

**OVERVIEW**

We are a leading mid-to-high end children's apparel brand in China. Our "redkids" brand was ranked second among mid-to-high end children's apparel brands in China based on retail revenue for the year ended December 31, 2012, according to Frost & Sullivan. We accounted for 4.3% of the mid-to-high end children's apparel market in China, and 1.2% of the total children's apparel market in China, both in terms of retail revenue for the year ended December 31, 2012, according to Frost & Sullivan. In addition, the mid-to-high end children's apparel market accounted for 27.0% of the total children's apparel market in China, according to Frost & Sullivan. We believe that our success in building our "redkids" brand is attributable to our ability to produce high-quality, functional and comfortable products that reflect the latest market trends. In 2013, we were awarded the "Top Ten Brands for Children's Apparel in China" (中國十大童裝品牌) issued by the China National Garment Association (中國服裝協會), an organization of designers, brand owners and manufacturers in the apparel industry in China.

We sell substantially all of our products on a wholesale basis to our distributors. Our distributors in turn sell our products either to end customers at retail outlets operated by them or their sub-distributors, or through online sales platforms. We also manufactured children's apparel for domestic and international brands on an OEM basis during the Track Record Period. As of June 30, 2013, our distributors and their sub-distributors had established a total of 582 retail outlets for our branded products including 62 shopping mall outlets, 308 street shops and 212 department store concessions located across 24 provinces and municipalities in China. The continual expansion of our network of retail outlets during the Track Record Period has established the presence of our brand nationwide. We plan to gradually increase the number of our self-operated retail outlets, which we intend to use as model stores to enhance our brand recognition, demonstrate our standards for store appearance and provide guidance to distributors in brand promotion and retail management. We expect to open no more than 50 self-operated retail outlets by end of 2014. As of Latest Practicable Date, we have one designated online distributor, Red Kids E-commerce, which purchases products from us on a wholesale basis before selling them to end customers through online sales platforms such as Taobao, VIPShop and V+. Our sales to Red Kids E-commerce increased significantly from RMB0.8 million for the year ended December 31, 2010 to RMB29.8 million for the year ended December 31, 2011 and further to RMB87.8 million for the year ended December 31, 2012, and our sales to Red Kids E-commerce increased from RMB24.5 million for the six months ended June 30, 2012 to RMB37.1 million for the six months ended June 30, 2013. For the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013, our sales to Red Kids E-commerce, represented 0.2%, 7.6%, 16.9% and 14.7% of our total turnover.

Our strong capabilities in design, research and development enable us to quickly respond to market developments and change of consumer preferences. Our product design and research and development team comprises experienced designers who are familiar with different consumer preferences in the China market. Their sensitivity to international fashion trends coupled with their insights into consumer preferences have helped us develop our brand recognition and expand our customer base. Our design and research and development team gathers information on latest market trends and consumer preferences through various sources, including market research, international fashion shows as well as discussions with our major distributors and our OEMs. In addition, our design and research and development team coordinates closely with our raw material suppliers, production team and OEMs throughout our product design process to ensure the production viability of our products. For the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2012 and 2013, we offered approximately 328, 385, 552, 223

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and 368 new SKUs under our “redkids” brand, respectively. In 2011, we received the “China Color Application Award” (中國色彩應用獎) and were accredited as “The Top Fashion Children’s Apparel Brand of China” (年度最具流行魅力童裝品牌) by the China Fashion & Color Association (中國流行色協會). In 2010, we were accredited as a “China Fashionable Product Release Base for Children’s Garments” (中國童裝時尚新品發佈基地) by the China Fashion & Color Association (中國流行色協會).

We manufactured a portion of our products at our production facility in Quanzhou, Fujian Province and outsourced the remaining to OEMs during the Track Record Period. For the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013, the proportion of our products that were manufactured by our OEMs continued to increase, accounting for approximately 14.6%, 40.2%, 50.1% and 68.1% of our total cost of sales, respectively. All of our OEMs are Independent Third Parties, and our major OEMs are enterprises experienced in the production of apparel. We have adopted a stringent quality control policy to maintain the quality of our products. In 2013, we were recognized as an “Excellent Enterprise for Trustworthy Quality in China” (全國質量誠信優秀企業) issued by the China Quality Inspection Association (中國質量檢驗協會). We intend to continue to increase the proportion of outsourced production to OEMs so that we can focus our resources and management’s attention on certain stages in our production life cycle that we believe contribute more value to our business, such as product development, brand promotion, channel management and sales and marketing. We utilize our production know-how, accumulated through our years of experience as an OEM service provider to international apparel brands, to identify and collaborate with qualified OEMs and raw material suppliers. Furthermore, we seek to identify OEMs and raw material suppliers in different regions that are cost-effective and with whom we can collaborate on the product design and research and development.

We have achieved significant growth in turnover and net profit in recent years. Our turnover increased from RMB327.0 million for the year ended December 31, 2010 to RMB392.4 million for the year ended December 31, 2011 to RMB520.0 million for the year ended December 31, 2012, and our turnover increased from RMB176.5 million for the six months ended June 30, 2012 to RMB253.2 million for the six months ended June 30, 2013. Our profit for the year increased from RMB75.9 million for the year ended December 31, 2010 to RMB77.3 million for the year ended December 31, 2011 to RMB115.4 million for the year ended December 31, 2012, and our profit increased from RMB33.8 million for the six months ended June 30, 2012 to RMB42.2 million for the six months ended June 30, 2013.

### OUR COMPETITIVE STRENGTHS

We believe that our success and potential for future growth are attributable to the following competitive strengths:

**We are a leading mid-to-high end children’s apparel brand in China and well-positioned to capture opportunities in China’s fast-growing children’s apparel market**

We are a leading mid-to-high end children’s apparel brand in China. Our “redkids” brand is ranked second among mid-to-high end children’s apparel brands in China based on retail revenue for the year ended December 31, 2012, according to Frost & Sullivan. We believe that our success in building our “redkids” brand is attributable to our ability to produce high-quality, functional and comfortable products that reflect the latest market trends. We have received a number of awards and recognitions for our brand. In 2013, we were recognized by the China National

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Garment Association (中國服裝協會), an organization of designers, brand owners and manufacturers in the apparel industry in China, as one of the “Top Ten Brands for Children’s Apparel in China” (中國十大童裝品牌). In the same year, we were also recognized as an “Excellent Enterprise for Trustworthy Quality in China” (全國質量誠信優秀企業) issued by the China Quality Inspection Association (中國質量檢驗協會). In 2009, our “redkids” brand was accredited as a “Fujian Province Famous Brand” (福建省著名商標) by the Administration for Industry and Commerce of Fujian Province (福建省工商行政管理局).

We operate in a fast-growing and highly fragmented industry. The PRC has experienced significant economic growth in recent years. Economic growth in the PRC contributes to increases in disposable income and consumer spending among its population, which, in turn, drive demand for consumer products according to Frost & Sullivan. The average annual Chinese household’s disposable income is expected to increase to RMB46,814 in 2017, representing a CAGR of 13.8% from 2012 to 2017. According to Frost & Sullivan, the per capita annual expenditure on children’s apparel in the PRC grew at a CAGR of 20.5% between 2008 and 2012 and is expected to continue to increase from RMB740.30 in 2012 to RMB1,658.90 in 2017, representing a CAGR of 17.5% for the period from 2012 to 2017. In addition, according to the National Bureau of Statistics of China, the PRC had over 250 million children under 14 years of age in 2012, representing the world’s second largest children’s consumer group. According to Frost & Sullivan, the number of urban Chinese children will likely continue to grow as a new policy will allow married couples to have a second child if either of the parent is an only child. Previously, only parents that are both the only child of their respective families were permitted to have a second child. In addition, we believe the increase in disposable income of PRC urban households and the growth in PRC urban children’s population are likely to continue to drive the growth of its children’s apparel market. Moreover, we believe that as parents in the PRC become more affluent, they will be more willing to pay for high-quality children’s apparel.

We believe that our brand reputation and extensive distribution network will enable us to further expand our customer base and capture opportunities in this favorable market.

### **We have an established distribution network with strategic geographical coverage**

As of June 30, 2013, our retail network covered 24 provinces and municipalities in China. The continual expansion of our retail network during the Track Record Period has established wide geographic coverage of our products and broadened our customer base. We strategically prioritized establishing street shops under our “redkids” brand in third- and fourth-tier cities in China where the market size of children’s apparel has been growing rapidly, according to Frost & Sullivan. Given the large consumer base, the growth in consumer spending and relatively weaker competition from other international or top-end Chinese children’s apparel brands, retail outlets under our brand in third- and fourth-tier cities are our most established sales channels and major contributors to our revenue.

We have a nationwide distribution network. We work together with our distributors on new retail outlet openings and we have implemented sales management guidelines to manage our distributors and their sub-distributors as well as retail outlets operated by them. Our prior approval is required for the selection of the location and the design and decoration of each retail outlet. We require the layout and appearance of the retail outlets reflect our brand image and culture consistently. We initiate pre-sales discussions with our distributors prior to our sales fairs and arrange follow up reviews to ensure that their purchase orders placed during the sales fairs are reasonable and in line with the relevant distributor’s capacity and growth. We monitor the sales performance and inventory level of our major distributors, including our top ten distributors

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measured by sales revenue during the Track Record Period, and their sub-distributors through monthly visits to retail outlets operated by them and by requiring our major distributors to submit monthly inventory reports. For our other distributors and their sub-distributors, we conduct the same procedures on a quarterly basis and we require the distributors to submit quarterly inventory reports. The retail outlets we visit are selected randomly to avoid any potential bias and to enhance the accuracy of the sales and inventory data collected. We also conduct spot checks and physical stock counts on the inventory level of our distributors. In addition, we regularly communicate with the management of department stores on the sales performance of the department store concessions under our “redkids” brand to confirm our sales data for such distributors. Our distributors and their sub-distributors are not permitted to sell other children’s products that directly compete with our products within the same retail outlet they operate. We believe that our centralized management control over our retail network helps to ensure that our brand concepts are reflected and our sales and promotion strategies are executed at the retail level in a consistent manner nationwide.

### **Our diversified sales platform enables us to serve a broad customer base and to meet growing and different customer demands**

We have a diversified sales platform which enables us to cater various consumption habits of children’s apparel consumers in different regions in China. We sell substantially all of our products on a wholesale basis to our distributors, who in turn sell our products through shopping mall outlets, department store concessions and street shops operated by them or their sub-distributors. Shopping mall outlets under our brand typically have relatively large display areas that allow us to introduce a wide range of products and to carry out marketing activities. Department store concessions under our brand are generally located in prime commercial locations in first- and second-tier cities, which attract large volumes of end customers, allow for effective brand advertising and increase brand exposure to a broader customer base. Street shops under our brand are individual stores generally located in prime commercial areas of third- and fourth-tier cities, which are our main customer base. In addition, to capture the significant market potential for the sales of children’s products through online sales platforms, we have authorized an online distributor, Red Kids E-commerce, since 2010 to sell our products online. Based on the consumer preference data we gather from the online distributor, we design products with distinct styles that target the online consumer group, in particular younger parents. Our sales to Red Kids E-commerce increased significantly from RMB0.8 million for the year ended December 31, 2010 to RMB29.8 million for the year ended December 31, 2011 and further to RMB87.8 million for the year ended December 31, 2012, and our sales to Red Kids E-commerce increased from RMB24.5 million for the six months ended June 30, 2012 to RMB37.1 million for the six months ended June 30, 2013. For the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013, our sales to Red Kids E-commerce represented 0.2%, 7.6%, 16.9% and 14.7% of our turnover. As evidenced by the significant increase in sales through our online distributor, we believe we have successfully captured the preferences of the target online consumers. Furthermore, we believe that through our diversified sales platform of retail outlets and online sales, our “redkids” brand not only covers a broad customer base in our target markets, but also meets different customer needs.

### **Our strong capabilities in design and product development enable us to respond to changing market trends in a timely manner**

We have strong capabilities in design and product development, which enable us to quickly respond to market developments and change of consumer preferences. Our design and research and

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development team comprises 20 designers located in our Shanghai design center, who are familiar with the different consumer preferences in the Chinese market. Their sensitivity to international fashion trends coupled with their insights into consumer preferences has helped us build brand recognition and expand our customer base. We gather information on latest market trends and consumer preferences through market research, sales fairs, experiences from working with international children's apparel brands and attending international fashion shows as well as international fabric shows. Our design and research and development team also collaborates with the China Fashion & Color Association (中國流行色協會) on the research and application of colors in children's apparel and accessories. In addition, we involve our major distributors in our product design and development process to take advantage of their knowledge of market trends and consumer preferences, which helps ensure that our products cater to the latest consumer trends and preferences in children's apparel and accessories. For the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2012 and 2013, we introduced 328, 385, 552, 223 and 368 SKUs, respectively. We believe our design and research and development team has a proven track record and possesses the requisite expertise and experience to identify and respond to children's apparel trends in China. In 2011 we received the "China Color Application Award" (中國色彩應用獎) and were accredited as "The Top Children's Apparel Brand of China" (年度最具流行魅力童裝品牌) by the China Fashion & Color Association (中國流行色協會). In 2010, we were accredited as a "China Fashionable Product Release Base for Children's Garments" (中國童裝時尚新品發佈基地) by the China Fashion & Color Association (中國流行色協會).

Our design and research and development team coordinates closely with our raw material suppliers, production team and OEMs during our design and production process. Commencing at the initial stages of our product design process, we seek feedback on the production viability of our products from our raw material suppliers, production team and OEMs. In addition, we continue to engage them prior to finalizing our seasonal collection to ensure that our products may be produced economically. We believe that as a result of our efforts, we have been able to transform product concepts into commercially viable products efficiently and effectively. Furthermore, by leveraging on our industry knowledge and experiences and close relationships with our raw material suppliers and OEMs, we will be able to continue to swiftly respond to market changes, which in turn will enable us to remain competitive in the fast-paced children's apparel industry.

### **We have a stable and experienced management team with a proven track record**

Our management team is led by our founder and chairman, Mr. Ding (丁培基). Mr. Ding has over thirteen years of experience in the children's apparel retail industry. Our general manager, Mr. Ding Peiyuan (丁培源), has over eight years of experience in the children's apparel retail industry. Mr. Ding, Mr. Ding Peiyuan and one of our two deputy general managers, Ms. Ding Lizhen (丁麗真), a sister of Mr. Ding and Mr. Ding Peiyuan, have all been with our Company for over eight years. Our other deputy general manager, Mr. Gu Jishi (顧及時), also has approximately ten years of experience in the apparel and retail industry. Our senior management team also includes our design director, Ms. Chong Pui Shan (莊佩珊), who has over ten years of experience in the apparel industry. Members of our senior management team possess in-depth industry experience and expertise in various areas of the children's product industry, including sales, marketing, brand management, research and development and production.

Our management team has demonstrated strong execution capabilities, successfully established our brand and expanded our distribution network to cover 24 provinces and municipalities in China as of June 30, 2013.



**OUR BUSINESS STRATEGIES**

We intend to further strengthen our position as a leading mid-to-high end children's apparel in China. We plan to achieve our goals by pursuing the following principal strategies:

**Establish self-operated retail outlets and continue to expand our distribution network**

We intend to establish and gradually increase the proportion of our self-operated retail outlets in prime locations of selected regions which we believe have sales growth potential and are not currently covered by our distributors. We currently expect to establish no more than 50 self-operated retail outlets by the end of 2014. We intend to use our self-operated retail outlets as model stores to enhance our brand recognition, demonstrate our standards for store appearance and provide guidance to our distributors in brand promotion and retail management. In addition, through our self-operated retail outlets, we will be able to gain first-hand feedback from end customers regarding their preferences, which we may utilize for enhancing our product design and for building a better shopping experience for customers so as to improve our brand image.

We also intend to develop our VIP customer program through the self-operated retail outlets. Currently, we do not have a unified VIP customer program. It is at the discretion of our distributors to decide whether to establish a VIP program for their retail outlets and set out the specific terms and conditions under the program. We intend to establish a centralized VIP customer program first at our self-operated retail outlets and to gradually expand it to cover all retail outlets for our products. We believe such a unified VIP customer program would help to increase customer loyalty, allow us to better understand customer preferences and enhance our marketing plans.

In addition, we plan to work with our distributors to expand our retail network to new markets and increase our penetration in existing markets. We believe that it is important to continue to expand the retail coverage of our products to capture the growth potential in third- and fourth-tier cities, while developing our brand recognition in the first- and second-tier cities. We intend to work with distributors to expand our retail network and determine the number, type and location of new retail outlets to be opened. We intend to closely manage such sales channels to ensure that service and appearance are consistent across all stores.

**Further promote our “redkids” brand and enhance our marketing and promotional strategies**

We intend to continue to improve our brand awareness by delivering a consistent brand image from product design to sales and marketing. Our marketing, sales and promotion initiatives include enhancement of the image of retail outlets under our brand, in-store marketing and promotions and online advertising. We intend to continue such marketing strategies in the future. In addition, in our self-operated retail outlets, we intend to place children's play clothes around children's play areas to induce parents to purchase those items. In addition to promoting our “redkids” brand through our self-operated retail outlets, we plan to hold events that include more interactive activities with our target customers, including seminars on how to select children's apparel and events where parents participate in the seasonal product evaluations. Furthermore, we plan to promote our “redkids” brand through new media, such as micro-blogs. We also intend to selectively increase our television and outdoor commercials in target markets and to participate in children's apparel exhibitions that target our customer base. Furthermore, we intend to strengthen our customer loyalty and expand our

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customer base by managing and further cultivating our interaction with end consumers through enhanced customer service and support, which we intend to accomplish by creating a nationwide customer service hotline to address customer needs and increase their satisfaction.

### **Continue to develop online sales**

We believe there is significant market potential for the sales of children's products through online platforms and we intend to continue to capture opportunities in this growing market. During the Track Record Period, sales to our designated online distributor, Red Kids E-commerce, increased significantly from RMB0.8 million in 2010 to RMB87.8 million in 2012. We intend to continue to expand online sales through collaboration with our online distributor, Red Kids E-commerce. In addition, we plan to continue to introduce products that specifically target the online consumer group, such as younger parents. We believe these products, which are tailored to the preferences of the online consumer group, are likely to help us attract new customers and broaden our customer base. We face intense competition in the fast-paced online children's retail market. In order to remain competitive in this market, we need to frequently introduce new products to attract the attention of our target customers. To support the development of online sales, we also plan to continue to identify and establish relationships with OEMs that can efficiently supply our orders and help reduce our online products' time-to-market.

Furthermore, we plan to use our self-operated retail outlets to support the development of our online sales. We intend to showcase certain products at our self-operated retail outlets so that potential customers can experience these products physically before purchasing them online. We believe this option would help online customers gain a better understanding of our product quality and brand culture and, as a result, would help increase the online sales of our products.

### **Implement management information systems to manage our operations more effectively**

As we expand our retail network and increase the scale of our operations, we intend to install an ERP system to enhance our overall management in sales, inventory, financial management, production and logistics. We believe that the ERP system will enable us to improve the overall efficiency of our operations by allowing us to centrally monitor the sales and inventory data in our retail network in real time. The fully integrated ERP system will minimize our production and logistical bottlenecks and allow our merchandising and inventories to keep pace with our expanding network of retail outlets. We plan to install the ERP system at all our self-operated retail outlets first and gradually require our distributors and sub-distributors to install the ERP system at their retail outlets and to upload management data relating to sales and inventory on a real time basis. The costs associated with the installation of the ERP system will be incurred by us. We believe that the ERP system will facilitate the day-to-day operations of our distributors and help strengthen the management of our distribution network, which in turn will help the growth of our Company by enabling us to record sales details, monitor our SKUs, track our inventories and analyze our customers' purchase habits in a more effective manner. This operating data will in turn allow us to more effectively market to our target customers. We also believe that implementing the ERP system would help facilitate the exchange of information between ourselves and our distributors, strengthen our supply chain management and our sales and marketing, support our decision process in product design and development, further enhance our ability to implement our operating guidelines and better formulate our growth plans in a feasible manner.

**Further strengthen our design and research and development capabilities**

We believe that strong design and research and development capabilities are critical to our future development and sustainable growth as competition within China's children's apparel market intensifies. We intend to further strengthen our design and research and development capabilities to maintain and enhance our position as a leading brand in the mid-to-high end children's apparel market in China. We have established a research and development center in Shanghai, through which we plan to recruit and hire more designers with experience working for international children's apparel brands who are both sensitive to global trends and familiar with consumer preferences in the Chinese market. In addition, we aim to hire individuals who are knowledgeable about the development and production process of particular categories of children's apparel and professional buyers who are experienced in sourcing high-quality finished products. Furthermore, to enhance creativity in the design and development of our products, we plan to purchase new equipment that can further enhance our design process, collaborate with international design institutes, engage third-party design studios and continue to provide extensive training to our designers. We also intend to continue to collaborate with the China Fashion & Color Association (中國流行色協會) on the research and application of colors in children's apparel.

We seek to further enhance our collection of market information through various online resources, including the online sales data of our products. Through timely collection and analysis of such market information and collaboration with the China Fashion & Color Association (中國流行色協會), we expect to improve our current products and to design and market new products that better cater to consumer needs while at the same time reflecting our brand culture and leading market trends.

**Continue to expand our product offerings and pursue strategic alliances and acquisitions**

We intend to further diversify and expand our product portfolios, including children's footwear and accessories, in order to increase our coverage of the PRC children's apparel market. In addition, we plan to continue to focus on developing clothing of superior quality and comfort, which incorporate natural, eco-friendly fabrics. Furthermore, we commenced our search for OEMs that can help us in developing children's products that complement our current product mix during the first half of 2013.

We also plan to increase our portfolio of brands through strategic acquisitions or alliances that we believe will create synergy for our existing "redkids" brand. Specifically, we will consider the acquisition of, or strategic alliance with other international children's apparel brands that complement our existing product portfolio. We believe that pursuing these selective acquisitions or strategic alliances will help increase our brand awareness, expand our distribution network in prime commercial locations, enlarge our customer base, enhance our competitiveness and further solidify our market position. We will carefully consider and evaluate each potential acquisition and alliance on the basis of its merits to ensure that our existing business platform will derive the appropriate benefits. Currently, we do not have any specific acquisition or alliance targets.

**OUR BUSINESS MODEL**

We primarily design, manufacture, market and sell children's apparel under our "redkids" brand. In addition, we also manufacture children's apparel for domestic and international brands on an OEM basis. For the three years ended December 31, 2010, 2011 and 2012 and the six months



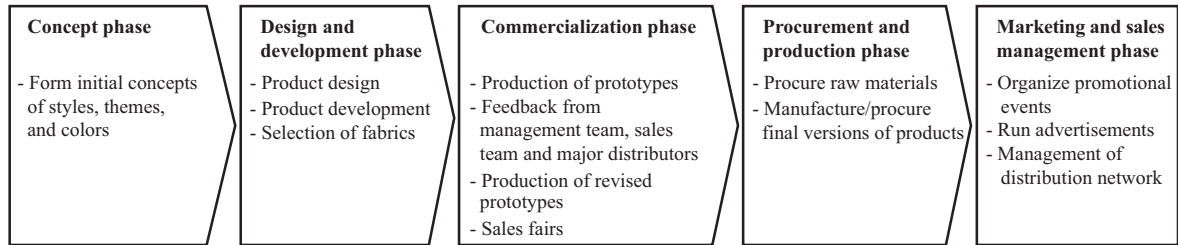
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ended June 30, 2013, sales of children's apparel, footwear and accessories contributed to 95.7%, 97.6%, 99.5% and 99.7% of our revenue, and OEM services contributed to 4.3%, 2.4%, 0.5% and 0.3% of our revenue, respectively.

The following diagram illustrates our business model:



We manage and operate our “redkids” brand through a cycle of concept phase, design and development phase, commercialization phase, procurement and production phase, and marketing and sales management phase:

- *Concept phase*, where we determine the main themes of our seasonal collection in consultation with our major distributors, sales team, raw material suppliers, OEMs and customers and in reference to other external sources, such as international and local fashion shows;
- *Design and development phase*, where our design and research and development team develops our seasonal collection and collaborates with our raw material suppliers and OEMs on fabric selection and sample creation;
- *Commercialization phase*, where samples of the seasonal collection are created in collaboration with our raw material suppliers and OEMs, feedback is solicited from our senior management team, sales team and major distributors, necessary revisions are made and sales orders are finalized during sales fairs;
- *Procurement and production phase*, where we procure raw materials, manufacture and contract with OEMs and raw material suppliers to manufacture the final versions of our seasonal collection; and
- *Marketing and sales management phase*, where we organize marketing and promotional events for our seasonal collection, sell our products on a wholesale basis to our distributors and manage our distribution network.

## BRAND AND PRODUCTS

We offer a wide range of children's apparel and accessories under our “redkids” brand primarily for children from 3 to 12 years of age. We believe that brand recognition is important to our success as a children's apparel brand. We believe that our success is attributable to our ability produce high-quality, functional and comfortable products that reflect the latest market trends and our ability to distinguish ourselves from our competitors by our product quality, distinctive designs and brand identity.

For the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2012 and 2013, we offered a total of approximately 328, 385, 552, 223 and 368 new SKUs

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under our “redkids” brand, respectively. Our “redkids” brand features a variety of seasonal apparel and accessory items designed to appeal to the brand’s targeted consumer group. Products offered under our brand include:

- Apparel: T-shirts, shirts, tank tops, coats, pants, jeans, shorts, sweaters, down jackets; and
- Accessories: socks, underwear, gloves.

The following are sample photos of our apparel products:



### DESIGN AND RESEARCH AND DEVELOPMENT

We have strong in-house design and research and development capabilities, which are essential to our business, as they establish the key concepts and identity for our brand and products. We design our children’s apparel and accessory products under our “redkids” brand and launch two seasonal collections annually. We have a dedicated design and research and development team that possesses an in-depth understanding of our brand concepts and are familiar with the preferences of our target consumer base. As a result, we are able to design products that meet evolving market demands while maintaining our consistent brand identity.

Our design and research and development team is primarily responsible for market research, product design and development. In addition, our design and research and development team also collaborates with our procurement, production and quality control personnel to help ensure that our products can be produced at our desired quality standards in a cost-efficient manner. We control our design and research and development expenses by requiring members of the design and research and development team to obtain approval from their manager and our management team prior to incurring research and development expenses. Such approvals are generally granted based on previously agreed seasonal and annual budgets for design and research and development. As of

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June 30, 2013, our design and research and development team consisted of a total of 20 employees, all located at our Shanghai design center. Our design and research and development team is led by our design director, Ms. Chong Pui Shan (莊佩珊). Ms. Chong has over ten years of experience in the fashion industry and has experience collaborating with international brands.

### **Market research**

Our design and research and development process typically begins by identifying fashion trends, market demands and consumer preferences. We gather information on the latest fashion trends through international and local industry updates relating to children's apparel, feedback from our distributors and our sales and marketing personnel on the sales performance of products, our experience working with international brands to whom we provide OEM services and attending international fashion shows as well as international fabric shows. We have entered into a strategic alliance with the China Fashion & Color Association (中國流行色協會) and have been collaborating with them for over 3 years on the research and application of colors in children's products. We regularly receive color scheme recommendations from the China Fashion & Color Association (中國流行色協會), which our designers often use as a reference during the initial stages of our design process.

### **Product design and development**

Our designers first determine the themes and color elements for each of our seasonal collections. Afterwards, they prepare drawings and sketches of the products and work together with our production team, raw material suppliers and OEMs to determine the technical specifications for the products and the raw materials to be used. In addition, we involve certain of our major distributors and sales and marketing personnel at this stage to gauge the potential market acceptance of our sample products, which helps to ensure that our products cater to the latest consumer trends and preferences in children's apparel and accessories. Our design and research and development team then selects those designs which they perceive to have better commercial viability and marketability and modifies the designs according to the feedback collected during consultation. Furthermore, we also develop products that are distinctively designed and specifically offered by our online distributor in order to cater to the preferences of our online customers. We believe that these distinctly styled products help to attract the attention of new customer groups and to enlarge our customer base.

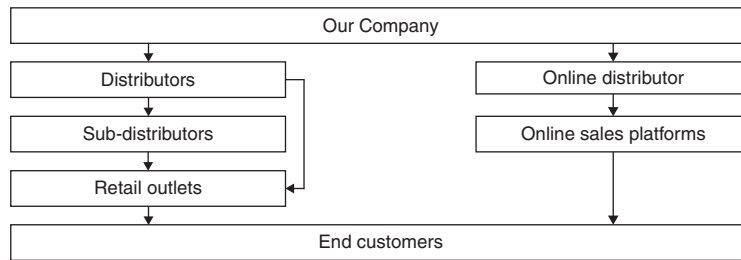
### **Sample creation**

After the design and development phase is completed, we make part of our initial apparel samples at our own production facilities and collaborate with our OEMs to produce the rest in order to analyze procurement and production costs. We work to ensure that the samples adhere to our original design concepts and can be commercially produced in a cost-effective way. By creating product samples, we introduce the technical specifications of our new products, including raw materials specified by us, production steps, quality standards and delivery requirements, to our raw material suppliers, production team and OEMs. Our raw material suppliers, production team and OEMs then provide feedback on production aspects such as technical specifications, risk control with respect to production, projected costs and delivery terms. After we have made necessary adjustments based on the feedback, we further liaise with our production team and OEMs to produce finalized product samples for use in our sales fairs.

**SALES AND DISTRIBUTION****Overview**

We sell substantially all our products on a wholesale basis at approximately 35% of the suggested retail price to our distributors, who in turn sell the products to end customers or resell the products to their sub-distributors or through online sales platforms. Our distributors resell the products to their sub-distributors at a markup of approximately 10% to 20% to the wholesale price. We believe that our distributorship business model, which allows us to allocate more resources to our core competitive strengths, such as product design and development and brand management, is commonly adopted by brand owners in the retail industry in China and enables us to expand our distribution network to a wide geographical area by leveraging the local market knowledge of our distributors and/or their sub-distributors. We recognize revenue upon delivery of our products to our distributors.

The following chart illustrates our current distribution model:



Our distributors and their sub-distributors have established an extensive retail network for our products, covering 24 provinces and municipalities in China as of June 30, 2013. Our brand has strong recognition and appearance in third- and fourth-tier cities, which have achieved substantial economic growth in recent years. Moreover, the ongoing urbanization and increasing purchasing power of consumers in these cities have led to increases in both children’s apparel market size and demand for mid-to-high end children’s apparel. In addition, according to Frost & Sullivan, since international and high-end domestic children’s apparel brands have a considerably lower level of market presence in third- and fourth-tier cities, we believe we face less competition there as compared to first- and second-tier cities. We believe these favorable market conditions have allowed us to continue to enhance the recognition of our “redkids” brand and contributed to the fast growth of our target customer base.

We plan to establish and gradually increase the proportion of our self-operated retail outlets in prime locations of selected regions which we believe have high sales growth potential. We intend to use our self-operated retail outlets as model stores to enhance our brand recognition, demonstrate our standards for store appearance and provide guidance to distributors in brand promotion and retail management. Furthermore, we believe that self-operated retail outlets will enable us to have direct contact with our target customers, thereby allowing us to tailor our marketing efforts to them and to directly instill in them our brand image and culture. In our self-operated retail outlets, we intend to place children’s play clothes at various designated children’s play areas to increase the attractiveness of our products and to induce parents to purchase those items. We believe that self-operated retail outlets will allow us to provide high-quality services to our end consumers in a consistent manner and to obtain first-hand feedback from them, which in turn will provide us with useful information for our future product designs.

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Our distributors and their sub-distributors are only authorized to sell our products at our branded retail outlets. As of June 30, 2013, in our distribution network, there were a total of 582 retail outlets, which comprised 62 shopping mall outlets, 308 street shops and 212 department store concessions. Our distributors and their sub-distributors own and operate these retail outlets, and we do not have any ownership in or contractual relationship with the retail outlets operated by them. We generally require our distributors and their sub-distributors to seek to open street shops in prime commercial areas with high pedestrian traffic in third- and fourth-tier cities and concessions in large and well-known department stores. Our branded retail outlets in prime locations allows us to meet the demands of our targeted end consumer group. The following chart illustrates our current distribution map:



### Our Distribution Network

#### Overview

As of June 30, 2013, we had 24 distributors who, together with their sub-distributors, operated a total of 582 retail outlets, including 62 shopping mall outlets, 308 street shops and 212 department store concessions.

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The following table sets forth the number of our branded retail outlets opened and closed during the periods indicated. The increase in the number of retail outlets was primarily due to our strategic plan to expand our distribution network to cover a wider geographical area and increase our market penetration. The closings of retail outlets in 2010 were primarily due to their unsatisfactory sales performance and the termination of a number of sub-distributors that were relatively small in size. The closings of retail outlets in 2011 resulted from the termination of certain distributors and sub-distributors, which were relatively small in size or did not possess or were not willing to invest the necessary resources to continue to open and manage retail outlets to further develop the “redkids” brand. The closings of retail outlets in 2012 and the six months ended June 30, 2013 were primarily a result of some of the distributors’ or sub-distributors’ decision not to renew the lease agreements of their retail outlets because of increases in rental expenses, unsatisfactory sales performance at certain locations or better locations becoming available.

	As of/For the year ended December 31,									As of/For the six months ended June 30,					
	2009			2010			2011			2012			2013		
	Total	Opened	Closed	Total	Opened	Closed	Total	Opened	Closed	Total	Opened	Closed	Total		
Number of retail outlets . . . . .	330	231	85	476	177	93	560	82	48	594	20	32	582		

The following table sets forth the number of retail outlets opened and closed by our distributors during the periods indicated:

	As of/For the year ended December 31,									As of/For the six months ended June 30,					
	2009			2010			2011			2012			2013		
	Total	Opened	Closed	Total	Opened	Closed	Total	Opened	Closed	Total	Opened	Closed	Total		
Number of retail outlets operated by our distributors . . . . .	134	117	30	221	94	57	258	32	30	260	7	26	241		

The following table sets forth the number of retail outlets opened and closed by the sub-distributors engaged by our distributors during the periods indicated:

	As of/For the year ended December 31,									As of/For the six months ended June 30,					
	2009			2010			2011			2012			2013		
	Total	Opened	Closed	Total	Opened	Closed	Total	Opened	Closed	Total	Opened	Closed	Total		
Number of retail outlets operated by sub-distributors . . . . .	196	114	55	255	83	36	302	50	18	334	13	6	341		

The following table sets forth the number of retail outlets for our products in China by city type as of the dates indicated:

City Type	As of			
	December 31,			June 30,
	2010	2011	2012	2013
Tier 1 . . . . .	56	62	67	68
Tier 2 . . . . .	85	93	109	104
Tier 3 . . . . .	105	146	167	165
Tier 4 . . . . .	230	259	251	245
Total . . . . .	<u>476</u>	<u>560</u>	<u>594</u>	<u>582</u>



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The following table sets forth a breakdown of our branded retail outlets by distribution channel as of the dates indicated:

	As of			
	December 31,			June 30,
	2010	2011	2012	2013
Shopping mall outlets .....	30	47	54	62
Street shops .....	267	321	326	308
Department store concessions .....	179	192	214	212
Total .....	<u>476</u>	<u>560</u>	<u>594</u>	<u>582</u>

The following table sets forth changes in the number of our distributors for the periods indicated:

	As of/For the year ended December 31,								As of/For the six months ended June 30,				
	2009		2010		2011		2012		2013				
	Total	Appointed	Terminated	Total	Appointed	Terminated	Total	Appointed	Terminated	Total			
Distributors <sup>(1)</sup> ..	25	1	—	26	14	13	27	1	4	24	—	—	24

Note:

1. "Distributors" include our online distributor but do not include sub-distributors.

During the year ended December 31, 2010, we added an online distributor, Red Kids E-commerce, in October 2010 and did not terminate any distributors.

In 2011, we commenced to invest more resources in developing and managing the retail network of our distributors. We performed an evaluation of our distributors based on criteria including their ability to meet our operating standards and to comply with our overall expansion plan. In 2011, we terminated 13 distributors, most of which we originally appointed as wholesalers but which we subsequently found upon re-evaluation (i) to be relatively small in size or (ii) do not possess or are unwilling to invest resources to open and manage retail outlets and to further develop the "redkids" brand. We integrated the markets covered by these terminated distributors into the markets covered by other existing distributors whom we believe have stronger management resources. In addition, we appointed distributors that we believe could support our expansion plans in provinces previously not covered by our distribution network. In 2012, we continued to evaluate our distributors and made changes accordingly. We terminated a distributor which was relatively small in size and appointed a new distributor for our Beijing and Tianjin market. Our Beijing market and our Tianjin market were previously covered by two separate distributors. These two distributors jointly formed a new entity which we appointed as our distributor to cover the Beijing and Tianjin markets. We added one and terminated four distributors in 2012, which includes the termination of the two distributors that previously covered our Beijing and Tianjin markets as well as the termination of two distributors that were relatively small in size in Hunan Province and the Xi'an region. The markets originally covered by these two distributors were then merged into the regions covered by larger distributors in the same area whom we believe have more resources and are better able to cover the respective regions. In the six months ended June 30, 2013, we did not appoint or terminate any distributors. We intend to continue conducting periodic evaluations of our distributors in the future.

During the Track Record Period, some retail outlets were transferred from terminated distributors or sub-distributors to existing or new distributors or sub-distributors. In such instances, we generally help to coordinate the transfer of inventory from terminated distributors to existing distributors or newly appointed distributors or their sub-distributors, as the case may be.

***Our distributors***

Our distributors are corporate entities or individuals in the PRC with relevant retail and management experience. All of our current distributors are Independent Third Parties except for Xiamen Minghao. Mr. Ding Peijie, a brother of Mr. Ding, owns 80% of Xiamen Minghao. Mr. Ding Peijie was never a director or shareholder of our Company and our Directors confirm that all transactions between us and Xiamen Minghao were entered into at arm's length and on normal commercial terms. For the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013, our sales to Red Kids E-commerce amounted to RMB0.8 million, RMB29.8 million, RMB87.8 million and RMB37.1 million, respectively, which represented 0.2%, 7.6%, 16.9% and 14.7% of our turnover for those respective periods. Prior to July 25, 2012, Mr. Ding Peiyuan, one of our executive directors, and his wife, Ms. She Xuefen (余雪芬), owned 60% and 40% of Red Kids E-commerce, respectively. Red Kids E-commerce ceased to be a connected party on July 25, 2012 when Mr. Ding Peiyuan and his wife, Ms. She Xuefen, disposed their interests in Red Kids E-commerce to Independent Third Parties. Our sales to Red Kids E-commerce were RMB35.3 million and RMB52.5 million for the period between January 1, 2012 and July 24, 2012 and for the period between July 25, 2012 and December 31, 2012, respectively. Mr. Ding Peiyuan and Ms. She Xuefen decided to dispose their interests because neither they nor the Group had sufficient resources or expertise to further expand the online sales business and Independent Third Parties with more online distribution experience would be more able to enhance "redkids" branded products' online sales. In addition, Mr. Ding Peiyuan and Ms. She Xuefen sold Red Kids E-commerce because they wanted to focus on our Group's business. Please see "Directors and Senior Management — Mr. Ding Peiyuan (丁培源)" for more details regarding our disposal of Red Kids E-commerce.

Our Directors confirm that the transactions between Red Kids E-commerce and us were conducted on similar terms and at arm's length before and after the disposal. We sell our products to Red Kids E-commerce at a slightly higher discount to the suggested retail price when compared to our other distributors, mainly because Red Kids E-commerce does not receive the marketing reimbursements we provide to our other distributors that operate physical retail outlets. Other than the difference in wholesale price, our sales to Red Kids E-commerce are subject to the same terms and conditions as sales to other distributors, including a 90-day credit period and the same product return policy.

Under our distribution agreements and the standard agreements between distributors and their sub-distributors, we require our distributors and their sub-distributors to obtain our prior approval before they open any new retail outlets. Through the direct control of the locations in which our distributors and their sub-distributors may establish a retail outlet, we are able to prevent cannibalization amongst our distributors, their sub-distributors and the retail outlets operated by them. Based on our standardized nationwide sales policy, our distributors are only authorized to sell our products at their retail outlets under our "redkids" brand and are not allowed to sell other products at the same location which create direct competition with our products. During the Track Record Period, there were two incidents in which distributors displayed products that directly competed with our "redkids" products in their retail outlets or retail outlets operated by their sub-distributors. As soon as we discovered such incidents, we requested the violating distributors to cease such activities. We did not terminate the distribution agreements with the two violating distributors because both distributors ceased the violating activities in a timely manner and neither had previously engaged in such violating activities. As of the Latest Practicable Date, the two incidents of distributor violations had been resolved.

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### *Criteria for selection of distributors*

We generally seek to engage distributors with retail and managerial experience, customer networks, a proven track record and adequate capital resources. In addition, we require our distributors to comply with all applicable laws and regulations for their operations pursuant to our distribution agreements. We have the right to examine and obtain copies of business licenses from our distributors upon their joining our distribution network. We also require our distributors to submit copies of their renewed business licenses every year after completing their annual inspection by the local industrial and commercial administration authorities. In addition, we designate retail management team members to carry out both on-site inspections and spot checks to ensure that our distributors comply with our sales policies. We reserve the right to terminate distribution agreements if our distributors deviate from any key terms.

### *Distribution agreements with our distributors*

We typically enter into distribution agreement with each of our distributors for periods ranging from one to four years and renew distribution agreements with them upon the expiration of these agreements. Our distribution agreement with each of our distributors generally includes the following principal terms:

- **Duration:** Generally from one to four years and are renewable by mutual consent subject to negotiation of new terms two months prior to expiration.
- **Designated geographical areas:** Distributors are typically authorized to establish retail outlets to sell our products within designated areas or geographical regions or engage sub-distributors to operate retail outlets within designated geographical areas provided that their sub-distributors operate in compliance with our sale policies.
- **Brand and products:** Distributors are typically authorized to sell our products under our “redkids” brand at each retail outlet they operate. Our distributors are not allowed to sell other products in our branded retail outlets that directly compete with ours.
- **Our principal rights and obligations:** We have the right to check sales and inventory data of our distributors on both regular and spontaneous bases; we have obligations to (i) provide regular training to our distributors and their sales personnel with respect to retail outlet operations, brand culture, product information, sales techniques and customer service skills; and (ii) provide guidelines regarding store design and layout.
- **Principal rights and obligations of distributors:** Our distributors have the right to engage sub-distributors, subject to our prior approval; our distributors have obligations to (i) comply with all laws and regulations of the PRC relating to the qualifications of engaging in the retail business; (ii) strictly comply with our unified nationwide sales and pricing policies; (iii) use their best efforts to participate in all the promotional events organized by us; and (iv) adopt our standardized retail outlet design and layout and maintain our brand image and reputation.
- **Annual purchase guidance:** We generally discuss with and provide annual purchase guidance for our distributors before they will place and confirm their orders during our sales fairs, which are held twice a year. The annual purchase guidance varies among

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distributors depending on their historical sales performance, market position and influence, management experience, operational ability, financial capability and local competitors' performance in their designated geographical areas.

- Expansion target: Our distributors are generally required to open an agreed minimum number of retail outlets each year and the expansion target varies among our distributors depending on their sales capabilities and the geographical areas granted to them. We have the right to terminate the distribution agreement with our distributors in the event that they fail to commit to the agreed minimum number of retail outlets.
- Sale and pricing policies: Our distributors are required to and shall ensure that their sub-distributors strictly adhere to our standardized nationwide sales, pricing and discount policies for our products.
- Marketing reimbursement: Distributors, excluding Red Kids E-commerce, typically receive marketing reimbursement, which is referred to as "marketing rebate", when they meet or exceed performance targets based on sales revenue.
- Payment: Distributors are generally required to pay the full purchase prices of the products they confirmed during the sales fairs within 90 days of delivery to the designated areas or geographical regions.
- Restrictions on operations: Distributors are typically prohibited from distributing our products in any undesignated geographical areas or selling self-manufactured products. Distributors are not allowed to engage sub-distributors without our prior consent. Distributors are required to adopt our standardized retail outlet design and layout, use our standard product labels and packaging and follow our standardized marketing brochures.
- Sales return policy: Apart from products defects caused by quality issues, distributors are not allowed to return the products they have purchased from us.
- Termination: We are entitled to terminate the distribution agreement in writing with our distributors for their non-compliance with our sales policy, for instance, engaging in the sale of unauthorized products, changing retail prices without our prior approval, failing to manage sub-distributors in accordance with our operational standards or materially damaging our brands' reputation.
- Confidentiality: Distributors are obligated to keep confidential any of our trade secrets known or used by such distributors and to not disclose the same to any other third party under circumstances pursuant to the distribution agreements.

We entered into the distribution agreement with Red Kids E-commerce on October 1, 2010. Our distribution agreement with Red Kids E-commerce does not include the marketing reimbursement clause. It is otherwise substantially the same as our other distribution agreements. Our distribution agreement with Red Kids E-commerce will expire on December 31, 2013. We are currently in negotiation with Red Kids E-commerce with regard to the renewal of the agreement. As of the Latest Practicable Date, though we have not reached an agreement with Red Kids E-commerce, our Directors confirm that both us and Red Kids E-commerce have the intention of renewing the distribution agreement under substantially the same terms as the current agreement. We did not grant Red Kids E-commerce the exclusive right to distribute our products online, but as of the Latest Practicable Date, we have not appointed online distributors other than Red Kids E-commerce.

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During the Track Record Period, although our agreements with distributors typically required them to pay us in full for our products upon delivery, we granted credit periods to our distributors on a case-by-case basis, usually when we believed that the extension of credit periods to our distributors would provide liquidity and support them in developing their business with us. For the year ended December 31, 2010, we granted 30 day credit periods to substantially all of our distributors. For the each of the two years ended December 31, 2011 and 2012, we further extended the credit period to 90 days for distributors who have stable financial conditions based on our internal assessment. As part of our effort to enhance our internal control measures, commencing in July 2013 we established a credit system which systematically assesses our distributors' credit worthiness based on their financial condition, operational capabilities and past credit history. We generally do not allow credit periods over 90 days. We review and follow-up the outstanding trade receivables on a monthly basis. If the distributor does not settle its outstanding balances, we will consider suspending our delivery of products to such distributor until outstanding receivables have been settled. We recognize the provision of bad debt when the repayment from trade and bills receivables is considered doubtful. Aging trade and bills receivables are reviewed by our management team regularly to determine whether there is objective evidence of bad debt, which includes (i) significant financial difficulty of the debtor, (ii) bankruptcy of the debtor and (iii) whether the receivables were overdue for an extended period of time. During the Track Record Period, we did not suspend any delivery of products to distributors due to delay in settlement.

### *Management of our distributors*

We believe that maintaining our image and brand recognition is critical to our success. Accordingly, we require our distributors and their sales personnel to undergo our mandatory training sessions on product knowledge and retail outlet operations to ensure that they understand our brand culture and maintain our unified brand image in their daily operations. All retail outlets in our distribution network are under the management and supervision of our retail management team, which focuses primarily on product sales, retail outlet operation and customer services. Our retail management team conducts site visits to retail outlets on a regular basis to assist our distributors in retail outlet operations and staff training. From time to time, we will have our management team personnel provide assistance to our distributors to ensure compliance with our standards.

Our distributors are required to adopt our standardized retail outlet design and layout in their retail outlets. We also have dedicated staff who work with distributors to establish these retail outlets. We closely monitor the establishment of these retail outlets and verify that the construction work meets our standards.

We typically grant each of our distributors exclusive rights in a designated area or region to avoid cannibalization among themselves. Furthermore, our distributors are not allowed to re-allocate inventories or obsolete products among themselves without our prior approval. We closely monitor inventories of our distributors, assist with the liaisons between our distributors and facilitate the re-allocation of inventories between different retail outlets on a case-by-case basis. Our distributors are typically required to make purchase orders based on their sales capabilities and are not allowed to return the products they have purchased, except in cases of defective products in which case our distributors are typically required to notify us in writing three days upon receipt of our products and are generally allowed to exchange after our further examination.

For marketing purposes, our distributors participate in various promotional campaigns and events initiated by department stores, shopping malls, or business districts where their respective

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retail outlets are located and file records with us after their participation. Our distributors are required to participate in all promotional events we initiate. We meet with our distributors at our sales fairs to collect feedback and exchange ideas regarding market trends, consumers' responses to our products and retail outlet operation. We also communicate our latest marketing strategies to our distributors on a regular basis to maintain consistent business operation and brand image across our distribution network.

We regularly evaluate the performance of our distributors based primarily on the following factors:

- ordering products in accordance with annual purchase guidance;
- opening new retail outlets in accordance with expansion targets;
- improvement in the overall sales performance and same store sales growth;
- maintaining and enhancing store appearance; and
- improvement in operating and business management capabilities.

Distributors typically receive marketing reimbursements when they meet or exceed the relevant purchase targets. These marketing reimbursements are for our distributors to use when they incur marketing expenses. For the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013, our marketing rebates to distributors amounted to RMB27.5 million, RMB29.8 million, RMB38.8 million and RMB18.2 million, respectively.

As we sell products to our distributors on a wholesale basis, we are not obligated to and did not accept return of inventory that had not been sold by our distributors upon termination of distributorship during the Track Record Period. Distributors that terminate their relationship with us are generally allowed to continue to sell our products that have already been purchased in their respective retail outlets for a period of 60 days following the termination of distributorship. After such period, the terminated distributor is required to cease sales of our products and return all furniture, fixtures, signs and labels printed with the "redkids" logo back to us. We send representatives from our sales team to conduct on-site inspection following the 60-day period and during regular stores visits to ensure all terminated distributors do not continue selling the unsold products. The terminated distributor will bear the ultimate loss for the unsold products. During the Track Record Period, all of the terminated distributors complied with our termination policy and we did not notice any irregularities.

### *Sub-distributors*

Our distributors are generally allowed to engage sub-distributors in their respective designated geographical region with our prior approval, and through our distributors, we indirectly give authorization to the sub-distributors to sell our products under our "redkids" brand in retail outlets operated by them. We do not require our distributors and their sub-distributors to be independent from each other. We do not have direct contractual relationships with sub-distributors. We rely on our distributors to manage their sub-distributors and to ensure that their sub-distributors comply with our policies. Based upon our current distribution agreements, the forms of agreements between our distributors and their sub-distributors are provided by us and are



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consistent with the terms of the distribution agreements entered into between us and our distributors. Based on the distribution agreement, the sub-distributors engaged by our distributors are required to sell our products exclusively at their retail outlets. We do not have direct contractual relationships with the sub-distributors engaged by our distributors, but we are still entitled to claim against the sub-distributors if they infringe on our rights, including our intellectual properties. Moreover, our distributors are required to ensure that their sub-distributors operate in compliance with our sales policies pursuant to the distribution agreements, and our distributors and their sub-distributors shall be jointly liable for all our damages and losses caused by their misconduct. Our distributors are also required to notify us within ten days upon signing the sub-distribution agreements with their sub-distributors. In addition, we require that our distributors receive our prior approval before they or their sub-distributors open a retail outlet. Through the direct control of the locations in which our distributors and their sub-distributors may establish a retail outlet, we are able to prevent cannibalization amongst our distributors, sub-distributors and the retail outlets operated by them. By allowing the engagement of sub-distributors by our distributors, we are able to effectively manage a smaller number of distributors directly. We believe that this strategy enables us to focus more on assisting our distributors to improve their operation of retail outlets and to manage them more efficiently.

As of December 31, 2010, 2011 and 2012 and June 30, 2013, there were 66, 46, 40 and 41 sub-distributors engaged by 26, 27, 24 and 24 distributors, respectively. As of the Latest Practicable Date, all of the current sub-distributors engaged by our distributors are Independent Third Parties. As of December 31, 2010, 2011 and 2012, we had 476, 560, 594 and 582 retail outlets in our distribution network, of which 255, 302, 334 and 341 were operated by sub-distributors. The following table sets forth changes in the number of sub-distributors during the periods indicated:

	As of/For the year ended December 31,								As of/For the six months ended June 30,				
	2009		2010		2011		2012		2013				
	Total	Appointed	Total	Appointed	Total	Appointed	Total	Appointed	Total	Appointed	Total		
Sub-distributors . . .	104	12	50	66	9	29	46	5	11	40	2	1	41

The number of sub-distributors decreased from December 31, 2009 to December 31, 2010 primarily due to terminations of sub-distributors that (i) were relatively small in size or (ii) had unsatisfactory sales performance. At the same time, our distributors appointed sub-distributors which they believe have better resources to cover the areas originally covered by the terminated sub-distributors. Our total number of sub-distributors further decreased from 66 as of December 31, 2010 to 46 as of December 31, 2011 primarily because of terminations of our distributors which were relatively small in size or did not possess or were not willing to invest the resources to open additional retail outlets. In turn, the sub-distributors appointed by such terminated distributors were also terminated. Our distributors terminated 11 sub-distributors in 2012 for reasons such as unsatisfactory sales performance or the termination of their lease agreements. In the six months ended June 30, 2013, one sub-distributor was terminated because of unsatisfactory sales performance.

Terminated sub-distributors are generally allowed to continue to sell our products that have already been purchased by them in their respective retail outlets for a period of 60 days following the termination of sub-distributorship. After such period, the terminated sub-distributor is required to cease sales of our products and discard all of our products that are unsold. The terminated sub-distributor will bear the ultimate loss for the unsold products. Our distributors then send representatives to conduct an on-site inspection to ensure that the terminated sub-distributor has terminated all sales of “redkids” branded products. In addition, our distributors are required to

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inform us as soon as they detect any terminated sub-distributors selling the unsold products after the 60 days following the termination of sub-distributorship. During the Track Record Period, we have not been informed by our distributors that any of the terminated sub-distributors failed to comply with the termination policy and we have not been informed of any irregularities with respect to the terminated sub-distributors by our distributors.

### **Sales Fairs and Purchase Orders**

We generally organize two sales fairs for our distributors and their sub-distributors to purchase our new collections each year. The exact time of our sales fairs varies from year to year because our sales fairs are typically organized to accommodate our sales and marketing plan. We generally organize sales fairs for our new products of the spring/summer collection during August to September and our new products of the fall/winter collection during March to April.

We collect orders from our distributors primarily at our sales fairs. During the Track Record Period, substantially all of the sales orders placed by our distributors at our sales fairs have been recognized. In addition, during the years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013, 95.2%, 95.4%, 95.6% and 90.4% of our turnover were derived from sales orders placed and confirmed by our distributors during the two sales fairs.

### **Pricing**

Our profitability depends in part on the market positioning of our brand and products. In order to maintain our price competitiveness and sales volume, we review our retail pricing strategy regularly and make adjustments based on the following factors:

- production costs and procurement costs of our products;
- historical sales data of our products;
- the characteristics of our products;
- the expected profit margin of our individual products;
- the price of our competitors' products; and
- the degree of saturation of the current market, anticipated market trends and expected changes of demand from end customers.

The retail price range of our products is typically determined by our headquarters. All of our distributors are required to strictly follow our standardized nationwide retail pricing and discount policy pursuant to the terms of the distribution agreements entered into by us and our distributors. Our products are sold to distributors at an annual pre-determined discount to the suggested retail prices.

### **Retail Outlets for Our Products**

We generally seek to open street shops under our brand primarily in prime commercial locations with high pedestrian traffic flow in third- and fourth-tier cities and to establish concessions in large and well-known department stores in selected prime locations in cities where our products are sold, which typically attract frequent visits by our target end customer base.

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### *Street shops*

Street shops under our “redkids” brand are mainly individual stores located in prime commercial locations of third- and fourth-tier cities. As of June 30, 2013, we had 308 street shops, all of which were operated by our distributors and their sub-distributors.

### *Department store concessions*

Our distributors lease concession space for the display and sale of our products in major department stores across China. As of June 30, 2013, there were approximately 212 concessions under our “redkids” brands with the majority located in prime commercial locations, which aim to attract large end customer volumes and allow for effective brand advertising. All of our department store concessions are operated by our distributors and their sub-distributors.

### *Shopping mall outlets*

Shopping mall outlets under our “redkids” brand are independent stores in large shopping malls. The large display areas at our shopping mall outlets allow us to carry out promotional activities and introduce a wide range of products. As of June 30, 2013, we had 62 shopping mall outlets, all of which were operated by our distributors and their sub-distributors.

## **Management of Retail Outlets**

### *Location*

We believe that location selection is critical to the success of the operation of retail outlets in our distribution network. As a result, we work together with our distributors to select locations for our branded retail outlets and our prior approval is required before opening any retail outlets. Retail outlets in our distribution network are typically located in prime commercial locations with high levels of pedestrian traffic flow in third- and fourth-tier cities. We typically consider the following factors when selecting a location to establish a new retail outlet:

- proposed location of the retail outlets and the shopping patterns and spending power of the target end customers;
- analysis of the population density and growth, and development potential;
- competition in the surrounding area of the proposed location; and
- estimated initial capital investment, investment payback period and date of return on investment.

### *Design and appearance*

Each of our branded retail outlets is characterized by our trendy and colorful brand image and happy and healthy brand culture. We also aim to create a comfortable and uniform shopping environment for our end consumers. The design, appearance and layout of retail outlets under our “redkids” brand follow visual guidelines set by us and are readjusted every season based on the featured themes. Under the guidelines, all retail outlets must present a consistent visual image, particularly through the design and color of the products, shop setup, merchandise, and window

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and model display. In addition, we have dedicated staff who work with distributors to establish these retail outlets. We monitor all stages of the establishment of these retail outlets and verify that the construction work meets our standards.

### *Competition*

We typically grant each of our distributors exclusive rights in a designated area or region to avoid cannibalization amongst themselves. Furthermore, under our distribution agreements and the standard agreements between our distributors and their sub-distributors, we require our distributors and their sub-distributors to obtain our prior approval before they open any new retail outlets. Through controlling the locations in which our distributors and their sub-distributors may establish a retail outlet, we are able to avoid cannibalization and prevent competition amongst our distributors and their sub-distributors at the retail level.

In order to avoid direct competition with our distributors and their sub-distributors, we seek to establish our self-operated retail outlets in locations that complement and not duplicate the coverage of retail outlets operated by our distributors and their sub-distributors. In the event that there is an overlap in the geographical coverage of our self-operated retail outlet and a retail outlet operated by our distributor or their sub-distributor, we will engage in prior discussions with our distributor in that particular region regarding our plans to establish our self-operated retail outlet. In addition, we plan to apply the following measures to mitigate the potential adverse effects resulting from having more than one retail outlet in a geographical region:

- (i) offering our products through different sales channels. For instance, establishing our self-operated retail outlets in concession stands of department stores when our distributors' retail outlets are located in shopping mall outlets or street shops;
- (ii) offering different product mix or product categories in our self-operated retail outlets and retail outlets operated by distributors or sub-distributors; and
- (iii) strictly implementing a standardized nationwide retail pricing and discount policy for our products.

### **Online Sales**

We sell a portion of our products to a designated online distributor, Red Kids E-commerce, which purchases products from us on a wholesale basis before selling them to end customers through online sales platforms such as Taobao, VIPShop and V+. Under our distribution agreement with Red Kids E-commerce, we recognize revenue when our products are delivered to Red Kids E-commerce. We intend to continue to expand our online sales business together with Red Kids E-commerce by collaborating with online sales platforms which focus on the same target customer group as we do, in particular those frequently visited by younger parents. Our sales to Red Kids E-commerce increased significantly from RMB0.8 million for the year ended December 31, 2010 to RMB29.8 million for the year ended December 31, 2011 to RMB87.8 million for the year ended December 31, 2012, and it increased from RMB24.5 million for the six months ended June 30, 2012 to RMB37.1 million for the six months ended June 30, 2013. For the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013, our sales to Red Kids E-commerce represented 0.2%, 7.6%, 16.9% and 14.7% of our turnover.

We have also been collaborating with online sales platforms to promote our "redkids" brand through the placement of online advertisements prior to holiday seasons, such as Chinese New Year. In addition, we seek to enhance our brand awareness by continuing to introduce products

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with distinct styles online that are designed to attract the attention of new customer groups, in particular younger parents who comprise a large portion of online customers, which in turn may help enlarge our customer base. To support the development of our online sales business, we also seek to identify quality raw material suppliers and OEMs that can help us reduce our online products' time-to-market. In order to remain competitive in the online market we must frequently introduce new products to attract the attention of our target customers. In the future, we plan to use the information gathered from online sales as a reference for our product design and development.

We plan to further develop our online sales business by connecting it with the establishment of our self-operated retail outlets. We intend to showcase certain products at our self-operated retail outlets so that potential customers can experience these products physically before purchasing them online. In turn, we believe this sales model will help to not only strengthen our brand image, but also increase our market share. We aim to further develop our online sales channel so as to increase our reputation and profitability.

Mr. Ding Peiyuan, one of our executive directors, and his wife, Ms. She Xuefen, owned 60% and 40%, respectively, of Red Kids E-commerce prior to July 25, 2012, when Mr. Ding Peiyuan and Ms. She Xuefen sold their interests in Red Kids E-commerce to Independent Third Parties. Our sales to Red Kids E-commerce were RMB35.3 million and RMB52.5 million for the period between January 1, 2012 and July 24, 2012 and for the period between July 25, 2012 and December 31, 2012, respectively.

Our Directors confirm that the transactions between Red Kids E-commerce and us were conducted on similar terms and at arm's length before and after the disposal. Sales to Red Kids E-commerce are subject to similar terms and conditions as sales to other distributors.

### **Self-Operated Retail Outlets**

We plan to establish self-operated retail outlets in prime locations of selected regions which we believe have high sales growth potential and to gradually increase the proportion of our self-operated retail outlets. We intend to use our self-operated retail outlets as model stores to enhance our brand recognition, demonstrate our standards for store appearance and provide guidance to our distributors in brand promotion and retail management. We believe that these self-operated retail outlets, along with our other efforts, would help to further improve and unify our brand image at the retail level. See "Business — Our Business Strategies — Establish self-operated retail outlets and continue to expand our distribution network".

There are certain potential risk associated with establishing self-operated retail outlets. Our management team members have to allocate their time from our other daily operations to retail management matters. In addition, we expect the staff costs under our selling and distribution expenses to increase as we employ additional employees to run our self-operated retail outlets. Furthermore, we incur expenses and capital expenditures for our self-operated retail outlets, including rental for the premises, utilities, cost of display furniture and fixtures and maintenance of inventories, all of which put pressure on our cash flows. If we fail to properly manage our self-operated retail outlets, we face the risk of adversely affecting the reputation of our "redkids" brand and our financial performance. Please see "Risk Factors — Our limited experience operating self-operated retail outlets and our failure to effectively handle the risk associated with operating our self-operated retail outlets may materially and adversely affect our business, financial condition, results of operations and prospects."

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To manage these risks, we plan to expand our self-operated retail outlets in a phased and well-paced manner. We intend to open self-operated retail outlets initially in first- and second-tier cities, such as Shanghai and Wuhan, to ensure that we have adequate market exposure for our first self-operated retail outlets. We intend to open additional self-operated retail outlets gradually and to keep the total number of self-operated outlets under 50 before December 31, 2014 to limit the impact on our cash flows and allow our management to continue to focus on our principal operations. All of our self-operated retail outlets will be newly set-up and will include street shops, shopping mall outlets and department store concessions. While we believe our management team has sufficient prior experience operating retail outlets, we plan to strengthen our ability to operate these self-operated retail outlets through the hiring of qualified personnel. Before we open a self-operated retail outlet in a location, we plan to study the sales pattern of other industry players in that market and use as reference in determining the proper business strategies, sales and inventory management and product mix for that market. Furthermore, we plan to discuss with our distributor covering that market to avoid potential competition and to gain a better understanding of that market through their accumulated local knowledge. In our selection of the location for our self-operated retail outlet, we seek to complement and not duplicate the coverage of retail outlets operated by our distributors. In areas already covered by our distributors, we plan to strictly implement a standardized nationwide pricing and discount policy with the respective local distributor.

We expect to incur an average of approximately RMB0.6 million to RMB1.0 million in initial set-up costs for each self-operated retail outlet depending on the location of the retail outlet. The initial set-up costs for our retail outlets include store decoration, furniture, inventory and staff and other operating expenses. We expect to incur no more than RMB3.0 million and RMB40.0 million of capital expenditures for establishing our self-operated retail outlets in 2013 and 2014, respectively. We plan to use our internal funds and proceeds from our Global Offering to fund the establishment of these retail outlets. We expect the payback period<sup>(1)</sup> for the initial setup costs of each of our self-operated retail outlets to be approximately two to three years. We expect the profit and loss breakeven period<sup>(2)</sup> for each of our self-operated retail outlets to be between three to six months.

Following the establishment of our self-operated retail outlets, part of our revenue will be derived directly from retail sales at our self-operated retail outlets in addition to revenue derived from wholesales to distributors and the provision of OEM services. We expect sales from our self-operated retail outlets to drive the growth of our revenue alongside our sales to distributors. We expect the increase in our selling and distribution expenses to outpace the growth of our revenue in 2013 and 2014 due to the costs to be incurred associated with the opening of our self-operated retail outlets. As a result, we do not expect our operating profit and net profit margin to improve prior to 2015. However, we expect our operating profit and net profit margin to improve in the long-run as we expect to incur most of the costs associated with the opening of our self-operated retail outlets in 2013 and 2014.

We expect to incur net cash outflow in 2013 and 2014 in relation to the operation of self-operated retail outlets because of the costs associated with the opening of these retail outlets.

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*Note:*

- (1) *The period of time required to recover the initial setup costs, which is expected to grow in line with the Group's overall capital expansion plan, of each self-operated retail outlet by its net profit, assuming the revenue will increase in line with the overall business growth and there will be no material impact on the business and operating result of the self-operated retail outlet due to the seasonal fluctuations in market demand, market inflations, increase in new material costs and labor expenses throughout the operation periods.*
- (2) *The period of time required for a self-operated retail outlet to generate sales equal to its operating cost for the first time, assuming the nurturing period for each of the new self-operated retail outlets would generally take one to three months after opening and revenue growth rates and gross profit margins would be similar to the existing self-operated retail outlet.*



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However, we still expect to have net cash generated from operating activities in 2013 and 2014 as a result of the cash inflow from sales to distributors. We expect to incur net cash outflow for investing activities in 2013 and 2014 in relation to the set-up costs associated with the opening of our self-operated retail outlets.

We believe it is appropriate to pursue the strategy of establishing self-operated retail outlets because (i) we have years of experience in building our sales and distribution network in the PRC; (ii) we would have a more comprehensive retail coverage with the establishment of self-operated retail outlets; (iii) we expect our overall gross profit margin to improve through the establishment of our self-operated retail outlets; and (iv) as a brand management company, it is essential that we understand the latest changes in market preferences and collect first-hand feedback from end customers through our self-operated retail outlets in order to continue to improve our product designs and further enhance our marketing plans.

### MARKETING AND PROMOTION

We believe that an effective marketing and promotion strategy is imperative in building our brand. We have received increasing media attention and were accredited as one of the “Top Ten Brands for Children’s Apparel in China” (中國十大童裝品牌) in 2013. Moreover, our marketing and promotion activities such as advertising campaigns and charity events help us to raise our brand profile and increase awareness of our brand concepts. Our brand promotion and marketing division is responsible for understanding our brand position and for making appropriate sales and marketing plans.

The following are our main promotional activities:

#### Advertising Campaigns

We generally organize our advertising campaigns with the release of our new seasonal collections. Our advertising campaigns typically include billboard advertisements and magazine advertisements. We believe advertising campaigns are important for promoting our brand awareness and brand culture as well as for attracting our target consumers. In addition, we provide reimbursements to distributors who meet performance targets to support their advertising campaigns.

#### Seasonal Events

We encourage our distributors and their sub-distributors to actively participate in the seasonal promotion events held by department stores, shopping malls and business districts where our “redkids” brand retail outlets are located. Such promotions generally entail price reductions storewide and are typically held during holidays, new product releases and change of seasonal collections. We also recommend our distributors and their sub-distributors to offer discounts on selected products during promotional periods, which usually take place at the end of each season.

#### Websites

We will also promote our “redkids” brand through Internet media, such as micro-blogs. Consumers can access our official company website ([www.redkids.com](http://www.redkids.com)) and our online distributor’s website to obtain more information about our brands, latest products and promotional events. Furthermore, through our designated online distributor, we have been collaborating with online sales platforms to promote our “redkids” brand through various forms of online advertisements.

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### Other Marketing Campaigns

In addition to the aforementioned marketing campaigns, we also participate in fashion shows and charity events to heighten our media coverage and enhance our brand image. In 2011, we displayed the latest designs and styles of our “redkids” brand at the Beijing International Clothing & Accessories Fair (北京國際服裝服飾博覽會). The media coverage of this event helped raise awareness of our brand within the fashion community. Furthermore, we also promote our brand through charity events. For instance, we donate our products to children in rural areas of the PRC. We believe that such form of marketing not only strengthens our brand recognition but also enhances our brand image.

Furthermore, some of our distributors have implemented VIP customer programs at the retail outlets operated by them or their sub-distributors. Through the VIP customer programs, they provide discounts to end customers.

For the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013, our marketing and promotion expenses were approximately RMB28.8 million, RMB36.2 million, RMB41.2 million and RMB18.7 million, respectively, representing approximately 8.8%, 9.2%, 7.9% and 7.4% of our turnover, respectively.

### PRODUCTION, OUTSOURCING AND PROCUREMENT

During the Track Record Period, we manufactured a portion of our products at our production facilities in Quanzhou, Fujian Province and outsourced the remaining to OEMs. Our self-produced products include T-shirts, shirts, tank tops, pants, blouses, and shorts, while we outsource the production of products that require special production technologies and know-how, such as jeans, sweaters and down jackets. For the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013, the proportion of products that were manufactured by our OEMs continued to increase, accounting for approximately 14.6%, 40.2%, 50.1% and 68.1% of our total cost of sales, respectively. For the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013, the gross profit margin of our self-produced products were 40.5%, 37.4%, 40.2% and 36.3%, respectively, while the gross profit margin for our outsourced products were 38.6%, 35.6%, 35.0% and 37.9%, respectively. In the future, we intend to utilize our production know-how, accumulated through our many years of experience as an OEM service provider to international apparel brands, to identify and collaborate with qualified OEMs and raw material suppliers. We intend to continue to increase our outsourced production to OEMs to support our increased sales.

### Our Production Facilities, Production Capacity and Utilization Rate

Our production facilities are located in Quanzhou, Fujian Province and occupy 20,575.8 sq.m. of land. The following table shows the annual designed production capacity, annual weighted production volume and overall utilization rates during the Track Record Period:

	Year ended December 31,			Six months ended June 30,
	2010	2011	2012	2013
	('000)	('000)	('000)	('000)
Designed production capacity <sup>(1)</sup> .....	38,610	38,610	38,610	19,305 <sup>(4)</sup>
Weighted production volume <sup>(2)</sup> .....	30,244	29,055	30,487	8,834
Overall utilization rates <sup>(3)</sup> .....	78.3%	75.3%	79.0%	45.8%

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*Notes:*

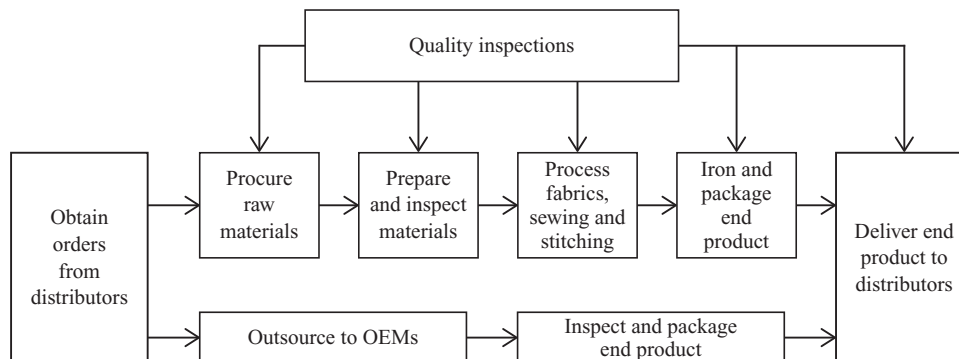
- (1) *Designed capacity is calculated by assuming that the production of T-shirts is carried out on all of our production lines for one shift of 11 hours per day and 300 days per year.*
- (2) *Weighted production volume is calculated by summation of the weighted production volume of all product categories manufactured in-house when converted into equivalent volume of T-shirts.*
- (3) *Utilization rate is calculated by dividing the weighted production volume by the designed capacity.*
- (4) *For the six months ended June 30, 2013, our designed capacity is calculated by assuming that the production of T-shirts is carried out on all of our production lines for one shift of 11 hours per day and 150 days per year.*

Our overall utilization rate decreased from 79.0% for the year ended December 31, 2012 to 45.8% for the six months ended June 30, 2013 primarily because of our decision to focus our resources and management's attention on aspects other than manufacturing that we believe contribute more value to our business, such as brand management and sales and marketing. While we outsourced a greater proportion of our production for the six months ended June 30, 2013, we do not intend to further reduce our in-house production volume going forward. We expect to maintain our current utilization rate and the excess capacity as back-up for any unforeseen surge in demand for our products or disruption to our supply chain. During the Track Record Period and as of the Latest Practicable Date, we incurred no impairment for our property, plant and equipment. Our manufacturing personnel decreased from approximately 590 as of December 31, 2012 to approximately 350 as of June 30, 2013. There were no compensations paid nor outstanding disputes or settlements relating to the reduction of our manufacturing personnel during the six months ended June 30, 2013.

### ***Our production process***

Our workflow for in-house manufacturing is streamlined to enhance production efficiency and product quality. We participate in every stage of the production process, including (i) procuring raw materials; (ii) preparing and inspecting raw materials; (iii) processing fabrics, sewing and stitching; (iv) inspecting finished products; and (v) ironing and packaging finished products. Members of each team along the production line work together. We inspect fabrics, products-in-progress and final products throughout the manufacturing process. Product concepts usually take four months to go through our design and production process.

The following diagram outlines our in-house production process:



### **Raw Materials Procurement**

As of June 30, 2013, we procured raw materials, such as fabrics and auxiliary materials including buttons and zippers, from our 21 domestic raw material suppliers, all of which were

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Independent Third Parties, for our in-house production. Our total cost of raw materials accounted for approximately 64.8%, 44.6%, 37.2% and 23.7% of our total cost of sales for the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013, respectively. We have on average over two years of relationship with our top five raw material suppliers. Our raw material suppliers are responsible for the transportation costs incurred in delivering raw materials to our designated warehouse. Our Directors have confirmed that we did not experience any shortage of supply in raw materials during the Track Record Period.

### **Outsourcing**

We typically engage OEMs to manufacture or process products that require special skills or production technologies, such as sweaters, jeans and down jackets. Our OEMs are enterprises with experience in the production of apparel and accessories as well as advanced manufacturing facilities and technologies, and we request them to consistently provide products that fulfill our quality requirements. We did not experience any labor strikes of or disputes with our OEMs during the Track Record Period.

We carefully select OEMs which could satisfy our evaluation and assessment criteria, including their overall track record, financial strength, experience, reputation, ability to produce high-quality products and quality control. We request to inspect the business licenses, tax registrations and other relevant certificates of our OEMs before engaging them. We require our OEMs to keep confidential our commercial secrets known or used during our cooperation period. Our OEMs shall be liable for all our financial losses if they disclose our commercial secrets to any third party under any circumstances without our prior consent.

Purchases from our five largest OEMs and raw material suppliers accounted for approximately 36.5%, 37.4%, 43.1% and 54.9% of our total cost of sales for the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013, respectively. Purchases from our largest supplier accounted for approximately 12.0%, 11.2%, 10.4% and 15.8% of our total cost of sales for the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013, respectively. Our purchases from OEMs increased significantly during the Track Record Period because we made the strategic decision to focus our resources and management's attention on certain stages in our production life cycle that we believe contribute more value to our business, such as brand promotion and sales and marketing. As a result, we did not expand our production capacity as our sales volume increased and instead outsourced the production of this additional demand. Furthermore, we outsource to OEMs the manufacturing of products which we do not have the requisite technologies and machineries to produce internally, including jeans, sweaters and down jackets. We have on average over two years of relationship with our five largest OEMs and raw material suppliers. We generally receive from our OEMs and raw material suppliers credit periods of approximately 30 days. Our OEMs and raw material suppliers typically require us to make deposits and prepayments. Our purchase agreements with OEMs state that if we suffer losses due to manufacturing defects attributable to the OEM, that OEM shall be liable and bear the relevant costs. According to our PRC legal adviser, Jingtian & Gongcheng, the purchase agreements are valid, binding and enforceable under PRC laws, and the OEMs engaged by us are liable for any costs and liabilities relating to any defects of the products produced by them. During the Track Record Period, we did not experience any shortage of supply and we have not claimed any damages or losses from our OEMs in respect of product defects.

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The following table sets forth changes in the number of our OEMs during the periods indicated:

	For the year ended December 31,						As of June 30,						
	2009		2010		2011		2012		2013				
	Total	Appointed	Terminated	Total	Appointed	Terminated	Total	Appointed	Terminated	Total	Appointed	Terminated	Total
OEM ...	4	2	0	6	11	2	15	2	4	13	5	6	12

For 2010 and 2011, we appointed a number of new OEMs to support our increased proportion of outsourced production. In 2011, we terminated two OEMs that could not continue to deliver our orders at competitive prices. In 2012 and the six months ended June 30, 2013, the total number of OEMs we engaged remained relatively stable. During those periods, we appointed two and five and terminated four and six OEMs, respectively, as we sought to work with OEMs that could better support our production needs and business developments. We terminated the engagement of OEMs that did not deliver our products on time or could not support our production needs at competitive prices.

We are generally not involved in our OEMs' selection of raw material suppliers and we generally do not require that our OEMs purchase raw materials from designated suppliers. Our quotes from the OEMs include the total costs only, and the raw material costs are not separately listed. We apply our manufacturing experience and refer to publicly available prices of raw materials applicable to the fabrics used in our products to assess and examine the reasonableness of our OEMs' quotes. Our fees paid to the OEM are determined with reference to publicly available raw material prices, the scale and reputation of the OEM, the product delivery time and price quotes offered by comparable OEMs. We may suggest that our OEMs seek alternative raw material suppliers or recommend raw material suppliers if we find an OEM's quote to be unreasonable. To ensure the quality of the raw materials procured by our OEMs, our quality inspection team examines the quality of the raw materials purchased by our OEMs. In addition, our quality inspection team inspects final product samples prior to large-scale production, work-in-progress products and subsequently all batches of finished goods. Our sales team inspects the area around "redkids" branded retail outlets during their regular store visits to detect and prevent our OEMs from selling sub-standard products or engaging in unauthorized production of our products. We also encourage our distributors to detect and report back to us any sales of sub-standard products or unauthorized products in the market. Our distributors are generally willing to collaborate as such activities may adversely affect their sales. During the Track Record Period, we were not aware of any incidents relating to our OEMs disclosing our commercial secrets to other parties, nor were we aware of any of our OEMs engaging in the selling of sub-standard products or the unauthorized production of our products.

None of our Directors, their associates, or any shareholders who, to the knowledge of our Directors, owns more than 5% of our issued share capital, had any interest in any of our top five OEMs and raw material suppliers during the Track Record Period.

Set out below are the material terms of the purchase agreements we generally enter into with our OEMs:

- **Quality:** Our OEMs are generally required to procure raw materials, manufacture and package our products in accordance with national standards and our guidelines. Our OEMs are not allowed to sub-contract their work to third parties without our prior written approval. We periodically dispatch order handling and quality control staff to inspect the production process, including pre-production samples and final products, both prior to and after admitting them to our warehouses. OEMs are required to obtain our approvals before a volume production can commence.

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- **Delivery:** OEMs are generally required to deliver the finished products to our designated warehouse.
- **Payment:** We are generally required to pay 30% of our total contract value as an initial deposit upon execution of the purchase agreements with OEMs. We shall pay the remaining amount within 30 days of confirming the quality and quantity of the finished products delivered by OEMs.
- **Product defects:** OEMs are generally liable for damages and losses in connection with the quality of the supplied products that occur within one year of product delivery. We are entitled to request OEMs to unconditionally refund the purchase price paid for the defective products within one year after we receive such products.
- **Termination:** We reserve the right to terminate the purchase agreement with OEMs for their delay or failure in product delivery, defective products or non-compliance with our production guidelines or if the OEM engages in selling sub-standard products or unauthorized production of products under our “redkids” brand.
- **Confidentiality and non-competition:** Our OEMs do not exclusively produce products for us. We require that they keep confidential any of our intellectual properties and/or trade secrets known or used by such OEM, and to not disclose or pass the same to any third party under any circumstances pursuant to the purchase agreements. Our OEMs are required to use the labels imprinted with our brand logo provided by us or our designated raw material suppliers and are required not to use the leftover labels without our authorization.

### OUR OEM BUSINESS

We provide OEM services for certain domestic and overseas customers at our production facilities in Quanzhou, Fujian Province. Our domestic customers primarily consist of sportswear retailers in China, and our overseas customers are mainly children’s apparel wholesalers from Russia, Italy and Saudi Arabia. For domestic customers, we have the right to receive full payment for our services within a month of our delivery of our products. For overseas customers, we have the right to obtain up-front prepayment and the remaining sum after our customer receives the original receipt of shipment from us. We are obligated not to engage a third party to manufacture the products of our customers, and we provide a one-year product warranty to domestic customers but no product warranty to overseas customers. We are able to fulfill our obligation to not engage third parties to manufacture the products of our customers because we do not accept OEM orders unless we are certain that we have the production capacity required to fulfill such orders. For domestic sales, we are liable under the PRC Product Quality Law (產品質量法) and the PRC Tort Law (侵權責任法) for the quality of the products we manufacture and for the damage caused to others by any defective products we produce. Our OEM contracts with overseas customers do not stipulate the laws applicable to disputes arising from these contracts. However, according to our PRC legal adviser, Jingtian & Gongcheng, when a contract does not stipulate the laws applicable to disputes arising from such contract, the laws of the country deemed most relevant to the transaction may be applied. If PRC laws, which includes the PRC Product Quality Law, the PRC Tort Law and related regulations, are determined to be most relevant by the relevant dispute settlement bodies, we may be subject to the same liabilities for products we manufacture for overseas customers as for products we manufacture for domestic customers. Our turnover from OEM services accounted for 4.3%, 2.4%, 0.5% and 0.3% of our total turnover for the three years



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ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013. Our turnover derived from OEM services decreased over the Track Record Period as we continued to shift our focus to the development and sale of products under our own “redkids” brand.

### QUALITY CONTROL

We believe that our commitment to quality control is one of the principal factors contributing to our success. In 2013, we were recognized as an “Excellent Enterprise for Trustworthy Quality in China” (全國質量誠信優秀企業) issued by the China Quality Inspection Association (中國質量檢驗協會). We are committed to continuing to offer high-quality products to consumers and performing stringent quality control throughout procurement and production. We have implemented multiple points of quality control and inspection throughout our in-house manufacturing process and production outsourced to our OEMs. Our quality control process starts early in the design and research and development stage when we carefully examine the functionality and quality of raw materials to be used for manufacturing. We then review the product samples produced by our production team or our OEMs. We also arrange for our quality control staff members to carry out spot checks of semi-finished products at our production facility and the production facilities of our OEMs regularly and when necessary to ensure that they comply with our standards. After the manufacturing process, our quality control staff generally conducts random sample tests before packaging and warehousing. We also inspect our finished products before they are sold to distributors. In addition, to further ensure the quality and safety of our products, we have engaged nationally accredited quality inspection agencies to examine both raw materials and product samples provided by our OEMs before their large-scale production and for subsequent batches of products. We paid the nationally accredited quality inspection agencies approximately RMB32,000, RMB102,000, RMB151,000 and RMB71,000 for the three years ended December 31, 2010, 2011 and 2012 and for the six months ended June 30, 2013 respectively for such inspections. We obtained a confirmation letter issued by Quanzhou Administration Bureau of Quality and Technology (the “Bureau”) dated July 29, 2013 (the “Quality Control Confirmation”) in which the Bureau confirmed we complied with the relevant laws and regulations in relation to product quality, and our products met the relevant national standards. As advised by our PRC legal adviser, Jingtian & Gongcheng, the Bureau is a competent and appropriate authority to provide such confirmation and such confirmation should not be challenged by a higher level authority because Article 8 of the PRC Product Quality Law (產品質量法) stipulates that local quality control bureaus at or above the county level are the competent authority for supervising product quality within their respective administrative regions. In addition, as advised by our PRC legal adviser, Jingtian & Gongcheng, under the Product Quality Law of the PRC, the product quality supervision and inspection system is conducted on a sampling basis. Our products are subject to and have all passed the sampling inspection implemented by the Bureau. According to our PRC legal adviser, Jingtian & Gongcheng, we were able to obtain the “Quality Control Confirmation” despite of the two quality control incidents mentioned below because our products that were taken for random inspection by the Bureau have all passed the sampling inspection. In addition, we have not received any written notices from relevant government authorities with regard to fines or punishment in relation to our product quality.

Our Directors confirm that there were no material product recalls or major complaints against our products. During the Track Record Period, we had no sales returns. We comply with relevant PRC consumer protection laws with respect to policies on the return of merchandise.

### **Quality Control Incidents**

During the Track Record Period, there were two quality control incidents with regard to three of our products. Our aggregate maximum potential liability under the two incidents in terms of fines from the relevant government authorities is RMB5.4 million. Our Controlling Shareholders have agreed to indemnify us in relation to penalties or fines resulting from the two incidents.

#### *First Quality Control Incident*

The first incident involved a batch of 9,740 pairs of Product One, which was produced by one of our OEMs. Our attention was first drawn to this incident on May 13, 2013 by our online distributor, Red Kids E-commerce. We learned from Red Kids E-commerce that they received an anonymous call informing them that Product One contained aromatic amine levels that exceeded the relevant national standard. On the following day, in response to such information, we immediately sent another sample batch of Product One to the National Textile and Fashion Quality Control Inspection Center in Fujian for re-inspection. The inspection result indicated that Product One had aromatic amine levels of 291 mg/kg, which exceeded the 20 mg/kg safety threshold under the National General Safety Technical Code for Textile Products<sup>(1)</sup> by 271 mg/kg on May 18, 2013, and on the same day, we immediately requested that Red Kids E-commerce (i) cease sales of, (ii) commence to accept returns of, and (iii) announce the inquiry hotline for the return of Product One. On May 30, 2013, in order to provide timely product safety information to our customers, Red Kids E-commerce announced the product return notice on its website, and we have requested all of our distributors and their sub-distributors to place in their respective retail outlets a written notice with regard to accepting returns of Product One (the “Announcement”). The Announcement was placed on Red Kids E-commerce’s website on May 30, 2013 and at the retail outlets of our distributors and their sub-distributors from May 30, 2013 until August 2013. As of the Latest Practicable Date, (i) we have not withdrawn the acceptance of return of Product One and (ii) no customers have returned any of Product One to our distributors or their sub-distributors. CCTV broadcasted this incident based on the investigations and finding of the BCA on May 30, 2013. The BCA published on its official website that our products contained aromatic amine levels exceeding relevant national standards on May 31, 2013. Our Directors are of the view that the BCA’s investigation and findings and the report of this incident on CCTV did not cause adverse effects on our business and product reputation because our business operation had not been interrupted since the publication of this incident and our sales continued to grow for the four months ended October 31, 2013.

To the best of our knowledge, dyes containing aromatic amine are used in the dyeing process of dark colored jeans to increase the brightness of the fabric and to fix the color to the fabric. Based on publicly available information, the use of dyes containing aromatic amine during the production of deep-blue children’s jeans is not uncommon within the industry in the PRC. Daily exposure to aromatic amine and ammonia could cause adverse effects to an individual’s health, including the development of cancer. However, according to confirmations we received from the Bureau and Zhong Fang Xie Quality Control (Quanzhou) Technology Services Company, Ltd. (中紡協檢驗(泉州)技術服務有限公司) on December 11, 2013 (the “First Quality Control Incident Confirmations”), (i) in general, repetitive and continuous contact with or exposure to large amounts of aromatic amine could increase the likelihood of adverse effects on an individual’s

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*Note:*

(1) *Promulgated in January 2011 and effective in August 2012 (GB18401-2010)*

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health, including the development of cancer; (ii) under normal circumstances, our end customers will not wear Product One, which has an aromatic amine level of 291 mg/kg, on a daily basis over many years; and (iii) based upon information and research results available to the Bureau and Zhong Fang Xie Quality Control (Quanzhou) Technology Services Company, Ltd. (中紡協檢驗(泉州)技術服務有限公司), as of December 11, 2013, there is no conclusive evidence that there will be severe adverse effects on one's health or development of cancer following a quantified amount or length of contact with aromatic amine and there are currently no known instances of development of cancer or other severe adverse health effects on individuals resulting from wearing children's apparel that contain aromatic amine levels exceeding the relevant national standard. According to the First Quality Control Incident Confirmations, our end customers should not suffer from severe adverse health effects, including the development of cancer, under normal usage of Product One. As advised by our PRC legal adviser, Jingtian & Gongcheng, the Bureau is a competent and appropriate authority to provide such an opinion. Zhong Fang Xie Quality Control (Quanzhou) Technology Services Company, Ltd. (中紡協檢驗(泉州)技術服務有限公司) is accredited by a national accreditation body of China, which in turn is part of an international accreditation multilateral recognition system, unitarily responsible for the accreditation of certification bodies, laboratories and inspection bodies. Based on the foregoing, the Joint Sponsors are of the view that Zhong Fang Xie Quality Control (Quanzhou) Technology Services Company, Ltd. (中紡協檢驗(泉州)技術服務有限公司) is a qualified and competent, internationally recognized institution and that the Bureau is a competent authority to provide their views on the risk of causing adverse effects to an individual's health through wearing Product One.

Although we require our OEMs to test for aromatic amine in the products they manufacture for us, our investigation revealed that this particular OEM did not conduct all required tests on this batch of deep-blue jeans. We did not detect this quality control incident due to administrative oversight by our quality control personnel. The amount of sales for Product One amounted to approximately RMB0.6 million and according to our PRC legal adviser, Jingtian & Gongcheng, we may be subject to a fine that includes the sales revenue from this batch of Product One and a penalty of no more than three times the amount of sales revenue. We have since terminated the engagement of this OEM. We sold this batch of jeans to Red Kids E-commerce in September 2011 and as of the Latest Practicable Date we have not received any formal notices of penalties from relevant authorities. According to our PRC legal adviser, Jingtian & Gongcheng, there are no relevant laws or regulations in the PRC requiring apparel manufacturers and distributors to recall products that do not meet certain quality standards. Nevertheless, upon discovery of this incident we immediately ordered Red Kids E-commerce to cease the sales of Product One and we requested that it return the products in question that remained unsold. According to our communication with Red Kids E-commerce, all of Product One were sold to end customers. As of the Latest Practicable Date, neither Red Kids E-commerce nor end customers returned any of Product One upon receiving our request. In view of the foregoing and the Quality Control Confirmation obtained, our PRC legal adviser, Jingtian & Gongcheng, is of the view that the risk of us being penalized by the relevant authorities for this incident is relatively low. Under the relevant PRC laws and regulations, we have the right to demand indemnification when we incur losses resulting from products that do not meet national quality standards. As we have neither been fined by relevant regulatory authorities nor received any customer complaints in relation to this incident, we did not request the relevant OEM to indemnify us for this incident. As we have not previously had any notification of non-compliance with regard to the incident above, the Directors are of the view that the above incident is an isolated case. As of the Latest Practicable Date, we have not been fined by relevant regulatory authorities and we have not received any customer complaints in relation to this incident. Thus, we currently have no reason to believe that the reputation of our products suffered from this incident. However, in the event that we are fined for this incident, according to our PRC legal adviser, Jingtian & Gongcheng, we may be

subject to a fine that includes the sales revenue from this batch of Product One and a penalty of no more than three times the sales revenue from this batch of Product One, which amounts to no more than RMB2.4 million.

According to our PRC legal adviser, Jingtian & Gongcheng, under the PRC Product Quality Law (產品質量法), the PRC Tort Law (侵權責任法) and relevant laws and regulations, we are liable for medical and other expenses resulting from adverse effects to our end consumers' health caused by our products that do not meet national quality standards. According to Jingtian & Gongcheng, there are no relevant laws or regulations in the PRC specifying our maximum product liabilities or litigation exposures relating to Product One should our end customers bring civil lawsuits against us. Thus, we are not able to quantify our maximum product liabilities or litigation exposures in relation to claims arising from Product One. Our maximum liability relating to Product One will be determined by the number of claims brought against us and the amount of damage claimed under each lawsuit. Furthermore, according to our PRC legal adviser, Jingtian & Gongcheng, when a claim or lawsuit is brought against us in relation to Product One (i) the individual who brought the claim bears the burden to prove that (a) Product One was defective under relevant PRC laws; (b) the individual suffered severe adverse health effects; and (c) the defect of Product One was the cause of the severe adverse effects on the individual's health. Based on the First Quality Control Incident Confirmations, regular usage of Product One would not lead to severe adverse effects on one's health. The likelihood that an end customer will be able to prove that he or she suffered severe adverse health effects as result of regular usage of Product One is remote. Our PRC legal adviser, Jingtian & Gongcheng, is of the view that provided that the customer could not be able to prove that he or she suffered severe adverse health effects as result of regular usage of Product One, the probability of any successful claim against us and the likelihood that relevant PRC courts will hold us liable for the claims relating to Product One is low. Our Controlling Shareholders have agreed to indemnify us against all claims relating to Product One.

### *Second Quality Control Incident*

The second incident involved a batch of 498 units of our boy's knitted jacket (Product Number: RQF113017) ("Product Two") and a batch of 8,848 units of our boy's hoodie (Product Number: 1230418) ("Product Three"). Our attention was first drawn to this incident on May 30, 2013 following China Quality Inspection Net's (中國質檢網) posting on its website that according to the result of examinations organized by Jilin Bureau of Industry and Commerce (吉林省工商局) in April 2013, Product Two did not meet the fiber content analysis, instructions guidance and the durability of fabric color tests under the relevant national quality standards, while Product Three did not meet the fiber content analysis and the durability of fabric color test under the relevant national quality standards. Under the Measures for Monitoring the Quality of Commodities in Circulation (流通領域商品質量監測辦法), provincial-level bureaus of industry and commerce are responsible for organizing and leading quality control inspections of the products sold within their respective jurisdictions, and because Product Two and Product Three were sold in Jilin Province, they were subject to Jilin Bureau of Industry and Commerce's inspections. Jilin Bureau of Industry and Commerce provided us neither with a notification with regard to the inspection of these products nor did they involve us during the inspection process. In addition, we did not receive the corresponding inspection reports for Product Two and Product Three.

Upon discovery of this incident on May 30, 2013, we immediately contacted all distributors in Jilin Province and requested that they cease sales of Product Two and Product Three on the same day. We sold Product Two and Product Three to our distributors in Jilin province in 2012, and according to our communication with our distributors in Jilin Province, Product Two and

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Product Three have subsequently been sold to end customers. As of the Latest Practicable Date, none of our distributors in Jilin Province or end customers returned any of the products in question. In addition, on May 30, 2013, we sent to all of our distributors and their sub-distributors in Jilin Province an instruction to place in their respective retail outlets our written notice with regard to the acceptance of returns of Product Two and Product Three. As of the Latest Practicable Date, we have not withdrawn the acceptance for the returns of Product Two and Product Three and according to our communication with our distributors in Jilin Province, no customer has returned the products in question to our distributors in Jilin Province or their sub-distributors. According to our PRC legal adviser, Jingtian & Gongcheng, there are no relevant laws or regulations in the PRC requiring apparel manufacturers and distributors to recall products that do not meet certain quality standards.

Product Two had passed all quality control inspections conducted by the National Textiles and Fashion Quality Control Inspection Center in Fujian (國家紡織服裝產品質量監督檢驗中心(福建)) on May 4, 2011. Furthermore, Product Three had passed the quality control inspections conducted by the Zhong Fang Xie (Beijing) Quality Control Technology Services Company, Ltd. (中紡協(北京)檢驗技術服務有限公司) on June 26, 2012. Both the National Textiles and Fashion Quality Control Inspection in Fujian (國家紡織服裝產品質量監督檢驗中心(福建)) and Zhong Fang Xie (Beijing) Quality Control Technology Services Company, Ltd. (中紡協(北京)檢驗技術服務有限公司) are certified third-party inspection agencies qualified to issue quality inspection reports that can be recognized nationwide. According to our PRC legal adviser, Jingtian & Gongcheng, (i) the examinations conducted by the National Textiles and Fashion Quality Control Inspection in Fujian (國家紡織服裝產品質量監督檢驗中心(福建)) and Zhong Fang Xie (Beijing) Quality Control Technology Services Company, Ltd. (中紡協(北京)檢驗技術服務有限公司) were conducted on a sampling basis; (ii) according to the reports prepared by the two agencies our products that were taken for sampling inspection have all met the relevant national quality standards. In addition, we have not received any formal notices or penalties from Jilin Bureau of Industry and Commerce or other relevant quality control authorities since the release of the examination result in May 2013. In view of the foregoing and given that the two products comply with the relevant mandatory national quality standards and the Quality Control Confirmation obtained, our PRC legal adviser, Jingtian & Gongcheng, believes that we are not likely to be penalized for this incident. We do not believe we need the relevant OEM to indemnify us as we have neither been fined by relevant regulatory authorities nor received any customer complaints in relation to this incident. Our Directors are of the view that this was an isolated incident. Due to the aforementioned, we currently have no reason to believe that the reputation of our products suffered from this incident. However, in the event that we are fined for this incident, according to our PRC legal adviser, Jingtian & Gongcheng, we may be subject to a fine that includes the sales revenue from Product Two and Product Three and a penalty of no more than three times the amount of sales revenue for each batch of products, which amounts to no more than RMB3.0 million.

### **Enhanced Quality Control Measures**

In response to the two incidents described above, we are enhancing our quality control procedures by increasing the frequency of quality control inspections and enlarging the sampling size of raw materials, semi-finished products and final products inspections. Based on the enhanced internal control procedures that we implemented at the end of November 2013, our sampling size for quality control inspections has increased by up to 50% when compared to the sampling size prior to the occurrence of the two incidents. For instance, prior to the two incidents, we sampled not less than 100 units of production batches that included not more than 5,000 units. Following our enhanced quality control measures, we plan to sample not less than 150 units per every production batch that is not larger than 5,000 units. In addition, to enhance supervision of



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the above quality control procedures, we intend to also increase the frequency of inspections conducted by our senior quality control personnel to ensure that all of our products, whether manufactured in-house or procured from OEMs, comply with the quality control thresholds under GB 18401-2010 National General Safety Technical Code for Textile Products (國家紡織產品基本安全技術規範 (GB 18401-2010)) as required by relevant PRC product quality regulations. Prior to the two incidents, we required that our senior quality control personnel inspect not less than three times each batch of products during the production process, whether the products are manufactured in-house or procured from OEMs. Commencing from end of November 2013, we require that our senior quality control personnel inspect the production of each batch of products not less than five times. As of the Latest Practicable Date, following the implementation of our enhanced quality control procedures, we have not identified any quality related issues for our products. We require all of our products to pass the relevant inspections under GB 18401-2010 National General Safety Technical Code for Textile Products (國家紡織產品基本安全技術規範 (GB 18401-2010)) prior to being delivered to our distributors both before and after the incidents. We believe that our enhanced quality control process has been effective because we have not received further quality control complaints and we were awarded the “Excellent Enterprise for Trustworthy Quality in China” (全國質量誠信優秀企業) from the China Quality Inspection Association (中國質量檢驗協會) in 2013.

The Joint Sponsors have (i) reviewed the enhanced quality control procedures adopted by the Company at the end of November 2013; (ii) reviewed the qualification and scope of the agreed-upon procedures work performed by the internal control consultant engaged by the Company; and (iii) reviewed the factual findings of the internal control consultant on the results of the procedures performed on the relevant quality control procedures. Having considered amongst others, the internal control consultant’s findings and based on discussions with our management, the Joint Sponsors are of the view that the Group’s enhanced quality control procedures adopted by the Company at the end of November 2013 are adequate and effective.

### OUR CUSTOMERS

As of June 30, 2013, our five largest customers were all our distributors, which were all primarily engaged in the sales of children’s products. We have more than three years of relationship on average with our top five customers. Sales to our five largest customers accounted for approximately 32.0%, 35.2%, 46.3% and 45.9% of our total turnover for the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013, respectively, while sales to our largest customer accounted for approximately 7.0%, 7.6%, 16.9% and 14.7% of our total turnover for those respective periods.

Except in the case of Red Kids E-commerce, in which our Director, Mr. Ding Peiyuan, held a 60% interest until July 25, 2012, none of our Directors, their associates, or any shareholders who, to the knowledge of our Directors, owns more than 5% of our issued share capital, had any interest in any of our top five customers during the Track Record Period.

### INVENTORY CONTROL AND LOGISTICS

We recognize that controlling the level of inventory is important to our overall operational efficiency and cost control. Based on the purchase orders received at our sales fairs, we are able to anticipate the demand for our products in advance and plan ahead for the production of the goods and the orders we will place with our OEMs.



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We closely monitor inventories of our distributors, including inventory levels, inventory age and inventory composition. We conduct monthly visits of retail outlets operated by our major distributors, including our top ten distributors measured by sales revenue during the Track Record Period, and their sub-distributors and we require our major distributors, including our top ten distributors measured by sales revenue during the Track Record Period, to submit monthly inventory reports. For our other distributors and their sub-distributors, we conduct the same procedures on a quarterly basis and we require the distributors to submit quarterly inventory reports. The retail outlets we visit are selected randomly as we believe random sampling would eliminate sampling bias and thus enhance the accuracy of the sales and inventory data collected. We also conduct spot checks and physical stock counts on the inventory level of our distributors. In addition, we regularly communicate with the management of department stores on the sales performance of department store concessions under our “redkids” brand to confirm the accuracy of our sales data for such distributors. Furthermore, to help our distributors lower their inventory levels, we provide them with guidance to ensure that they would not over-purchase and advise them on when to commence promotional activities.

Based on (i) the fact that during the Track Record Period, (a) we had not recorded any sales return from the distributors, (b) there was no provision required for bad debts, and (c) our trade receivables at the end of each reporting period during the Track Record Period had been fully settled; and (ii) reference to monthly/quarterly visits to distributors and sub-distributors and review of monthly/quarterly inventory reports and quarterly sales reports of distributors, our Directors are of the view that there were no accumulations of inventory at the distributor and sub-distributor levels.

We generally deliver our products to our distributors through third-party logistics companies engaged by our distributors. These logistics companies bear the risks and losses associated with the delivery of our products.

### AWARDS AND RECOGNITION

Our brand has won various awards and recognitions in China since 2005, as evidenced by the following awards and certificates:

<u>Year</u>	<u>Award/Certificate</u>	<u>Awarding Body</u>
2013	“Excellent Enterprise for Trustworthy Quality in China” (全國質量誠信優秀企業)	China Quality Inspection Association (中國質量檢驗協會)
2013	“Top Ten Brands for Children’s Apparel in China” (中國十大童裝品牌)	China National Garment Association (中國服裝協會), an organization of designers, brand owners and manufacturers in the apparel industry in China
2011	“China Color Application Award” (中國色彩應用獎)” “The Top Fashion Kids’ Wear Brand of China” (年度最具流行魅力童裝品牌)	China Fashion & Color Association (中國流行色協會)
2010	“China Fashionable Product Release Base for Children’s Garments” (中國童裝時尚新品發佈基地)	China Fashion & Color Association (中國流行色協會)

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Year	Award/Certificate	Awarding Body
2009	“Fujian Province Famous Brand” (福建省著名商標)	Administration for Industry and Commerce of Fujian province (福建省工商行政管理局)
2005	“China Famous Brand of Export To Be Developed Emphatically” (重點培育和發展- 中國出口名牌) for 2005 and 2006	MOFCOM

### RISK MANAGEMENT MEASURES

We have written risk management policies and guidelines in place prior to Listing. The following table sets out some of the primary risks our business faces and our existing risk management measures:

Risk Identified	Our Risk Management Measures and Procedures
Protection of product design	<ul style="list-style-type: none"> <li>We require our designers to sign confidentiality and non-competition agreements upon joining our Company.</li> </ul>
Limited control over our distributors	<ul style="list-style-type: none"> <li>We have a standardized distributor selection process, in which more important distributors must meet more stringent standards.</li> <li>We train our sales and marketing team to conduct rigorous evaluations of potential distributors.</li> <li>We have a system of accessing the credit history of our distributors to ensure that they are of good financial health.</li> </ul>
Quality of outsourced production	<ul style="list-style-type: none"> <li>We have established internal standards for selecting and evaluating our OEMs.</li> <li>We require our OEMs to keep our commercial secrets confidential and hold them liable for all financial losses should they disclose our commercial secrets to any third party under any circumstance without our prior consent.</li> <li>We inspect products at multiple stages in the production process, including pre-production prototypes, fabric printing and embroidery as well as final products.</li> </ul>

There are various other risks to our business and industry. For further details, please refer to the section headed “Risk Factors” in this prospectus.

### CORPORATE GOVERNANCE

Our Company recognizes the importance of good corporate governance in management and internal control procedures and will adopt the following measures to safeguard the interests of our Shareholders:

- (a) our Articles provide that, except in certain limited circumstances, a Director shall not vote on any resolution approving any contract or arrangement or any other proposal in

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which such Director or any of his associates have a material interest, nor shall such Director be counted in the quorum present at the meeting. As such, our Controlling Shareholders shall not vote or be counted in the quorum in respect of any proposals involving the Controlling Shareholders or any of their affiliates;

- (b) we are committed to the principle that our Board should include a balanced composition of executive and independent non-executive Directors. We believe our independent non-executive Directors are of sufficient caliber, are free of any business or other relationship which could interfere in any material manner with the exercise of their independent judgment and will be able to provide an impartial, external opinion to protect the interests of our public shareholders;
- (c) we intend to ensure that any transaction that is proposed between us and connected persons will comply with Chapter 14A of the Listing Rules including, where applicable, the announcement, reporting and independent shareholders' approval requirements of those rules; and
- (d) in addition, if our independent non-executive Directors consider it necessary or desirable, they may also engage professional advisers at the cost of our Company to advise them on matters relating to any non-competition agreement or on any business opportunities which may be referred to us by our Controlling Shareholders.

### **Compliance Adviser**

Our Company will appoint RHB OSK Capital Hong Kong Limited as our compliance adviser pursuant to Rule 3A.19 of the Listing Rules. Pursuant to Rule 3A.23 of the Listing Rules, the compliance adviser will advise our Company on the following matters:

- (a) the publication of any regulatory announcement, circular or financial report;
- (b) where a transaction, which might be a notifiable or connected transaction, is contemplated, including share issues and share repurchases;
- (c) where our Company proposes to use the proceeds of the Global Offering in a manner different from that detailed in this prospectus or where its business activities, developments or results deviate from any forecast, estimate, or other information in this prospectus; and
- (d) where the Stock Exchange makes an inquiry of our Company regarding unusual movement in the price or trading volume of the shares of our Company.

The term of the appointment shall commence on the Listing Date and end on the date on which our Company distributes its annual report in respect of its financial results for the first full financial year commencing after the Listing Date. Such appointment may be subject to extension by mutual agreement.

### **COMPETITION**

The PRC market for children's apparel is fragmented and highly competitive, but the demand for mid-to-high end children's apparel has been growing steadily in recent years, in line with economic growth in the PRC. We face competition from several domestic manufacturers of

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children’s apparel in our regional markets, such as Balabala, Goodbaby, Dadida and Annil Kidswear. We believe that we compete on the basis of brand image, design, product mix, quality, price, end customer service and the breadth of our distribution network. For a description of some of the risks associated with the competition we face, see “Risk Factors — Risks Relating to Our Business and Our Industry — We operate in a fragmented and highly competitive market. If we fail to compete effectively, our market share and profit margins may decline.”

### EMPLOYEES

As of June 30, 2013, we had a total of 593 full-time employees in the PRC. The following table sets forth a breakdown of our employees by department as of June 30, 2013:

	<u>Number of Employees</u>
Management and administration .....	43
Research and development .....	40
Sales and marketing .....	71
Finance and accounting .....	27
Production, procurement and quality control .....	<u>412</u>
<b>Total</b> .....	<b><u>593</u></b>

### Remuneration

We incurred staff costs of approximately RMB33.5 million, RMB34.2 million, RMB34.9 million and RMB13.0 million for the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013, respectively, representing 10.2%, 8.7%, 6.7% and 5.1% of our turnover for those periods, respectively. We review the performance of our employees annually, the results of which are used in his or her annual salary review and promotion appraisal.

Our senior management is also entitled to participate in our Pre-IPO Share Option Schemes, the details of which are more fully set out in Appendix V of this prospectus. We believe that by offering our key employees a shareholding stake in us, we are aligning their interest with that of ours, thereby providing our key employees with additional incentives to improve our performance.

We consider our relationship with our employees to be good. We have not experienced any strikes, work stoppages or significant labor disputes in the past and have not experienced any significant difficulties in recruiting or retaining staff.

### Training

We are committed to employee development and have implemented various programs for the development of our employees. All our newly recruited employees are required to participate in training programs to learn basic information about our culture and brand and the skills needed in his or her particular job. We provide employees with training tailored to his or her position in our Company. Training programs for our production team cover topics that relate to production know-how, safety, product quality and rules and regulations. In addition, members of our management team receive training in topics such as management skills, technical knowledge and company operations. Furthermore, we require our senior management team members to receive training in management strategies. We have updated and intend to continue to improve our employee training curriculum according to our business needs. For instance, in light of our increased outsourced production, we launched our first training program regarding the production of children’s apparel by OEMs in 2013. We also place particular importance on the training of sales personnel in retail

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outlets operated by our distributors and their sub-distributors. We believe that such training equips them with the skills and knowledge to provide better, more uniform service to our end consumers.

### INTELLECTUAL PROPERTY RIGHTS

#### Trademarks and Other Intellectual Properties

As of the Latest Practicable Date, we have registered 38 trademarks in China and three trademarks in countries and regions outside China for our “redkids” brand under different classes. As of the Latest Practicable Date, we have also applied for 13 additional trademarks of our “redkids” brand in China.

We have also entered into employment contracts, confidentiality agreements, non-compete agreements and cooperation agreements with our design and research and development personnel and the parties we cooperate with in design and research and development activities to protect our intellectual property rights.

In addition to intellectual property rights and trademarks, we rely on know-how, processes and other intellectual property rights in our operations. For further details of the intellectual property rights of the Group, please see the paragraph headed “C. Further Information about Our Business — 2. Intellectual property rights of our Group” in Appendix V to this prospectus.

### PROPERTIES

#### Self-owned Properties

##### *Land*

As of the Latest Practicable Date, we held the State-owned land use right certificates to occupy three parcels of land in Quanzhou, Fujian Province, with a total site area of approximately 20,575.8 sq.m. As advised by our PRC legal adviser, Jingtian & Gongcheng, we have obtained all State-owned land use right certificates for the land we use and we are entitled to occupy, use, transfer, lease, pledge or otherwise dispose of the land use rights under applicable PRC laws and subject to the conditions stipulated by the mortgage contract concerning the land.

##### *Buildings*

As of the Latest Practicable Date, we held the building ownership certificates for buildings with an aggregate floor area of 18,786.6 sq.m. in Quanzhou, Fujian Province, which are mainly used for production, storage, staff quarters and ancillary purposes. As advised by our PRC legal adviser, Jingtian & Gongcheng, we have obtained all building ownership certificates for the buildings we own, and we are entitled to occupy, use, transfer, lease, pledge or otherwise dispose of the buildings under applicable PRC laws and subject to the conditions stipulated by the mortgage contract concerning the buildings.

We currently occupy a building in Quanzhou, Fujian Province with a total gross floor area of 5,486 sq.m., which we use as office space. We used the building prior to the completion of the final acceptance inspection for the building and we have subsequently completed the final acceptance inspection for this building as of November 2, 2013. Our PRC legal adviser, Jingtian Gongcheng has confirmed that we had received the Construction Work Planning Permits

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(建設工程規劃許可證) and Construction Work Commencement Permits (建築工程施工許可證) for the construction of this building. Pursuant to the Administrative Regulations on the Quality Management of Construction Engineering (建設工程質量管理條例), if a construction unit delivers a building which has not completed the inspection process required for the final acceptance to users, the users shall be ordered to stop using the building and the construction unit shall be subject to a penalty of 2-4% of the contractual price of the construction project. According to our PRC legal adviser, Jingtian & Gongcheng, the likelihood that we will be penalized by the relevant authority is remote as we have successfully completed the final inspection of this building. Our Directors confirm that the occurrence of the non-compliance was primarily due to their unfamiliarity with the relevant rules and regulations under PRC laws. We intend to use the building as office space in the future. According to our PRC legal adviser, Jingtian & Gongcheng, since we have successfully completed the final acceptance, there should be no material legal impediment for us to obtain the building ownership certificate for the relevant building. Based on our communication with the relevant authority, we currently expect to obtain the building ownership certificate for this building by March 2014.

In addition, we are in the process of constructing another building in Quanzhou, Fujian Province with a total gross floor area of 18,696 sq.m. We intend to use this building as storage space in the future.

According to a due diligence report issued by Jones Lang LaSalle Corporate Appraisal and Advisory Limited (“Jones Lang LaSalle”), production at our facility located at Quanzhou, Fujian Province, is a material part of our operation and substantially contributes to our turnover. As a result, Jones Lang LaSalle has identified it as material property. According to the investigation of Jones Lang LaSalle, as of December 31, 2012, none of our properties has a carrying amount over 1% (for properties having property activities) or 15% of the total assets. Thus, on this basis, we are not required under Chapter 5 of the Listing Rules to value or include in this prospectus any valuation report of our property interests.

### **Property to be acquired by our Group**

Pursuant to a property pre-purchase agreement (the “Pre-purchase Agreement”) dated June 3, 2013 and entered into between Shanghai Fashitu Investment Group Limited (上海法詩圖投資集團有限公司, “Shanghai Fashitu”), an Independent Third Party, and Red Kids China, Red Kids China agreed to acquire from Shanghai Fashitu a building under construction situated at Shangzhifang Fashion Culture Creative Park, No.6066, Songze Avenue, Qingpu District, Shanghai with a gross floor area of 10,709.6 sq.m. (“Shangzhifang Fashion Culture Creative Park”). According to Shanghai Fashitu, the Shangzhifang Fashion Culture Creative Park will be developed in three phases, and it targets to host domestic and international apparel companies and brands to foster an environment that promotes creativity. We intend to utilize this building to set up our research and development center in Shanghai.

The relevant details relating to the above property required to be disclosed under the Listing Rules are as follows:

Name of the vendor: Shanghai Fashitu. Founded in 2004, Shanghai Fashitu is involved in the real estate business, including the selling and leasing of real estate properties.

Address of the vendor: Room 301, Building 2, No.6066 Songze Avenue, Shanghai

Total consideration payable to the vendor and payment schedule: RMB115.0 million (45% of the total consideration upon signing of the Pre-purchase Agreement, 15% by December 31,



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2013, 10% by April 30, 2014, 10% by June 30, 2014 and the remaining 20% upon satisfaction of inspection for acceptance and transfer of the title of the building)

Particulars of transactions relating to the building under construction completed within the two preceding years in which any vendor or any person who is or was at the time of the transaction a promoter or a Director or proposed Director and had any interest direct or indirect: Nil

As of the Latest Practicable Date, we have paid approximately RMB51.8 million towards the total consideration payable. We intend to use approximately RMB63.2 million, from our internal resources, to finance the balance of the consideration payable.

According to our PRC legal adviser, Jingtian & Gongcheng, the Pre-Purchase Agreement does not constitute a legally binding obligation for Shanghai Fashitu to deliver the building to the Group. Shanghai Fashitu will be responsible for the construction of the building, and according to the Pre-purchase Agreement, we are required to pay the outstanding installments by December 31, 2013, April 30, 2014 and June 30, 2014. However, according to our PRC legal adviser, Jingtian & Gongcheng, we have the right to dissolve the Pre-purchase Agreement and are entitled to demand that Shanghai Fashitu return the amount paid by the Group and indemnify us for relevant losses if Shanghai Fashitu is unable to deliver the building to the Group, or fails to obtain or transfer the title of the building as agreed. We decided to enter into Pre-Purchase Agreement with Shanghai Fashitu primarily because of the location of the property and the commercial terms of the transaction, including price, which we consider to be reasonable. Furthermore, Shanghai Fashitu has provided us the construction commencement permit with the address of No. 6066, Songze Avenue, Qingpu District, Shanghai and confirmed that such construction commencement permit covered the building under the Pre-Purchase Agreement. According to Shanghai Fashitu, it has contracted to sell/lease approximately 80% of the area of phase one of Shangzhifang Fashion Culture Creative Park. Occupants of the properties located in phase one include other established PRC apparel brands and companies. Our research and development center will be located in the phase one area, which is expected to be delivered in August 2014.

According to the Pre-purchase Agreement, Shanghai Fashitu Investment Group Co., Ltd. (上海法詩圖投資集團有限公司) is scheduled to enter into a formal purchase agreement with us by October 2014.

### **Leased properties**

As of the Latest Practicable Date, we have also leased 2 properties, with a total gross floor area of 946 sq.m. in the PRC. Our leased properties were located in the Changning and Qingpu Districts of Shanghai and were used as office space.

### **ENVIRONMENTAL AND SAFETY MATTERS**

We are subject to PRC environmental laws and regulations, which include the Environmental Protection Law of the PRC, Law of the PRC on the Prevention and Control of Water Pollution, Law of the PRC on the Prevention and Control of Atmospheric Pollution, Law of the PRC on the Prevention and Control of Pollution From Environmental Noise and Law of the PRC on the Prevention and Control of Environmental Pollution by Solid Waste. These laws and

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regulations govern a broad range of environmental matters, including air pollution, noise emissions and water and waste discharge. During the Track Record Period, we did not receive any material claim from either the government or any third party relating to any liability arising or relating to environmental or safety matters. Our cost of compliance with the applicable rules and regulations during the Track Record Period was RMB4,000, RMB3,000, RMB2,000 and RMB200 for the three years ended December 31, 2010, 2011 and 2012 and for the six months ended June 30, 2013. We expect our cost of compliance to be less than RMB10,000 per year beginning in 2014.

### **INSURANCE**

Our insurance coverage includes personal insurance for our employees and properties and car insurance. We generally do not maintain product liability insurance for our products, which is in line with the general practice in the PRC. During the Track Record Period, we did not receive any material claim from our customers or end customers relating to any liability arising from or relating to the use of our products.

### **LITIGATION AND LEGAL COMPLIANCE**

As of the Latest Practicable Date, we were not involved in any outstanding litigation, arbitration or claim of material importance, and no litigation, arbitration or claim is known to our Directors to be pending or threatened by or against us, which would have a material and adverse effect on our business, financial condition, results of operations or prospects.

As of the Latest Practicable Date, our PRC legal adviser, Jingtian & Gongcheng, and our Directors have confirmed that we have complied with applicable PRC laws and regulations in all material aspects, and have obtained all material licenses, approvals, permits and certificates from the appropriate regulatory authorities for our business operations in the PRC. We intend to engage our current legal advisers both before and on an on-going basis after the Listing.

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### NON-COMPLIANCE

#### Non-compliance relating to PRC regulations

<u>Event of non-compliance</u>	<u>Reason for non-compliance</u>	<u>Rectification action taken and latest status</u>	<u>Legal consequence and financial impact including potential maximum penalty</u>	<u>Measures to prevent future breach and ensure on-going compliance</u>
<p>As of June 30, 2013, we leased an office with a gross floor area of 700 sq.m. in Changning District, Shanghai and another office with a gross floor area of 246 sq.m. in Qingpu District, Shanghai, both of which were used as our office space. According to our PRC legal adviser, Jingtian &amp; Gongcheng, we may be required by the relevant PRC authorities to register our lease contracts, which we have not yet been arranged.</p>	<p>As of the Latest Practicable Date, one of our landlords could not provide us with the relevant building ownership certificates and as a result, we could not register our lease contracts with the relevant PRC authorities.</p>	<p>We have requested that the landlord of our office with a gross floor area of 700 sq.m. to provide the relevant building ownership certificate. In addition, we have commenced the process of searching for a suitable place in the event that we are unable to complete the registration of our lease agreement and the need for relocation arises.</p> <p>We have obtained from the landlord the building ownership certificate of the office with a gross floor area of 246 sq.m. and are filing for the registration of the lease agreement. In addition, we have commenced the process of searching for a suitable place in the event that we are unable to complete the registration of our lease agreement and the need for relocation arises.</p>	<p>The penalty for failing to register our lease contract is not less than RMB1,000 and not more than RMB10,000 per incident.</p> <p>According to our PRC legal adviser, Jingtian &amp; Gongcheng, our maximum potential liabilities arising from such lease registration irregularities amount to RMB20,000.</p>	<p>We will request for building ownership certificates prior to leasing properties in the future.</p>

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Event of non-compliance	Reason for non-compliance	Rectification action taken and latest status	Legal consequence and financial impact including potential maximum penalty	Measures to prevent future breach and ensure on-going compliance
<p>As required under the Regulation of Insurance for Labor Injury (工傷保險條例), the Provisional Insurance Measures for Maternity of Employees (企業職工生育保險試行辦法), the Interim Regulation on the Collection and Payment of Social Insurance Premiums (社會保險費徵繳暫行條例), the Interim Provisions on Registration of Social Insurance (社會保險登記管理暫行辦法) and the Social Insurance Law (社會保險法), we are required to provide our employees in the PRC with welfare schemes covering the “Mandatory Social Insurance”. For the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013, we did not pay the requisite contribution for Mandatory Social Insurance for approximately 950, 950, 820 and 620 of our employees in the PRC, respectively.</p>	<p>Due to practical difficulties in making contributions for employees with short-term employment and high turnover rate, we did not make all contributions as required under the Mandatory Social Insurance. In addition, many of our employees did not wish to participate in Mandatory Social Insurance because they came from other provinces.</p>	<p>We have received a confirmation letter dated July 26, 2013 from the Human Resources, Labour and Social Security Bureau of Quanzhou City (泉州市人力資源和社會保障局), the competent and responsible authority in Quanzhou, Fujian Province with respect to our employee social welfare scheme, stating that we have not been subject to any administrative punishment as a result of any breach of the applicable laws and regulations on Mandatory Social Insurance. According to the PRC Social Insurance Law (社會保險法), social security bureaus at or above the county level are responsible for the administration of social insurance within their jurisdiction. Thus, according to our PRC legal adviser, Jingtian &amp; Gongcheng, the Labor and Social Security Bureau of Quanzhou City is the competent authority to issue this confirmation, and this confirmation should not be challenged by higher level authorities.</p>	<p>For our unpaid contribution to the Mandatory Social Insurance accrued prior to the effectiveness of the Social Insurance Law of the PRC on July 1, 2011, relevant authorities may require us to pay the outstanding amount within a prescribed time limit. If we fail to make the overdue contribution within such time limit, an additional late payment penalty at daily rate of 0.2% of the outstanding amount may be imposed.</p> <p>For our unpaid contribution to the Mandatory Social Insurance accrued after July 1, 2011, relevant authorities may require us to pay the outstanding amount within the prescribed time limit with an additional late payment penalty at the daily rate of 0.05% from the due date. If we fail to make the overdue contribution within such time limit, the relevant authorities may also impose a fine on us equal to an amount between 100% and 300% of the total amount of the overdue contribution. We have made provisions for the accrued but unpaid social insurance</p>	<p>We are in the process of rectifying our internal control measures in relation to contributions to the Mandatory Social Insurance and intend to make contributions for any new employees to be employed going forward. We intend to raise our employees’ awareness with regard to Mandatory Social Insurance through enhanced communications with them. We will settle the unpaid social insurance with any employee who demands such payment in the future.</p> <p>As approved by the relevant authority, we are in the process of rectifying this non-compliance by making contributions for our existing employees. We expect the coverage rate of our employees to reach 30% and 70% by the end of 2013 and 2014, respectively, and we intend to have full coverage for our employees by end of 2015. We intend to rectify this non-compliance over three years because the relevant authority may only handle the registration and</p>

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Event of non-compliance	Reason for non-compliance	Rectification action taken and latest status	Legal consequence and financial impact including potential maximum penalty	Measures to prevent future breach and ensure on-going compliance
		As of the Latest Practicable Date, we have not received any notification from any government authorities alleging that we have not fully contributed to the Mandatory Social Insurance.	and housing fund contributions which amounted to approximately RMB6.5 million as of June 30, 2013.  Our PRC legal adviser, Jingtian & Gongcheng, are of the view that the risks of the local governmental authority demanding outstanding payments or imposing any penalty on us with respect to our employee Mandatory Social Insurance are low.	accept the contributions in batches spread over three years.
According to the Regulations on Management of Housing Fund (住房公積金管理條例) and relevant regulations, we are generally required under the applicable PRC laws and regulations to provide our employees in the PRC with welfare schemes covering housing funds and housing benefits. For the three years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013, we did not pay the requisite contributions for housing fund for approximately 950, 950, 820 and 620 of our employees in the PRC, respectively.	Due to difficulties in making contributions for employees with short-term employment and high turnover rate, we did not make all contributions as required under the Regulations on Management of Housing Fund. In addition, many of our employees did not wish to participate in housing benefits because they came from other provinces.	We have received a confirmation letter dated July 30, 2013 from the Housing Fund Administration Centre of Quanzhou City (泉州市住房公積金管理中心) confirming that (i) we fully complied with the laws, regulations, requirements and standards on housing funds since our inception; and (ii) we have not been subject to any administrative punishment as a result of any breach of the applicable laws and regulations on housing funds. According to the Administrative Regulations on the Housing Provident Fund (住房公積金管理條例), city-level housing provident fund administration	Our PRC legal adviser, Jingtian & Gongcheng, has advised us that in the event that the relevant authorities demand that we pay our unpaid housing fund contributions, we shall be required to make such payments, and if we do not do so within the prescribed time limit, the relevant authorities may apply for an order for payment from the relevant PRC court. We have made provisions for accrued but unpaid social insurance and housing fund contributions which amounted to approximately RMB6.5 million as of June 30, 2013.  Our PRC legal adviser, Jingtian & Gongcheng, is of	We are in the process of implementing our internal control measures in relation to contributions for housing fund and intend to make necessary contributions for any new employees to be employed going forward. We intend to raise our employees' awareness with regard to housing benefits through enhanced communications with them. We will settle the unpaid housing fund contribution with any employee who demands such payment in the future.  As approved by the relevant authority, we are in the process of rectifying this

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<u>Event of non-compliance</u>	<u>Reason for non-compliance</u>	<u>Rectification action taken and latest status</u>	<u>Legal consequence and financial impact including potential maximum penalty</u>	<u>Measures to prevent future breach and ensure on-going compliance</u>
		<p>centers are responsible for the administration of housing provident fund. Thus, according to our PRC legal adviser, Jingtian &amp; Gongcheng, the Housing Fund Administration Centre of Quanzhou City is the competent authority to issue this confirmation, and this confirmation should not be challenged by higher level authorities.</p> <p>As of the Latest Practicable Date, we have not received any notification from any government authorities alleging that we have not fully made housing fund contributions.</p>	<p>the view that the risk of the local governmental authority demanding outstanding payments or imposing any penalty on us with respect to our housing fund is low.</p>	<p>non-compliance by making contributions for our existing employees. We expect the coverage rate of our employees to reach 25% and 70% by the end of 2013 and 2014, respectively, and we intend to have full coverage for our employees by end of 2015. We intend to rectify this non-compliance over three years because the relevant authority may only handle the registration and accept the contributions in batches spread over three years.</p>



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### Non-compliance relating to the Companies Ordinance

During the preparation for the Listing, we discovered that Red Kids HK, a subsidiary of our Company, was not in compliance with the requirements under section 111 of the Companies Ordinance to convene annual general meetings and section 122 of the Companies Ordinance to lay the annual audited accounts before its shareholders at its annual general meetings. We set out below a summary of the non-compliance incident:

<u>Event of non-compliance</u>	<u>Reason for the non-compliance</u>	<u>Rectification action taken and latest status</u>	<u>Legal consequence and financial impact including potential maximum penalty</u>	<u>Measures to prevent future breach and ensure on-going compliance</u>
<p>Red Kids HK was incorporated in Hong Kong as a limited liability company on July 29, 2005.</p> <p>Red Kids HK failed to convene annual general meetings and lay the annual audited accounts before its shareholders at its annual general meetings since incorporation up to the financial year ended December 31, 2012.</p>	<p>During relevant times, the directors of Red Kids HK were Mr. Ding and Mr. Ding Peiyuan. Mr. Ding and Mr. Ding Peiyuan have each confirmed that the occurrence of the non-compliance was primarily due to their unfamiliarity with the relevant rules and regulations under Hong Kong laws, and their reliance on the advice from the statutory auditors of Red Kids HK, who were then also responsible for the company secretarial matters of Red Kids HK on the relevant requirements.</p>	<p>Application was made to the High Court of Hong Kong by Red Kids HK on July 17, 2013 for an order to extend the period of nine months to lay the annual audited accounts before its shareholders to within 28 days from the date of such court order. Such order was granted by the High Court of Hong Kong on August 21, 2013.</p> <p>On September 16, 2013, Red Kids HK held a general meeting in accordance with the aforesaid court order, on which the annual audited accounts of Red Kids HK were laid.</p>	<p>A company and each officer of the company who is in default of section 111 of the Companies Ordinance shall be liable to a fine of up to HK\$50,000.</p> <p>Each director of a company which is in default of section 122 of the Companies Ordinance shall be liable to a fine of up to HK\$300,000 and, if the court is of the opinion that such offense was committed willfully, up to 12-month imprisonment.</p> <p>No provision has been made in the consolidated financial statements of our Group as after obtaining the order from the High Court of Hong Kong and convening the general meeting of Red Kids HK pursuant to such court order, the non-compliances with sections 111 and 122 of the Companies Ordinance have effectively been rectified as of the Latest Practicable Date.</p>	<p>To avoid future re-occurrence of such non-compliance incidents, we will, prior to the Listing, engage Hong Kong legal advisers to continue to provide legal advice to us after the Listing and keep us updated about our on-going obligations and duties under the relevant laws of Hong Kong, and provide training to our Directors on the latest developments of various compliance matters that relate to us, including the Listing Rules and the Companies Ordinance after the Listing, from time to time as and when needed. Furthermore, our Company has engaged Mr. Ng Cheuk Him, who possesses the qualifications of a certified public accountant and an associate member of the Hong Kong Institute of Chartered Secretaries, as the Company Secretary. Mr. Ng will be in charge of, among other matters, ongoing compliance</p>

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<u>Event of non-compliance</u>	<u>Reason for the non-compliance</u>	<u>Rectification action taken and latest status</u>	<u>Legal consequence and financial impact including potential maximum penalty</u>	<u>Measures to prevent future breach and ensure on-going compliance</u>
				with Hong Kong company secretarial affairs of our Group.