Management Discussion and Analysis

RESULTS

On the back of a worldwide rebound in the athletic shoe industry, turnover reached US$1,691 million for the year ended 30th September, 2000, an increase of 14% over the same period last year. Net profit went up by 7.7% to US$210 million, while earnings per share for the financial year under review was US$0.297, compared to US$0.291 for the same period last year.

COSTS REVIEW

During the year, while the global market improved, the Group has experienced an increase in operating cost in certain areas. Staff costs as a percentage of turnover increased by just over 1%, in line with the increase in the minimum wage in the Guangdong province of the People's Republic of China. Also contributing to this increase was a rise in headcount, attributable to the hiring of additional workers to compensate for stricter restrictions limiting employees' working hours. Material costs rose slightly, partly due to the increase in global petroleum prices over the past year. Selling and distribution expenses increased as a result of the growth in production volume, as well as slight rises in sales and marketing expenses.

The Group remains committed to improve its internal operating efficiency. Inventory turnover in days has been slightly reduced from 41 days in 1999 to 40 days in 2000. Additionally, increases in production volume continue to allow better utilisation of facilities and the advantages of economies of scale.

PRODUCTION VOLUME AND CATEGORIES

Total production volume showed strong growth this year, an increase of 17%, from 87.8 million pairs to 103.1 million pairs. The Group continued to make strides in diversifying its production bases and product mix. For the year of 2000, athletic shoes accounted for 76% of overall turnover (1999:78%), while casual shoes accounted for 15% (1999:13%). Growth by dollar value for athletic and casual shoes was 11% and 33%, respectively.

GEOGRAPHICAL MARKET

The Group continues to make significant progress in diversifying its sales by geographical market. The U.S. market accounted for 53% of turnover (1999: 61%), while sales to Europe rose to 27% of turnover (1999:21%). The Asian, Canadian, South American and other markets collectively accounted for 20% of turnover (1999:18%).

GROWTH STRATEGY

During the year, the Group pursued a multi-faceted growth strategy through a combination of vertical and horizontal expansion. Yue Yuen furthered the vertical integration of its business to upstream footwear material production by teaming up with leading material manufacturers from Taiwan to establish facilities in China to produce polyurethane (PU) resin and synthetic leather, and facilities in Vietnam to produce cloth and synthetic fabric for making shoes and sportswear. These initiatives enhanced the Group's ability to secure a consistent and high quality supply of upstream shoe materials to meet its production requirements. In addition, the Group commenced a joint venture with a vulcanised shoe and children shoe factory in Indonesia to expand its product base horizontally.

The Group's initial investment in these projects was approximately US$54 million. This was financed by the proceeds of a private placement of 35.3 million new shares in October 1999, which raised a net proceed of US$85 million.

LIQUIDITY

During the year, the Group took advantage of its solid financial position to expand production capacity (See "Capital Expenditure" for detailed explanation). At year-end, the Group had cash on hand of US$117 million (1999:US$171 million) and total borrowings of US$294 million (1999:US$273 million). This represented a gearing ratio of 0.31 (1999:0.35) and a net debt to equity ratio of 0.19 (1999:0.13). Short-term loans increased to US$170 million from US$78 million in 1999. This rise was largely attributable to the reclassification of US$60 million of long-term loans as short-term loans, in addition to borrowings related to the expansion of production capacity. The interest coverage ratio of the Group's profit before interest, tax, depreciation and amortisation (EBITDA) to total net interest expense was 35.4 times in 2000, compared to 24.6 times in 1999.

CAPITAL EXPENDITURE

To effectively capture volume growth generated by strong customer orders, the Group took active measures to increase production capacity in China, Indonesia and Vietnam during 2000. During the year, the Group increased the number of production lines from 182 to 215, including 10 in Indonesia as part of a new joint venture for the production of vulcanised and children shoes. Through this investment, the Group continued to diversify its production bases.

Capital expenditure for the year totalled US$203 million. Of this amount, the Group purchased land and buildings at a cost of US$19 million and acquired plant and equipment for US$128 million for the purposes of expanding its business as well as improving recreational and welfare facilities for employees. The Group also invested US$56 million in the construction of new factory buildings, dormitories, staff quarters, mainly in the People's Republic of China and Indonesia.

DIVIDEND POLICY

The Group maintained a position of financial stability and solid cash holdings at the end of 2000. In this light, the Group has continued its policy of steadily increasing dividend payments to its shareholders. Dividend per share proposed for year 2000 totalled HK$0.95, an increase of 18.75% from HK$0.80 in 1999. Dividend pay-out ratio increased to 41.3% in 2000 as compared to 36.7% in 1999.

EMPLOYEE INFORMATION

At 30th September, 2000, the Group had a total of 190,000 full time employees, compared to 154,000 in 1999. The Group's emolument policies are formulated on the performance of individual employees and are reviewed regularly every year. The Group will also provide discretionary performance bonuses to its employees as an incentive to enhance their contribution, subject to the profit of the Group and the performance of the employees. Some social and medical insurance coverage, as well as access to a provident fund scheme, is offered to our employees in different locations.

CORPORATE SOCIAL RESPONSIBILITY

The Group has continuously engaged in social responsibility programmes to promote the welfare, safety and personal development of staff, as well as to contribute to the well-being of the environment and the community as a whole. The Group has established a committee at the Board level dedicated to overseeing these programmes, of which there were several in 2000. Amongst other activities, the Group instituted a programme to treat wastewater generated by its production and living facilities with minimal impact on the environment. The Group sponsored evening schools in China and Indonesia for employees, and co-sponsored a new project with Nike and World Vision in Dongguan, China, to offer our employees self-development, educational and recreational programmes. We also collaborated with Save the Children Hong Kong and our customers to co-sponsor a basketball competition for underprivileged youths.

OUTLOOK

Although there are initial indications that the U.S. economy is slowing down, there have also been signs that the recovery of the U.S. athletic footwear market is gaining momentum. Furthermore, casual shoe sales are likely to remain robust. The probable accession of the People's Republic of China to the World Trade Organisation, as well as the normalisation of trade relations between the U.S. and Vietnam, are also likely to open up new trading opportunities for the Group in 2001.