IN CHALLENGES SEE WHERE OUR STRENGTHS LIE

The year under review was a challenging yet successful year for Le Saunda. Against a background of fierce competition in both Hong Kong and Mainland China, we were well on our way to refocusing our business and further establishing the Group as a vertically-integrated retailer in the two places. We continued to foster business growth, stressing on product expansion — the growth of new and existing product lines, and achieve encouraging results.

The year under review underpinned our defined operating philosophy: we focus on developing our mainline footwear, and complementing it with apparel and accessory products. We lay emphasis on product and service quality, and perfect them with total satisfactory shopping experience.

During the year, the Group continued to report strong growth in turnover and profit attributable to shareholders. Group turnover posted a 27% growth to HK$720 million whilst profit attributable to shareholders also increased 32% to HK$90 million. Operating profit amounted to HK$82 million, with gross margin remaining relatively stable at a high level of 51%.

Notwithstanding heavy pressure in rental hikes in both Hong Kong and Mainland China, the Group succeeded in its continual implementation of diligent cost control and risk management, thanks to efficient allocation of resources on our production front. Much of the Group's production was now channeled to its own facilities in Shunde, Mainland China, with a small proportion contracting out to other factories to maximize utilization. Moreover, material sourcing was expanded from Europe to other lower-pricing regions such as Mainland China whilst upholding the quality at constant level to enhance margins.

BUSINESS REVIEW

During the year under review, with primary engagement in the footwear operation, the Group also extended its reach to apparel business through the establishment of *Antinori* and partook in some investments in property development. Nevertheless, footwear segment remained the core business of the Group, accounting for 91% of the Group's total turnover.

MAINLINE AND COMPLEMENT — GOING HAND IN HAND

Footwear

Competition in footwear has intensified dramatically. Women are in the hunt for style, quality and outstanding value on every visit. When footwear offers right, our accessory products benefit too.

At Le Saunda, our two brands bear their own character targeting different level of customers, whilst both maintaining affordable value.

- le saunda – Italian style dress footwear catering for mid to high end market
- Comfort and Easy – fashionable and casual footwear appealing to trend-conscious young ladies

Newness is also the key. As such, we managed to execute more production cycles for each product line during the year. This not only generated better store traffic, but also encouraged purchases.

During the year, footwear continued to be the largest contributor to the Group with year-on-year turnover increased by 19% to HK$653 million.

Hong Kong

This market continued to report satisfactory growth in turnover, which amounted to HK$186 million or an increase of 6% from a year earlier. The growth was mainly attributed to the new concept stores and renovated outlets, whose operation was gradually maturing. This, in part, helped offset the negative impact on operating profit brought forth by the increase in rental expenses and discounted sales stemmed from intensified market competition. Opportunely, quite a number of store contracts were concluded at far lower rates two to three years ago, enabling the Group to face the current climb in rentals with relative ease.

During the year, the Group continued with its brand enhancement plan by consolidating smaller *Le Saunda* outlets on the street and opening more concept stores of the brand in big shopping malls at prime commercial locations. This strategy worked well to increase store traffic and reinforce our established brand image as a whole.

Additionally, the Group opened its first *CnE* outlet in Hong Kong to target the younger and more price-sensitive shoppers during the year under review. Initial market response was enthusiastic, indicating the enormous potential to be offered by this product line.

Mainland China

Mainland China was the bright spot that offered ready cheer. Being the largest market for the Group's footwear business, strong momentum was also evident, which reported robust turnover and operating profit growth.

Competition became increasingly severe during the year, with aggressive pricing cutting into the profits of players in the market. Nevertheless, the Group continued to manage to raise its sales and profit, thanks to effective store strategy and tighter controls of cost of sales.

The Group operates its footwear business under two brands, namely *Le Saunda 萊爾斯丹* and *CnE 斯艾依* in the market. Whilst self-operated outlets are dominant in major cities including Guangzhou, Shanghai, Beijing, Shenzhen, Chengdu, Tianjin and Chongqing, franchising is the mode that the Group's footprint is spreading like wildfire in second-tier cities.

Mainland China (continued)

During the year, the Group moved purposefully ahead with its expanding strategy for *CnE 斯艾依*, benefiting from stronger demand for trendy yet lower-pricing products in the market. In view of the market potential of *CnE 斯艾依*, the Group further increased the number of self-operated *CnE 斯艾依* outlets in major cities and franchised the brand in second-tier cities. On the other hand, the Group concentrated on existing operations for *Le Saunda 萊爾斯丹* and took a stringent control over the quality of franchisees to ensure our products and services are delivered at their highest standard at all times.

Apparel

2005 was also marked by our product expansion strategy, which saw the Group introduce *Antinori* to the Hong Kong market after establishing a presence in the major cities of Mainland China. Going for the high end fashion market with elegant, sexy and avant-garde apparel, the new *Antinori* outlets are set to serve as the showcase for the mainland stores, helping with the positioning of the brand in Mainland China. In this regard, the 2 outlets are both housed in prestigious shopping malls in prime shopping districts in Hong Kong.

In Mainland China, we adopted a disciplined growth approach in promoting *Antinori 安蒂諾里* and focused on working with department store partners to further expand into the market. Since starting the business in late 2004, a number of *Antinori 安蒂諾里* outlets have been opened in major cities, including Shanghai, Guangzhou and Shenzhen. As the business is in its early development stage, its earning ability and growth potential have not yet been fully reflected in the year's financial statements.

Accessory products

Heaven is the details with accessory products. To complement our footwear line and to reflect the contemporary living lifestyles of our customers, we concentrated on materials and design details for our handbags which provide the products with the *Le Saunda* and *CnE* signatures. The Group sees continued growth in this market, which, however, represented only a small fraction of the total turnover at the current stage.

RETAIL AND OEM — RUNNING IN PARALLEL

Whilst we took much initiative in setting up more prominent visual displays and enhancing customer service to improve conversion of visits into sales at retail outlets, the Group also extended its reach by engaging in export sales through its original equipment manufacturing ("OEM") business and retailing in Macau as well.

In 2005, turnover from footwear operations outside Hong Kong and Mainland China amounted to HK$112 million, representing a 34% increase from the previous year.

The OEM business continued to flourish during the year. The Group's production facilities are located in Shunde and provide product services to both intra-group operations and independent third parties. During the year, the business reported sales to Russia, Spain, Italy, Japan, Australia, New Zealand and Germany, where our customers are mostly up-market brands or among the biggest department stores locally.

WAREHOUSE MANAGEMENT — DECENTRALIZATION IS THE KEY

Since mid 2005, the Group has been pushing ahead with its decentralized warehouse management scheme by setting up regional distribution centres to assure logistic support and distribution network. To date, six regional offices are being set up in Hong Kong, Guangzhou, Shanghai, Beijing, Shenzhen and Chengdu respectively to serve a substantial network of self-owned outlets and franchised outlets in total nationwide. The plan contributed to our ability to meet rising demand since the retail market recovery and resulted in growth in Group turnover for the year under review.

OTHERS

During the year, the Group recognised a dividend income of HK$20 million from available-for-sale financial asset in Mainland China. The Group's Shunde-based wholly-owned property company also reported a turnover of HK$59 million from the sale of some of the remaining residential units of a development project named Sunny Garden. The following properties are under development for sale at the year end:

	Property 1	Property 2
Postal address, lot number and such designation:	Sunny Garden, Phase 3 中國佛山市順德區 容桂鎮環山路以北 順建要點(2000)0687 號	Sunny Garden, Phase 4 中國佛山市順德區 容桂鎮環山路 24 號 順建要點(2000)0683 號
The stage of completion as at the date of the year end:	80%	70%
The expected completion date:	July, 2006	October, 2006
The existing use:	Residential	Residential
The site and gross floor area of the property:	Area for land used: 2,259 sq. m. Site area: 7,578.17 sq. m.	Area for land used: 700 sq. m. Site area: 3,370.43 sq. m.
The percentage interest in the property:	100%	100%

FINANCIAL POSITION

During the year, the Group's cash position remained sound. Its cash and bank balances amounted to HK$118 million as at 28 February 2006, as compared with HK$139 million at the start of the financial year. The Group obtained total banking facilities of HK$65 million (28 February 2005: HK$74 million). The Group's other properties and leasehold land with net book value amounting to HK$27 million (28 February 2005: the Group's investment properties, other properties and leasehold land with net book value of HK$43 million) had been pledged to secure bank loan facilities of HK$45 million (28 February 2005: HK$68 million) granted to certain subsidiaries of the Group. Out of such facilities, the Group's short-term bank borrowings were HK$4 million as of 28 February 2006, compared with HK$3 million as of 28 February 2005. The Group's net worth amounted to HK$557 million (28 February 2005: HK$492 million). The Group's gearing ratio stood at 0.008 as at 28 February 2006, against 0.005 as at the start of the financial year. The calculation of the Group's gearing ratio was based on the total bank borrowings of HK$4 million and net worth of HK$557 million as at 28 February 2006.

The Group's liquidity position also remained healthy, with a current ratio of 3.7 times (28 February 2005: 3.7 times) and a quick ratio of 1.3 times (28 February 2005: 1.5 times) as at 28 February 2006.

During the year, the Group increased its inventory level to ensure sufficient quantities and styles were available to meet market demand. As a result, the Group's inventory turnover rose from 123 days to 160 days, and the amount of inventory increased from HK$106 million to HK$162 million during the year.

Bank loans of the Group were taken out in US dollars and Euro. The annual interest rate of the borrowings during the year ranged from 3.48% to 6.38%. Forward contracts will be used, if necessary, for hedging of purchases from overseas, related debts and bank borrowings. During the year, the Group was not exposed to material foreign exchange risk regarding Renminbi currency exposures on revenues generated or assets located in Mainland China as the exchange rate of Hong Kong dollars against Renminbi was relatively stable. In addition, working capital requirements for business in Mainland China will be financed, if necessary, by local bank loans denominated in Renminbi as far as possible for hedging purposes.

The Group believes that its cash holding, liquid asset value, future revenue and available banking facilities will be sufficient to fund the working capital requirements.

During the year, the Group did not have material acquisitions or disposals of subsidiaries, associated companies or jointly controlled entities. For the current financial year, other than the establishment of a number of footwear and apparel outlets in certain parts of Mainland China and Hong Kong, the Group does not have plans for material investments or change of capital assets.

CONTINGENT LIABILITIES

Details of the contingent liabilities of the Group at the balance sheet are set out in note 33 to the financial statements.

EMPLOYEES AND REMUNERATION POLICIES

As at 28 February 2006, the Group had a staff force of 2,650 people. Of this, 208 were based in Hong Kong and 2,442 in Mainland China. The remuneration of employees was in line with the market trend and commensurate with the level of pay in the industry. Remuneration of the Group's employees comprises basic salaries, bonuses and long-term incentives. Total staff costs for the year, including directors' emoluments and net pension contributions, amounted to HK$116 million (2005: HK$95 million). The Group has all along organized structured and diversified training programmes for staff of different levels. Outside consultants would be invited to broaden the content of the programmes.

PROSPECTS

The effective execution of the brand enhancement plan has been critical to our success. This allows us to leverage on our significant strengths to expedite our business development nationwide as the Chinese retail market continues to maintain a fast growth momentum, offering huge potentials to long-standing market players like Le Saunda.

Increasing affluence among China's 1.3 billion people are supportive of the surging demand for quality goods as well as consumer spending. The double-digit increase in per-capita disposable incomes in towns and cities unquestionably fuels retail sales growth.

Without doubt, our decisive move to find our regional offices at six decentralized yet strategic locations, which offer seamless logistics support from production to sales at stores, would allow the Group to achieve more efficient growth in a highly competitive environment.

Moving into the 2006/07 financial year, we will continue to focus on strengthening our core business of footwear in both Hong Kong and Mainland China, backed by the Group's enhanced brand image and ever growing distribution network. We will penetrate further into existing markets and reach out to new ones when appropriate opportunities arise with a view to establishing a truly national footprint with balanced and strong presences in the country in the long run.

PROSPECTS (continued)

Whilst we are proactively expanding our distribution network into big shopping malls at prime locations in Hong Kong, we see no pause in extending our feelers to both first- and second-tier cities of the Mainland China market to capitalize on the constant climb in purchasing power among urban residents. Laying emphasis on establishing outlets of our own, we would also continue with the growing pace of franchised operations at department stores.

With the strong backing of the established *Le Saunda* brand, we are as well stretching our reach to the young people's market under *CnE* which targets fun-loving and fashion-conscious individuals. Numerous outlets under the *Le Saunda* and *CnE* brands are expected to be opened in Hong Kong and Mainland China respectively in the financial year of 2006/07. This, in turn, would increase the gross selling area of the Group substantially. The dynamic development of the *CnE* line points to the direction that it will carry the same weight as *Le Saunda* in our business portfolio over the next two to three years.

Needless to say, we would also drive our business of the *Antinori* line at full gear, enhancing the brand's character and awareness among customers via various brand building initiatives. We are looking for suitable shopping malls in prime commercial districts to launch more outlets in the months to come.

At Le Saunda, we are continuously challenging ourselves to deliver ever higher quality to our retail and OEM customers. With a brand new production line equipped with state-of-the-art technology becoming operational starting in July 2006, as well as the support of a robust design team, there is no doubt that we will take the business we excel into a new level and reinforce our leadership as a vertically-integrated retailer in the industry.

Outstanding values, affordable prices and stylish products all help to drive sales. We see no let-up in the management's drive to deliver the quality standards that our customers trust in different facets across our product ranges.

Looking ahead, the Group would spare no effort to fortify its strengths. Whether it is by way of direct partnership or franchising, we aim to capture the business opportunities offered by the vast market and grow stronger and bigger in the marketplace. Another promising year is lying ahead.