# management discussion and analysis

**FOR THE YEAR ENDED JUNE 30, 2001**

## REVIEW OF OPERATIONS

### TURNOVER

Group turnover increased by 11.4% to HK$8,109 million during the year. The wholesale and sourcing business grew by 21%. The retail and licensing businesses grew by 1.1% and 2.9% respectively.

We achieved growth in our three largest markets — Germany, Hong Kong and the Benelux (i.e. Belgium and the Netherlands) countries. In Hong Kong dollar terms, turnover in Germany, accounting for 48.4% of the Group's total turnover, recorded a growth of 19.2%. Hong Kong, our second largest market, reported growth of 1.4%. Benelux, our third largest market grew at 22.8%. France and Austria reported a growth of 42.3% and 36.8% respectively — a result of our efforts to grow our smaller markets in the region.

We reported increases in growth for most of our product lines. Net sales under the ESPRIT brand name accounted for 95.2% of the Group's turnover. Women's wear reported 13.5% growth, accounting for 54.1% of our Group's turnover. Men's wear grew by 13.8%, whereas growth in the Kids' wear line was stable at 3.6%. The turnover of Red Earth colour cosmetics declined by 20.9% overall in view of the difficult retail environment in Asia and the repositioning of the business in Australia.

### GROSS PROFIT

Our gross profit increased by 10.4% to HK$3,999 million. Margins declined by 0.5% point to 49.3% as a result of the increase in turnover from the lower margin wholesale business in Europe. Gross profit was also affected by the depreciation of the Euro and Australian Dollars.

**our foundation and long-term conviction for fast growth remain intact**



esprit kids' wear

## NET OPERATING EXPENSES (INCLUDING NET INTEREST EXPENSES)

Total net operating expenses dropped from 37.8% to 35.3% when expressed as a percentage of turnover. Building expenses as a percentage of turnover declined 0.4% point to 10.0%, as the Group took advantage of lower rentals to expand retail space in both Europe and Asia Pacific. The net increase in directly managed floor area was 27%, whilst building expenses increased by 7.3% to HK$810 million.

Staff expenses as a percentage of turnover dropped from 15.1% to 14.2%, due to the operation of more megastores, as well as our various cost control measures. Building and staff expenses accounted for 68.5% of the Group's net operating expenses.

In spite of the turnover growth, other operating expenses (excluding building and staff expenses), including depreciation and amortization, sales and general administration expenses, as well as net interest expenses, stayed relatively flat in comparison to the previous year; primarily due to better economies of scale. Accordingly, other operating expenses as a percentage of turnover dropped from 12.3% to 11.1%.

## EARNINGS BEFORE INTEREST, TAXATION, DEPRECIATION AND AMORTIZATION (EBITDA)

Our EBITDA increased by 25.4% to HK$1,341 million and the EBITDA margin improved 1.8% points to 16.5%. This improvement was attributable to a combination of our greater economies of scale, effective cost controls, and improved efficiencies.

## OPERATING PROFIT (AFTER FINANCE COSTS)

The Group has achieved eight consecutive years of growth in operating profit. The operating profit in FY2000/2001 increased 30.7% to HK$1,139 million after finance costs. Germany, Benelux and Hong Kong remained the three largest profit contributors.

## TAXATION

The effective tax rate in FY2000/2001 was 44.2%, 4.7% points higher than the previous financial year. This was mainly due to a higher proportion of profits being generated in Europe, where tax rates are relatively higher.

## PROFIT ATTRIBUTABLE TO SHAREHOLDERS

Compared with FY1999/2000, profit attributable to shareholders increased by 25.1% to HK$575 million. The net profit margin improved from 6.3% to 7.1% as a result of a lower percentage in net operating expenses to turnover.

# 5-year key financial and performance data

| FOR THE YEAR ENDED JUNE 30 | 2001 | 2000 | 1999 | 1998 | 1997 |
|---|---|---|---|---|---|
| **OPERATING RESULTS** (HK$ MN) | | | | | |
| turnover | 8,109 | 7,277 | 5,994 | 5,087 | 3,352 |
| operating profit (after finance costs) | 1,139 | 871 | 625 | 490 | 401 |
| profit attributable to shareholders* | 575 | 460 | 352 | 280 | 236 |
| **PER SHARE DATA** (HK¢) | | | | | |
| earnings per share — basic* | 51.2 | 41.3 | 32.1 | 25.7 | 26.1 |
| dividend per share | 16.8 | 15.0 | 14.5 | 3.8 | 11.5 |
| **KEY STATISTICS** (HK$ MN) | | | | | |
| shareholders' fund | 2,044 | 1,724 | 1,436 | 1,163 | 1,121 |
| working capital | 478 | 543 | 487 | 439 | 420 |
| cash position (net of overdraft) | 388 | 707 | 543 | 382 | 530 |
| term loans | 0 | 395 | 551 | 704 | 767 |
| **OTHER DATA** | | | | | |
| number of directly managed stores | 485 | 472 | 446 | 432 | 364 |
| directly managed sales footage (SQ FT) | 1,364,580 | 1,075,403 | 867,335 | 714,263 | 602,735 |
| monthly sales per square foot (HK$) | 310 | 386 | 401 | 387 | 470 |
| capital expenditure (HK$ MN) | 512 | 323 | 257 | 181 | 79 |
| number of employees | 5,954 | 5,208 | 4,471 | 4,257 | 4,377 |
| **KEY RATIOS** | | | | | |
| return on shareholders' equity*# *(ROE)* (%) | 30.5 | 29.1 | 27.1 | 24.6 | 26.5 |
| return on total assets*^ (%) | 16.2 | 13.8 | 11.8 | 9.6 | 11.6 |
| debt to equity** (%) | 2.8 | 24.0 | 39.6 | 64.7 | 68.9 |
| net debt to equity (%) | net cash | net cash | net cash | 23.3 | 17.7 |
| interest cover (times) | 29.7 | 23.3 | 13.6 | 9.2 | 8.8 |
| current ratio (times) | 1.3 | 1.3 | 1.4 | 1.4 | 1.4 |
| stock turnover period*** (days) | 36 | 37 | 40 | 37 | 51 |
| earnings before interest, taxation, depreciation and amortization *(EBITDA)* margin (%) | 16.5 | 14.7 | 13.7 | 13.4 | 16.3 |
| earnings before interest and taxation *(EBIT)* margin (%) | 14.0 | 12.1 | 10.9 | 10.4 | 12.7 |
| earnings before taxation *(EBT)* margin* (%) | 14.0 | 12.1 | 10.4 | 9.3 | 12.0 |

* calculated before profit or loss on listed investment held for long term (HK$78mn exceptional gain for FY1999, HK$125mn exceptional loss for FY1998)
\# calculated based on net earnings as a percentage of average shareholders' equity
^ calculated based on net earnings as a percentage of average total assets
** debt refers to all interest bearing borrowings
*** calculated as closing stocks balance as at year-end over average daily turnover for the year


## LIQUIDITY AND FINANCIAL RESOURCES

### A SOLID FINANCIAL POSITION

Cash generated from the Group's operating activities remained strong at HK$1,085 million. Of these funds, HK$445 million was used in the purchase of fixed assets and HK$374 million in tax payments. After allocating HK$382 million to retire all outstanding bank loans, the Group was free of short-term and long-term debt, holding HK$388 million net cash, as at the balance sheet date. Only utilized overdraft facilities aggregating the equivalent of HK$56 million, remained outstanding for our normal trading activities. Our debt to equity ratio, expressed as a percentage of interest bearing borrowings over shareholders' funds of HK$2,044 million, went down significantly from 24.0% to 2.8%. The Group has assets of HK$73 million pledged as security for overdraft and short-term revolving facility. The current ratio remains at 1.3: 1.

During the year, as is our policy, the Group entered foreign exchange forward contracts to reduce exposure to foreign currency exchange risk. These agreements were contracted with large and reputable financial institutions, thereby minimizing the credit risk. We were also able to reduce the Euro exchange risk arising from Asian sourcing for our European sales by agreeing with Asian suppliers to quote prices in Euro. As at June 30, 2001, outstanding contracts valued at contracted rates decreased to HK$170 million, from HK$189 million last year.

## CAPITAL EXPENDITURE

### INVESTING IN THE GROUP'S FUTURE

Capital expenditure totaled HK$512 million in FY2000/2001. HK$445 million was used primarily to generate a net increase in our directly managed sales footage by over 289,000 square feet, or 27%, to bring the total to approximately 1,364,000 square feet. Approximately HK$134 million of the HK$445 million was spent in Asia Pacific with the balance of HK$311 million invested in Europe, resulting in increases of around 111,000 square feet and 178,000 square feet respectively. The remaining HK$67 million represented capitalized expenses in connection with the expansion of our global distribution network.


For FY2001/2002, the Group has planned around HK$400 million for capital expenditure. This is expected to be funded out of operating cash flow, primarily to bolster worldwide retail space further. The Group plans to enter into new markets such as Korea and New Zealand. We expect total sales footage of the Group in June 2002 to reach over 1.6 million square feet.

## EMPLOYMENT, TRAINING AND DEVELOPMENT

As at June 30, 2001, the Group had a total of 5,954 employees, an increase of 740 staff over last year, in line with our expansion plans.

Total staff expenses for the year amounted to HK$1,150 million. We remunerate our employees based on their performance, experience and prevailing industry practices, with remuneration policies and packages being reviewed on a regular basis. Bonuses are linked both to the performance of the Group and to individual performance as recognition to value creation. Aligning individual interests with the Group, share options are granted to senior management. We are also fully committed to staff training and the ongoing development of our people.