GROUP MANAGING DIRECTOR'S REVIEW OF OPERATIONS

RETAIL OPERATIONS

Hong Kong

During the early part of the year of 2003, Hong Kong was badly hit by the SARS epidemic. From May 2003, the Mainland Chinese and HKSAR Governments launched various policies in stimulating the local economy: the promoting of Hong Kong programs; the relaxation of the PRC individuals' travel to Hong Kong from selected cities; the permission of the local banks to perform clearing business of Renminbi and issuance of Renminbi credit cards in Hong Kong, etc. All those policies provided a strong base for the local economy to rebound, which happened in our second half of the year. The GDP in the fourth quarter of 2003 recorded a growth of 5% while the unemployment rate in the first quarter of 2004 has improved favorably by over 1% to 7%. The resurgent economy benefits all industries, especially tourism and retail. Total retail sales dollars in January 2004 were well above HK$18 billion, which was the record high since year 2000.

The operating management team has been well prepared for the above economic rebound. A series of marketing strategies to capture the focal and potential customers have been executed, including varieties of spending and loyalty programs. To strengthen our competitive edges and to provide the utmost convenience to our customers, we have restructured our merchandise mix, refurbished the store layout and provided appropriate language training to our front-line staff. We have modified our buying strategy and have introduced more concession counters to expand the range of merchandise but not at the expense of increasing the holding cost of inventory.

Due to the increased concentration of our income from consignment and concession counters recognized as other income, the yearly income for department store sales dropped by 9%. Note that the re-mix of merchandise contributed a higher profit margin, thus raising the earnings from operation. Gross margins for the year have improved favourably from last year. With the expiry of the Mongkok store tenancy in August 2003, the 3 stores operating in Hong Kong have performed well in the second half.

During the year, the Mainland Chinese government has relaxed the policy for the local individuals from certain major cities, such as Beijing, Shanghai and Guangzhou to travel to Hong Kong. This attracted millions of people to cross the border and enter into Hong Kong, lifting the revenue from the general services sector and supporting the overall purchasing atmosphere of the retail sector. To capture this fringe market, our department stores have liaised with tourists and commuter agencies in several cities, providing their tourists with welcoming gifts and special promotion discounts.

Despite the economic rebound in the second half of the year, management continues to exercise tight controls over the operating expenses. The general administrative expenses together with the selling and distribution costs were reduced by 12% in total, resulting in a substantial reduction in the net loss from $58 million in the previous year to $37 million.

Central Store

The store was refurbished in November 2003 to provide a refreshed lifestyle image to the customers. We have re-arranged the 3/F to be specialised in household, bedding and bath departments and expanded the electrical, sports and casual departments on the 2/F. This provided a clearly defined store with identified departments to the customers. To enlarge the customer profile and to attract more repeat customers, a bargain center has also been introduced on the 3/F by offering different special offers at different periods.

Shamshuipo Dragon Centre Store

The household products were still the major line of business for this store. Catering to the specific needs of the locality, in particular for families in the neighbourhood, the "Event Hall" concept has been an important sales contributor. This has successfully drawn the customers' attention and interests to our merchandise, in particular during the period of the festive seasons. Following the management strategy to introduce more branded handbags, this section had been expanded and the performance exceeded our expectation.

Grand Century Place Store

The mall where our store is located is linked to the KCR Mongkok railway station and is also the terminal for the Hong Kong – China Huang Gang buses. With the relaxing policy for Mainland tourists to travel to Hong Kong, this store has seen a tremendous increase in foot traffic from the PRC tourists. Special selections such as high-end and branded merchandise have been included. To better support the above, we have refreshed the entrance of L2 and invited famous cosmetic brands for an uplifted department store image.

The Group will continuously examine its internal synergies and sharpen its competitive advantages in its retail operations; promptly respond to the market changes and introduce more branded merchandise. To increase the proportion of consignments to reduce the operating risks will be a major focus of the retail operation in the coming year.

Home Furniture

The home furniture business had been repositioned and repackaged by March 2004 as "Sincere Living". A show room has been opened in Causeway Bay. The business mode is to provide more comprehensive service to customers including interior design and tailor made furniture. The target market segment will primarily be on the property developers who are focusing on the middle-income earners for Hong Kong and Southern China. As the property market locally is resurgent and the Southern part of Mainland is booming, the Group believes the potential growth in this segment of business is substantial.

PRC

The PRC economy has been growing but there is always a danger that the economy overheats and the PRC government is forced to intervene. During the first half of the year, SARS epidemic hit the economy. In the second half of the year, the PRC Government cooled the heated economy through Macro Economic Control to avoid the previous year's torrid GDP of 11.5%. With those negative market impacts, the Group has decided to slow down and to rectify the business strategy of the Shanghai convenient chain stores. At the year end, we have 72 convenience stores operating and we intend to take only minimum risks in opening further new stores. The Dalian economy was also impaired by SARS and economic decline, in particular in the first half of the year. Our property in Dalian, however, contributes a stable rental income to the Group from both the shopping mall and the rental apartments.

Mövenpick Marché

The restaurant sales of Mövenpick at the Peak were also dampened by the SARS epidemic in Hong Kong that eroded the opportunities during the first half of the year. Management had put in their optimal effort to substantiate the business. Effective control on food costs, operating expenses, together with the revised tenancy, has successfully reduced the operation cost. When the economy picked up in the second half of the year, the turnover recorded a favourable growth especially in the traditional festivals, such as Christmas, Halloween, New Year's Eve and Valentine's Day. The operating loss for the year as a result has reduced favourably, despite a softened turnover. The management will continue to implement the tactical strategy to enlarge market share and to enhance operational efficiency.

Securities Trading

To minimize the downside risk on securities investments in the volatile market last year, the operating management has diversified its securities portfolio to investment funds and bonds with more stable returns. With the recovery of the global stock market, the Group's investment portfolios have been doing well from regular income of dividend and the realisation of profitable securities.

OTHER OPERATIONS

Advertising

The advertising business has been operating for a year; it contributes a steady turnover to the Group. During the year, the company obtained several reputable customers with satisfactory income. Management will grasp this opportunity to establish a continuous and long-term relationship with the existing customers. The Shanghai office was set up in late 2003. The foremost mission in the coming year is to look for new opportunities and to enhance our reputation in the advertising industry both in Hong Kong and PRC.

PRC Property Investments

There was a huge supply of residential and commercial properties in Dalian over the year; this, in conjunction with SARS and the local economy, impaired the occupancy rate. The PRC Government policy aims to rein in the overheated economy, hence fixed asset investments and capital expenditures are being repressed. We are now in discussion with potential parties to further develop the building to achieve a better operational competitiveness.

UK Property Investments

The Group had seven prime property investments in the UK; namely Pembroke House at Chesham Street, Jubilee Street, Lancaster Gate with two projects, 140 Parklane, West India Quay and Lowndes Square.

The Pembroke House at Chesham Street, London has sold two units with favourable returns. The only remaining unit contributes a rental income and management is confident that it will generate favourable sales income to the Group next year.

The total re-developed 73 units in Jubilee Street are now completed after much delay; there are a total of 41 units being reserved with deposits received. The management anticipates that the remaining 32 units comprising penthouses and apartments will sell out by the first quarter of 2005.

The refurbishment of Hyde Park Lancaster Gate No. 17 for the 6 apartments has been completed. During the year, 4 apartments have been sold and income was fully recognised. The new redevelopment project of Lancaster Gate Nos. 19-21 was started in March 2003 and it is expected that sales will commence in the last quarter of 2004.

The London Marriott Hotel with the 140 Parklane project picked up its occupancy rate after the Middle East crisis. Out of the 18 apartments for sales, a total of 16 units have been sold. The commercial unit is fully leased and contributed a stable rental income during the year.

The investment in West India Quay has 158 residential units on top of the spectacular Marriott Hotel. At the year end, total 108 units have been reserved with deposits received; the remaining units will be pushed on to the market in the fourth quarter of 2004.

The newest project is Lowndes Square in Belgravia, a superb penthouse apartment in the top end of the London market will be refurbished and ready for launch in the fourth quarter of 2004.

LOOKING AHEAD

With a recovering Hong Kong economy and the vast opportunities offered by the China market, the Group is cautiously optimistic that our operations will continue to improve and new opportunities will be seized. We will focus to build on our financial strength.

Philip K H MA
Group Managing Director

24 June 2004