Management Discussion & Analysis

FINANCIAL HIGHLIGHTS

During the year ended 30th September, 2003, the Group recorded a turnover of approximately HK$2,678 million (2002: HK$5,196 million) and incurred a net loss of approximately HK$115 million (2002: HK$234 million). The Group's overall gross margin had dropped to approximately 4% in 2003 from that of 7% in 2002. The Group's loss per share for the year was HK$0.022 (2002: HK$0.047).

HONG KONG AND MACAU

With Hong Kong remaining predominantly as a replacement market, the Group continued to focus its efforts on strengthening its relationships amongst major network operators, dealers and retail chain stores in Hong Kong.

As the economic and business environment in Hong Kong continued to stay stagnant in 2003, the mobile handsets business in this market has become more challenging than ever. Fierce competitions, brought about by the increasing number of handsets manufacturers and the simultaneous releases of competing new models by different suppliers, had caused rapid drops in handsets prices. The SARS outbreak in the first half of 2003 had severely damaged the consumption sentiment of an already sluggish market, driving sales volume and prices to drop further during the year.

As a result of the above unfavourable factors, the Group's turnover for this region had dropped to approximately HK$1,789 million for the year ended 30th September, 2003 (2002: HK$3,413 million).

TAIWAN

In 2003, one of our suppliers began to expand their presence in Taiwan. To align with this strategic move, the Group had also acted to modify its operations and investment activities accordingly for better overall business coordination. As a result of the above efforts, the Group's sales for Taiwan reached approximately HK$735 million for the year ended 30th September, 2003.

However, Taiwan's mobile handsets business is also similar to Hong Kong, very intense and well-developed. Its only growth is mainly driven by replacement demand. The Group hopes that through strengthening and developing its relationships with the local retail network, as well as working closely with local operators on product's promotions and marketing activities, it will achieve more decent results in the future.

Despite the increase in turnover, the Group regards this market as being on par with the rest of the Greater China region, where highly intensified competitions prevail. As a result, we had made a stock provision of approximately HK$12 million to provide for its slow moving items and reflect the net realisable value of its inventories in this region as at 30th September, 2003. The Group will continue to take a very cautious approach to explore future opportunities in this market.

MAINLAND CHINA

The mobile handsets market in Mainland China continued to expand during the year. However, competitions in this region also increased significantly as we had forecasted last year. Domestic suppliers continued to emerge as a result of high market acceptance of local handset brands in China. At the same time, the number of local distributors also rose. These increases in competition, together with the growth of mobile subscriber base in China showing signs of slowing down during the first half of 2003, had severely reduced the margins of the mobile handsets industry. The SARS outbreak in Mainland China in early 2003 had also worsen the situation, creating an overstocking problem in the PRC market. As suppliers are keen to clear their inventories following the stabilisation of the SARS in the third quarter, adverse pricing pressure on mobile handsets is likely to remain strong. It is the Group's view that profit margin erosions will persist in this region within the foreseeable future.

In consideration of the intensifying margin threat, the prevailing potential inventory risks, and our objective to preserve profit margins over market share growth, the Group has been adopting a cautious approach towards the China market since the second half of the year. As a result, the Group's turnover for the Mainland China region has dropped significantly for the year ended 30th September, 2003. In light of the overstocking situation and as a measure of prudence, the Group had also made a stock provision of approximately HK$11 million for its slow moving items during the year.

SALES MIX AND PROFIT MARGINS

The Group's turnover for the year ended 30th September, 2003 amounted to HK$2,678 million (2002: HK$5,196 million), with overall margin declining to 4% (2002: 7%). In 2003, the Group reduced its PRC trading activities in light of the cut-throat margin squeeze. It had also made a total stock provision of approximately HK$23 million (2002: HK$257 million) across the whole Greater China region in view of the intensifying competitions region-wide and the overstocking problem in PRC. These events, together with the generally unfavourable economic conditions and the disastrous effect of the SARS on the region, had contributed directly to the Group's declining sales and margins for this year.

During the year, our main supplier had introduced a series of new mobile handsets models in the region. These new models have received good market response. However, due to unforeseen product testing delays of our suppliers caused by the SARS, some of our launching schedules were unexpectedly postponed. These delays had significantly weakened the Group's advantage in an increasingly competitive market with many rival brands and models. The prevailing weak consumption sentiment in the market during the year had also imposed considerable pressures on the Group's pricing strategies. These constraints have jointly undermined the Group's opportunities to maximise its margins otherwise attainable from these new innovative product launches.

RETAIL OPERATIONS

The retail business of the Group recorded a turnover of approximately HK$58 million (2002: HK$67 million). This drop was mainly due to the SARS outbreak, which had further reduced the consumption power in an already depressed retail market. Subsequent to the ending of the SARS crisis and the recent launch of the "individual visit" scheme for Mainland China visitors to Hong Kong, the retail market began to show slight signs of recovery in late third quarter. With a lengthy recovery process at sight, the Group will continue to act vigilantly and endeavour to bring better retail performance for the coming years.

LIQUIDITY, WORKING CAPITAL AND FINANCIAL RESOURCES

Despite the tough business environment, the Group's financial position continued to remain sound. As at 30th September, 2003, its current ratio rose to 4.03 (2002: 1.64), while its liquid ratio increased to 3.42 (2002: 1.36). These improvements were mainly due to the significant drop in the Group's current liabilities in term loans and bills payables.

As a result of the Group's tightened credit policy, its trade receivables also fell correspondingly. As at 30th September, 2003, the accounts receivables of the Group decreased from HK$675 million to HK$419 million, including a provision for doubtful debts of approximately HK$114 million made during the year with reference to the Group's internal policy and the prevailing economic conditions.

In 2003, the Group continued its efforts to strengthen its receivable profile through adopting more vigourous credit control and receivable management procedures in view of the competitive and adverse market environment. We will continue to review and enhance these measures for further improvements.

The inventory level as at 30th September, 2003 was HK$138 million (2002: HK$408 million). This decrease was mainly due to the Group's high commitment towards its tightened inventory policy. As a prudent measure, a stock provision of approximately HK$23 million was made for the Group's slow moving items and net realisable values of its inventories remaining on hand as at 30th September, 2003.

In 2003, the Group sold its investments of HK$262 million in certificates of deposits and principal guarantee securities. These investments, previously pledged with banks for the Group's facilities, were subsequently released during the year.

As at 30th September, 2003, the Group's banking facilities decreased to approximately HK$181 million (2002: HK$1,366 million), of which approximately HK$26 million (2002: HK$1,350 million) have been utilised. As a result of this reduction, certain conditions and charges previously required for granting bank facilities were released accordingly.

In February 2003, the Company offered to accelerate the repayment of its transferable term loan of approximately HK$281 million obtained from certain banks (the "Banks") in 2001. The Banks accepted the early repayment proposal and the entire outstanding balance of the loan was fully settled by 30th June, 2003. This contributed directly to the fall in the Group's gearing ratio (total borrowings over total assets) to 0.4% from that of 9.6% as at 30th September, 2002.

As at 30th September, 2003, the Group's total cash on hand was approximately HK$192 million (2002: HK$1,070 million). The cash shortfall was mainly attributed to the Group's accelerated repayment of its 2001 term loan and its lesser utilisation of short-term banking facilities. The Group will continue to tailor its business, financing and operating strategies in line with the changing business environment to maximise its profit margins, improve working capital efficiency and sustain a healthy liquidity position.

CURRENCY EXPOSURE

The Group conducts its core business transactions mainly in Hong Kong and US dollar currencies. Majority of its cash and bank balances are in either Hong Kong or US dollar currencies, hence the Hong Kong dollar peg presents a natural hedge against currency fluctuations under normal trading circumstances.

STRATEGIC INVESTMENTS

On 6th January, 2003, resolutions were passed in an Extraordinary General Meeting of Sino Media Group (SMG) Limited ("SMG") and a Directors' Meeting of Chinese Infobank Company Limited ("CIC") to voluntarily wind up these two subsidiaries of the Company. Pursuant to these resolutions, SMG began its statutory liquidation procedures by creditors-appointed liquidators on 28th June, 2003. CIC also began its liquidation proceedings by court-appointed liquidators on 3rd November, 2003.

PROSPECTS AND STRATEGIC OUTLOOK

Faced with the adverse conditions imposed by the persistent economic downturn, intensifying mobile handsets market and the aftermath of the SARS crisis, the Group will be taking a cautious approach in formulating future strategies for its business. It will continue to work closely with its suppliers and business partners on effective pricing, marketing and promotion strategies to deter further margin drops. It will also continue to refine and strengthen its financing and cost control measures to maintain its competitiveness and healthy financial position.

The Group will continue its efforts in the mobile handsets replacement markets where relative market stability is expected to continue despite increasing competitions and price pressures. We will continue our efforts on premium, high-end products that offer enhanced functionalities and value-added services to our customers. The Group will also reassess its business risks in the region and exercise due consideration and care to formulate new business strategies to regain our competitiveness.

In anticipation of the rapidly changing business environment, and based on our intimate knowledge of the mobile telecommunications markets, our well-established distribution network and marketing expertise in the Greater China region, the Group will continue to explore new business diversification and expansion potentials to bring more values and improved profitability to the Group.

CONTINGENT LIABILITIES

As at 30th September, 2003, the Group had the following contingent liabilities:

(a) The Company and two of its subsidiaries provided corporate guarantees to several banks for securing banking facilities granted to certain subsidiaries of the Group (note 25 to the accounts).

(b) Included in the terms of the sale and purchase agreement in connection with the acquisition of Calaview Assets Limited and SMG (the "Acquired Companies") in 2000, the Group is liable to pay the vendor HK$35 million, contingent on the successful listing on any recognised stock exchange by any one of the Acquired Companies. SMG has already begun its statutory liquidation procedures and the Group has no plan to list any of the Acquired Companies.

(c) As stated in note 6(c) to the accounts, the Inland Revenue Department of Hong Kong ("IRD") issued estimated assessments to certain subsidiaries of the Group in respect of their potential taxation liabilities for the years of assessment from 1996/1997 to 2001/2002. However, no provision for tax penalty has been made in the accounts as in the opinion of the Directors of the Company, the estimated assessments were incorrect and it would be premature to endeavour to determine whether any tax penalty would arise.

CHARGES ON GROUP ASSETS

Following the reduction of the Group's facilities during the year, some assets of the Group previously pledged or placed as security for the extension of banking facilities to the Group's subsidiaries were subsequently released. As at 30th September, 2003, approximately HK$4,309,000 of trade receivables of a subsidiary of the Group have been pledged for banking facilities granted to certain subsidiaries of the Group.

EMPLOYEE INFORMATION

As at 30th September, 2003, the Group had 134 employees (2002: 125). This increase corresponded to the Group's cautiously modest outlook during the year. Total employee remuneration of the Group, including that of Directors, had substantially decreased to approximately HK$65 million (2002: HK$90 million). The overall workforce had been very stable during the past year and the turnover rate was below 3%.