

Management Discussion & Analysis

Carpet Operations

In 2003, the Group's turnover in carpet manufacturing and trading rose by 20% to HK\$409.6 million.

USA

Sales to the USA, mostly generated by Tai Ping Carpets Americas, Inc. ("TPCA"), dropped marginally by 2% to HK\$107.7 million. This accounted for 26% of the Group's turnover in carpet manufacturing and trading. During the year, the US hospitality market remained slow in recovery. This fueled competition, especially pricing. In response to this competitive environment, our US office reacted by widening their sales efforts into other markets. In the first half of the year, it secured a contract for the Washington D.C. Rapid Transit Authority and developed an OEM business with a leading designer rug retailer.

Europe

Sales to Europe jumped 80% to HK\$43.5 million, due to an excellent sales growth achieved by our Paris office, Tai Ping Carpets Europe S.A. ("TPCE") and the appreciation of the Euro. In the year, our German office, Tai Ping Carpets Interieur GmbH ("TPCI") recorded an increase in sales of 16% to HK\$13.8 million, reflecting the stronger Euro. While the orders from one of its major customers, which previously accounted for more than 65% sales of TPCI, had shown a downward trend, TPCI made up a large part of the lost sales by shifting some of its efforts to drive project sales. Our Paris office, TPCE, by contrast, showed very strong sales momentum registering turnover of HK\$23.8 million, representing growth of 194% year on year. This growth was attributable to its sales efforts to generate more contract businesses, and make further inroads into private yacht and aircraft markets.

Hong Kong & China

The Hong Kong market has been difficult for several years. The outbreak of SARS aggravated an already competitive market. During the SARS period the hospitality industry in Hong Kong and China put almost every carpeting project on hold. With the subsidence of SARS, activities slowly recovered and our sales bounced back. However, for the year our sales in Hong Kong and China still suffered a drop of 16% to HK\$38.2 million.

Thailand and South East Asia

The sales to Thailand and South East Asia, generated primarily from our factory in Thailand, Carpets International Thailand Public Company Ltd. ("CIT"), surged 38% to HK\$179.1 million, representing 44% of the Group's turnover in carpet manufacturing and trading. CIT maintained its leadership in the carpet industry in Thailand and its domestic sales in Thailand benefited from the buoyant Thai property market despite keen competition from Indonesia, Malaysia and China. Its exports sales also performed well within South East Asia, though gross margin was depressed due to appreciation of the Thai Baht.

Overall, the carpet manufacturing and trading operation managed to grow the sales to HK\$409.6 million, compared to HK\$342.5 million in 2002, but its segmental profits fell 23% to HK\$18.6 million before tax, finance and unallocated costs. The decline in segment profit was partly by the pressure on gross margin due to price competition across most of the major markets the Group operates, partly by more investments in marketing activities and sales tools, and by an increase in headcount in order to better service our customers and increase our market share.

Joint Ventures and Associated Company

Weihai Shanhua Huabao Carpet Co. Ltd., Weihai Shanhua Premier Carpet Co. Ltd. and Weihai Shanhua Floorcovering Products Co. Ltd. ("Weihai") reported very good results for the year and continued to lead the carpet industry in China in terms of sales and profits. Their combined sales increased by 19% to HK\$325.0 million as a result of increasing demands both domestically and overseas, facilitated by adding more Axminster looms and a BCF extrusion line during the year. The Group's share of Weihai's profit before taxation was HK\$14.9 million, compared to HK\$ 6.5 million in 2002 after provisions for inventories and debtors.

Philippine Carpet Manufacturing Corporation ("PCMC") had a challenging year in 2003. Its domestic and export markets all experienced a decline in sales as the sluggish US economy and the domestic political concerns continued to dampen consumer and institutional expenditures. The Group's share of PCMC's pre-tax profit amounted to HK\$0.9 million (2002: HK\$3.1 million).

Other Operations

Yarn Dyeing

The combined sales of yarn manufacturing and dyeing operation of our factory in Nanhai, China, and in the USA of Premier Yarn Dyers, Inc. ("PYD") dropped by 40% to HK\$57.2 million. Given PYD's major customers continued to shift their dyeing service demands from skein dyeing to space dyeing, PYD increased its capacity of space dyeing facilities by 15% towards the year end, to meet the growing demand. On the other hand its skein dyeing facilities were under-utilized. This mismatch of production facilities in the USA coupled with lower yarn sales by Nanhai affected adversely the results. Profit from this segment declined to HK\$10.5 million from HK\$19.7 million in 2002.

Interior Furnishings

The interior furnishings operation consists of Banyan Tree Ltd. ("BYT") in furniture retail business and Options Home Furnishings Ltd. ("OHF") in the furniture rental business. In 2003, their combined sales amounted to HK\$51.5 million, representing an increase of 45% over 2002. This was attributable to OHF's notable success in its first full year of operation in establishing its name and capturing market share in the business through offering a wide range of quality products coupled with a high level of customer service. BYT's sales, however, were affected by the weak retail market and the outbreak of SARS. The combined results of the operation was a profit of HK\$5.1 million, compared to a loss of HK\$0.5 million in 2002.

Management Discussion and Analysis

Last Year's Balance Sheet (Consolidated Balance Sheet at 31.12.2002)

| | As restated HK\$'000 |
|--|-------------------------|
| Assets | |
| Intangible assets | 2,461 |
| Fixed assets | |
| and construction in progress | 353,888 |
| Investments in affiliates | 112,734 |
| Investment securities and | |
| other investments | 30,733 |
| Cash & cash equivalents | 105,610 |
| Finance lease investments | 2,008 |
| Deferred tax assets | 1,640 |
| Other current assets | 207,072 |
| | 816,146 |
| Shareholders' equity and liabilities: | |
| Share capital, premium & reserves | 324,964 |
| Retained earnings | 307,814 |
| Bank borrowings | 79,866 |
| Other current liabilities | 82,527 |
| Minority interests | 16,972 |
| Deferred tax liabilities | 4,003 |
| | 816,146 |

Cash Flow For The Year (Consolidated Cash Flow Statement for the year ended 31.12.2003)

| | HK\$'000 |
|--------------------------------|----------|
| Cash generated from operations | 45,225 |
| Tax paid | (12,320) |
| Net interest paid | (1,128) |
| Net dividend received | 4,731 |
| Capital expenditure | (27,927) |
| Acquisitions | (198) |
| Other investing activities | 3,108 |
| Net decrease in bank loans | (32,195) |
| Net decrease in cash | (20,704) |
| Foreign exchange rate effect | (219) |
| Cash & cash equivalent | |
| at 31.12.2002 | 105,610 |
| at 31.12.2003 | 84,687 |

Earnings For The Year (Consolidated Profit and Loss Account for the year ended 31.12.2003)

| | HK\$'000 |
|--------------------------------|-----------|
| Turnover | 525,212 |
| Cost of sales | (317,095) |
| Gross profit | 208,117 |
| Other revenue and income | 9,143 |
| Expenses | (201,679) |
| Operating profit | 15,581 |
| Finance costs | (2,475) |
| Share of profits of affiliates | 15,765 |
| Profit before taxation | 28,871 |
| Taxation | (11,524) |
| Profit after taxation | 17,347 |
| Minority interests | (1,054) |
| Net profit | 16,293 |

Earnings Retained (Consolidated Retained Earnings for the year ended 31.12.2003)

| | HK\$'000 |
|---|----------|
| Balance at 31.12.2002 (as previously reported) | 308,190 |
| Change of accounting policy | (376) |
| Balance at 31.12.2002 (as restated) | 307,814 |
| Exchange adjustments | 23,950 |
| Net profit | 16,293 |
| 2002 final dividend paid | (6,229) |
| Balance at 31.12.2003 | 341,828 |

Current Year's Balance Sheet
(Consolidated Balance Sheet at 31.12.2003)

| | HK\$'000 |
|--|----------|
| Assets | |
| Intangible assets | 1,324 |
| Fixed assets and construction in progress | 372,829 |
| Investments in affiliates | 118,276 |
| Investment securities and other investments | 30,089 |
| Cash & cash equivalents | 84,687 |
| Finance lease investments | 1,715 |
| Deferred tax assets | 834 |
| Other current assets | 230,854 |
| | 840,608 |
| Shareholders' equity and liabilities: | |
| Share capital, premium & reserves | 329,582 |
| Retained earnings | 341,828 |
| Bank borrowings | 54,306 |
| Other current liabilities | 91,888 |
| Minority interests | 17,992 |
| Deferred tax liabilities | 5,012 |
| | 840,608 |

The capital expenditure includes additions of fixed assets of HK\$12,676,000 and construction in progress of HK\$15,251,000.

Acquisitions represented purchase of 0.106% of Carpets International Thailand (CIT).

Cash inflow from other investing activities included disposal of fixed assets of HK\$338,000, disposal of investment securities of HK\$252,000 and repayment of finance lease receivables of HK\$2,518,000.

Turnover represented revenue from sale of carpet, yarn, interior furnishing and rental income from property investment and interior furnishings. The turnover increased by 9.2%.

Expenses include distribution costs of HK\$78,945,000, administrative expenses of HK\$116,516,000 and other operating expenses of HK\$6,218,000.

Share of profits of affiliates include HK\$890,000 from an associated company and HK\$14,875,000 from joint ventures.

Intangible assets represented net book amount of positive goodwill of HK\$1,680,000 arising from acquisitions of 100% interest in White Oak Carpet Mills, Inc., and of remaining 10% interest in SCM; and of negative goodwill of HK\$356,000 mainly from remaining 10% interest in Treasure Looms (China) Limited.

Investment in affiliates included HK\$96,565,000 in joint ventures in Weihai, Shandong Province of the PRC and HK\$21,711,000 in an associated company in the Philippines.



Group Capital Expenditure

For the year, the total capital expenditure amounted to HK\$29.5 million in the form of fixed assets and construction in progress. It was primarily financed from internal resources. The net book value of the Group's fixed assets and construction in progress stood at HK\$372.8 million as at 31st December 2003.

Investment in Joint Ventures, Associated Company and Other Investments

The breakdown of the Group's investments in joint ventures, associated company and other investments in each geographical region is shown below:

| | 2003 | | 2002 | |
|---------------------|----------------|--------------|----------|-------|
| | HK\$'000 | % | HK\$'000 | % |
| Carpet Business | | | | |
| – Mainland China | 96,565 | 66.3 | 89,164 | 63.3 |
| – South East Asia | 21,904 | 15.0 | 23,763 | 16.9 |
| Property and Others | | | | |
| – Hong Kong | 27,272 | 18.7 | 27,975 | 19.8 |
| | 145,741 | 100.0 | 140,902 | 100.0 |

Additional financial information on the Group's significant associated company in the Philippines, and two significant joint ventures in Weihai, Shandong Province, the People's Republic of China (the "PRC") are disclosed in notes 16 and 17 to the accounts.

Net Current Assets

The breakdown of the Group's net current assets by geographical region is shown below:

| | 2003 | 2002 |
|-------------------|----------------|----------|
| | HK\$'000 | HK\$'000 |
| – Hong Kong | 61,232 | 91,816 |
| – China | 36,369 | 39,658 |
| – South East Asia | 27,834 | (9,851) |
| – Europe | 6,739 | (1,935) |
| – United States | 41,168 | 38,734 |
| | 173,342 | 158,422 |

Note: Certain Group companies have receivables and payables with other fellow subsidiaries, which are eliminated on consolidation and not reflected in the above analysis.



Shareholders' Funds

Shareholders' funds at 31st December 2003 increased to HK\$671.4 million from HK\$632.8 million at 31st December 2002 (as restated after the adoption of HKSSAP12 "Income Taxes"), reflecting the profit made in the year and the inflation of the Group's net investment in Europe and Thailand as a result of the appreciation of Euro and Thai Baht.

Financial Position and Liquidity

The Group is in a healthy financial position. The Group's cash deposits and bank balances amounted to HK\$84.7 million at the end of 2003 (2002: HK\$114.4 million).

Bank loans, overdrafts, and other loans at 31st December 2003 amounted to HK\$54.3 million (2002: HK\$88.6 million). The maturity profile of the bank loans, overdrafts and other loans is as follows:

| | 2003 HK\$'000 | 2002 HK\$'000 |
|---|------------------|------------------|
| Repayable within one year (including bank overdrafts) | 54,306 | 84,972 |
| Repayable after 1 year, but within 2 years | – | 3,636 |
| Total | 54,306 | 88,608 |

The currency denomination of the borrowings at 31st December 2003 was as follows:

| | 2003 | | 2002 | |
|-----------------------|---|---|---|---|
| | Borrowing (including overdraft) HK\$'000 | Carrying value of assets pledged HK\$'000 | Borrowing (including overdraft) HK\$'000 | Carrying value of assets pledged HK\$'000 |
| Thai Baht | | | | |
| – Secured | 19,787 | 43,788 | 55,122 | 39,234 |
| – Unsecured | 24,050 | – | 19,361 | – |
| United States Dollars | | | | |
| – Unsecured | 10,469 | – | 11,538 | – |
| Euro | | | | |
| – Unsecured | – | – | 2,587 | – |
| | 54,306 | 43,788 | 88,608 | 39,234 |

As at 31st December 2003, 18% of the borrowings was charged at floating interest rates, and 82% at fixed interest rates with the repayable period within one year.

As the cash deposits and bank balances exceeded all the outstanding bank loans and overdrafts as at 31st December 2003, no gearing ratio has been calculated. The management believes that the Group has sufficient financial resources to finance its operations and capital expenditure. However, should the management identify some acquisition targets to grow our core carpet business, financing by bank loans may be considered.



Contingent Liabilities

As at 31st December 2003, the total contingent liabilities of the Group amounted to HK\$6.1 million (2002: HK\$7.0 million) excluding litigation. Full disclosure of contingent liabilities as at 31st December 2003 is made in note 32 to the accounts.

Foreign Exchange Exposure

The Group has overseas operations in the PRC, Thailand, Singapore, USA and Europe. Given our Singaporean and European operations are relatively small, and the Chinese Renminbi currency is relatively stable, most of the exchange differences arising from translation of overseas operations arose from CIT, our operation in Thailand. However, the effect of these exchange differences is reduced by CIT's borrowings denominated in local Thai Baht currency. As these exchange differences arise from translating the Group's net investments in these foreign operations, they are dealt with in the reserves and do not affect cash flows or the profit and loss account.

Cash Flows

| | 2003 HK\$'000 | 2002 HK\$'000 | Change HK\$'000 |
|-----------------------------|------------------|------------------|--------------------|
| Cash provided by/(used in): | | | |
| – Operating activities | 32,905 | 40,306 | (7,401) |
| – Investing activities | (16,946) | (46,401) | 29,455 |
| – Financing activities | (36,663) | 9,024 | (45,687) |
| | (20,704) | 2,929 | (23,633) |

Net cash provided by operating activities decreased by HK\$7.4 million reflecting the fall of the operating profits in 2003.

Cash used in investing activities was primarily for capital expenditure on fixed assets, construction in progress and from net proceeds on disposal of fixed assets and investment securities.

Net cash from financing activities in 2003 mainly derived from net increase in bank borrowings, less interest and dividend paid.

Employee and Remuneration Policy

The Group had approximately 2,900 employees as at 31st December 2003. Employees are remunerated according to the nature of their job and market trends, with built in merit components incorporated in the annual increment to reward and motivate individual performance. Total staff costs and retirement benefit costs for the year ended 31st December 2003 amounted to HK\$151.7 million (2002: HK\$133.5 million) and HK\$3.2 million (2002: HK\$2.9 million) respectively.

Environmental Management

During the year, our carpet manufacturing and woollen yarn spinning operations in both Nanhai, the PRC and Thailand were awarded ISO 14000, the certification for meeting the Environmental Management Standard. Securing this accreditation reinforces the Group's commitment to environmental management and enhances its reputation in carpet manufacturing. The Group will continue its efforts on its environmental management, notably on development of environmentally friendly products and carpet solutions.

Alison S. Bailey

Chief Operating Officer

Hong Kong, 19th April 2004