Chairman's Statement

Mr. Ngan Hei Keung, *Chairman*

On behalf of the board of directors of Mainland Headwear Holdings Limited (the "Company"), I am pleased to present the annual results of the Company and its subsidiaries (collectively, "Mainland Headwear" or the "Group") for the year ended 31 December 2003.

Business Review and Prospect

Overview

During the year under review, the global consumer market in the first half of the year was hard hit by both the outbreak of war in Iraq and the SARS (Severe Acute Respiratory Syndrome) epidemic. The second half of the year saw the economy rebound as the effects of the war in Iraq and SARS wore off. Operating in this difficult and volatile environment, Mainland Headwear continued to focus on its core business. Through the implementation of a series of cost control initiatives, the Group was able to maintain a stable business performance and achieved a profit attributable to shareholders of HK$66,967,000, an increase of 4.6% over the figure for 2002.

Recognising that direct sourcing is emerging as a trend in the industry, the Group increased its 85.71% and 80% respective shareholdings in its US subsidiaries, Drew Pearson Marketing, Inc. ("DPM") and Drew Pearson International, Inc. ("DPI") to 100% in late 2003. As a result, both companies are now wholly owned subsidiaries of the Group. These moves enable the Group's direct sourcing team to fully leverage the DPM's and DPI's strong presence and extensive client networks in the US.

The Group has also won two prestigious awards in the 2003 Hong Kong Awards for Industry – "Export Marketing Grand Award" and "Productivity" Award. This signifies the industry's recognition of Mainland Headwear's efforts and achievements in these two areas.

Looking ahead, the Group will strive to expand the scale of its Headwear Manufacturing Business while consolidating its Trading of Headwear and Other Products Business. Leveraging its existing operations, the Group also plans to diversify into the headwear retail business. This move will not only generate new income streams for the Group, but also create synergies with the existing Headwear Manufacturing and Trading operations.

Chairman's Statement

Financial Review

Group turnover for the year ended 31 December 2003 amounted to HK$469,905,000 (2002: HK$394,122,000), a 19.2% increase over the previous year. This increase was largely due to the consolidation of full year results of DPM, a Group subsidiary acquired in April 2002. Profit attributable to shareholders amounted to HK$66,967,000, up from HK$64,032,000 in 2002. While substantial increases in raw materials costs during 2003 placed pressure on gross profit, the Group was able to achieve a 4.6% increase in profit and maintain its gross profit margin at about 37% through the implementation of a series of stringent cost control measures. At HK23.7 cents, earnings per share for the year were the same as in 2002.

Ms. Pauline Ngan, *Deputy Chairman and Managing Director*

Business Review

The Headwear Manufacturing Business

2003 saw the Group's Headwear Manufacturing Business performed steadily, with a turnover of HK$262,535,000 representing a slight increase of 2.2% on the HK$256,802,000 figure for 2002. Of the figure, turnover from external customers accounted for about 42.2% of the Group's total turnover. This business contributed HK$67,088,000 to operating profit before finance costs and taxation, which accounted for about 88% of the Group's total operating profits and represented an increase of 8.1% on the HK$62,045,000 figure for the previous year. While substantial increases in raw material costs during 2003 placed heavy pressure on gross profits, the Group was able to maintain a gross profit margin of over 35% for this business as a result of effective cost control measures. The administration costs for this business also sharply reduced by approximately 18% when measured against those for 2002.

The global retail market suffered from the effects of the war in Iraq during the first half of 2003. Coupled with pricing pressures facing the Group as a result of increased market competition and a sharp increase in the cost of quotas for knitted hats, which slowed down the Group's knitted hats business in the second quarter, the performance of the Headwear Manufacturing Business was adversely affected in the first half of the year. With the war in Iraq gradually stabilizing, the retail market began to rebound towards the end of the third quarter. As a result, the Group recorded a substantial increase in manufacturing orders during the fourth quarter. That said, as delivery dates for some of these orders did not fall due until early 2004, turnover for the Headwear Manufacturing Business only recorded a slight increase in 2003.

The sufficient material inventories, coupled with ongoing efforts since late 2002 to identify new raw materials suppliers in China enabled the Group to control costs without compromising quality. As a result, the Group has been able to effectively reduce the impact of material cost increases on its 2003 results.

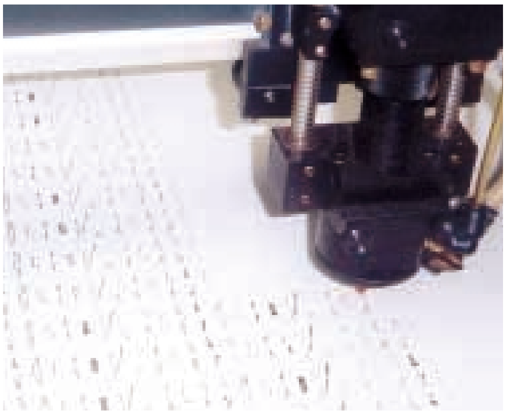
Chairman's Statement

Laser-cutting embroidery unit

On the product design front, 2003 saw the Group enhancing its technical capabilities by installing latest models of laser-cutting embroidery machine. The establishment of a silk printing department further adds to the range of design choices on offer to customers.

The Trading of Headwear and Other Products Business

The Trading of Headwear and Other Products Business ("Trading Business") generated a turnover of HK$271,651,000 during 2003, accounting for 57.8% of the Group's total turnover. Its contribution to operating profit for the year (before finance costs and taxation) amounted to HK$10,624,000, representing 13.9% of the Group's total operating profit. The gross profit margin was maintained at above 25%. The Trading Business recorded a higher level of expenses in areas such as marketing and promotion. This resulted in a lower profit to sales ratio to that recorded by the Headwear Manufacturing Business.



Laser-cutting embroidery

The US is the biggest single market for the Group's Trading Business. Affected by the war in Iraq, the Trading Business performed below expectations during the first half of 2003 but picked up in the second half. Additionally, the consolidation of the licensed sports headwear market in the US means that exclusive licenses are now being granted to particular licensees. DPM's loss of some of its sports headwear distribution licenses as a result of this consolidation also affected the performance of the Trading Business during 2003.

The Group's Trading Business in the European market also performed below expectations. The performance of the Group's distribution business for products of the US-based "Mudd" brand was particularly disappointing. This was largely due to the lack of product and marketing strategy support from the Mudd brand itself. Consequently, 2003 saw the Group terminated this business in order to better focus its resources on developing its core headwear business. All possible losses related to the termination of the Mudd business are reflected in the financial statements for 2003.

Chairman's Statement

Prospects

Steady improvement in the US economy since late 2003 has boosted consumer demand for headwear products. The amounts of manufacturing orders received by the Group in the final quarter of 2003 and first quarter of 2004 are significantly higher than those for the corresponding periods in previous years. In view of the favorable market sentiments, the Group is confident that sales orders will continue to increase. The Group will also implement various development plans to further enhance its future growth.

Headwear Manufacturing will remain the core business of the Group. Following years of effort and commitment, the Group has established a solid customer base and will continue to explore new opportunities to expand it. Building on its success in the US market, the Group will continue to develop other potential markets in Europe and Asia.

Zhen Han Industrial City, Buji, Shenzhen

The Group is now upgrading its production facilities and product quality in order to satisfy its increasing flow of orders. In addition to expanding its workforce, the Group installed additional digitized embroidery equipment during the first quarter of 2004. These moves will enable the Group to increase its production capacities by 25% in the second quarter of 2004. The Group has also recently established a knitted headwear factory in Dongguan, China. The new facility will commence operations in the second quarter of this year. These initiatives reflect the Group's confidence in its future business development.

To capture the immense business opportunities presented by direct sourcing, the Group recruited additional design and purchasing professionals and scaled up its product development during the first quarter of 2004. Enriching the Group's product range, this move will further sharpen our competitive edge and attract new customers.

On the Trading Business front, the Group will actively explore opportunities in the private label and branded headwear market. In addition to sports headwear, the Group will further diversify its product range to include lifestyle, fashion, and hip-hop headwear. In the European market, the Group will focus on headwear as its core business. The Group plans to further enhance the attractiveness of its products within this market by infusing local and pop culture into its product designs. The Group will also strive to identify new distribution agents who can add to the strength of its Trading Business in Europe.

Chairman's Statement

2004 will also see the Group move into the retail business. This area will be a central element of the Group's future development. In early 2004, the Group signed a license agreement with the leading US headwear retailer, Hat World Corporation to open a series of "LIDS" headwear retail outlets in Hong Kong and China. Some 300 specialty stores, shops in shops and kiosks are expected to open in the next three years, of which two-thirds are planned to be in China. The Group plans to open 50 stores in China and Hong Kong during 2004/05, with the first two stores scheduled to open in Hong Kong and Shanghai respectively in the first half of 2004. The Group's management believes that the Headwear Retail business will create enormous synergy with its Headwear Manufacturing and Trading businesses. With more and more Chinese customers embracing global trends and the Chinese Government actively promoting sports, the Group is confident that its new Headwear Retail business will be a powerful engine for future growth.

Talent is an essential driver of the Group's continued growth. As a result, the Group will continue to commit resources to staff training in product design, material deployment, product development and management skills. By empowering staff, constantly updating them on market trends, the Group will ensure they are better equipped to both implement its future development strategies and fully exploit new market trends such as direct sourcing.

In addition to the development plans and strategies outlined above, Mainland Headwear will continue to enhance its competitive edge. Steps to be taken will include the implementation of stringent cost control measures and operational efficiencies aimed at optimizing synergies among its manufacturing, trading and retail businesses.

Acknowledgement

The steady growth of the Group's business is directly attributable to the long-term support of our shareholders, customers and suppliers, the dedication of our staff, and the vision of our management team. In closing, I would like to express my deepest appreciation to all of these stakeholders for their invaluable contribution to the Group's continued success.

Ngan Hei Keung
Chairman

Hong Kong
14 April 2004