

REVIEW AND PROSPECTS

Result

The Group registered solid growth for the six months to 31st March, 2001. During this period, overall turnover reached US\$896 million, 8.8% higher than the previous corresponding period. The total number of shoes produced during the period was 57 million pairs, an increase of 12.4% against 2000. Growth was primarily driven by an increase in orders from most of the Group's existing customers and the addition of several branded footwear customers. The trend of U.S. and European manufacturers outsourcing the production of casual shoes has continued. The Group's casual shoes sales rose 31.7% compared to 2000; athletic footwear sales grew 5.7%.

The Group has effectively weathered the slowdown in the U.S. economy, with sales to the U.S. growing 11.1% compared to 2000. European sales rose 5.4%. Sales to the U.S. constituted 53.6% of the Group's total turnover, while sales to Europe accounted for 27.7% and Asia 12.6%. This compares to 52.5%, 28.6% and 12.7% of sales to the U.S., Europe and Asia for the same period in 2000, respectively.

Net profit during the six-month period was US\$112.2 million, an increase of 2.5% compared with the last corresponding period. Cost of sales increased by 9.1% against the 8.8% increase in turnover.

Operations

As of March 2001, the Group operated 224 production lines (March 2000: 198 lines) located in China, Indonesia and Vietnam. During the six-month period, 9 lines were added. The investment made in expanding the Group's production base and other facilities during this period totalled US\$82 million.

With the entry of China into the World Trade Organisation approaching, Yue Yuen continues to see an increasingly favourable business environment in the region. The Group has further enhanced its facilities in China in 2001 and remains well positioned to capitalise from the expansion of global trade with China. In addition, Yue Yuen's operations in Vietnam and Indonesia continue to perform smoothly and have become established production centers for the Group.

Financial Position

The Group maintains a satisfactory financial position derived from the steady growth of its business. As at 31st March, 2001, the Group had cash on hand of US\$155.4 million (March 2000: US\$122.2 million) and total borrowings of US\$412.5 million (March 2000: US\$209.0 million). This represents a net debt to equity ratio of approximately 25.2% compared to 9.3% for the previous corresponding period.

Growth Strategy

The Group has continued to actively execute its growth strategy through a combination of horizontal expansion and vertical integration.

Yue Yuen has achieved satisfying results with regard to horizontal expansion in the period. The Group has effectively expanded its business with both existing and new footwear customers, as well as in new product categories.

Yue Yuen has advanced its vertical integration strategy by expanding its business to upstream footwear material production. In particular, it has expanded its production and procurement capabilities in the areas of footwear components and raw materials, specifically Polyurethane (PU) resin, synthetic leather, synthetic fabric and soles. These investments will enable the Group to procure upstream shoe material locally on a just-in-time basis and shorten the production cycle. Yue Yuen remains committed to evaluate other opportunities to expand vertically as they arise.

Corporate Responsibility

As an integral part of our manufacturing operations, corporate responsibility (CR) addresses the issues of workers' rights, benefits and opportunities; health and safety in the workplace; environmental concerns and community involvement, etc. The Group has been constantly working with its blue-chip customers to address these issues and considerable progress throughout the period has been made. During the period under review, we focused on managing working hours, improving air quality, reducing waste materials, counselling and education for our workers, and developing group CR policies and internal audit systems. We firmly believe in developing and putting in place a pro-active and long-term CR programme to advance both the Group's contribution to society and competitive advantage.

Looking Forward

Based on the results achieved during the period, the Directors are confident the Group, with its horizontal and vertical growth strategy firmly in place, will be able to work through the current economic slowdown in the U.S.. In addition, the Group will benefit incrementally from its recent investments in various joint venture companies, as they progress through the startup period and become increasingly established.