

VERTICAL INTEGRATION

The strength and flexibility of bamboo make it uniquely solid and adaptable, just as our vertically integrated production processes give us a solid platform from which to build further business success and the agility to seize new opportunities.

- Leveraged on upstream businesses acquired in 2002.
- Integrated and expanded facilities for raw material supplies in Vietnam.
- Enhanced productivity through innovative production initiatives.



MANAGEMENT DISCUSSION AND ANALYSIS

REVIEW OF OPERATIONS

General Overview

For the year ended 30th September, 2003, the Group achieved significant growth. Turnover increased year-on-year by 29.4% to US\$2,509.5 million. Net profit rose year-on-year by 34.8% to US\$308.2 million and earnings per share increased year-on-year by 22% to US\$0.197. The increases in turnover and net profit were due to the strong full-year contribution from the core footwear manufacturing operations and the upstream businesses acquired in November 2002.

Turnover at the core footwear business, excluding the contribution of the upstream businesses, was US\$2,265.2 million for the year, an increase of 16.8% over 2002. Sales by the upstream businesses to unaffiliated third parties amounted to US\$244.3 million in fiscal year 2003, accounting for 9.7% of the Group's total turnover.

Combined total turnover from China wholesale and retail operations in fiscal year 2003 amounted to US\$46.3 million, compared with US\$31.3 million in 2002. The retail operation's turnover of US\$25.7 million is reflected in the consolidated accounts, while the contribution from the wholesale operation is incorporated under the "jointly controlled entities". In August 2003, we raised our stake in the China wholesale operation from 50% to 51%. All wholesale and retail sales derived from China since then have been incorporated in the Group's turnover.

Although the outbreak of SARS dealt a blow to our operations in Beijing and Guangzhou in the first half of 2003, since then the Group has been able to progressively expand the retail sales network in China. Turnover picked up strongly in the second half of 2003. The vibrant growth in China's consumer market and the growing awareness of branded footwear and

apparel will provide opportunities for the Group to expand its operations in the country going forward.

The sportswear apparel manufacturing operation has experienced a significant turnaround since being acquired in April 2003. Turnover increased to US\$21.4 million for the fiscal year 2003, compared with US\$11.7 million in 2002. We currently have sportswear apparel production facilities in China, Vietnam and Mexico.

There were strong increases in other operating income and the major items included utilities service income, cash discount on early settlement, interest income and contributions from the upstream businesses.

Share of associates and jointly controlled entities also saw a substantial rise in contribution in fiscal year 2003, mainly due to the acquisition of the upstream businesses in November 2002 and improving performance of our 50% holding in a joint venture which in turn holds a 51% interest in Symphony Holdings Limited. The Group acquired a 50% interest in a joint-venture, Hua Jian Industrial Holding Co., Limited in April 2003, which is an OEM/ODM of ladies' shoes and its attributable contribution is reflected under "jointly controlled entities".

Production Review

The total production volume of shoes jumped year-on-year by 20.9% to 157.7 million pairs. Athletic shoes remained the key product, accounting for 65% of total turnover. Growth in casual/outdoor shoes categories remained strong, rising 21.6% year-on-year in 2003. The Group expanded its product mix, adding sandals as a new product category, which accounted for 1.2% of turnover. The expansion of the Group's product categories to lower-priced items and the deflationary environment contributed to a fall in average selling price during the year.

At the end of fiscal year 2003, the Group operated a total of 290 production lines, an increase of 36 lines over the previous year. The Group had 161 lines in China, 78 in Vietnam and 51 in Indonesia.

Total Turnover by Product Category

	2003 ^{Note}		2002		y-o-y % change
	US\$ millions	%	US\$ millions	%	
Athletic Shoes	1,630.4	65.0	1,451.5	74.9	12.3
Casual/Outdoor Shoes	431.9	17.2	355.2	18.3	21.6
Sports Sandals	29.1	1.2	–	–	–
Soles & Components	378.9	15.1	128.7	6.6	194.4
Apparel	13.5	0.5	–	–	–
Retail Sales – Shoes & Apparel	25.7	1.0	3.2	0.2	703.1
Total Turnover	2,509.5	100.0	1,938.6	100.0	29.4

Note: The consolidated turnover of the Group for the year ended 30th September, 2003 includes sales by the upstream subsidiaries during that period. Turnover at the upstream subsidiaries, after adjusting for intra-group sales, amounted to US\$244.3 million for the year ended 30th September, 2003.

The US remained the Group's biggest market, accounting for 41.5% of total turnover. Sales to Europe and Asia recorded encouraging growth, increasing 43.1% to US\$753.9 million and 113.4% to US\$570.7 million respectively year-on-year in 2003.

Total Turnover by Geographical Market

	2003 ^{Note}		2002		y-o-y % change
	US\$ millions	%	US\$ millions	%	
U.S.A.	1,041.5	41.5	1,001.0	51.6	4.0
Canada	43.5	1.7	39.5	2.0	10.0
Europe	753.9	30.0	527.0	27.2	43.1
South America	51.1	2.0	57.1	3.0	-10.5
Asia	570.7	22.8	267.4	13.8	113.4
Other Areas	48.8	2.0	46.6	2.4	4.6
Total Turnover	2,509.5	100.0	1,938.6	100.0	29.4

Note: The consolidated turnover of the Group for the year ended 30th September, 2003 includes sales by the upstream subsidiaries during that period. Turnover at the upstream subsidiaries, after adjusting for intra-group sales, amounted to US\$244.3 million for the year ended 30th September, 2003.

Cost Review

Total operating costs increased by 31.2% year-on-year to US\$2,309.9 million and cost of sales rose by 30.0% to US\$1,855.4 million for the year ended 30th September, 2003, in tandem with strong growth in sales. The increase in other operating expenses was in line with the rise in other operating income, with the major components including expenses for utilities service, R&D expenses and amortisation of goodwill.

Research and Development

The Group is committed to investing in research and development (R&D) in order to provide customers with advanced technical support in areas ranging from mold shops to client-specific R&D centers. Efforts are focused on raw material development and streamlining production processes, with the respective aims of developing advanced footwear and shortening the product cycle. In 2003, the Group spent US\$84.2 million in R&D, an increase of 39.4% over 2002.

FINANCIAL REVIEW

Liquidity

The Group maintains a strong financial position. As at 30th September, 2003, the Group had cash on hand of US\$383 million (2002: US\$312 million) and total borrowings of US\$640 million (2002: US\$421 million). The gearing ratio (total borrowings to shareholders' equity) was 40% (2002: 33%), and the net debt to equity ratio (total borrowings net of cash on hand to shareholders' equity) was 16% (2002: 9%).

Short-term loans stood at US\$146 million in 2003 compared with US\$155 million in 2002. Long-term loans increased to US\$494 million in 2003 from US\$266 million in 2002 due to the financing for the acquisition of the upstream businesses. The interest coverage ratio of the Group's earnings before interest, tax, depreciation and amortisation (EBITDA) to net interest expenses was 36.2 times compared with 36.9 times in 2002.

Capital Expenditure

Capital expenditure for the year jumped to US\$170 million, a rise of 74% over 2002's US\$98 million. During the year, the Group invested approximately US\$44.5 million in constructing new factory buildings and ancillary facilities, mainly in Vietnam and China. The Group also spent US\$104.4 million in machineries and leasehold improvement for the expansion of the Group's business and US\$7.9 million in acquiring new land and buildings. In addition, property, plant and equipment with an aggregate net book value of approximately US\$66.7 million were acquired as a result of the acquisition of subsidiaries.

Dividends

A final dividend of HK\$0.46 per share (2002: HK\$0.375) has been recommended, making the full-year regular dividend per share HK\$0.69 compared with HK\$0.575 in 2002. In addition, a special dividend of HK\$0.37 per share had been declared in the 2003 interim announcement making the full-year total dividend HK\$1.06.

The Group's operating cash flow remains strong, and a sufficient level of cash holdings will continue to be maintained. The policy of maintaining steady growth in regular dividend payment each year remains intact. The regular dividend payout ratio was approximately 46% in 2003, compared with 49% in 2002.

Employees

As at 30th September, 2003, the Group employed a total of 242,000 staff, up from 205,000 in 2002. The acquisition of upstream businesses contributed to the rise in the workforce. The Group is an equal opportunity employer and the remuneration system is based on an employee's performance throughout the year. Incentives in the form of discretionary performance bonuses are in place to reward staff who make an extra contribution, come up with creative ideas and improve productivity.

Subsequent Events

1. On 13th November, 2003, the Company entered into a subscription agreement with Credit Suisse First Boston (Hong Kong) Limited ("CSFB") for the issue of the convertible bonds ("Convertible

Bonds") with an aggregate principal amount of US\$300 million for the refinancing of the Company's bank borrowings and working capital for general business purposes.

The Convertible Bonds are convertible into ordinary shares of HK\$0.25 each in the share capital of the Company at conversion price of HK\$27.33 per share, subject to adjustments. The Convertible Bonds have been approved for the listing on the Luxembourg Stock Exchange. The transaction was completed on 23rd December, 2003.

An over-allotment option of US\$17 million was exercised by CSFB on 12th January 2004.

2. In December 2003, 16,000,000 share options were exercised at a price of HK\$5.11 per share, resulting in the issue of 16,000,000 shares of HK\$0.25 each in the Company.
3. In December 2003, investment securities with a carrying value of approximately US\$24,137,000 at 30th September, 2003, were disposed of for a consideration of approximately US\$47,000,000.