

## CHAIRMAN'S STATEMENT

I am pleased to present my review of the results and operations of the Herald Group (the "Group") for the year ended 31 March 2001.

### RESULTS

The Group's turnover ("Turnover") and profit attributable to shareholders ("Net Profit") for the year ended 31 March 2001 amounted to HK\$954 million and HK\$8.7 million respectively. As compared to last year, the Turnover increased marginally by 0.7% while the Net Profit decreased by 78%. The earnings per share for the year decreased by 77% to 1.39 cents from last year's 6.10 cents.

During the year under review, the Group faced very tough market conditions. Though the Group was able to maintain the Turnover at a similar level to last year, the gross profit percentage declined by 5.6 percentage points to 22.5% from last year's 28.1%. The drop in gross profit margin was the primary factor contributing to the decrease in the Net Profit. Other than the timepiece division which made a loss of approximately HK\$2 million, the toy division, the computer head division and the houseware division were all profitable in the year under review.

### REVIEW OF OPERATIONS

#### TOYS

In the first half of the financial year, the toy division's performance was affected by the world-wide shortage of electronic components. The unstable situation improved in the second half and the division finished the year with a 15% increase in turnover. Without any particularly hot items, the division produced a much wider range of toys resulting in higher costs of production and lower gross margins. To cope with the shifting marketing trend for more sophisticated and high-tech toys, the division has improved its production abilities for toys which require more advanced high speed equipment using Surface-Mount Technology.

#### COMPUTER HEADS

Due to high costs associated with the development of the new half-inch high-capacity ferrite tape heads, the computer head division did not perform well in the first half of the year under review. In early 2001, the division's concerted efforts significantly improved the production yield of these heads which was the main factor that enabled the division to recover the losses made in the first half. Throughout the year, the demand for half-inch thin film heads remained stable. As in the case of ferrite heads, the division has started to build the Head Frame Assemblies for the thin film heads which would result in more added value and increased revenues.

#### HOUSEWARE

The results of the houseware division were adversely affected by the weak sterling as the UK market accounts for approximately 50% of the total turnover of the division. Following a very strong growth in turnover in the previous fiscal year, Pilot, the UK operation of the division posted a further 8% growth in turnover in local currency. This year the growth was primarily due to the successful launch of a new range of stainless steel cookware sourced from third-party manufacturers. Due to the strong competition from other aluminum cookware suppliers in the PRC and South Korea, the division saw a rapid decline in its sales to the USA and Japan. Despite the difficult market conditions, the division had a satisfactory performance and contributed positively to the Group's profit in the year under review.

## CHAIRMAN'S STATEMENT

### TIMEPIECES

The turnover of the timepiece division for the year under review decreased by 24% over the same period last year. The decrease was partly due to a significant slowdown in the level of sales to Zeon Limited's major mail order customers in the UK, who have themselves experienced falls in trade. In addition, a lower conversion exchange rate being used when the sales of Zeon were consolidated in the Group's turnover was also a factor accounting for the decrease. On the other hand, sales in France and Germany performed very well due to "Pokemon" timepiece products. However, these increases could not make up the shortfall in the UK.

### INVESTMENT

In early 2000 the Group invested US\$1 million in a new company which specializes in e-commerce security solutions. However, the overall sentiment of the new economy venture capital investment market has deteriorated rapidly. It is now extremely difficult for this company to raise new funds to enable the company to launch its products into the market. In view of the uncertainty of the future of this company, the Group made a full provision against this investment.

### FINANCIAL POSITION

The Group has maintained its sound financial position. At the end of the financial year, the Group had a strong balance sheet with a healthy liquidity position. As at 31 March 2001, the Group had total assets of HK\$601 million (2000: HK\$641 million) which were financed by current liabilities of HK\$114 million (2000: HK\$149 million), non-current liabilities of HK\$29 million (2000: HK\$28 million) and shareholders' equity of HK\$458 million (2000: HK\$464 million).

At 31 March 2001 the Group's cash balances aggregated to HK\$91 million representing a decrease of HK\$69 million over the comparable figure in last year's balance sheet. The decrease in the Group's cash balances was partly due to higher inventories and trade receivables and partly due to payments of dividends to shareholders.

As in the previous year, the Group's borrowings were maintained at a low level of HK\$1 million (2000: HK\$6 million). None of the Group's assets are charged to secure the Group's banking facilities. Furthermore, the Group has no long-term borrowings. The Group's gearing ratio, which is calculated based on the Group's total borrowings and the shareholders' equity, was 0.003 (2000: 0.01). As at 31 March 2001, the working capital ratio, an indicator of a company's liquidity represented by a ratio between the current assets over the current liabilities, was 3.14 compared to 2.57 last year. The quick ratio, another ratio that gauges the short-term liquidity of a company measured by trade debtors and cash at bank and in hand over the current liabilities, decreases slightly to 1.52 from 1.59.

### CONTINGENT LIABILITIES

As at 31 March 2001 the Group did not have significant contingent liabilities.

### PROSPECTS AND GENERAL OUTLOOK

In January this year, the Directors were more optimistic about the overall prospects for the business in the following financial year. The prospects for both the toy division and the computer head division looked quite promising. However, we have seen a very rapid deterioration in the overall market sentiment largely due to a more obvious and severe slowdown of the U.S. economy.

## **CHAIRMAN'S STATEMENT**

The overall toy industry in 2001 is very difficult. Following disappointing results in 2000, the major toy companies in the USA continued reporting losses in the first quarter of 2001. Facing an increasingly severe competitive environment, the toy division has substantially reduced its profit margins to secure more business. It is anticipated that such an aggressive approach will enable the division to maintain at least a similar level of sales in the new fiscal year as in the previous year.

As the UK is an important market for both the houseware division and the timepiece division, the weak sterling will continue to be a negative factor affecting both divisions. The houseware division continues its efforts on the new stainless steel and anodized product lines to offset the adverse impact from the weaker currency. Both divisions have recently streamlined their operations to reduce administrative expenses.

The computer head division also sees a rapid and unfavorable change in its market condition. The division's products are mostly for the high-end backup storage systems which are particularly more sensitive to the slowdown of the overall information technology spending. Buyers' decisions for these backup systems may either be put off or delayed. To cope with the adverse situation, the division downsized its work force in June 2001.

Despite the adverse economic environment and market condition, the management has confidence that with all the various steps that have been taken, the Group shall weather the economic downturn.

### **DIVIDENDS**

The Directors will not recommend any final dividend at the forthcoming Annual General Meeting to be held on 18 September 2001. As the Company has paid an interim dividend of HK1 cent per share, the total dividend for the year under review is HK1 cent per share too.

### **APPRECIATION**

On behalf of the board of directors and shareholders, I should like to extend my sincere thanks to all the Group's employees for their efforts and hard work under difficult market conditions.

**George Bloch**

*Chairman*

Hong Kong, 16 July 2001