

OVERVIEW

The Group is principally engaged in the operation of “lifestyle” department store and other retail outlets. The Group owns most of the properties at which its department store is situated. To the Group, “lifestyle” department store is characterised by the “one-stop shop”, “shops-in-shop”, “Japanese style” and “customer oriented” concepts, which offers quality goods and services, customer convenience, comfortable and pleasurable shopping environment. In addition, goods offered at the Group’s “lifestyle” department store range from daily necessity to luxury products for meeting the needs of the “lifestyle” of a typical consumer in a modern society. At present, the Group operates the **Sogo Store**, **Nufront** and **Daiso Land Ten-dollar Shop** in Hong Kong.

The Group has been granted the sole and exclusive licence to use the **Sogo Trademark** in relation to the retail department store business operated, and the merchandise, supplied and sold by reference to the said trademark in Hong Kong. Since completion of the Sogo HK Transaction in May 2001, Sogo HK was granted the licence to use the **Sogo** trademark for a period of 18 years from Sogo Co. Ltd. **Sogo** Store offers a wide range of merchandise, which can be broadly categorised into apparels and fashion, cosmetics and accessories, household, toys and others and food and confectionery. Merchandise is sold by means of the Group’s direct sales as well as concessionaire sales.

Sogo Store was opened in May 1985 and the existing shareholders of the Group have been in control of Sogo HK since completion of the Sogo HK Transaction on 9th May, 2001. **Sogo** Store is located at the prime shopping district in Causeway Bay, Hong Kong. The store currently occupies a total gross floor area of about 364,419 sq.ft., about 95% of which is owned by the Group. The Directors believe that **Sogo** Store is one of the largest individual department stores in Hong Kong in terms of floor area by location.

As to the other retail formats, the Group operates (i) **Nufront**, a Japanese-style shopping centre serving the young trendy customers; and (ii) **Daiso Land Ten-dollar shop**, a ten-dollar shop offering a variety of quality budget items.

Even though a number of similar operators were forced to close down their department store operations in Hong Kong over the past few years due to the downturn of the market conditions, the **Sogo** Store was able to sustain through those difficult periods and the Group managed to record an operating profit of about HK\$400 million and a net profit of about HK\$275 million in 2003, representing a year-on-year growth of 32.0% and 126.4% respectively. The Directors consider that the success of the Group is attributable to:

- ✓ the extensive experience of the team in operating the **Sogo** Store as a “lifestyle” concept based department store in Hong Kong and its ability to cope effectively in a dynamic retail environment, particularly during the economic recession period in Hong Kong after the Asian financial crisis which started in 1997;

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- ✓ the prime location of the **Sogo** Store as one of the landmark of the prime shopping district in Causeway Bay, Hong Kong, thereby attracting a steady flow of visitors and customers from various age group, income group, preferences and origins;
- ✓ its immunity to rental fluctuations and flexibility to renovation arrangements as the Group owns most of the properties in which the **Sogo** Store is situated;
- ✓ the comprehensive range of quality merchandise, especially well-known brands, offered for sale in the **Sogo** Store; and
- ✓ its ability to influence the product mix of the merchandise offered by the **Sogo** Store.

HISTORY AND DEVELOPMENT

With the view that the properties in which **Sogo** Store situated are amongst the best locations in the prime shopping district in Causeway Bay, Hong Kong and its operation has been well recognised within the society, the shareholders of Crystal Key had then been interested in such properties and business for some time. It was understood that Sogo Japan was, during the late 1990's and early 2000's, in the process of financial restructuring with its major bankers and, as such, had been disposing some of its overseas assets and operations outside Japan. In light of the investment opportunity, Crystal Key entered into discussions with Sogo Japan in 2000. The discussions materialised and led to the Sogo HK Transaction.

On 1st January, 2001, Crystal Key entered into a sale and purchase agreement with Sogo Japan in respect of the acquisition of all the issued shares in Grandville (which would be the holding company of Sogo HK and its subsidiaries) and certain related properties in Hong Kong. The sale and purchase agreement was completed on 9th May, 2001. Crystal Key then became the holding company of Grandville and the ultimate owner of certain related properties in Hong Kong, including certain properties in which the **Sogo** Store occupied. In addition, the Sogo HK Transaction resulted in Sogo Co., Ltd. granting Sogo HK the sole and exclusive licence to use the **Sogo** trademark in relation to the retail department store business operated and the merchandise supplied and sold by reference to the said trademark in Hong Kong for 18 years commencing from 9th May, 2001.

Sogo HK was established in 1983 for the purposes of opening and operating a department store in Hong Kong. Sogo HK re-developed the 22 storeys retailing and office building as the present East Point Centre, Old Wing, and kept for its own use for the floors from 2nd basement to 10th Floor with certain upper floors; whereas remaining floors were sold, and are now held by independent third parties. On the same day as the opening of the MTR's Causeway Bay station on 31st May, 1985, the **Sogo** Store was opened with a store area of some 189,470 sq.ft. with an entrance joint with the MTR Causeway Bay station. At

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that time, there were a number of other department store operators in Hong Kong and the industry was dominated by a few Japanese-style department stores. All of these dominating operators were originated with parent companies in Japan and a majority of them had stores in the shopping district of Causeway Bay, Hong Kong.

To implement the concept of “one-stop shop”, plans were drawn up to enlarge the store space so that a broader range of merchandise could be offered. This led to Sogo HK enlarging the store area by expansion through re-development of its adjacent site into the wholly-owned New Wing. Launched in November 1993, the enlarged store, known as **Jumbo Sogo**, has a store area of some 347,677 sq.ft..

Beginning in 1996, building on its established position and as part of its expansion plans to house additional concessionaire counters to attract younger customers, Sogo HK leased some 39,095 sq.ft. over three floors in the Excelsior Plaza which is across the street from East Point Centre. Most of the concessionaires in this new extension of the **Sogo** Store were new comers to the Hong Kong market and/or the merchandise sold at these counters targeted at the younger generation. This part of the store was named “New Face by **Sogo**”. In 1997, Sogo HK also expanded its supermarket operations by extending through underground connection to 2nd and 1st basements of the Island Centre, 1 Great George Street, Causeway Bay, Hong Kong.

In order to satisfy changing consumers' needs and general shopping trends, the new management of Sogo HK has further expanded its operations of the supermarket and re-launched the enlarged supermarket under the name of “Freshmart” in November 2001.

In addition to the above expansion, the new management of Sogo HK allocated the 1st basement of the Island Centre to a third party concessionaire to operate “**Daiso Land Ten-dollar shop**” in November 2001. In August, 2002, the Group acquired all the relevant inventories and outfit from the then concessionaire and started its own operation of “**Daiso Land Ten-dollar shop**” in Island Centre.

However, the downturn of the market since 1997 had an adverse impact on the sales of those start-up concessionaire counters located at the New Face by **Sogo**. As such, plans were drawn up by the new management of Sogo HK to re-launch this part of the department store into other retail formats. In May 2002, Beauté@SOGO was opened on the ground floor to house selective concessionaire counters of cosmetics products. In mid-2002, the Group completed the renovation of the New Face by SOGO's first and second floors, and sub-leased other parts of the area to various retail outlets, restaurant, and further expanding the “**Daiso Land Ten-dollar shop**” by increasing its retail space. In order to build up a trendy and energetic image of this retail area, the new management of Sogo HK re-named this part (except for the area occupied by “**Daiso Land Ten-dollar shop**”) of the store as **Nufront**, a Japanese term meaning “stop awhile and shop”, to match with the foresaid image.

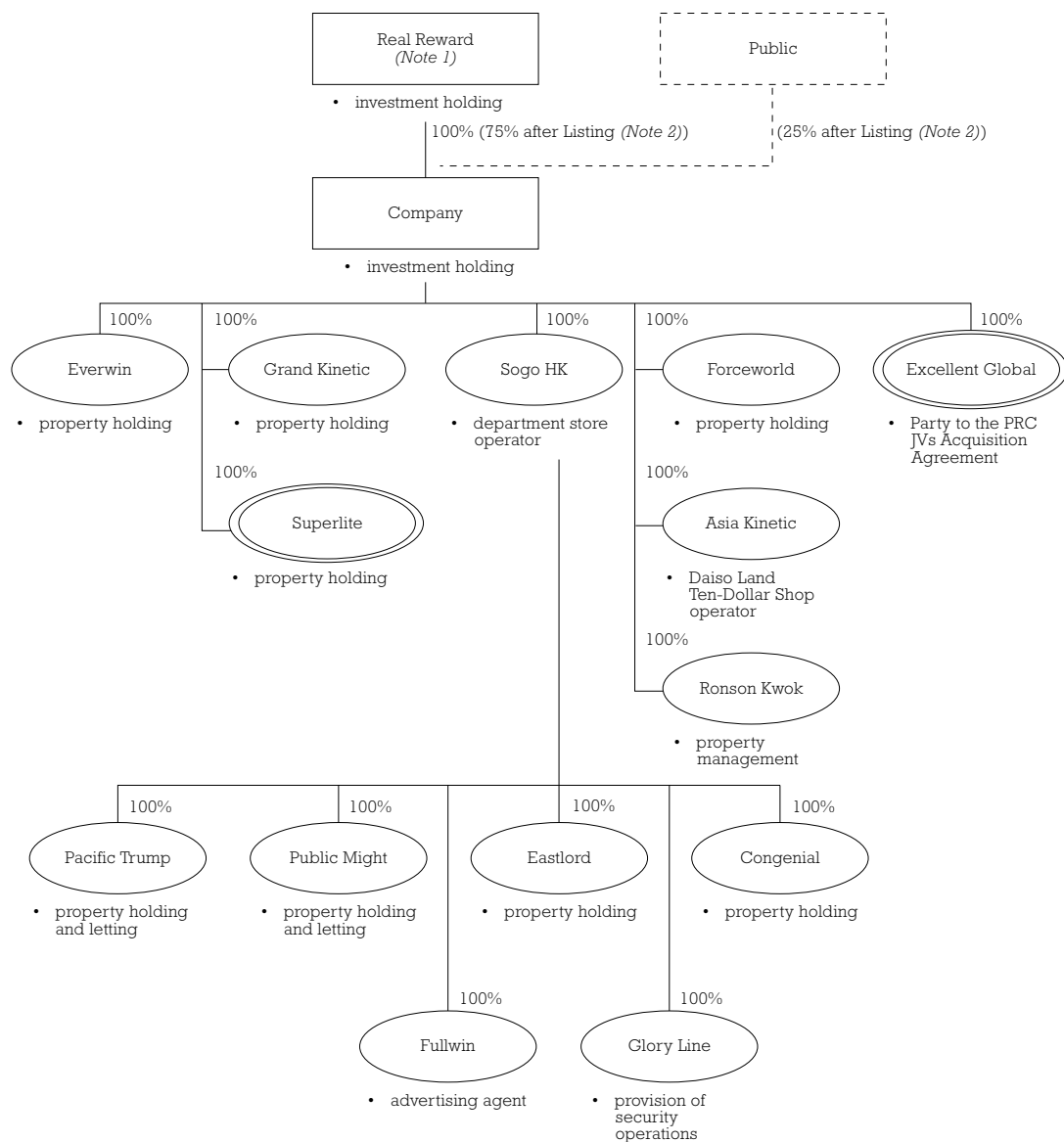
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As an initial step to enter into the PRC market, the Group targets to be one of the first movers in terms of a foreign enterprise with a controlling stake in the operation of a department store in the PRC. The Group entered into the PRC JVs Acquisition Agreement on 30th March, 2004 to effectively acquire interests in two joint venture companies in the PRC, the Property JV and the Operating JV. Consideration is subject to a cap of HK\$500 million and will be satisfied by part of the net proceeds of the Share Offer. The Property JV was established for the purposes of developing and holding the Shopping Complex. The property occupies a site area of 17,222 sq.m. (equivalent to about 185,376 sq.ft.) at Plot No. 117 Yuyuan Road, Jingan District, Shanghai, the PRC. The development is a 10-level shopping complex with the gross floor area of 91,613 sq.m. (equivalent to about 986,113 sq.ft.). It is proposed that the Operating JV will operate a department store located in the subject property with a store area of not less than 70% of the gross floor area available from the Shopping Complex under the name of "Ongoing Department Store" (久光百貨). Completion of the acquisition will take place upon, among others, due establishment of the Operating JV, due execution of the tenancy agreement between the Property JV and the Operating JV in respect of the premises to be occupied by the Ongoing Department Store; satisfactory completion of due diligence by the Group in respect of the PRC JVs; and the Listing. Operation of the Ongoing Department Store is expected to commence in mid-2004. Details of the Property JV and the Operating JV are set out in the section headed "PRC JVs Acquisition Agreement".

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GROUP STRUCTURE

Immediately before the Listing, the Group has undergone a reorganisation with the Company becoming the holding company of the Group. The following diagram illustrates the group structure of the Group comprising principal operating subsidiaries immediately upon completion of the Reorganisation and immediately prior to the Share Offer:



- represents companies incorporated in the Cayman Islands with limited liability
- represents companies incorporated in Hong Kong with limited liability
- represents companies incorporated in the BVI with limited liability

Notes:

1. (a) Real Reward is owned as to 50% by United Goal Resources and as to 50% by Go Create.
- (b) United Goal Resources is ultimately owned by Mr. Thomas Lau and a discretionary trust of which certain family members of Mr. Joseph Lau are eligible beneficiaries.

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- (c) Go Create is wholly-owned by Chow Tai Fook of which the family members of Dató. Dr. Cheng Yu-tung have controlling interests.
2. Before taking into account any Shares to be issued under the exercise of the Over-allotment Option.

BUSINESS ACTIVITIES

The Group is principally engaged in the operation of "lifestyle" concept based department store and other retail outlets that offer a wide variety of merchandise aimed at meeting the needs of the lifestyle of a typical consumer in a modern society. The Group also owns most of the properties at which its department store is situated. At present, the Group operates the **Sogo** Store, **Nufront** and **Daiso Land Ten-dollar Shop**. The Group also leases and sub-leases certain of the properties to independent third parties. An analysis of the Group's turnover for the Track Record Period is set out below.

	For the period from 1st March, 2001 to 31st December, 2001 (note a) HK\$' million	For the year ended 31st December, 2002 HK\$' million	2003 HK\$' million
Turnover			
– Direct sales of merchandise	663	875	775
– Commission income from concessionaire sales (note 1)	254	418	473
– Other income (including rental income and service income)	23	37	56
	<u>940</u>	<u>1,330</u>	<u>1,304</u>

Note:

1. The table below is a summary of the sales proceeds of the Group (comprising sales proceeds from direct sales, gross proceeds from concessionaire sales and other income) during the Track Record Period:

	For the period from 1st March, 2001 to 31st December, 2001 (note a) HK\$' million	For the year ended 31st December, 2002 HK\$' million	2003 HK\$' million
Sales proceeds			
– from Direct sales	663	875	775
– from Concessionaire sales (gross value)	1,246	1,955	2,155
– Other income (including rental income and service income)	23	37	56
	<u>1,932</u>	<u>2,867</u>	<u>2,986</u>

Note:

- a. The Group had no turnover and sales proceeds during the period from 1st March, 2001 to 8th May, 2001 as operations of the Group were commenced on 9th May, 2001.

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GROUP'S RETAILING SPACES

A breakdown of the Group's retailing spaces as at the Latest Practicable Date is set out in the following table:

	Own properties		Leased properties			
	East Point Centre		Excelsior Plaza		Island Centre	
	Occupying floors	Gross floor area <i>sq.ft.</i>	Occupying floors	Gross floor area <i>sq.ft.</i>	Occupying floors	Gross floor area <i>sq.ft.</i>
Retailing spaces operated by the Group						
Sogo Store:						
Jumbo Sogo	2nd Basement and 1st Basement, Ground Floor to 7th Floor, and 9th and 10th Floor	338,870	-	-	2nd Basement (including subway under East Point Road)	11,847
Beauté@SOGO	-	-	Ground Floor	4,895	-	-
Event hall of Jumbo Sogo (<i>note 1</i>)	21st Floor	8,807	-	-	-	-
Daiso Land						
Ten-dollar Shop	-	-	2nd Floor	7,520	1st Basement	6,423
Other retail area under the Group						
Nufront	-	-	1st and 2nd Floor	26,680	-	-
Total gross floor area (<i>sq.ft.</i>)		347,677		39,095		18,270

Notes:

1. Event hall is part of Jumbo Sogo where periodic private sales events of the **Sogo** Store are conducted.
2. As part of the pilot plan for the expansion of the **Sogo** Store's range of services, a portion of the 19th Floor of the New Wing owned by the Group was renovated into temporary facial treatment centre for some of the cosmetic concessionaires of the Group since February, 2004. Due to the temporary nature, such area is not currently considered as the Group's retailing spaces.

THE **SOGO** STORE

The **Sogo** Store is located at the prime shopping district in Causeway Bay, Hong Kong and is situated at three buildings, being East Point Centre, Excelsior Plaza and Island Centre. The store has a total gross floor area of about 364,419 sq.ft..

The **Sogo** Store opens daily from ten o'clock in the morning to ten o'clock in the evening (except for Beauté@SOGO which opens daily from eleven o'clock in the morning to eleven o'clock in the evening) with extended trading hours during the Christmas, New Year and Chinese New Year seasons, and for some special occasions.

The **Sogo** Store is designed and managed to create an attractive department store environment to maximise operating efficiencies and to make shopping convenient and pleasurable. Visual displays can be easily changed for seasonal and holiday promotions, and sales area can be flexibly reallocated. To make shopping at **Sogo** Store more convenient, the store layout is easy to understand, and clear in-store signs help customers identify and locate branded shops. The Directors believe that the Group's customers are able to easily select desired styles, colours and sizes, as merchandise offered at the **Sogo** Store are plentiful, well organised and attractively displayed.

In addition, the Group has always aimed to provide the highest standard of customer services so as to allow its customers to have an enjoyable and pleasurable shopping experience at the **Sogo** Store. The Group adopts a "customer oriented" approach in respect of the customer services provided at the **Sogo** Store where customers' satisfaction is the top priority of the Group. Friendly and knowledgeable sales staff are available on the sales floors to assist customers; and as a Japanese tradition, lift operators are employed to serve customers and senior management staff will greet and extend gratitude to customers at the entrance of the store at the time of store opening and closing every day. Certain departments, such as electronics and cosmetics, have specialised sales staff trained to assist customers on a full-service basis. Most importantly, the Group "listens" to the needs of its customers and "pays" particular attention to any customers' feedback.

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Merchandise

The **Sogo** Store offers a wide range of merchandise, which can be broadly categorised into “apparels and fashion”, “cosmetics and accessories”, “household, toys and others” and “food and confectionery”, to satisfy customers’ different needs. Sales proceeds (representing the proceeds from direct sales and gross proceeds from concessionaire sales) of each category of merchandise of the **Sogo** Store for the Track Record Period were as follows:

Category	For the period from 1st March, 2001 to 31st December, 2001 <i>(Note)</i>			For the year ended 31st December, 2002			For the year ended 31st December, 2003		
	Direct	concess- ionaire	Total	Direct	concess- ionaire	Total	Direct	concess- ionaire	Total
	sales	sales	sales	sales	sales	sales	sales	sales	sales
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
Apparels and fashion	221	649	870	295	1,036	1,331	247	1,192	1,439
Cosmetics and accessories	170	453	623	199	651	850	167	662	829
Household, toys and others	155	89	244	207	148	355	180	188	368
Food and confectionery	88	55	143	162	120	282	171	113	284
	<u>634</u>	<u>1,246</u>	<u>1,880</u>	<u>863</u>	<u>1,955</u>	<u>2,818</u>	<u>765</u>	<u>2,155</u>	<u>2,920</u>

Category	For the period from 1st March, 2001 to 31st December, 2001 <i>(Note)</i>			For the year ended 31st December, 2002			For the year ended 31st December, 2003		
	Direct	concess- ionaire	Total	Direct	concess- ionaire	Total	Direct	concess- ionaire	Total
	sales	sales	sales	sales	sales	sales	sales	sales	sales
	%	%	%	%	%	%	%	%	%
Apparels and fashion	34.8	52.1	46.3	34.2	53.0	47.2	32.3	55.3	49.3
Cosmetics and accessories	26.8	36.4	33.1	23.0	33.3	30.2	21.8	30.7	28.4
Household, toys and others	24.4	7.1	13.0	24.0	7.6	12.6	23.5	8.7	12.6
Food and confectionery	14.0	4.4	7.6	18.8	6.1	10.0	22.4	5.3	9.7
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

Note:

The Group had no sales proceeds during the period from 1st March, 2003 to 8th May, 2001 as operations of the Group were commenced on 9th May, 2001.

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The following table lists some of the selective brands featured in the **Sogo** Store (*in alphabetical order*):

Apparels and fashion

Aquascutum
Brooks Brothers
Celine
Christian Dior
Daks
Diesel
Durban
Gucci
Hermes
Le Coq Sportif
Marlboro Classics
Miss Sixty
Nike
Polo Ralph Lauren
Prada
Wacoal

Cosmetics and accessories

Biotherm
Chow Tai Fook
Estee Lauder
Lancome
Shu Uemura
Shiseido

Household, toys and others

Asahiya Book Shop
Lalique
M.J. Hummel
Panasonic Showroom
Sheridan
Slumberland
Sony

Food and confectioneries

Beard PaPa
Dong
Mary's Chocolate
Minamoto Kitchoan
Morozott

Apparels and fashion

The merchandise under this category include formal dresses, business wear, casual and sporty wears, pyjamas and underwear for men, women, children and infants. They are offered at the following departments of the **Sogo** Store:

- *International boutiques* – branded shops located at Ground Floor of East Point Centre;
- *Men's wear department* – men's casual wear, business wear, dress shirt, neckties, underwear and socks, located at 5th Floor of East Point Centre;

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- *Young fashion department* – young casual wear, jeans and T-shirts, located at 3rd Floor of East Point Centre;
- *Ladies' wear department* – ladies' dresses, suits, blouses, sweater, jackets, skirts, pants, foundation and lingerie, located at 1st Floor and 2nd Floor of East Point Centre;
- *Kid fashion department* – children's and babies' wear, children's and babies' shoes, maternity wear and babies' goods, located at 6th Floor of the **Sogo** Store; and
- *Sport department* – sportswear and general sporting goods, located at 4th Floor of the **Sogo** Store.

As at the Latest Practicable Date, these departments in aggregate occupy about 47% of the total gross floor area of the **Sogo** Store.

Cosmetics and accessories

The merchandise under this category include skin care products and cosmetics, jewellery and watches, shoes, handbags and other fashion accessories. They are principally offered at the following departments of the **Sogo** Store:

- *Cosmetics counters*, located at Ground Floor of the **Sogo** Store and in an extended area under the name of "Beauté@SOGO" located at Ground Floor of Excelsior Plaza;
- *Men's and Ladies' accessories department* – men's shoes, ladies' shoes, leather goods, ladies' handbags, ladies' fashion accessories, stockings, and cigars and smoking accessories, mainly located at 1st Basement of the **Sogo** Store; and
- *Luxury accessories department* – handbags and accessories, and jewellery and watches, located at Ground Floor and 1st Floor of the **Sogo** Store.

As at the Latest Practicable Date, these departments in aggregate occupy about 16% of the total gross floor area of the **Sogo** Store.

As illustrated in the above table, over 70% of the total sales under the categories of "apparels and fashion" and "cosmetics and accessories" for the two years ended 31st December, 2003 were made by concessionaire sales. The Directors attribute this to the stronger tendency of consumers' "brand awareness" with respect to "apparels and fashion" and "cosmetics and accessories" items than other merchandise. In addition, as most "apparels and fashion" and "cosmetics and accessories" suppliers place great importance on their own brand images, they normally sell their products through their own concessionaire

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counters and not by way of wholesale distribution so that the brand images could be closely monitored. As at the Latest Practicable Date, there were 132 and 94 concessionaire counters set up under the above “apparels and fashion” department and the “cosmetics and accessories” department, respectively.

Household, toys and others

The merchandise under this category include kitchen utensils, chinaware, electrical appliances and audio and video equipment, etc. They are offered at the following departments of the **Sogo** Store:

- *Household department* – tableware and kitchen utensils, located at 7th Floor of East Point Centre;
- *Home appliances department* – furniture and bedding, towels and bathroom accessories, carpets, mattress, home electrical appliances, audio and visual equipment, health care equipment and amusement goods such as books and magazine, gifts, stationeries and optical, etc, located at 9th Floor and 10th Floor of East Point Centre; and
- *Toys department* – character’s shop, children’s stationeries and toys, located at 6th Floor of the **Sogo** Store.

As at the Latest Practicable Date, these departments in aggregate occupy about 18% of the total gross floor area of the **Sogo** Store.

In contrast to the categories of “apparels and fashion” and “cosmetics and accessories” where revenues were mainly generated from concessionaire sales, majority of sales under the category of “household, toys and others” were made by direct sales. This is consistent with the general market practice as most of the products under this category are supplied by suppliers through wholesale distribution and by way of consignment sales. As at the Latest Practicable Date, there were only 36 concessionaire counters set up under the departments for “household, toys and others”.

Food and confectionery

The merchandise under this category include:

- Freshmart, a supermarket store;
- Gourmet which includes coffee shops, bakery shops, confectionery counters, fast food stands and a wine corner; and
- Miscellaneous shops which include a drug store and a flower shop.

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The Group operates a supermarket in the **Sogo** Store under the name of “Freshmart” which stands for “quality”, “freshness”, “variety”, “nutrition” plus utmost cleanliness and highest hygienic standard. Freshmart is located at 2nd Basement of East Point Centre and B2 of Island Centre and commercial subway under East Point Road. Foods and domestic goods offered at “Freshmart” include groceries, confectioneries, perishable food products, dairy products, delicatessen and Japanese food. Merchandise are mainly direct purchases and inventories of the Group which are sourced from local suppliers or agencies.

As a “one-stop-shop” department store, there are restaurants, cafes, bakery shops, fast food stand, wine corner and confectionery counters in traditional Chinese and Japanese style within the **Sogo** Store. Majority of these gourmet shops such as **Cafe Royce, Sogo Cafe, Beard Papa, Donq, Morozott** and **Mary’s Chocolate**, etc. are located at 1st Basement and 2nd Basement of Jumbo Sogo. However, for the convenience of shoppers, there are also cafes opened at different shopping floors in Jumbo Sogo including “UCC Coffee Shop” on 2nd Floor and “UCC by Cafe City” on 4th Floor. All these gourmet shops are concessionaire counters and the Group is not involved in their daily operations. As at the Latest Practicable Date, there were 29 concessionaire counters set up under the departments for “food and confectionery”.

As at the Latest Practicable Date, these departments in aggregate occupy about 14% of the total gross floor area of the **Sogo** Store.

Store management

The day-to-day operations for each sales department of the **Sogo** Store, including merchandising and inventory stock control, are mainly carried out by its sales division managers under the overall supervision of the general management. Regular sales reports will be generated and prepared to assist the management in closely monitoring the operations of the store. Information will include sales analysis on individual department/shopping floor, day-by-day/week-by-week/month-by-month/year-on-year comparison, visitor traffic and visitor stay and buy ratio. Set out below is the analysis data gathered during the Track Record Period which, in particular, are highlighted with the average visitors traffic and visitor stay and buy ratio of the **Sogo** Store:

Period	Approximate number of visitors (persons)	Average number of visitors per day (persons)	Stay and buy ratio (%)
9th May, 2001 – 31st December, 2001	19,900,000	83,989	27.2
2002 full year	31,300,000	85,802	30.1
2003 full year	30,600,000	83,840	28.9

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The following table summarises the hi-low traffics of the **Sogo** Store in each of the three years ended 31st December, 2003:

Year	Highest visitors flow			Lowest visitors flow		
	Date	Approximate number of visitors (persons)	Stay and buy ratio (note)	Date	Approximate number of visitors (persons)	Stay and buy ratio (note)
2001	23rd January	151,577	34.1	4th June	55,291	29.2
2002	21st December	143,875	33.5	11th June	59,192	27.0
2003	20th December	150,101	29.4	31st March	43,183	27.3

Note: Stay and buy ratio is calculated by dividing the number of invoices issued by the number of visitors on a particular date.

These analyses assist the management to respond and take any necessary measures to formulate strategies to improve the overall performance of the store. Sales division managers will then be responsible to implement and monitor compliance with various strategies adopted by the Group. Their work ranges from the design of the store layout, the display of goods to the organisation of promotion and special bargain sales. It is the continuous objective of the Group to improve the quality of products and services offered at the **Sogo** Store, in particular, to provide a warm and comfortable shopping environment within the store for customers' ultimate satisfaction.

For the overall management of the store, the Group initiates and coordinates the overall promotion events within the store and frequently reviews the merchandise mix, pricing and quality of goods.

Payment arrangements

Merchandise are sold at the **Sogo** Store on a "cash" basis, either in cash, by "cleared" cheque, EPS, gift certificates issued by Sogo HK or credit card payments. The Group is, therefore, not subject to any bad debts in its retailing business.

Sogo Store has no return or refund policy. However, **Sogo** Store will consider for some special circumstances, allowing customers to return or refund goods bought at the **Sogo** Store in order to maintain its high standard of quality customer service.

Gift certificates

Gift certificates are issued by the Sogo HK in different denominations. The gift certificates issued before 15th February, 2003 ("Old Gift Certificates") do not have any expiry dates and are redeemable upon presentation of the certificate. The value of the

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outstanding redeemable Old Gift Certificates as at 31st December, 2003 was about HK\$13 million. The gift certificates issued from 15th February, 2003 (“New Gift Certificates”) onward has a three-year validity from the date of issue. The value of the outstanding redeemable New Gift Certificates as at 31st December, 2003 was about HK\$24 million.

	Amount of gift certificates issued		
	For the period from 9th May, 2001 to 31st December, 2001	For the year ended 31st December, 2002 2003	
	<i>HK\$'million</i>	<i>HK\$'million</i>	<i>HK\$'million</i>
Old Gift Certificates	11	31	7
New Gift Certificates	—	—	47
Total	<u>11</u>	<u>31</u>	<u>54</u>

NUFRONT

Nufront is a Japanese-style shopping centre for the young trendy people, occupying a gross floor area of about 26,680 sq.ft. **Nufront** has been operating under a sub-leasing/sub-licensing arrangement with small retailers since mid-2002. As at the Latest Practicable Date, **Nufront** had about 63 tenants/licensees, representing an occupancy rate of over 80%. Rental income recorded for the two years ended 31st December, 2003 were about HK\$6.8 million and HK\$17.9 million respectively.

DAISO LAND TEN-DOLLAR SHOP

“**Daiso Land Ten-dollar Shop**” – A ten-dollar shop which is currently operating under the name of “**Daiso Land**”. Merchandise at HK\$10 per item are available for sale at the “**Daiso Land Ten-dollar Shop**”. In August 2002, after the Group acquired the inventories and outfit from a third party concessionaire who had operated the **Daiso Land Ten-dollar shop**, the Group started its own operation of the **Daiso Land Ten-dollar shop**. The **Daiso Land Ten-dollar Shop** is located at 1st Basement of Island Centre and at 2nd floor of Excelsior Plaza, which in aggregate occupies a gross floor area of 13,943 sq.ft.. Revenue from the **Daiso Land Ten-dollar shop** was generated by way of direct sales and amounted to about HK\$5.5 million and about HK\$9.9 million respectively for the two years ended 31st December, 2003.

SALES

Sales of the Group are conducted by way of direct sales and concessionaire sales.

Direct sales

For direct sales, the Group sources and sells its own direct-purchase merchandise for **Sogo** Store and **Daiso Land Ten-dollar Shop**. The **Sogo** Store has been the key contributor to the direct sales of the Group during the Track Record Period. Normally, merchandising plans are prepared every year by each sales division which set out the range of products to be purchased based on past experience and the projected market trend/demand, taking into account the Group's budgeted sales and gross profit margins for that year. Sourcing of merchandise and negotiation of terms and conditions are then handled by the sales managers of respective departments with reference to the merchandising plans. Most of the merchandise of the **Sogo** Store are imported through local agents in Hong Kong. During the Track Record Period, less than 2% of the Group's purchases for direct sales were settled in foreign currencies.

The merchandising plans are revised regularly in order to provide an appropriate mix of merchandise and to improve the control of the store's inventory level and at the same time enhance the efficient use of working capital. Merchandise, in general, are purchased under either the "Purchase Order" arrangements or the "After Purchase Order" arrangements with suppliers. Under "Purchase Order", the Group will record and account for the purchased goods as inventories at the time when they are delivered and are satisfactorily received; whereas under "After Purchase Order", the Group will only record and account for the purchased goods at the time when they are sold. The "After Purchase Order" arrangement significantly reduces inventory risk to the Group. Up to about 65% of the purchases were conducted under the "After Purchase Order" mechanism.

The **Sogo** Store has a team of 11 staff responsible for checking the physical conditions of the goods upon their delivery and the sales team which orders the merchandise will be responsible for checking the quality of the goods prior to display and/or storage. During the Track Record Period, the Group had received a limited number of claims for defective goods sold by way of direct sales, and such claims, whether on an individual or an aggregate basis, are not considered as material. Stock-takes are carried out twice a year for inventory control purpose. There is no policy on general provision of inventories. The management of the Group will assess the marketability and the condition of the merchandise on a regular basis. Provision will be made for the obsolete merchandise once they are identified by the management of the Group. The provision in 2001 was about HK\$10 million. There were no provisions made for each of the two years ended 31st December, 2002 and 2003.

During the Track Record Period, the Group's five largest suppliers accounted for about 15% of the Group's total purchases under direct sales. During the same period, the largest supplier (a cosmetic brand supplier) accounted for about 7% of the Group's total purchases under direct sales. Top five suppliers of the Group include world renowned brands. Products provided by the top five suppliers include cosmetics, apparels and fashion, electric appliance and food and confectionery products. None of the Directors or chief executive of the Company or its subsidiaries or any of their respective associates or, so far

as the Directors are aware, any shareholder who owns more than 5% of the issued share capital of the Company or its subsidiaries, has any interest in any of the five largest suppliers of the Group for the three years ended 31st December, 2003.

In general, the Group enjoys a credit period of 30 to 45 days. For "After Purchase Order", invoices are settled by autopay on the 25th of each month for sales of the previous month.

Concessionaire sales

In addition to direct sales, the Group also enters into concessionaire agreements with certain suppliers (known as concessionaires) who are allowed to occupy designated areas in the **Sogo** Store and establish their own sales counters for their products. Concessionaire agreement usually specifies which types of products are allowed to be sold by the concessionaires in the **Sogo** Store. In general, concessionaire agreements are subject to renewal every two years. Almost all of the concessionaires will be responsible for the design, decoration and fitting out works of their counters at their own cost under the decoration policy guidelines set out by the Group and will also be responsible for any regular repair and maintenance costs being incurred. In addition, the concessionaire has the obligation to employ its own staff and to maintain standards of quality acceptable to the Group with regards to the merchandise sold and the services provided. In respect of the concessionaire sales, the Group actively monitors the product mix and the sales of the concessionaire counters. In addition, the Group frequently discusses with and provides advice to the concessionaires regarding their sale performances, marketing and promotion strategies, and merchandise displays, etc. Furthermore, the Group offers customer service technique briefings to the personnel of the concessionaires of the Group.

The Group charges each concessionaire a turnover commission calculated at an agreed percentage rate of sales for that concessionaire and with reference to an agreed amount of minimum commission. Nearly all concessionaires are charged on such basis. For those concessionaires whose turnover commission otherwise payable do not exceed their respective minimum commission, the minimum commission will be charged. Sales amount received from the concessionaire sales is first collected by the **Sogo** Store on their behalf and then refunded to the concessionaires on a monthly basis after deduction of all relevant expenses and commission.

This "shops-in-shop" arrangements with concessionaires increase the attractiveness of the **Sogo** Store by broadening the range of merchandise offered to customers. In addition, the risks and the costs of holding inventories, as well as the selling costs, are borne by and transferred to the concessionaires. Concessionaires are typically for the operations of fashion, luxury accessories, cosmetic counters, home appliances, restaurants and fast food outlets. As at the Latest Practicable Date, there were 291 concessionaire counters operated in the **Sogo** Store. During the Track Record Period, the Group did not receive any material claims against the Group for damages caused by defective goods sold by the concessionaires of the Group.

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To further enhance the “shops-in-shop” concept, it is the intention of the Group to place a stronger emphasis on the concessionaire sales operations at the **Sogo** Store.

Seasonality

Sales of the Group follow the traditional shopping seasonal patterns in Hong Kong, with a high proportion of sales being recorded around Christmas and Chinese New Year. Together with the fact that merchandise for winter seasons are generally at a higher price, more than 39% of the Group's revenue was generated during the four months period from November to February for the two years ended 31st December, 2003.

In addition, the **Sogo** Store traditionally records higher sales in May and November each year for the anniversary of the **Sogo** Store and Jumbo Sogo, respectively.

MARKETING AND SALES PROMOTION

Marketing

The Group's marketing plans are drawn for each month, quarter and half year. Market research studies are conducted to collect market data relating to matters such as consumer behaviour and feedback from customers on the store's various marketing tactics. These market surveys are normally conducted by interviewing customers at each floor of the **Sogo** Store. Questionnaires, covering areas such as pricing and the range of merchandise offered in the store, the effectiveness of promotional materials distributed and comparison with competitors are often answered by customers. The information collected is then used as reference material in formulating the Group's marketing strategies. In addition to its survey, the Group also reviews the effectiveness of promotions which are held, for major events and special occasions at the **Sogo** Store including the anniversary sales and, during Christmas and Chinese New Year in order to further enhance its future performance.

To facilitate the promotion of store image and to position the **Sogo** Store as the “destination” store, advertisements are placed in newspapers, magazines, television, handbills and direct mail. In addition, the Group places advertisement in advertising signboards in the MTR Causeway Bay station, all of which are aimed at attracting the general public to visit the **Sogo** Store.

In-store advertising

As an additional marketing tool, the new management of Sogo HK renovated the external building walls as well as certain internal walls of the **Sogo** Store in 2001 to allow its concessionaires and suppliers to advertise and promote their products and/or goods through outdoor billboards and in-store light-boxes.

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For outdoor billboards, mega-size posters are posted on the external building walls of the **Sogo** Store along Hennessy Road, Lockhart Road and East Point Road. For in-store light-boxes advertising, complementing advertisements are usually placed close to the concessionaires' counters. Depending on the location of the advertisements, different monthly sponsorship fees are charged to the concessionaires and suppliers in addition to the initial production fee and, for outdoor billboards only, the monthly electricity fees.

Sales promotion

Seasonal sales

Regular sales campaigns are run every summer and winter through summer sales and winter sales (including the Chinese New Year Sales and the Stock Clearance Sales, which normally take place after the Chinese New Year Sales), during which discounts will be offered for almost all of the merchandise at the store.

In addition to regular sales campaigns, special promotion events under different themes will also be organised at the **Sogo** Store to attract customers. This includes the Spring Festival, the **Sogo** Store Anniversary (in May), the Autumn Festival, the Jumbo Sogo Anniversary (in November) and the Japanese Festival. During these events, special discount will be offered for selected items of merchandise and there will be gift rewards, lucky draw and enjoyable games, etc. Depending on the promotion events and nature, concessionaires at the store are invited to participate, for instance, by contributing to the costs and expenses incurred by the Group in public relation campaigns or by offering exclusively selected items at special prices.

Private sales

The **Sogo** Store conducts private sales periodically at its event hall to further increase its variety of merchandise.

Co-branded Credit Card

For the purposes of enhancing the store's image, building up customers' loyalty and the benefits of maintaining a database for direct marketing and sale promotion, the Group adopted a co-branded credit card arrangement. In September, 2003, Sogo HK re-launched its co-branded credit card (gold or classic) under the logos of "Sogo" and "UOB" in accordance with the co-branded card arrangement with United Overseas Bank Limited, a bank in Hong Kong. Besides the financial benefits of credit payment on purchases, the co-branded cardholders can enjoy certain shopping privileges, such as special 5% discounts at participating counters for purchase at the **Sogo** Store. The Group aims to develop the Sogo/UOB co-branded cards as its store loyalty cards. In the future, marketing and promotion materials as well as provision of extra purchases incentives, participation in special events would be communicated to this group of loyal customers. The Directors believe this group

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of customers will be frequent shoppers and deserve an effective direct mailing of promotion materials.

As at the Latest Practicable Date, there were over 32,000 approved Co-branded Credit Card holders.

Interest-free Installment

Arrangements have been made with credit card companies to offer interest-free installment for customers in purchasing certain electrical appliances or from certain participating concessionaires' counters with invoices over a pre-set amount. In addition to the normal credit card payment procedures, the customers applying for the interest-free installment arrangements are required to fill in an application form provided by the credit card companies. The extra credit card charges arising from such arrangement are usually borne by concessionaires since the objectives of the interest-free installment are to increase sales and to provide better services to customers which are for the benefit of both the Group and the concessionaires. With the benefit of the interest-free installment arrangements, the Group is able to further promote its sales without bearing any customer-related credit risk.

Customer services

The Group has offered the following services at the **Sogo** Store to enhance the quality of services being provided to shoppers/customers:

- ✓ Free delivery service
- ✓ Complimentary car parking
- ✓ Free alteration on non-discount items
- ✓ Money exchange
- ✓ Bridal list/wedding register
- ✓ Gift wrapping
- ✓ Nursery room

To provide incentive for its sales staff to deliver quality customer service, compensation of sales staff is performance-based. Bonus are being paid if certain targets are reached.

PRC JVs ACQUISITIONS

PRC JVs Acquisition Agreement

On 30th March, 2004, Excellent Global (a direct wholly-owned subsidiary of the Company) as purchaser entered into the PRC JVs Acquisition Agreement with Pure Group and Full Partner as vendors, Mr. Thomas Lau, Mr. Joseph Lau and CTF as warrantors. Pure Group and Full Partner each beneficially owns 50% of the issued share capital of Great Prosperity. Pursuant to the PRC JVs Acquisition Agreement, Excellent Global has conditionally agreed to acquire:

- (a) the entire issued share capital of Great Prosperity; and
- (b) the shareholders' loans due from Great Prosperity to Pure Group and Full Partner at completion, which were on-lent to Smart Fortune and Gainbest.

The consideration payable for acquiring the entire issued share capital of Great Prosperity will be an amount equal to 94% of the valuation of the Shopping Complex attributable to the interest held by Great Prosperity assuming completion of its interior decoration and fitting out works less the book costs of the Shopping Complex as at the completion date attributable to Great Prosperity, while the shareholders' loan will be sold at the face value thereof. The Shopping Complex has been valued at about RMB1,660 million by FPD Savills (Hong Kong) Limited assuming completion of interior decoration and fitting according to the specifications provided. On the basis of the unaudited book costs of the Shopping Complex as at 29th February, 2004, it is expected that the consideration would amount to some HK\$483 million. Under the PRC JVs Acquisition Agreement, the total consideration (as adjusted) payable by Excellent Global under the PRC JVs Acquisition Agreement will be subject to a cap of HK\$500 million. A post-completion audit will be conducted by an independent auditor for determining the revaluation surplus as soon as practicable after the issue of the final accounts for construction costs of the Shopping Complex (which is expected to be issued not later than 30th June, 2005). The total consideration payable by Excellent Global will be adjusted by an amount (net of tax, if appropriate) representing 50% of the difference (if any) between (a) the total construction costs attributable to the Shopping Complex (including those for full completion of the interior decoration and fitting according to the specifications provided to Excellent Global) as certified by the independent auditor; and (b) such construction costs as appeared in the completion accounts prepared at the time of completion of the PRC JVs Acquisition Agreement. At present, it is estimated that the total remaining outfitting and interior decoration costs for the Shopping Complex will not exceed RMB27 million (about HK\$25.2 million).

As the registered capital of the Operating JV has not been paid up, Gainbest will be required to pay up the amount of US\$4,030,000 as registered capital of the Operating JV. Any capital of the Operating JV paid up by Gainbest after completion of the PRC JVs Acquisition Agreement will be provided by the Group from the proceeds of the Share Offer.

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The terms of the PRC JVs Acquisition Agreement were arrived at after arm's length negotiations among the Company and the vendors with reference primarily to (a) the property valuation of the Shopping Complex prepared by the FPD Savills (Hong Kong) Limited as at 29th February, 2004; (b) the shareholders' total investment in Great Prosperity of about HK\$245.1 million in aggregate as at 29th February, 2004 and (c) the business prospects of the PRC JVs, in particular, the Operating JV.

Pure Group is ultimately owned by Mr. Thomas Lau and a discretionary trust of which certain family members of Mr. Joseph Lau are eligible beneficiaries. Full Partner is ultimately owned by CTF. Both Pure Group and Full Partner are companies incorporated in BVI with limited liabilities.

The Property JV

Smart Fortune is a wholly-owned subsidiary of Great Prosperity and its sole asset is its 50% interests in the Property JV. The Property JV was established pursuant to the approval dated 21st May, 2003 issued by Shanghai Foreign Investment Work Commission (上海市外國投資工作委員會) and the business licence dated 11th June, 2003 issued by the Shanghai Administration of Industry and Commerce (上海市工商行政管理局) with an operation term commencing from 16th April, 2003. It is the operating vehicle for developing and holding the Shopping Complex. Such property occupies a site area of about 17,222 sq.m. (equivalent to about 185,376 sq.ft.) and situated at Plot No.117 Yuyuan Road, Jingan District, Shanghai, the PRC, with a 10-level shopping complex having a gross floor area of 91,613 sq.m. (equivalent to about 986,113 sq.ft.) built on the site. The Property JV is responsible for the construction costs of the Shopping Complex. The construction of the Shopping Complex has been completed and internal decoration and fitting outs are in the progress. It is expected that soft opening of the Shopping Complex will take place in mid-2004.

The legal adviser of the Company on PRC laws has advised the Company that the Property JV has been duly organised and validly existing as a limited liability company and the Property JV is the registered owner of the use right to the land situated at Plot No. 117 Yuyuan Road, Jingan District, Shanghai, the PRC and the property under construction thereon. The registered capital of the Property JV is US\$35,000,000 and has been fully paid up.

Smart Fortune, Joinbuy Group and Shanghai Joinbuy (the A shares of which are listed on the Shanghai Stock Exchanges) are parties to the Sino-foreign equity joint venture contract dated 22nd August, 2003 as supplemented by an amendment agreement dated 11th November, 2003 (collectively the "Property JV Contract") whereby their rights and obligations in relation to the Property JV are regulated. Joinbuy Group is a wholly state-owned company

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and Shanghai Joinbuy is owned as to about 30.5% by Joinbuy Group. The major terms of the Property JV Contract are as follows:

Operation term:	40 years, from 16th April, 2003 to 15th April, 2043
Form of joint venture:	Sino-foreign equity joint venture
Approved total investment:	US\$90,000,000 (equivalent to HK\$702,000,000)
	If additional funding is required, the difference between the approved total investment of US\$90,000,000 and the approved registered capital of US\$35,000,000 will be made up by way of bank borrowings or by way of loans from the joint venture parties in accordance with their proportions of equity interest in the Property JV as described below.
Approved registered capital:	US\$35,000,000 (equivalent to about HK\$273,000,000) comprising: Joinbuy Group – US\$11,900,000 Shanghai Joinbuy – US\$5,600,000 Smart Fortune – US\$17,500,000
Equity interest, percentage of profit distribution, and the distribution of assets upon liquidation:	Joinbuy Group – 34% Shanghai Joinbuy – 16% Smart Fortune – 50%
Attributable interest to Smart Fortune:	50%
Board composition (maximum number of directors which each party may nominate):	Joinbuy Group – two directors Shanghai Joinbuy – one director Smart Fortune – three directors
Transfer of equity interests	If a party proposes to transfer its equity interests in the Property JV to a third party (other than a related company of the transferor), such equity interests have to be offered first to the other two parties for purchase on the same terms made available to that third party (<i>Note</i>).

Note: There is no requirement for Smart Fortune to obtain any regulatory approval in PRC under the PRC laws or the consents of Joinbuy Group and Shanghai Joinbuy under the Property JV Contract if the ultimate beneficial owner of Smart Fortune changes.

The Operating JV

Subject to the approval issued by the PRC Ministry of Commerce (中國商務部) and the business licence issued by the Shanghai Administration of Industry and Commerce (上海市工商行政管理局), the Operating JV will be established with Gainbest (a wholly-owned subsidiary of Great Prosperity) being the holder of 65% of the registered capital of the Operating JV. The Operating JV is to be established for the purpose of and will be principally engaged in the operation of the Ongoing Department Store (久光百貨). Application has been made for the establishment of the Operating JV. The legal adviser of the Company on PRC laws is not aware of any legal obstacles in obtaining business licence for the Operating JV. It is expected that all relevant approvals for the establishment of the Operating JV will be obtained in the second half of 2004. Apart from its business licence, the Operating JV may be required to obtain other licences or approvals (such as those in relation to food, non-staple fruits, audio-video products etc.) depending on the types of merchandise and service offered.

The legal adviser of the Company on PRC laws has advised the Company that after obtaining the approval from the PRC Ministry of Commerce, the certificate of approval and the business licence, the Operating JV will be duly established and validly existing as a limited liability company.

Gainbest, Joinbuy Group and Shanghai Joinbuy are parties to a Sino-foreign equity joint venture contract dated 4th August, 2003 (the "Operating JV Contract") whereby their rights and obligations in relation to the Operating JV are regulated. The major terms of the Operating JV Contract are as follows:

Proposed operation term:	30 years from the date of issue of the business licence
Form of joint venture:	Sino-foreign equity joint venture
Proposed total investment:	US\$10,000,000 (equivalent to about HK\$78,000,000)

If additional funding is required, the difference between the proposed total investment of US\$10,000,000 and the proposed registered capital of US\$6,200,000 will be made up by way of bank borrowings or by way of loans from the joint venture parties in accordance with their proportions of equity interest in the Operating JV as described below or such other means agreed by all the joint venture parties.

Proposed registered capital:	US\$6,200,000 (<i>Note</i>) (equivalent to about HK\$48,360,000)
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Equity interest, percentage of profit distribution, and the distribution of assets upon liquidation:	Joinbuy Group – 16% Shanghai Joinbuy – 19% Gainbest – 65%
Attributable interest to Gainbest:	65%
Proposed board composition (maximum number of directors which each party may nominate):	Joinbuy Group – one director Shanghai Joinbuy – one director Gainbest – four directors
Transfer of equity interests	If a party proposes to transfer its equity interests in the Operating JV to a third party (other than a related company of the transferor), such equity interests have to be offered first to the other two parties for purchase on the same terms made available to that third party.

Notes:

1. Pursuant to the Operating JV Contract, the joint venture parties of the Operating JV have to contribute the first instalment of their respective share of the registered capital of the Operating JV (being 15% of the registered capital) within three months after the Operating JV has obtained the approvals for its establishment from governmental authorities. The balance has to be paid up within three years after obtaining such approvals.
2. Pursuant to the Operating JV Contract, Gainbest, Shanghai Joinbuy and Joinbuy Group are obliged to contribute US\$4,030,000, US\$1,178,000 and US\$992,000 respectively representing 65%, 19% and 16% of the registered capital of the Operating JV.
3. There is no requirement for Gainbest to obtain any regulatory approval in PRC under the PRC laws or the consents of Joinbuy Group and Shanghai Joinbuy under the Operating JV Contract if the ultimate beneficial owner of Gainbest changes.

The Operations

It is intended that the Ongoing Department Store (久光百貨) will be located at the Shopping Complex with a store area of not less than 70% of the total gross floor area available from the plaza. A rental agreement will be entered into between the Operating JV and the Property JV in due course at a rate by reference to the then prevailing market rates. The remaining gross floor area of the plaza is expected to be leased to independent third parties.

It is intended that the Ongoing Department Store will be a “lifestyle” concept based department store that offers a wide variety of merchandise. It is also intended that merchandise will be sold by means of direct sales as well as concessionaire sales. At present, merchandising plans in respect of the direct sales are being prepared. In respect of the concessionaire sales, some of the better known concessionaires that operate counters at the **Sogo** Store have indicated their interests in the operation of concessionaire counters at the Ongoing Department Store. As at the Latest Practicable Date, about 200 parties have written to indicate that they would like to participate as concessionaire. It is expected that the Ongoing Department Store will commence operations in mid-2004.

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The Group plans to recruit additional personnel to run the day-to-day operations of the Ongoing Department Store and the operations will be closely monitored and supervised by the existing senior management of the Group. At present, three Japanese staff with extensive department store experience were hired for this purpose.

Conditions

Pursuant to the PRC JVs Acquisition Agreement, the latest time for all the conditions to its completion to be fulfilled is 31st December, 2004 and completion shall take place within 10 business day after fulfillment of all the conditions to completion as set out in the PRC JVs Acquisition Agreement which, among others, include:–

- (i) due establishment of the Operating JV;
- (ii) due execution of the rental agreement between the Property JV and the Operating JV in respect of the premises to be occupied by the Ongoing Department Store;
- (iii) satisfactory completion of due diligence by the Group in respect of the PRC JVs; and
- (iv) the Listing.

Further information

As at 31st December, 2003, the net consolidated deficit of Great Prosperity was about HK\$12.1 million. The accountants' report of Great Prosperity is set out in appendix III to this prospectus. As at 29th February, 2004, the total investment of the shareholders in Great Prosperity amounted to an aggregate of about HK\$245.1 million. The net surplus arising from the valuation of the Shopping Complex attributable to Great Prosperity referred to below amounted to about HK\$190.7 million and is calculated based on the open market value of the Shopping Complex (assuming the internal decoration and fitting work were completed on 29th February, 2004) less the attributable book costs of the Shopping Complex and the further sum of about HK\$25.2 million to be spent for fitting out and decoration works (after taking into the relevant accruals of HK\$15.4 million) and the provision for deferred tax on revaluation surplus. The provision for deferred tax on revaluation surplus is calculated on the basis that both Land Appreciation Tax and Income Tax provisions are made against the Shopping Complex at the relevant prevailing tax rates.

The above mentioned valuation surplus includes about HK\$93.9 million provision for deferred tax on revaluation surplus of the Shopping Complex. Whilst such property will be held for long term purpose and there is no plan to sell such property in the foreseeable future, the crystallisation of such deferred tax liability is considered to be remote. The valuation surplus will be increased to about HK\$284.6 million if such deferred tax provision is excluded.

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The Shopping Complex has been valued as at 29th February, 2004 by FPD Savills (Hong Kong) Limited, an independent property valuer at RMB1,455 million (equivalent to about HK\$1,373 million). On 29th February, 2004, the Shopping Complex was in the process of internal decoration and fitting. If such works were completed on 29th February, 2004, the open market value of the Shopping Complex prepared by FPD Savills (Hong Kong) Limited would be about RMB1,660 million. The letter from FPD Savills (Hong Kong) Limited and the valuation certificate in relation to the valuation of the Shopping Complex are set out in appendix VI to this prospectus.

Shanghai Joinbuy is listed on the Shanghai Stock Exchange while Joinbuy Group is its holding company. Joinbuy Group is engaged in a variety of business including department store operation in Shanghai.

PROPERTIES

Properties for occupation

The Group owns most of the properties which the **Sogo** Store occupies. As at the Latest Practicable Date, the Group owns various floors of the New Wing and the Old Wing comprising a total gross floor area of about 458,027 sq.ft., of which a total gross floor area of about 454,132 sq.ft. is occupied by the Group. The head office of the Group is also situated in such owned properties. In addition, the Group owns five other properties in Hong Kong of a total floor area of 49,741 sq.ft.. Details of such properties are disclosed in section headed "Group I – Properties held by the Group for occupation in Hong Kong" in the property valuation report prepared by FPD Savills (Hong Kong) Limited as set out in appendix V to this prospectus. FPD Savills (Hong Kong) Limited has valued such property interests of the Group as at 29th February, 2004 at HK\$4,790.7 million.

To connect the Old Wing with the New Wing in 1993, the external wall of the Old Wing adjoining the New Wing was demolished. Certain management areas and common parts and facilities of the Old Wing have also been converted or demolished by Congenial. Some of these common facilities have been relocated to other areas in the Old Wing which were originally designated for the exclusive use of Congenial under the Deed of Mutual Covenant of the Old Wing ("DMC"). Certain areas which were originally management areas or common parts under the DMC are now used by Congenial or other members of the Group. According to Counsel's opinion obtained by Congenial, the aforesaid conversions and demolition constitute breaches of the DMC, but the practical risk of any claim being made against Congenial or the relevant member of the Group seeking damages for breach of the DMC and/or reinstatement is minimal. The Directors estimate that the reinstatement costs will be about HK\$10 million. Given that the above-mentioned conversions and demolitions existed prior to completion of the Sogo HK Transaction and that such conversions and demolitions were not caused by the existing Shareholders, no indemnity has been and will be sought from the existing Shareholders of the Company to reimburse the Company on the above rebuilding and reinstatement costs. During the Track Record Period, no

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complaints have been received in relation to such conversions or demolition. Should a claim be pursued in the Lands Tribunal or Court, Counsel is of the view that reinstatement is unlikely to be required and any claim for damages as aforesaid would be unlikely to succeed. The management committee of the Incorporated Owners of the Old Wing has, on 25th February, 2004, approved the conversion of the common areas and relocation of the common parts and facilities with a view to deal with the usage issues caused by the conversion and relocation of the common parts and facilities. Legal advisers and other necessary professional parties will be appointed in the preparation of a deed of mutual grant to remove the breaches.

As at the Latest Practicable Date, (i) Congenial, a wholly-owned subsidiary of the Company, is the registered owner of certain sections of the properties situated at the Old Wing (as more particularly described in note (1)(a)(i) to property numbered 6 and property numbered 12 in the valuation report as set out in appendix V to this prospectus) and (ii) Eastlord, a wholly-owned subsidiary of the Company, is the registered owner of certain sections of the properties situated at the New Wing (as more particularly described as properties numbered 8, 13 and 15 in the valuation report as set out in appendix V to this prospectus). The properties situated at the Old Wing are the subject matters of a sale and purchase agreement dated 29th May, 1985 (as amended and supplemented by supplemental agreements dated 8th July, 1986 and 29th May, 1987) between Congenial as vendor and Sogo HK, another wholly-owned subsidiary of the Company, as purchaser; and the properties situated at the New Wing are the subject matters of a sale and purchase agreement dated 31st January, 1996 (as amended by an addendum dated 7th July, 1997) between Eastlord, as vendor and Pacific Trump as purchaser. The assignment of such properties for the completion of the sales and purchases have not taken place and the Directors are ascertaining the possibility of completing the assignments in the near future and whether an exemption of stamp duty is available under section 45 of Stamp Duty Ordinance on the basis that Congenial, Eastlord and Pacific Trump are wholly-owned subsidiaries of Sogo HK. Please refer to note 28 of the accountants report as set out in appendix 1 to this prospectus for details of the contingent liabilities recorded in respect of the stamp duty payable. The Directors do not anticipate that the assignments of the above properties will be executed on or before 31st December, 2005.

Investment properties

Three properties in Hong Kong comprising a total gross floor area of about 19,415 sq.ft. are held by the Group for investment purpose. Two of them are leased to independent parties under various terms based on arm's length negotiation, and the lease with the latest scheduled expiry date is due to expire in December 2005. Details of such investment properties are disclosed in section headed "Group II – Properties held by the Group for investment in Hong Kong" in the property valuation report prepared by FPDSavills (Hong Kong) Limited as set out in appendix V to this prospectus. FPDSavills (Hong Kong) Limited has valued such property interests of the Group as at 29th February, 2004 at HK\$62.4 million.

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Properties rented by the Group

The Group has rented four properties in Hong Kong comprising a total gross floor area of about 57,365 sq.ft.. Two of such properties comprising various portions/units of Excelsior Plaza with an aggregate gross floor area of about 39,095 sq.ft. are leased from a subsidiary of Chinese Estates. Terms of such leases will expire on 31st October, 2005 and the monthly minimum rental is HK\$3.3 million. Part of the leased properties is occupied by the Group under the trade names of "Freshmart" of the **Sogo** Store and "**Daiso Land Ten-dollar-Shop**", and the remaining part having an aggregate area of about 26,680 sq.ft., is operated under the trade name of "Nufront" and is sub-leased or sub-licenced to various independent third parties under sub-lease/sub-licence arrangements. The terms of such sub-lease/sub-licence agreements are usually between one to three years. The sub-lease/sub-licence with the earliest expiry date is due to expire on 15th May, 2004 while the sub-lease/sub-licence with the latest expiry date is due to expire on 31st October, 2005. The Directors consider that the period of the term of the said sub-lease/sub-licence agreements is common and usual in the commercial context where the Group operates, particularly when taking into account the fact that the head lease in respect of the relevant portions/units of Excelsior Plaza is scheduled to expire on 31st October, 2005. Furthermore, the Directors have confirmed that the terms and conditions of such sub-lease/sub-licence with independent third parties are on normal commercial terms and are in the interest of the Group, and that the Group have obtained consents from its landlord on the above sub-lease/sub-licence arrangements.

Details of such properties leased to the Group are disclosed in section headed "Group III – Properties rented by the Group" in the property valuation report prepared by FPD Savills (Hong Kong) Limited as set out in appendix V to this prospectus. These leased properties have no commercial value.


INSURANCE

The Group has obtained insurance coverage for its operations, covering risks like business interruption, loss of or damage to property, public liability, employees' compensation and goods in transit, etc.. The Directors believe that the amount of coverage is typical for similar operations in the same business and is adequate for the Group.

The Group has not maintained any product liability insurance. Based on the limited number of claims for defective goods made against the Group during the Track Record Period and in view of the premiums for product liability insurance for a retail department store, the Directors do not consider it appropriate from a cost and benefit point of view to take up product liability insurance for all goods sold by the Group.

INTELLECTUAL PROPERTY

Trademark licence agreement

After completion of the Sogo HK Transaction which took place on 9th May, 2001, Sogo Japan no longer has any shareholding in Sogo HK or any of its group/subsidiary companies, nor it has any management role or is involved in the operation of the **Sogo** Store. However, as part of the Sogo HK Transaction, Sogo Co., Ltd. entered into a trademark licence agreement with Sogo HK in May 2001 (the "Licence Agreement") pursuant to which, Sogo Co., Ltd., as the licensor, granted a sole and exclusive and non-transferable licence for Sogo HK to use a series of trademarks with references to name, marks of "**Sogo/SOGO**", "崇光" and  (the "Licensed Trade Marks") in Hong Kong for 18 years. The Licence Agreement may be terminated by the licensor on the occurrence of certain events, including the insolvency of Sogo HK, breach of any of the terms of the Licence Agreement by Sogo HK and such breach not being remedied within 60 days of the written notice from the licensor, Sogo HK ceasing to carry on retail department store business for more than three years consecutively; or the acquisition by a third party of the control of Sogo HK. Except for the occurrence of the events specified in the Licence Agreement, the licensor may not terminate the Licence Agreement unilaterally by simply serving notice of termination upon Sogo HK. Pursuant to the Licence Agreement, any renewal of the Licence Agreement is subject to such terms and conditions as the parties may agree at least six months prior to its expiration. If the parties cannot agree on the renewal of the Licence Agreement, the Licence Agreement will expire and the Group may seek to undertake measures including but not limited to the use of other marks or names in its marketing and sales promotion plans. This may involve the Group incurring additional marketing expenses.

Under the Licence Agreement, Sogo HK is required to pay a royalty fee to Sogo Co., Ltd. at a certain rate of the net sales revenue including direct sales and concessionaire sales generated by Sogo HK from its retail department store business operations under the Licenced Trade Marks in Hong Kong. The licensor does not have the right to increase the royalty rate under the Licence Agreement unless otherwise agreed by the parties.

Sogo Co., Ltd. assigned the Licensed Trade Marks to Sogo, Inc. on 31st January, 2002. As a result, the licensor in the Licence Agreement changed to Sogo, Inc. (subsequently renamed as Millennium Retailing, Inc.).

Other intellectual properties rights

As at the Latest Practicable Date, the Group is the registrant of the domain name of Sogo.com.hk. In addition, the Group has registered a trademark under class 42 in Hong Kong and has applied for the registration of certain trademarks under classes 18, 25, 35 and 36 in Hong Kong and certain trademarks under classes 35 and 36 in PRC. Please refer to the section headed "Intellectual Property" in appendix VIII to this prospectus for further details.

Infringement claims

During the Track Record Period, the Group received a few infringement claims from certain third parties who alleged that certain merchandise sold in the department store infringed their intellectual property rights. For avoiding unnecessary disputes, the Group agreed to withdraw or procure its concessionaires to withdraw the sale of such merchandise in the department store. No damages were required to be paid by the Group in connection with such claims during the Track Record Period.

For the purpose of settling a similar claim which arose prior to the Track Record Period, the Group made an ex-gratia payment of HK\$650,000 in 2002 on the basis of no admission as to liability to such claim.

BUSINESS LICENCES

In relation to the operation of the **Sogo** Store, certain licences and permits are required to be obtained, such as general restaurant or light refreshment restaurant licences with, where appropriate, endorsements to sell certain restricted foods or drinks, food factory licences, fresh provision shop licences, bakery licences, milk permits, frozen confections permits, non-bottled drinks permit, liquor licence, pesticides licences, licence for listed sellers of poisons, licences for the discharge of effluent depending mainly on the types of merchandise and services offered at the **Sogo** Store at the relevant time. Further, trade promotion competition licences are required for any specific trade promotion competition such as lucky draws carried on from time to time at the **Sogo** Store.

In connection with the security services rendered by certain member of the Group, a security company licence for supplying individuals to perform security work type I (i.e. provision of security guarding services) and mobile radio system licences for the mobile radio systems used in connection therewith are required.

Further details of the licences and permits obtained by the Group are set out in the paragraph headed "Licences" in appendix VIII to this prospectus. As at the Latest Practicable Date, a few restaurants or food counters at the **Sogo** Store operated by concessionaires offer certain types of food and/or operate in certain manner exceeding the scope of the existing food licence which may require additional food or restaurant licence. However, the total turnover of the food business operated in the aforesaid restaurants or food counters represented less than 0.3% of the total turnover of the Group for the year ended 31st December, 2003 and is insignificant to the Group. Under the Water Pollution Control Ordinance (Chapter 358 of the Laws of Hong Kong), a person has to obtain a licence from the Environmental Protection Department for the discharge of any matter (other than domestic sewage) into a communal sewer or communal drain into a water control zone. Such licence may be required for the effluent discharged by the concessionaire carrying on food business in the **Sogo** Store. Several concessionaires have not yet obtained the licences for the discharge of effluent from the Environmental Protection Department. The Group has already

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requested such concessionaires to rectify the breaches by requesting them to operate in compliance with the terms and conditions of the licences or permits for their operation and where appropriate, to obtain the requisite licence or permits. Save as aforesaid, the Group has obtained the necessary licences, permits or approval for its current business operation from the relevant governmental bodies in compliance with the applicable law and regulations.

The Group maintains a team comprising staff with experience in legal, compliance and company secretarial matters to monitor the operation of the Group to ensure that relevant regulatory requirements are complied with. The Group also engages consultants and professional advisers from time to time to advise them on licensing and regulatory requirements, the handling of disputes arising in the ordinary course of business of the Group and other legal matters.

COMPETITION

There are a number of department stores operating under different styles in Hong Kong. Japanese-style department stores are differentiated from department stores of other styles in term of customer services, selection of merchandise and shopping environment. Due to the burst of the economic bubble in Japan during the late 1990s, a number of Japanese corporations have been forced to undergo overseas retreat and a number of Japanese style department stores in Hong Kong have closed down.

Following the closure of a number of Japanese-style department stores in the late 1990's, the **Sogo** Store is one of the few Japanese-style department stores remained in Hong Kong. Whereas some of these Japanese-style department stores focus on the retailing of daily necessity goods and are located in residential areas; while another one focus on cosmetics and fashion, it seems that there is only one Japanese-style department store that is of similar focus and is located at a close proximity to the **Sogo** Store. **Sogo** Store is differentiated from these Japanese-style department stores by its "lifestyle" focus and the "One-stop shop" strategy. The **Sogo** Store offers a comprehensive merchandise mix and targets the middle-upper market segments. In addition, **Sogo** Store focuses on the "shops-in-shop" concept and the sale of premium branded products.

Despite the strong competition in the retail industry in Hong Kong, the Directors consider the quality, value, merchandise mix, service and the degree of convenience to be the most significant competitive advantages in the industry. The Directors believe that there is a significant distinction between the sales strategy of the Group and that of the other department store operators in Hong Kong. The Group places great emphasis on providing a comprehensive range of merchandise through direct sales and concessionaire sales. By offering such a range of merchandise, the Group is able to satisfy the requirements of and attract customers of different age group and income group. The payment arrangement of the concessionaire sales and a major portion of the Group's direct sales, which purchases are only recorded and accounted for after the merchandise are actually sold, enables the Group to reduce its inventory risk and enhance the use of its working capital.

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The Directors recognise that there is an increasing challenge to department store operators from chain stores specialising in certain categories of merchandise and believe that the “shops-in-shop” arrangement with concessionaires allows the Group to cope with such challenges. In addition, the Directors consider that with the **Sogo** Store located at the prime shopping district of Causeway Bay, which enables it to attract a steady flow of customers and with the **Sogo** Store situated mostly at properties owned by the Group, which immunises the Group from rental fluctuations and provides flexibility to renovation arrangements, the Group is well positioned to meet challenges in the market.