

# MANAGEMENT DISCUSSION AND ANALYSIS

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## **BUSINESS REVIEW**

Egana Jewellery continues to demonstrate itself as a specialist in the luxury and fashion branded jewellery industry, by capitalizing on Brand Pyramid approach.

Out of our total revenue of HK\$1,087 million for FY 2005/06, 62% are branded items and 38% for private label.

70% of our branded items are in-house developed and produced in our integrated production network in Europe and Asia. This allows us to undertake product research and development for bringing products' original design and innovation.

Silver jewellery continues to be the trend for the fashion statement since its acceptance by the market in 1990's. Esprit, MEXX, JOOP! and Pierre Cardin silver jewellery collections were well-received by the market.

We introduced stainless steel jewellery concept to Carrera with encouraging response, and have scheduled to launch CERRUTI 1881 stainless steel jewellery collection in 2006 Christmas to capture the affordable luxury segment.

Platinum jewellery is believed to have positive growth potential in the luxury ends. It has been our long-term ambition to bring the (in-house developed) innovative platinum jewellery production technology in conjunction with prestigious brands to reach the success stage.

In 2006 Basel Fair, Abel & Zimmermann of Germany launched its latest jewellery collection — Excession containing the innovative platinum technology. About this collection Baselworld News wrote that “not only has a very striking look, it also has an attractive price that is surprisingly inexpensive for platinum jewellery of this expensive size”. It has attracted strong interest from numerous customers, particularly from US, where 40% of the bridal jewellery business is in platinum category.

We receive similar encouraging responses from markets in Germany, China and Japan.

During FY 2005/06, the geographically revenue split for Europe represents 72% (76% in FY 2004/05); Asia Pacific: 20% (15% in FY 2004/05) and US: 8% (9% in FY 2004/05) respectively.

We are currently represented in 55 countries and over 6,000 Points-of-Sales worldwide.

EganaGoldpfeil (the parent company of Egana Jewellery) has successfully integrated Salamander (a renowned German footwear brand with established retail networks in Germany as well as in Eastern Europe). We have taken steps to capitalize on the experience and relationship of Salamander in Eastern Europe to introduce our branded jewellery products into this emerging market.

In Japan (the world's largest luxury market), we ride on the network of Goldpfeil leather to open up 600 Points-of-Sales to carry jewellery products. We extended similar collections into Taiwan market.

For China market (which is expected to enjoy 20% market share of the world's luxury and fashion accessories segments in 10-year time), we have opened 400 Points-of-Sales along the introduction of the branded watches by EganaGoldpfeil.

Middle East is the market that we have successfully entered into, and we saw continuous positive development there.

US jewellery market is highly fragmented, therefore, we continued to focus ourselves on the luxury and accessible luxury segments.

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## FINANCIAL REVIEW

Group's annual revenue reached HK\$1,087 million, an increase of 28% as compared to prior year's. The turnover growth reflected a result of organic growth.

The gross margin was at 34.7% in FY 2005/06 as compared to 42.5% in FY 2004/05 in the midst of the increase in average price of raw materials of around 18% during the last financial year.

The operating profit saw a significant increase of 22% from HK\$93 million to HK\$114 million in FY 2005/06, representing a margin of 10.5%. Distributable earnings attributable to shareholders was HK\$78 million, representing earnings per share of HK18 cents in FY 2005/06, consistent with that of FY 2004/05.

The inventories was at HK\$275 million in FY 2005/06, up 2% from FY 2004/05. During the year, costs of raw materials showed continuous appreciation at the end of June 2006 by 23% as compared to December 2005. We managed and would continue to keep a stable reserve of materials to support production of branded products as a trend setter and hedging against the anticipated increase in precious metal prices. The inventory turnover was 140 days as compared to 178 days in FY 2004/05.

The trade debtors have been increased by HK\$259 million during the financial year 2005/06, primarily due to increased orders for Esprit, Pierre Cardin, MEXX extended into Greater China received towards the end of the financial year.

The debtors turnover was 72 days as compared to 80 days in FY 2004/05, which demonstrated an enhanced credit control policy and ongoing inventory control measures.

Distribution costs to sales improved by 4.6% to 14% in FY 2005/06 from 18.6% in FY 2004/05 — thanks to the Group's defined communication and promotion strategies as well as the sales administration model which are proven to bring positive effect to the Group's branding, marketing and sales activities.

Our revenue and assets were denominated in Euro and Swiss Francs 62%; US\$ and HK\$ 37% and other 1%. Payments and liabilities were in Euro and Swiss Francs 23%; US\$ and HK\$ 70% and other 7%.

The Group practices natural hedging to the extent possible and currency hedging as far as is reasonably practicable. Hence, the foreign currency exposure against adverse exchange movements has been adequately contained.

The cash and cash equivalents consistently stood at HK\$628 million in FY 2005/06, as a result of positive cash inflow of HK\$210 million. Working capital was HK\$580 million and the current ratio stood at 1.78x (as compared to industry average of 1x). The gearing ratio (interest bearing debt to shareholders' funds) was 0.62x (0.67x for FY 2004/05). These provided a valid base for the Group to plan its financial resources in a more cost-effective manner, and with higher certainty in securing funds to cope with the business expansion.

The Group had no significant capital commitment as at 31st May, 2006. There are no material contingent liabilities or off balance sheet obligations.

Total assets increased by 20% to exceed HK\$1,573 million, with return on equity exceeding 10% in FY 2005/06. The shareholders' funds saw a 10% increase to HK\$728 million in FY 2005/06.

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### PROSPECT

On 11th September, 2006, the independent shareholders of Egana Jewellery approved the proposal from EganaGoldpfeil for privatization of Egana Jewellery. Subject to the sanction of the privatization proposal by the court, Egana Jewellery would become a wholly-owned subsidiary of EganaGoldpfeil and it is expected that Egana Jewellery will be delisted from the Stock Exchange of Hong Kong Limited (the "Stock Exchange") effective on 24th October, 2006.

The privatization exercise was believed to be beneficial for both of EganaGoldpfeil and Egana Jewellery shareholders, for 1) withdrawal of the listing will result in a leaner corporate structure and will enhance operational efficiency and management accountability; 2) the liquidity in the EganaGoldpfeil shares traded on the Stock Exchange has been relatively higher compared to that of the Egana Jewellery shares; 3) offering the Egana Jewellery shareholders an opportunity to exchange their investment to an interest in EganaGoldpfeil whose shares are considered to have higher market capitalization and wider range of investor's coverage as well as growth potential; and 4) the privatization would reduce the profit of EganaGoldpfeil attributable to the minority interest after Egana Jewellery becomes a wholly-owned subsidiary of EganaGoldpfeil, i.e. the inclusion of minority interests profit of Egana Jewellery (which otherwise has to be excluded from EganaGoldpfeil's consolidated financial statements if Egana Jewellery remains to be a non-wholly owned subsidiary of EganaGoldpfeil).

There should be no material change to Egana Jewellery's business as a result of the privatization.

We shall continue to provide quality product and services as well as innovativeness for customer's satisfaction with a view to sustaining a leading stance in the jewellery industry.