

Management's Discussion and Analysis

BUSINESS REVIEW

During the year, the Group's turnover increased by 19.1%, to HK\$1,407 million (2002: HK\$1,181 million), reflecting improved underlying performances. Profit attributable to shareholders recorded HK\$83 million (2002: HK\$26 million), an increase of 221% compared to the year 2002. Basic earnings per share was HK5.51 cents (2002: HK1.73 cents).

OEM Business

Being one of the two core businesses of the Group, sales from OEM products totalled HK\$758 million (2002: HK\$686 million), a steady increase year on year by 10.5%, which accounted for 53.9% (2002: 58.1%) of the Group's turnover. The products mix has shifted gradually towards own-brand products because the potential of sales growth in the PRC market will be much faster than in other places of the world.

Profit contribution for this business segment to the Group was HK\$47 million (2002: HK\$15 million). Better results were mainly due to the stringent control in production cost through various measures and focus of higher margin products. More favourable business environment worldwide was one of the factors that made the recovery of confidence in consumer sentiments, particularly in the US, faster than expected.

"Daphne" – Own-brand Business

Own-brand products reported a record high in turnover to HK\$649 million (2002: HK\$495 million), a 31.2% increase over last year. Profit contribution from this segment also surged by 1.7 times compared to last year, from HK\$20 million to HK\$54 million. This was mainly attributable to the fact that the Daphne brand has benefited from its brand name recognition and a well-established sales and distribution network.

During the year under review, over 2,000 Daphne selling points including over 500 specialty shops and over 200 counters were distributed across various regions in China. The operation became more mature and is contributing stable earnings to the Group. Revenue growth in future will be mainly driven by this well-established brand and sales and distribution network throughout China.

The Group will continue to explore further business opportunities by gradually distributing "Daphne" footwear to more outlets, with the objective of building a more extensive sales and distribution network to increase the market share and improve its competitive advantage.

"Adidas" – Exclusive Retail Shop Right Business

Being the exclusive retail shop licensee for "Adidas" "Original Collection" in the PRC, the Group has appointed an agent to operate the specialty shops in the PRC. Currently, more than 15 shops were operated in 3 major cities in the PRC. Agency fee income from the appointed agent was nearly HK\$0.8 million for the year ended 31st December 2003. With the ever-increasing demand for prestigious branded athletic and casual footwear and apparel in the PRC, the Group foresees that a higher growth in revenue will be attained. The agent plans to open additional 30 specialty shops in 2004.

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FINANCIAL REVIEW

Strong Financial Resources and Liquidity

As at 31st December 2003, cash and cash equivalents of the Group amounted to HK\$147 million (2002: HK\$130 million). With the decrease in short-term bank borrowings of HK\$41 million from HK\$151 million as at 31st December 2002 to HK\$110 million as at 31st December 2003, the net cash position was HK\$37 million compared to the net debt position of HK\$21 million last year. The Group will continue to keep a healthy financial position.

All of the bank borrowings as at 31st December 2003 were short-term in nature, repayable within one year and were denominated in New Taiwanese dollar, US dollar, Renminbi and Hong Kong dollar. Interest was charged on these bank borrowings based on fixed rates.

Improved Liquidity and Gearing Ratios

The Group's current ratio, being the proportion of total current assets against total current liabilities, improved from 1.48 as at 31st December 2002 to 1.64 as at 31st December 2003.

As a result of the remarkable profit generated from operation, total debt to equity ratio as at 31st December 2003 was only 0.94 compared to 1.15 in last year, which was calculated by dividing total liabilities of HK\$378 million (2002: HK\$400 million) by the total shareholders' equity of HK\$403 million (2002: HK\$348 million).

In line with the continuous improvement in the quality of assets, the gearing ratio of the Group has decreased from 43.3% to 27.4% as at 31st December 2003. Computation was based on the total borrowings of HK\$110 million (2002: HK\$151 million) divided by shareholders' equity of HK\$403 million (2002: HK\$348 million).

Foreign Exchange Exposure

The Group's monetary assets, liabilities and transactions are primarily denominated in Hong Kong dollar, Renminbi, US dollar and New Taiwanese dollar. As Hong Kong dollar is pegged to the US dollar, there is no significant fluctuation in the exchange rate. However, since most of the operations were carried out in the PRC, in which transactions were denominated in Renminbi, forward exchange contracts are utilised when suitable opportunities arise, and when considered appropriate, to hedge against major non-US dollar currency exposures.

During the year, the Group entered into forward exchange contracts to hedge its foreign currencies against fluctuations in exchange rates. As at 31st December 2003, the Group had commitments amounting to HK\$230 million in respect of forward exchange contracts entered into with banks.

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Significant Capital Investments

In order to satisfy the growth and to increase the production capacity of our existing factories, the Group set up a foreign wholly-owned subsidiary in Anhui Province in China with total registered capital of HK\$31.2 million. Up to the year under review, HK\$5.7 million has been injected. The remaining amount will be invested by the end of 2006. The Board has also authorised to establish two additional production plants located in Fujian and Jiangsu in the beginning of 2004. The registered capitals for Fujian plant and Jiangsu plant are estimated to be HK\$23.4 million and HK\$2.8 million respectively.

By optimising the allocation of resources, the leverage of various resources and enhancing the Group's competitiveness, the Group plans to set up four logistic centres located in Shanghai, Beijing, Fujian and Shenyang. The total investments are estimated to be HK\$24.1 million. Commercial operations of these four logistic centres are scheduled to commence from the second quarter of 2004 to December 2005.

As the economic outlook of China remains upbeat and there is keen demand for fashionable footwear, the Group is forming a joint venture company (the "JV Company") to launch a new brand of footwear for all genders and ages. The Group has a 50% shareholding in the JV Company. The JV Company will appoint an agent in the PRC to open up footwear mega stores selling footwear. The total investment in the JV Company is RMB50 million of which the Group has to contribute RMB25 million.

The funding of the above investments will be financed by internal resources and/or bank borrowings.

Charges on Group Assets

As at 31st December 2003, the Group's short-term bank loans of HK\$50 million were secured by certain leasehold land and buildings of net book value of HK\$10 million and investment securities with nil carrying value.

Material Acquisition and Disposals

There are no material acquisitions or disposals of subsidiaries and associated companies in the year 2003.

Contingent Liabilities

As at 31st December 2003, the Group had no significant contingent liabilities.

Human Resources

The Group had over 13,000 staff in Hong Kong, Taiwan and in the PRC as at 31st December 2003. The Group recognises the importance of human resources for its success. As a result, qualified and experienced personnel are recruited to enhance production capability and to develop new products. Remuneration is maintained at competitive levels with performance-related bonuses, retirement pension schemes and share options.

During the year, 43,500,000 and 16,000,000 share options were granted to directors and employees with exercise price of HK\$0.20 and HK\$0.16 per share, respectively.