



HORIZONTAL EXPANSION

Quality, style, and diversity: Our product portfolio is expanding into new areas such as ladies' shoes and sportswear.



- Strengthened and expanded our existing stronghold in footwear manufacturing.
- Broadened our product categories into sandals and ladies' shoes.
- Expanded through value-added mergers and acquisitions and has entered into the apparel manufacturing sector.

CHAIRMAN'S STATEMENT

Despite generally lackluster global economic conditions for much of 2003, I am pleased to report that it has been another excellent 12 months for Yue Yuen, with the Group achieving record revenue and earnings levels for the eleventh consecutive year. Turnover and net profit rose by 29.4% and 34.8% respectively in fiscal year 2003. It was also a groundbreaking year for us in other ways, too. By leveraging on the strength of our footwear manufacturing operation, we expanded our horizons, making strategic acquisitions in the new areas of sports apparel manufacturing and ladies' shoes.

Such strong growth and development would not have been possible without the commitment and vision of our management team and efficient line production staff. I therefore wish to express my deep appreciation and thanks for all their hard work.

We will continue to count on that commitment as we move forward in realizing our growth strategy goals in the four major areas of horizontal expansion, vertical integration, business opportunities in China, and logistics capabilities.

Given all our hard work in the past year, the Group has maintained its dominant position in the branded footwear manufacturing sector, and we now account for an estimated global market share of 17% of the combined wholesale value of athletic and casual shoes. Our turnover from core footwear manufacturing operations excluding the upstream businesses acquired in November 2002 rose year-on-year by

16.8% to US\$2,265.2 million in 2003; this compares with US\$1,938.6 million in 2002.

In line with previously stated goals, the Group expanded into apparel manufacturing with the acquisition of a 73% interest of Pro Kingtex Industrial Company Limited ("Pro Kingtex") in April 2003. Since then we have raised our stake to 92%.

We believe Pro Kingtex will provide us with a strong base from which to expand into the sports apparel and accessory manufacturing sectors. The scheduled removal of global quotas on garment products at the beginning of 2005 will present the Group with new opportunities, and should also result in a more level playing field on which to compete. This will allow us to excel further in the areas of production efficiency and logistics facilities, and thus in building stronger customer relations.

Elsewhere, the acquisition of a 50% interest in a joint venture, Hua Jian Industrial Holding Co., Limited ("Hua Jian"), in April 2003 broadened the Group's range of products into ladies' shoes. Hua Jian is an OEM/ODM for ladies' shoes with product mainly for export purpose.

Meanwhile, in line with our desire to streamline the Group's asset bases and maximize the use of our resources, we disposed of four adjacent sites in Huang Jiang, Dongguan, for US\$6.7 million in July 2003. We will continue to dispose of non-core assets going forward as appropriate.

Our China operations performed well during the year, and we intend to build on that going forward. The Group has had a presence in the China retail market for years and has become more active in exploring the market since 1999. The Group intends to leverage on its established relationships with leading international footwear brands, its local market knowledge and its connections with local wholesale distributors in expanding its retail network.

The Group plans to make further penetration in key strategic cities in China to take advantage of rising consumer demand for athletic and casual footwear as well as apparel products there. The Group is the exclusive licensee for four international brands in China: Converse, Asics, Coleman, and Hush Puppies. Currently, we have over 600 distributors and operate over 200 shops and counters in the country's major cities, including ones in Beijing, Guangzhou and Shanghai.

I am also pleased to note that our logistics operation also made steady progress during the year, particularly in the area of inbound raw materials. The joint venture, SupplyLINE Limited, has expanded its scope of operation and recorded a satisfactory increase in turnover growth.

The year had other milestones for us, chief among these was our selection as one of the constituent stocks of the Hang Seng Index and the Morgan Stanley Capital Investment (MSCI) Standard Index Series. We view this as not only a recognition of the Group's achievements and development, but also of our ability to consistently deliver earnings growth and expansion since we first listed on The Stock Exchange of Hong Kong Limited in 1992.

CORPORATE GOVERNANCE

The Group is strongly committed to enhancing corporate governance through effective communication and transparency in all our operations. Developments in this respect during the year included the acquisition of the upstream businesses in November 2002, which greatly reduced connected purchase transactions with the major shareholder. We are also in the process to further strengthen the internal auditing process and management control. As part of our commitment, independent directors and audit committee members will continue to be tasked with upholding good corporate governance.

CORPORATE SOCIAL RESPONSIBILITY

As a global company with employees in five countries, we fully recognize and acknowledge the responsibilities we have to our staff and to the communities in which we have a presence. Social responsibility is one of the elements at the heart of our corporate policy. The Group's Corporate Social Responsibility program, which is fully supported by the Board of Directors, is used to guide the Group in acting in a socially responsible manner in all areas. Throughout the year we continued to launch initiatives and programs that promoted the welfare, safety, health and personal development of our employees. Comprehensive training and educational sessions are part of our philosophy of enhancing workplace safety and the personal and professional development of our staff. Going beyond this, we have ensured that our staff have access to counseling services and a variety of medical facilities, such as hospitals and clinics.

In addition, during the year there were several specific projects and campaigns we supported in places where we have a presence. Among the causes and organizations that received donations and sponsorship from the Group were the Community Chest of Hong Kong Operation UNITE fund to combat SARS, Save the Children Hong Kong, World Vision and Sower Action. We also sought to nurture the spirit of community involvement in our staff, actively encouraging participation in events with a social dimension, such as the Slam Dunk for Youth, a basketball challenge for youngsters in need.

Our work in the area of community responsibility and good corporate citizenship was, I am proud to note, recognized by the Hong Kong Council of Social Service, which awarded the Group its Caring Company Logo 2003/04.

LOOKING FORWARD

Looking ahead to the next 12 months, our focus will continue to be on our core business as we progress along our defined growth strategy in the four key areas of horizontal expansion, vertical integration, China business opportunities and logistics capabilities. To expedite the exploration of new business opportunities, the Group is actively looking for joint venture opportunities as well as for companies that complement our existing interests and fit in with our stated growth strategy.

Mergers and acquisitions will remain an integral part of that strategy, with the focus on sports apparel and accessory manufacturing, footwear-related businesses and retail operations in China. The basic criteria for acquisitions will be that they are related to our core

business and be accretive to our earnings. At a more refined level, any acquisition targets will be screened on their management fit, and their potential to broaden our customer base and expand production capability.

At the same time we will be actively involved in transforming newly acquired joint ventures into investment bases for further business growth. Our expertise in production management and logistics, as well as our established business connections, will be used to add value to joint-venture companies, with the aim of accelerating business development. The capital raised through the recent issue of an aggregate amount of US\$317 million zero-coupon convertible bonds following the exercise of over-allotment option in part will be used to pay down part of the Group's borrowings and to enhance our ability to expand through appropriate mergers and acquisitions.

Elsewhere, the process of disposing of non-core businesses to allow us to better utilize our assets and improve the return to shareholders will continue. We will maintain our solid manufacturing operation, on the one hand, while opening a new chapter of growth through mergers and acquisitions on the other.

This strategy requires us to build on the organic expansion of our existing business and value-generating acquisitions. Over the last year, several key acquisitions have been made in order to enhance shareholder value. The addition of upstream businesses in November 2002 has provided us with a platform for full vertical integration. Meanwhile, the purchase of sports apparel manufacturing operations and the ladies' shoes joint venture have expanded

the Group's product range, leading us into new areas with good growth potential.

The second half of 2003 saw global economic growth shake off the dust of the first half and started to gather pace as the year ended. The momentum that has been built up is expected to be carried forward into 2004. The Group will benefit from the gradual pick-up in consumer expenditure and the opening up of new markets. However, there may be pressure on average selling prices, and we will also closely monitor fluctuations in raw material prices.

As a new year begins, the Group is opening a new chapter in its history, one that will see us pushing ahead to explore new business opportunities. The Group has both the expertise and the experience to meet the keen competition it will face in both new areas of business and in the ever-changing global business environment.

Our objective, therefore, remains unchanged: to maintain our position as the world's leading shoe manufacturer by continuously improving operating efficiencies. We see the coming year as one of exciting opportunities for us supported by a vibrant economic environment. Against this background, the Group will strive to deliver continued growth and enhanced value for our shareholders in 2004.

ACKNOWLEDGEMENTS

On behalf of the Board of Directors, I wish to thank all our customers, suppliers and shareholders for their continuous support. We would also like to thank our team of dedicated staff for their invaluable service and contribution throughout the year.

Tsai Chi Neng

Chairman

Hong Kong, 15th January, 2004