for a small fee (excluding any cost of additional materials). We also provide complimentary cleaning services. No provision for product warranty was made during the Track Record Period as after-sale services provided by the Group, such as resizing of rings, cleaning and polishing, incur only insignificant labour costs. There were no material refunds, returns or complaints related to product quality during the Track Record Period.

##### *Watches*

The warranties on the watches we sell are given by the relevant watch brands. Maintenance and repair services are provided by the official service centres of the relevant watch brands. We provide services such as delivery to the service centres and minor maintenance services such as basic cleaning and battery replacements.

#### ***Sales return and trade-ins***

Generally, we adopt a no-sales-return policy unless otherwise required by local laws and regulations or unless, in the case of Concessionaire Counters, otherwise required by the department stores' policy. However, we do permit returns in special cases if the reason for the return relates to quality issues, though we have rarely experienced such circumstances. We accept trade-ins of our jewellery products on a discretionary basis.

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### ***Credit policies***

We cooperate with banks from time to time on programmes which allow their credit card holders to purchase our products under the bank's installment payment programme. Save in respect of payments through credit cards, we do not allow customers to make purchases on credit.

### **MARKETING AND PROMOTION**

#### ***Our brand***

We believe that the “周大福” (CHOW TAI FOOK) brand represents one of our most important assets and through our 80 years of heritage and our branding campaigns, we believe the brand has come to symbolise trustworthiness and embodies our core brand value of “sincerity • eternity”.

We have gained a solid regional presence and a high level of brand awareness. Our brand is further strengthened by our well-established and stable customer base gained through our broad product portfolio.

We believe that we were one of the first Asian large-scale jewellers to establish a retail presence in a number of the Tier III cities and Tier IV cities in the PRC. Many of our PRC customers were first introduced to our brand through our POS in their local cities and on their visits to Hong Kong and Macau. Our POS in Tier III cities and Tier IV cities in the PRC not only generate sales locally, but also serve as a means for us to create brand awareness which we believe generates significant sales for our POS in Hong Kong and Macau.

#### ***Our branding strategy***

Our branding strategy focuses on creating consistency in our brand perception across all communication channels and all markets in which we operate. We use a wide range of advertising channels from print to Internet to achieve a high degree of visibility. Our brand messaging is coordinated to be consistent across the regional, national and provincial levels. To further this consistency in brand image, the design and renovation of our POS (including our window displays) are standardised and we have also established customer service protocols so that our customers enjoy the same “周大福” (CHOW TAI FOOK) experience regardless of the POS they patronise. We believe our branding strategy helps us to retain existing customers and attract new customers.

#### ***Our key marketing channels***

The key marketing channels that we use on an ongoing basis include consumer advertisements with specific coverage in local lifestyle, fashion magazines and newspapers, outdoor billboards and signage, online activities, television advertisements and advertisements on the exterior of 1,900 buses. Our marketing and promotion efforts seek to increase sales by increasing brand awareness that stimulates interest in our product range and entrenching our position as a leading Asian jeweller. We also leverage on our business milestones to create publicity, for example, we held a special high profile opening ceremony on 28 September 2010 when we opened our 1,000th jewellery POS in the PRC, which was located in Beijing. In 2011, we sponsored the “CHINA IN PARIS show” during the Paris fashion week which showcased our jewellery products alongside the fashion collections by rising Chinese fashion designers and we believe we were the first jeweller in the Greater China region to sponsor an event of this nature. We also plan to further expand our customer base, increase our brand awareness and enhance our corporate image by establishing partnerships with premium Chinese commercial banks in the PRC. We view partnership arrangements with premium PRC commercial banks as another sales channel and gives us an opportunity to broaden our customer base by exposing the customers of the banks, who may or may not be our existing customers, to our products. Such partnership arrangements are entered into for relatively short periods of time as promotional activities on an ad hoc basis with minimal investment cost.

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### ***Our customer loyalty programme***

To capture the full sales potential of our returning customers, we launched our customer loyalty programme in the PRC in 2002 and subsequently in Hong Kong in 2010. Sales generated from customer loyalty programme members in the PRC in our self-operated POS, as a percentage of our total retail turnover in the PRC, are continuously increasing, from 27.0% in FY2009 to 27.5% in FY2010, to 30.5% in FY2011 and to 33.0% for 1HFY2012, mainly due to our continuous effort to promote our customer loyalty programme. Sales generated from customer loyalty programme members in Hong Kong, as a percentage of our total retail turnover in Hong Kong and Macau, amounted to 16.5% in FY2011 and 11.6% for 1HFY2012. There was a temporary drop in the percentage mainly because we were focusing on an internal revamp of our customer loyalty programme in Hong Kong for 1HFY2012. Net repeat purchases from customer loyalty programme members in the PRC in our self-operated POS increased from approximately HK\$694 million (including value-added tax) in FY2009 to approximately HK\$1,121 million (including value-added tax) in FY2010, to approximately HK\$2,236 million (including value-added tax) in FY2011, and increased from approximately HK\$818 million (including value-added tax) for 1HFY2011 to approximately HK\$1,621 million (including value-added tax) for 1HFY2012. Net repeat purchases from customer loyalty programme members in Hong Kong amounted to approximately HK\$754 million in FY2011 and approximately HK\$543 million for 1HFY2012. In addition, our customer loyalty programme members tend to purchase higher value products. As at 30 September 2011, we had around 448,000 customer loyalty programme members in the PRC and over 50,000 customer loyalty programme members in Hong Kong. Both our self-operated and franchised POS in the PRC participate in the customer loyalty programme. We did not issue any cash coupon to our customers during the Track Record Period in the PRC.

In the first half of 2012, we expect to roll out a new customer loyalty programme in Hong Kong first and in the PRC subsequently. Under this new programme, there are various tiers of membership. Our members will enjoy benefits such as receiving cash coupons and/or discount coupons upon meeting certain minimum spending requirements. The total number and value of cash and/or discount coupons that we issue are closely monitored by our Financial Management Department to avoid over-exposure to cash and/or discount coupons. We believe the introduction of such coupons has certain significance to our overall business strategy of increasing same store sales and continuing to encourage repeat customer purchases as it has the dual advantage of encouraging repeat sales from existing members as well as attracting new customers when existing members pass on their cash coupons to family and friends. The fair value of such coupons would be deducted from our revenue at the time of the initial sale transaction, and is deferred in payables and recognised as revenue when such coupons are redeemed.

We are also upgrading to a more advanced database platform that will enable us to better manage the data of our customer loyalty programme members. We believe the database will assist us in profiling the purchasing power and product preferences of each individual member. Such profile information would enable our sales team to provide better service. Where we have unique jewellery pieces or special promotions, we will also be able to, subject to compliance with personal data privacy laws, make use of this database to identify members likely to be interested in such products and promotions and conduct personalised marketing.

We expect the number of members in our customer loyalty programme to continue to grow and as we increase our number of POS in the PRC, in particular those specialising in high-end jewellery products, we believe we will attract more high net worth customers.

### ***Our online marketing initiatives***

In recent years, we have increased our online marketing activities by leveraging online social networks such as Weibo (微博) in the PRC and Facebook internationally with a goal of creating interest in our products and attracting end customers to visit our various POS and e-commerce channels. We

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have also created a Chow Tai Fook iPhone application through which customers can download and browse our product offering, latest news and promotions and locate the POS nearest to them.

### ***Our marketing and promotional expenditure***

For FY2009, FY2010, FY2011 and 1HFY2012, our advertising and promotional expenses amounted to HK\$174.8 million, HK\$352.4 million, HK\$400.5 million and HK\$273.3 million, representing approximately 0.9%, 1.5%, 1.1% and 1.1% of our turnover for each of the corresponding years and period, respectively.

### **INVENTORY CONTROL**

Our inventory comprises jewellery components (which includes diamonds, gemstones and precious metals), finished jewellery products and watches. We have in place a comprehensive and robust security system to safeguard our inventory, which include vaults, 24-hour surveillance at our POS, insurance coverage and daily stock count. Further, our vaults have restricted access and only a limited number of senior staff have the keys and passwords to access them.

Each item starting from raw materials is assigned an identification number. This identification number, along with the details of each item, is linked to our IT system and is tracked and monitored throughout the lifespan of the item with us, from inspection, production, delivery to the POS to its final sale to a customer.

### ***Inventory of raw materials that we maintain***

The level of our raw materials that we maintain depends on a number of factors, including our anticipated stock turnover, production leadtime, sales forecast, POS expansion plans and market demand and supply of the raw materials. On average, approximately 66.1% and 30.5% of our raw materials represented gem-set jewellery and gold products, respectively during the Track Record Period. See the section headed “Financial Information — Inventories” for a breakdown of our inventories by categories of raw materials.

### ***Inventory of jewellery products at our warehousing facilities***

Our jewellery products are manufactured in response to market demand and inventory turnover. As a result, we generally do not have a significant amount of slow-moving or obsolete stock. In the event that there is such stock, we are usually able to accelerate their sales through promotional events and other marketing efforts. On average, approximately 50.7%, 11.0%, 27.6% and 10.7% of our finished goods represented gem-set jewellery, platinum/karat gold products, gold products and watches, respectively during the Track Record Period. See the section headed “Financial Information — Inventories” for a breakdown of our inventories by categories of finished goods.

### ***Inventory of jewellery products at our POS***

The inventory levels of our jewellery products at our POS are determined by the sales turnover and anticipated sales trend. Our centralised IT system that is updated with sales information on a real-time basis and accessible by our management enables our management and Sales Management Department to proactively monitor the turnover and inventory at each POS and arrange for the replenishing of inventory accordingly. Inventory at our POS is generally replenished daily to once to twice a month depending on the POS location. During peak seasons such as Christmas, Chinese New Year and Valentine’s Day, we may replenish the inventory of our POS more frequently as needed.

### ***Inventory of watches at our POS***

The level of watch inventory we maintain depends on the minimum stock level stipulated by the watch brand and our anticipated sales forecast.

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### ***Inventory management and provision policy***

We review inventory levels and status regularly through our Inventory Control System (“**ICS**”), which is a group-wide IT platform which records our sales and inventory movement of every POS on a real-time basis. We make provisions for obsolete and slow-moving inventory items when they are identified as no longer suitable for use in production or trading, or when their underlying value significantly deteriorates. Our jewellery products are manufactured in response to market demand and inventory turnover so we generally do not have a significant amount of slow-moving or obsolete stock. In the event that there is slow-moving merchandise, we are usually able to increase their sale through promotional events or other marketing efforts.

### **INFORMATION TECHNOLOGY**

Our Management Information System Department in each of our Hong Kong and Shenzhen head offices manages and supervises our IT system. We have three main IT platforms that support our business operations, namely (i) Raw Materials Control System (“**RCS**”), (ii) Order & Production System (“**OPS2**”) and (iii) ICS. Our IT platforms were developed in-house by our Management Information System Department to suit our requirements and they are continually refined and upgraded to meet our business needs.

Our RCS system allows us to manage our diamonds and gemstones inventory by sorting and grading the different items and raw materials, assigning each item an identification number. Our OPS2 system monitors the whereabouts of each item during the order, manufacture and distribution process. Our ICS system records our sales and inventory movements on a real-time basis as it is linked to every POS.

Our management is able to manage effectively our POS through our ICS system which provides them with the performance of each POS and its inventory status on a real-time basis. The ICS system also enables our management to keep track of the buying patterns and preferences of the customers readily which enables us to respond more swiftly to market demands.

### **CASH FLOW MANAGEMENT**

Sales reports are automatically generated by our IT system on a daily basis, enabling our management to have access to our operations and cash flow situation on a real-time basis. The procurement, production and sales information tracked and monitored by our IT system are provided to our Financial Management Department which is then able to monitor our use of cash and liquidity. Monthly management accounts are provided to our executive Directors and any unusual movements in our cash position are highlighted and reported to the Board of Directors.

In general, cash received by our self-operated POS is deposited into our bank account on a daily basis, with the exception of our Concessionaire Counters as department stores receive payment and transfer our portion to our bank account once to twice a month after we settle our accounts with them.

We receive cash from our franchised POS and effect delivery of products upon our acknowledgement of receipt of their payment.

### **COMPETITION**

The jewellery retail industry in the PRC is highly fragmented with numerous market participants and a high concentration of turnover amongst the largest retailers with the rest occupied by smaller players. In comparison, in Hong Kong and Macau, the top 10 jewellers generated the majority of the sales. In the PRC, there were approximately 12,000 companies in the jewellery retail industry as at 31 December 2010, according to the Frost & Sullivan Report. However, we believe that not all players

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within the jewellery retail industry are considered our core competitors due to differences in target customer base, product profile and consumers' perception of each player's respective brand equity and product quality. According to the Frost & Sullivan Report and considering only jewellery retailers whose turnover exceeded RMB500 million as at December 2010, the top 10 players in the PRC had a combined market share of 57.5% of the total jewellery retail market and, within this segment, we ranked first in the PRC geographic region with a 12.6% market share. As at 31 December 2010, the Hong Kong and Macau geographic regions comprised 325 jewellery retail companies, of which the top 10 players accounted for 51.7% of the total market, according to the Frost & Sullivan Report. In that segmentation, we ranked first in Hong Kong and Macau with a market share of 20.1%, which is more than double of that of the next largest player, according to the Frost & Sullivan Report. We believe that our principal advantages over our competitors are our iconic and trusted brand and our long-standing presence in the Greater China region. Our large retail network among jewellery retailers in the Greater China Region, our broad product portfolio and our commitment to delivering high quality products have helped us to secure a large and loyal customer base. Due to the importance of brand equity and product quality in the PRC, Hong Kong and Macau, we believe our leading presence in all three regions will allow us to remain competitive in the jewellery industry.

We believe there are barriers to enter this industry, which include (i) building and maintaining a strong brand in the industry, (ii) establishing and maintaining strong relationships with customers, (iii) building and operating a meaningful sales and distribution network, (iv) attracting and retaining talented designers and (v) large initial and ongoing capital investment required.

### INTELLECTUAL PROPERTY

As at 30 September 2011, we had three registered trademarks and two domain names which are material to our business. Further details of our intellectual property are set out in the section headed "Appendix V — Statutory and General Information — Intellectual property rights of the Group".

The Directors confirm that there has not been any material infringement of our trademarks or designs as at the Latest Practicable Date. However, if there is any infringement of our trademarks or designs in the future, our image and profitability may be adversely affected and we may take legal action against the third parties in respect of infringement of our intellectual property.

### PROPERTY

As at 30 September 2011, we owned a total of 428 properties in the PRC, Hong Kong and South Africa. Our properties are primarily used for retail, office, industrial and ancillary purposes. The gross area of our self-owned properties ranges from approximately 11 square metres to 930 square metres for retail purposes and approximately 13 square metres to 36,667 square metres for office, industrial and ancillary purposes.

As at 30 September 2011, we leased 294 properties in the PRC, Hong Kong, Macau, Taiwan and South Africa. Our leased properties are primarily used as retail stores, and their gross areas range from approximately 16 square metres to 1,337 square metres for leased retail stores, and approximately 2 square metres to 4,040 square metres for other leased properties. The term of our leases ranges from a minimum of six months to 153 months for retail stores and from a minimum of three months to 60 months for office, industrial and ancillary uses.



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The aggregate rental expenses for FY2009, FY2010, FY2011 and 1HFY2012 were HK\$289.5 million, HK\$371.1 million, HK\$502.4 million and HK\$284.7 million, respectively. The following table sets forth the average monthly rent paid in respect of our leased properties by geographical region and type of properties for the year and period indicated.

### Retail properties

Geographical region	Year ended 31 March						Six months ended 30 September				
	2009		2010		2011		2010		2011		
	Yearly Rental Cost	Monthly Average	Yearly Rental Cost	Monthly Average	Yearly Rental Cost	Monthly Average	Yearly Rental Cost	Monthly Average	Yearly Rental Cost	Monthly Average	
	HK\$million	HK\$million	HK\$million	HK\$million	HK\$million	HK\$million	HK\$million (unaudited)	HK\$million	HK\$million	HK\$million	HK\$million
PRC . . . . .	35.4	3.0	58.3	4.9	95.4	8.0	37.1	6.2	46.5	7.8	
Hong Kong, Macau and other markets . . . .	239.2	19.9	297.5	24.8	384.7	32.1	197.1	32.8	217.3	36.2	
Total . . . . .	274.6	22.9	355.8	29.7	480.1	40.1	234.2	39.0	263.8	44.0	

### Office, industrial and ancillary properties

Geographical region	Year ended 31 March						Six months ended 30 September				
	2009		2010		2011		2010		2011		
	Yearly Rental Cost	Monthly Average	Yearly Rental Cost	Monthly Average	Yearly Rental Cost	Monthly Average	Yearly Rental Cost	Monthly Average	Yearly Rental Cost	Monthly Average	
	HK\$million	HK\$million	HK\$million	HK\$million	HK\$million	HK\$million	HK\$million (unaudited)	HK\$million	HK\$million	HK\$million	HK\$million
PRC . . . . .	2.3	0.2	2.4	0.2	3.5	0.3	1.4	0.2	2.6	0.4	
Hong Kong, Macau and other markets . . . .	12.6	1.0	12.9	1.1	18.8	1.6	6.5	1.1	18.3	3.1	
Total . . . . .	14.9	1.2	15.3	1.3	22.3	1.9	7.9	1.3	20.9	3.5	

As at 30 September 2011, the percentage of our property interests (including land and buildings, furniture, fixtures and equipment and construction in progress, but excluding plant and machinery, leasehold improvements and motor vehicles) (the “**Property Interests**”) represented approximately 3.5% of our total assets.

The Directors confirm that no single Property Interest owned by us is material to our Group’s total assets, and none of our Property Interests is individually material to us in terms of turnover contribution or rental expenses.

Please see the section headed “Appendix V – Statutory and General Information – E. Waivers from Compliance with the Listing Rules and Exemptions from the Companies Ordinance” for details of the waiver from strict compliance with the Listing Rules and the certificate of exemption from the requirements of the Companies Ordinance in relation to the requirement to obtain a property valuation report.

### INSURANCE

We maintain different types of insurance policies to cover our operations, including public liability, business interruption, marine cargo, property all risks, jeweller’s block, directors and officers liability, employee compensation and group life and personal accident insurance. We review our insurance policies from time to time for adequacy in the breadth of coverage.

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The total insurance expenses for each of FY2009, FY2010, FY2011 and 1HFY2012 amounted to approximately HK\$71.1 million, HK\$69.2 million, HK\$82.3 million and HK\$44.7 million, respectively.

### CORPORATE SOCIAL RESPONSIBILITY

We believe our corporate social responsibility efforts reflect our corporate values of “sincerity • eternity”. We believe in giving back to local communities and supporting charitable causes such as the Diamond Empowerment Fund, which aids education initiatives that develops economically disadvantaged people in African nations where diamonds are a natural resource and the China Charity Federation, a PRC nationwide non-governmental charitable organisation, which supports relief efforts in the PRC.

Our subsidiary, CTF Diamond Trading Company Limited, is a member of the Responsible Jewellery Council. The Responsible Jewellery Council is an international not-for profit organisation which advances responsible business practices throughout the diamond and gold jewellery supply chain. As a DTC Sightholder through Zlotowski’s and CTF HK, we are required to comply with DTC’s best practice principles, which cover business responsibilities, social responsibilities, environmental responsibilities and mining standards. We believe we comply with the Kimberley Process Certification Scheme, a process designed to certify the origin of rough diamonds from sources which are free of conflict funded by diamond production and we believe the polished diamonds we procure are cut from rough diamonds which are compliant with the Kimberley Process Certification Scheme.

### EMPLOYEES

As at 30 September 2011, we had a total of 22,357 employees (including staff of joint-venture POS and excluding staff at franchised POS) in the PRC, 2,867 employees in Hong Kong, Macau and Taiwan as well as 350 employees in South Africa. As at 30 September 2011, approximately 80% of our employees at the managerial level has been employed by us for over five years and more than approximately 44% of our staff in general has been employed by us for over three years. The following table sets forth the breakdown of our employees by function as at 30 September 2011:

<u>Function</u>	<u>Number</u>
Sales .....	15,896
R&D and Manufacturing .....	4,050
Procurement <sup>(1)</sup> and Rough Diamonds Cutting & Polishing .....	2,158
General and Administrative .....	3,470
<b>Total</b> .....	<b><u>25,574</u></b>

*Note:*

(1) Includes the procurement of rough and polished diamonds as well as gemstones

We aim to create a strong sense of community and a motivating environment for our employees to enhance employee loyalty and work dedication.

We strive to motivate our employees with a clear career path which provides them with opportunities for upgrading their skills and promotions. Tailored training programmes are provided for our employees. For example, fresh graduates we recruit are provided with management training; sales staff are required to attend training programmes on customer service and our products; our technicians and craftsmen are provided with ongoing technical training to ensure excellence in the quality of our products; and our management personnel are invited to attend management courses to refine their business management skills. In addition, we also recruit technician students from polytechnics and technical institutes in the PRC as apprentices and subsequently employ them as permanent staff if their work performance meets our standards.

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Our compensation structure is designed to incentivise our employees to perform well by linking a portion of their compensation to our performance. The exact portion that is linked to performance would depend on each employee's job function and seniority.

### LEGAL AND REGULATORY

As at the Latest Practicable Date, no member of our Group was engaged in any litigation, claim or arbitration of material importance and no litigation, claim or arbitration of material importance was known to the Directors to be pending or threatened against any member of our Group.

We confirm that, as at the Latest Practicable Date, there were no material breaches or violations of laws or regulations applicable to us that would have a material adverse effect on our business or financial condition taken as a whole. As at the Latest Practicable Date, we had obtained all material licences and permits necessary for our business in the jurisdictions in which we operate.

As most of the Group's operations are in the PRC, laws, rules and regulations of material significance to the Group are those of the PRC. The Company's PRC legal advisers have confirmed to the Company that as at the Latest Practicable Date, there were no material breaches or violations of PRC laws or regulations applicable to the Group that would have a material adverse effect on the Group's business or financial condition taken as a whole. Please refer to the section headed "Risk Factors — Risks Related to Our Business — The Group's past intra-group loan advancing activities may be subject to penalties" for disclosure relating to a non-material breach of PRC regulations. Set out below is a brief overview of the PRC laws, rules and regulations of significance to our business and operations in the PRC:

#### Industrial Policy

On 31 October 2007, the National Development and Reform Commission (the "NDRC") and the Ministry of Commerce (the "MOFCOM") jointly issued the Foreign Industrial Guidance Catalogue (amended in 2007) (the "Catalogue") (外商投資產業指導目錄 (2007年修訂)) which came into effect on 1 December 2007. The Catalogue classifies industries into three categories, which are encouraged, restricted and prohibited. Industries that are not indicated as any of the above categories under the Catalogue are permitted areas for foreign investment. The MOFCOM or its local authorities are responsible for approving foreign investment in China.

#### Foreign Investment in Commercial Sectors

The principal PRC law governing foreign investment in retail enterprises is the Administrative Measures on Foreign Investment in Commercial Sectors (外商投資商業領域管理辦法) (the "Measures") which was promulgated by MOFCOM on 16 April 2004 and came into effect on 1 June 2004, pursuant to which, foreign investors are permitted to engage in the operation of distribution services on a wholly foreign-owned basis from 11 December 2004. Pursuant to the Circular of the MOFCOM on Delegating Matters concerning the Examination and Approval of Foreign Invested Commercial Enterprises (商務部關於下放外商投資商業企業審批事項的通知), which took effect from 12 September 2008, the establishment of commercial enterprises with foreign investment and changes in the relevant registration details as to the established foreign invested commercial enterprises shall be examined and verified by the commercial bureaus at provincial level, except that the MOFCOM shall continue to examine and approve the establishment and changes in the relevant items as to the foreign invested enterprises that engaged in non-store retailing through television, telephone, mail order, internet, vending machines, etc. or which deal with the wholesale of audio-visual products or the sale of books, newspapers and periodicals.

#### Franchise

Franchise activities are subject to the supervision and administration of the MOFCOM and its local counterparts, and are regulated by the Regulations for Administration of Commercial Franchising

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(商業特許經營管理條例) promulgated by the State Council and effective as of 1 May 2007. The Regulations for Administration of Commercial Franchising were later supplemented by the Administrative Measures for Archival Filing of Commercial Franchise (商業特許經營備案管理辦法) and the Administrative Measures for Information Disclosure of Commercial Franchise (商業特許經營信息披露管理辦法), both of which were issued by the MOFCOM and took effect on 1 May 2007.

Under these regulations, franchisors must satisfy certain requirements including, among other things, having mature business models, the capacity to provide operation instruction, technical support and business training to franchisees and ownership of at least two self-operated shops that have been in operation for more than one year in China. Franchisors already engaged in franchising activities before 1 May 2007 are not subject to the requirement of owning at least two self-operated shops in operation for more than one year. Franchise contracts shall include certain required provisions, such as terms, termination and payments. Franchisors are generally required to file franchise contracts with the MOFCOM or its local counterparts. In the first quarter of every year, franchisors are required to report to MOFCOM or its local counterparts any franchising contracts they executed, cancelled, renewed or amended in the previous year. Pursuant to the Administrative Measures for Information Disclosure of Commercial Franchise, franchisors are also required to provide franchisees with basic information in writing and franchise contracts 30 days prior to the execution of such contracts.

### Foreign Exchange Control

The PRC State Council promulgated the PRC Regulation for the Foreign Exchange (the “**Foreign Exchange Regulations**”) (中華人民共和國外匯管理條例) on 29 January 1996, which was then amended on 5 August 2008. On 20 June 1996, the PBOC further promulgated the Regulation on the Foreign Exchange Settlement, Sales and Payment (結匯、售匯及付匯管理規定) (the “**Settlement Regulations**”), which came into effect on 1 July 1996. Pursuant to the Foreign Exchange Regulation and the Settlement Regulation, foreign exchanges required for distribution of profits and payment of dividends may be purchased from designated foreign exchange banks in the PRC upon presentation of a board resolution authorising distribution of profits or payment of dividends. The Settlement Regulations remove the previous restrictions on convertibility of foreign exchange in respect of current account items, including the distribution of dividends, interest and royalty payments, trade and service-related foreign exchange transactions, while foreign exchange transactions in respect of capital account items, such as direct investment, loan, securities investment and repatriation of investment remain subject to the approval of the State Administration of Foreign Exchange.

### Dividend Distribution

The principal regulations governing dividend distribution of foreign invested enterprises include the Company Law of the PRC (中華人民共和國公司法) promulgated in 1993 and amended in 1999, 2004 and 2005, the Foreign Investment Enterprise Law of the PRC (中華人民共和國外資企業法) promulgated in 1986 and amended in 2000, Rules for the Implementation of the Foreign Investment Enterprise Law of the PRC (中華人民共和國外資企業法實施細則) promulgated in 1990 and amended in 2001, the Sino-Foreign Joint Ventures Law of the PRC (中華人民共和國中外合資經營企業法) promulgated in 1979 and amended in 1990 and 2001, and Rules for the Implementation of the Sino-Foreign Joint Ventures Law of the PRC (中華人民共和國中外合資經營企業法實施條例) promulgated in 1983 and amended in 1986, 1987 and 2001.

Under these laws and regulations, foreign invested enterprises in China may pay dividends only out of their accumulated profits, if any, determined in accordance with PRC accounting standards and regulation. In addition, these foreign invested enterprises are required to allocate certain amount of their accumulated profits after tax each year, if any, to fund certain reserve funds.

**Taxation***Enterprise Income Tax*

According to the New Tax Law which came into effect on 1 January 2008, enterprises incorporated in the PRC shall be subject to the rate of 25% on their income from 1 January 2008 onwards. Pursuant to the Circular on Implementing of Transitional Preferential Policies in respect of Enterprise Income Tax (關於實施企業所得稅過渡優惠政策的通知) promulgated by the State Council on 26 December 2007, as of 1 January 2008, enterprises that previously enjoy preferential tax rate in the form of tax deductions and exemptions within specified periods may, after the implementation of the New Tax Law, continue to enjoy the relevant preferential treatments under the preferential measures in the time period prescribed in the former tax law, administrative regulations and relevant documents until the expiration of the said time period. However, if such enterprises have not enjoyed the preferential treatments yet because of their failure to make profits, their preferential time period shall be calculated from 2008.

According to the New Tax Law, income such as dividends and profits distribution sourced within the PRC by a non-resident enterprise which does not have an establishment or place of business in the PRC or, where despite the existence of establishment or place of business in the PRC, the relevant income is not effectively connected with such establishment or place of business in the PRC, is subject to a 10% enterprise income tax, subject to reduction as provided by any applicable tax treaties or arrangements.

On 10 December 2009, the State Administration of Taxation issued the Circular on Strengthening the Administration of Enterprise Income Tax on Income Derived from the Equity Transfer of Non-resident Enterprises (Guo Shui Han (2009) No.698) (關於加強非居民企業股權轉讓所得企業所得稅管理的通知) (the “**Circular**”), which was made retrospectively effective from 1 January 2008. Pursuant to the Circular, where a non-PRC investor (the actual controlling party) indirectly transfers the equity interests of a PRC resident enterprise through disposing of its equity interests (the “**Indirect Transfer**”) in a non-PRC holding company, and such non-PRC holding company is located in a tax jurisdiction that: (i) has an effective tax rate less than 12.5% or (ii) does not tax foreign income of its residents, the non-PRC investor shall report the Indirect Transfer to the competent tax authority of the PRC resident enterprise. Using a “substance over form” principle, the PRC tax authority may disregard the existence of the non-PRC holding company if it lacks a reasonable commercial purpose and is established for the purpose of avoiding PRC tax. The Circular also provides that, where a non-PRC resident enterprise transfers its equity interests in a PRC resident enterprise to its related parties at a price lower than the fair market value, the relevant tax authority has the power to make a reasonable adjustment to the taxable income of the transaction.

*Value-added Tax*

The Provisional Regulations of the PRC on Value-added Tax (中華人民共和國增值稅暫行條例) (the “**Provisional VAT Regulations**”) was promulgated on 13 December 1993 and came into effect on 1 January 1994 and were amended on 10 November 2008. The Detailed Rules for the Implementation of the Provisional Regulations of the PRC on Value-added Tax (中華人民共和國增值稅暫行條例實施細則) (the “**Provisional VAT Implementation Rules**”) were promulgated on 25 December 1993 and were amended and came into effect on 1 January 2009, and were further amended on 28 October 2011. According to the Provisional VAT Regulations and the Provisional VAT Implementation Rules, all enterprises and individuals engaged in the sale of goods, the provision of processing, repair and replacement services, and the importation of goods within the territory of the PRC must pay value-added tax. For taxpayers selling or importing goods other than those specifically listed in the Provisional VAT Regulations, or for taxpayers providing processing, repairs and replacement services, the value-added tax rate is 17%.

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## BUSINESS

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### *Business Tax*

Pursuant to the Provisional Regulations of the PRC on Business Tax (中華人民共和國營業稅暫行條例) effective from 1 January 1994 (amended on 10 November 2008) and its implementation rules, all institutions and individuals providing taxable services, transferring intangible assets or selling real estate within the PRC must pay business tax. The items and rates of business tax shall be implemented in accordance with the List of Items and Rates of Business Tax attached to the regulation.

### **Environmental Protection**

We are subject to a variety of PRC environmental protection laws and regulations, among which, major environmental regulations applicable to us including the Environmental Protection Law of the PRC (中華人民共和國環境保護法), Law of the PRC on Prevention and Control of Environmental Noise Pollution (中華人民共和國環境噪聲污染防治法), Law of the PRC on Prevention and Control of Water Pollution (中華人民共和國水污染防治法), Law of the PRC on Prevention and Control of Air Pollution (中華人民共和國大氣污染防治法), Law of the PRC on Prevention and Control of Solid Waste Pollution (中華人民共和國固體廢物污染環境防治法), Law of the PRC on Environmental Impact Assessment (中華人民共和國環境影響評價法) and Law of the PRC on Promoting Clean Production (中華人民共和國清潔生產促進法).

In accordance with the abovementioned laws and regulations, a manufacturing enterprise shall adopt measures to control environmental pollution and harm resulting from waste gas, waste water, solid waste materials, noise and vibration at the manufacturing site. The Ministry of Environmental Protection of the PRC and its local counterparty are responsible for the supervision and administration of environmental protection during the course of manufacturing.

### **Social Insurance**

On 28 October 2010, the Standing Committee of the National People's Congress of the PRC promulgated the Law on Social Insurance of the PRC (中華人民共和國社會保險法), effective as of 1 July 2011. Under this law, the State shall establish basic pension insurance, basic medical insurance, occupational injury insurance, unemployment insurance, maternity insurance and other social insurance system to maintain citizens' right to receive material assistance from the state and society in the case of seniority, illness, occupational injury, unemployment, maternity or other circumstances. According to the Law of Social Insurance of the PRC, employers and employees shall pay social insurance contributions in accordance with the law, and be entitled to enquire about records of payment and individual interests and require social insurance agencies to provide advice or other services relating to social insurance, and employees shall be entitled to enjoy social insurance benefits and supervise contribution payment by their employers in accordance with the law.