

Chairman's Letter

Dear fellow shareholders,

It gives me great pleasure to present our 2002 annual results.

Last year we had greater difficulties than 2001. However, it was also a year when our previous work sheltered us from the adverse impact of the market place and enabled us to remain viable for the future.

The beginning of 2002 saw a continuous decline in the economic and the retail environment. The prolonged hardships experienced in Hong Kong precipitated in a vicious circle that resulted in increasingly cautious consumer spending.

Deflation created increasing pricing pressure that in turn precipitated progressively more difficult retail environment. Hong Kong's economy was more depressed than anytime in recent years. The unemployment rate as well as the number of personal bankruptcies reached its historic high to 7.2% and 6,973 in the fourth quarter of 2002.

Economic figures released by the Government's Census and Statistics Department indicated that the total retail sales in December 2002 dropped by 1.9% in value and 0.7% in volume when compared with December 2001. The figures of furniture and fixture sector were even worse, 13.4% and 10.5% drop in value and volume respectively were found. Weak property market persists, number of first hand and second hand residential transactions dropped by 3.8% in value and 3.0% in volume in 2002 when compared with the prior year. The Composite Consumer Price Index for December 2002 declined by 1.5% when compared with December 2001.

Needless to say, all our businesses suffered as a consequence. However, despite the difficulties, we are happy to report that by the end of the year, all the necessary steps have been taken to minimize our cost base and at the same time, all the necessary reforms and restructuring were completed to safeguard our future.

FINANCIAL SERVICES – CFSG GROUP

During the first quarter of 2002 the global economy showed a brief recovery, but investment appetite continued to be weak as fallouts such as the Enron debacle and poor corporate results from last year's recession continued to undermine investors' confidence. Locally, the poor market environment in 2001 led to the consolidation of pure Internet securities brokerages beginning the first quarter of 2002.

In 2002, CFSG continued its efforts to secure the position as a multiple financial services provider and investment services house of choice. We extended our core brokerage capabilities and offerings as well as further diversified our financial services offerings.

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CFSG commenced the integration of our online and offline retail presence and extended our service coverage for our electronic trading clients by rolling out electronic trading stations into our entire traditional branch network. Simultaneously, we finalised our corporate restructuring and rationalisation effort by closing our two cyber café demonstration outlets to reduce overlap in our geographic network coverage.

The local stock market staged a brief rebound at the beginning of 2002, stimulated in part by a price surge in technology-related shares in US. However, by the second quarter, market sentiments were weighed down by concern over rising unemployment and an uncertain business outlook. Consumer spending remained subdued, amidst record high unemployment rate and wage restraint. Investment sentiments, with concerns about job security, income uncertainty and protracted weakness in the asset markets, continued to be subdued. The global and regional economic environment also remained severe and indeterminate during the first half of 2002.

With China's accession into WTO, we focused significant efforts during the year to develop our expertise and business reach within the Mainland. Our Mainland reach together with the teams under development in our Shanghai liaison office will spearhead our Mainland business strategy.

The austere global and regional economic environment and local market uncertainties continued unabated throughout the second half of 2002.

As the weak investment sentiments prolonged, the Group faced difficult market conditions throughout the year. The subsequent weak consumer sentiments were further aggravated by the persistent sluggish property market and stock market. As a result, out of prudence, we made a provision for doubtful receivables from our accounts receivables amounting to HK\$95.7 million.

Serving clients with new products

In January 2002, the Group successfully developed the requisite systems and gained approval from The Stock Exchange of Hong Kong Limited ("Stock Exchange") to act as a market maker for warrants trading. As a result, we became a designated market maker for premier partners such as KBC. By forming the partnership with these warrant specialists, we actively participated in the market of this new Stock Exchange product with great success.

We continued to develop our international trading hub through link-ups with regional and international brokerage partners. We further broadened the market coverage for securities trading services to stocks listed in Taiwan, Korea, Singapore and London, albeit only via traditional channels initially, upgrading the futures and options trading platform to extend trading services of futures and options products in eight overseas markets.

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Through the new partnerships, we offered fixed-income trading services that cover a wide range of bonds including US government treasury bonds, perpetual corporate bonds, and Hong Kong and US corporate bonds. Complemented by the link-ups to the market information of bond trading with the CASH on-line website, our investors were able to capture concrete and timely information through our platform.

The launch of our international commodities electronic trading platform in the third quarter represented a further step towards our Group's development to become an international trading hub through link-ups with regional and international brokerage partners.

We were the first to provide an electronic channel for international commodities trading in Hong Kong. The development of the platform is consistent with our aim to become the financial services house of choice for our clients. We extend our capabilities of technological advancement on financial services by providing our investors with a more convenient and flexible way of trading, and a comprehensive range of financial products and services, to fit their investment and wealth management needs.

Our new trading platform enables investors to trade existing futures and options products provided by the Hong Kong exchanges, as well as facilitates commodities trading services covering futures and options products of 12 overseas markets, including US, Germany, UK, France, Singapore, Korea and Australia, etc.

New face

To pave way for the increasing role Mainland investors would play in the Hong Kong market, the Group revamped the CASH on-line website that was completed in May 2002. Through the revamp of the website, we developed a simplified Chinese version of *www.cashon-line.com* and our electronic trading platform.

APICTA: the fruit of our endeavours

In September, we were awarded the prestigious Asia Pacific ICT Awards ("APICTA") under the e-commerce category for our electronic trading platform. The award was bestowed upon us after thorough review on entries from all over the Asia Pacific region. As our electronic trading platform is one of the vital elements supporting our business success and service offering, the receipt of the award further acknowledged the standards of our electronic trading platform and hence our quality of service.

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Cost control measures

We have maintained over the past two years the importance of preserving our financial strength in light of the challenging global and local economic environment. Our focus has been consistently on maintaining cost leadership and our capital strength. Due to the poor market environment, we during the year had to conduct further rounds of rationalisation in our staffing amounting to around 32% of our total headcount of the prior year. The rationalisation that took place was unfortunate but necessary for the Group to weather the prevalent market conditions and forthcoming challenges.

It is again the very same principle of capital strength preservation that we opted to refrain from renewing the lease for some of our branches. Under such difficult market conditions, we see little possibility for such branches to achieve profitability.

We will continue to review closely the market developments and continue our policy and dedication to be a secure and credible financial institution for our clients to entrust with their investment needs and our partners to work with.

HOME IMPROVEMENT – PRICERITE

In terms of our product mix, furniture and household products accounted for HK\$335.1 million or 37.7% and HK\$554.8 million or 62.3% respectively of our total sales of HK\$889.9 million for the year under review. The five largest product categories by sales value for our household products were (1) Ready to Assembled Furniture, (2) Small Electrical Appliances, (3) Bathroom, Laundry and Cleaning, (4) DIY Products, and (5) Home Fashion. According to a recent market survey conducted by ACNielsen, our (1) Sofas, (2) Dining Tables or Chairs, (3) Guest Room Cabinets, (4) Tools, (5) Racks, (6) Movable Storage Accessories, and (7) Washroom Products enjoyed leading market share in terms of value in Hong Kong. In particular, our market share in Movable Storage Accessories is over 40%, which is almost 3 times of the follower in the 2nd rank.

During the year under review, we opened 5 new retail outlets in strategic locations at Metro Plaza, Carnarvon Plaza, Olympian City, Sau Mau Ping and Yau Oi. We conducted in-depth research to confirm high customer traffic. Our network was covered by a total of 48 outlets in Hong Kong at year end. We also opened our first retail outlet in Guangzhou in September, marking our first venture outside of the Hong Kong territory.

We continued to develop and operate our business according to the five key weapons for the retail world: brand power, product mix, logistic strength, customer service and shopping environment.

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Mapping our strategy

To cope with the increasingly challenging environment, we continued to engage independent market research agencies to conduct market studies to enhance our appreciation of changing customer needs and expectations in order to review and refine our market positioning and strategy. Ongoing "Mystery Shopper" Surveys at our stores conducted by these agencies helped us monitor and gauge customers' shopping experience and our customer service.

Strengthening our brand power

Despite concerns with the state of our economy, consumers continued to raise their expectations and their standard of living. During 2002, we focused on repositioning Pricerite's brand positioning among value-seeking consumers.

Pricerite is one of the most well-known and leading retailer chain stores in areas of home furnishings and household products in Hong Kong. During the year, we continued our efforts to build Pricerite into the most preferred brand in the furnishing and household categories in the Greater China Region.

In order to safeguard our operating margins and to maintain our pursuit of brand leadership, we invested substantial efforts and resources to realign Pricerite from its previous "price-driven" positioning into a "value-driven" brand.

To overcome the difficulties imposed by the harsh business environment, we further integrated our brand building efforts with enhancements in our shopping environments and our merchandise.

Enriching our product mix

During the year, we continued to build our ability to deliver value, quality and lifestyle solutions to our customers. We formed a new dedicated Product Planning Team. Staffed by well experienced and qualified professionals, this team began our drive to enhance our merchandise through strategic product sourcing.

We continued to increase our level of global direct sourcing to further reduce our middleman's cost in the supply chain.

We launched a product mix improvement programme together with new store categorisation for our Furniture Department. Our broader furniture range can now be clearly demarcated for those consumers seeking modern and contemporary design or the more traditional designs.

We further enhanced our house-brand items that enjoyed tremendous consumer goodwill. We increased the breadth of the range as well as redesigned the packaging to better leverage on our increasing brand value.

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We continued to expand our product ranges to seek out vacant niches and to fulfil customers' needs. In the household product category, we introduced the SOHO series (Small Office, Home Office) of stylish products to tap the increasing trend for small and medium sized enterprises and home offices. Along with the overall revamping of our furniture range, we further introduced our Kids series of children furniture.

Building our logistic strength

We maintained our logistic enhancement programme during the year with improvements in our electronic stock replenishment system maintaining supplier fulfilment rate maintained at a high level of 95.0%, an improvement of 0.8% over the previous year.

We further introduced morning fills to complement existing night fills to ensure that our network was well stocked. We also reviewed our partnership with our logistic distribution agency and a new agreement was signed to further enhance distribution efficiency and cost control.

Enhancing our customer service

To improve customer service and to enhance our team spirit, a leading training consultancy firm was invited to conduct a tailor made "Service with Hearts" company-wide training programme. A total of 600 frontline staff attended with additional "Train-the-Trainers" Workshop conducted to improve training skill of our supervisory staff.

A further Top Management Alignment Workshop was conducted for our executive team to ensure that our management team share the mission of the Group. An additional Winning Team Seminar was delivered to our back-office staff to enhance team spirit.

To supplement the training from the professional consultancy, our in-house training team conducted further hard skills workshops to our frontline staff during the year including: professional service standards, complaints and rejections handling, professional selling and social style selling. All workshops were reinforced with additional field coaching in stores.

To encourage our staff to further enhance our customer service, a series of incentive and goal setting programmes were organised. These included the outstanding store of the month and customer service goal for the month. External and internal mystery shoppers were arranged to give rating. A further best service staff award was launched to provide recognition and encouragement to outstanding service frontline staff.

In addition, we increased our frontline staff positions to include trained product demonstrators to enhance DIY product knowledge of customers.

We also created Customer Service Centre to provide priority handling and follow up on customer requests and feedbacks.

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We completed our specification and planning for our CRM programme to increase customer loyalty. We aim to launch the programme in 2003.

A review and planning for a major site enhancement for our e-shop was completed. The enhanced site will be launched during the first quarter of 2003. We planned to introduce our CRM programme via our e-shop ahead of our offline retailing operation. This CRM programme will be introduced at store level soon after we have gathered consumer feedbacks and systems fine-tuning.

We have also extended our customer base to corporate clientele to leverage on our merchandising ability and our buying power. A dedicated team of senior staff was put in charge of the development of this B2B programme.

Improving our shopping environment

During 2002, our Visual Merchandising Team continued to upgrade our store environment. Room setting was introduced to display our furniture products to provide additional ideas and inspirations to customers. We began our development of a model shop to provide a standardisation platform for product displays for our network.

Our new store design concept was implemented in our 5 new stores. Feedback on the contemporary design with the use of plasma, digital display pillar, special lighting and colour-mix were encouraging.

Pricerite China

We opened our first store in the Mainland with the opening of our Guangzhou store in September 2002. With the different consumer demographics, we utilised this opportunity to enlarge our overall product mix. To better position ourselves for the broad demographic profiles and significantly different consumer requirements, a new Chinese brand name was created together with new store layout and designs developed specifically for the Mainland market.

TECHNOLOGY SOLUTIONS – HALO GROUP

The lack of development funds in the market resulted in us taking a cautious view for the Halo Group. During the year, we pursued three major business streams: web services, bespoke solutions development and IT solutions consultancy. Our web services remain the most successful, and were able to retain blue chip corporate clients for development work on their websites.

OPTICAL FIBRE MANUFACTURING – TRANSTECH GROUP

Our development work for the Transtech Group was completed on schedule and within budget. By mid-year, we were able to successfully produce the preform production as well as the fibre drawing technology we set out to develop and were able to produce preform utilising MCVD technology as well as the single mode optical fibres (G652).

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However, due to the global telecommunications industry shakeout, established manufacturers initiated dumping strategies to stay afloat. Single mode optical fibre prices declined from the historic high in 2001 of over US\$40 per km to around US\$10 which would be below our operating cost. At this level of pricing, the Transtech operation would draw much capital to fund its operation and would have become a major cash drain on our Group's financial position.

Thus, after serious deliberations, the Board decided to put our manufacturing operation into hiatus, until such date that the supply and demand in the global market place normalise. We stress that we remain committed to our optical fibre investment. This is merely a prudent and necessary slowdown in the development timeline of Transtech.

THE FUTURE

We are currently weathering a global recession. It is imprudent for any of our Directors to assume speedy recovery in any particular sectors.

For CFSG, with Hong Kong being an international financial centre, is suffering from a similar crisis of confidence as in markets elsewhere. In particular, with our close link to the US market, we are certain that the financial services industry here will be hard hit. We do not anticipate any significant improvement in our business environment in the foreseeable future. As such, we hold little expectation, if any, for improvements in our revenue picture for the first half of 2003.

Nonetheless, we remain positive over the longer term, and are confident that the rationalisation being or already put in place, would lay us on a cost and resource base that will enable us to ride out the current market doldrums.

As the landscape of the securities industry alters, catalysed by recent regulatory and market changes, apart from maintaining a highly robust and cost-effective operational structure, it is also important that we seek to revamp our business model so as to achieve the agility that is essential for business to prevail in the currently austere market environment. As such, among other rationalisation moves, we have begun to significantly consolidate our branch network, which we believe would be of diminishing value in terms of revenue generation going forward. In fact, we believe that a compact network would put us in a much better position to focus our resources to service our most valued high net worth clients with personalised professional service, improving incoming generation efficiency.

While we seek to become leaner, we will also continue with our strategy of diversifying revenue sources to reduce our reliance on the securities business income stream. Since embarking on the strategy a few years back, we have now achieved a core revenue mix that encompasses, on top of securities broking, commodities broking and investment banking related incomes. As the latter two revenues become increasingly significant, moderating the impact on our business from the currently sluggish market turnover in securities trading, we are continuing to broaden our core competence within the financial services domain with a view to add on to our revenue mix incomes of a higher profit margin and of a more "anti-cyclical" nature.

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For Pricerite, the future will be a challenge for delivering and retaining value as price becomes the key denominator in the retail formula. We will continue to increase our competitiveness in the challenging market place through improvements in our five key weapons.

We will review network strategy with greater considerations on demographic, household income, rental trend, customer traffic and store distribution factors. We aim to consolidate our network to bring greater focus on enhancement of store efficiency and sales per footage.

We will continue to upgrade our store environment and shopping experience through improving product signage, POP, merchandise display, display equipment and re-design of store layout. We plan to renovate selected major stores to provide more enjoyable store environment to customers. We may consider closing some of the stores with less traffic or overlapped location coverage and aim to roll out our new brand image implemented in 2002 in our new store across the entire network during the course of 2003 and onwards.

Pricerite China will be a main focus for development as it remains the principle area with potential for significant growth. Moving forward, Pricerite will focus on testing out new ideas as well as fine tuning its retail model be it the merchandise, promotion strategies as well as shopping environment. Its intention is to arrive at an appropriate model using its Guangzhou store during next year before rolling out to other major centres.

For Halo and Transtech, while the business sectors will remain difficult, we are confident that the operation now as at a level where we will not be suffering from any significant cash drain. We will continue to monitor market demands closely and will leverage on the existing infrastructure to move forward rapidly when demand returns.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Bankee P Kwan', followed by a comma.

Bankee P Kwan

Chairman & CEO