# MANAGEMENT DISCUSSION AND ANALYSIS

## ANALYSIS OF RESULTS

### Turnover

To deal with the potential grave impact and growing uncertainty as a result of the outbreak of war between US and Iraq, for the period under review, the management opted for a prudent strategy to quickly restructure the production schedule by soliciting fewer orders so as to reserve more of the Group's production capacity to meet customers' demand for shorter manufacturing time. As such, for the year ended 31st March, 2004, the Group's sales of knitted-to-shape garments decreased by approximately 20.6% to HK$317 million (2003: HK$ 399 million) and the Group's sales of non knitted-to-shape garments also decreased by 26.6% to HK$6.9 million (2003: HK$9.4 million). The strategy and measure paid off as anticipated. Most of the customers' orders were completed in time by the Group itself without the need to subcontract work to outsiders and/or to deliver the products by air-freight. The gross profit margin of the Group was therefore significantly improved from 7.4% for the year ended 31st March, 2003 to 13.2% for the year ended 31st March, 2004. The Company had actually out-performed the comparable period for 2003.

For the period under review, sub-contracting income slightly increased by 3.5% to HK$5.9 million (2003: HK$5.7 million). As the Group strategically solicited fewer orders for the period under review, during the non-peak season, which started from about November up to April each year, there was spare production capacity to undertake more sub-contracting work which the Group did not need to take responsibility for sourcing raw materials or arranging for shipment.

During the year, US continued to be our largest market. Sales to US represented approximately 89% of the total turnover of the Group for the year ended 31st March, 2004 (2003: 89%).

### Profitability

For the year ended 31st March, 2004, the Group recorded a net loss of HK$4,991,000 as compared to a restated net loss of HK$38,219,000 for the year ended 31st March, 2003. This significant achievement was attributable to the implementation of strict cost control measures and the restructuring of our production schedule. Air freight cost and subcontracting wages drastically reduced by 86.7% and 38.8% to HK$2 million and HK$60 million respectively (2003: HK$15 million and HK$98 million respectively).

The peak season for the Group's production is from about May to October each year. In order to ensure that all customers' orders would be completed in time during the peak season without the need to substantially outsource production or to deliver the products by air-freight, the Group strategically solicited fewer orders to create more buffer for its production capacity.

The second half of the financial year usually presents the Group with a particularly challenging environment as it is the non-peak season. It had a negative impact on the growth momentum of the Group. As a result, the Group recorded a net loss of HK$4,991,000 for the year ended 31st March, 2004. However, the Group's earnings before interest and tax and depreciation as at 31st March, 2004 were HK$5 million (2003: loss of HK$32 million). In addition, cash generated from operations during the year was about HK$7 million (2003: cash used HK$12 million).

## ANALYSIS OF RESULTS *(Continued)*

### Profitability *(Continued)*

In the past, with our factories in PRC, Thailand, Vietnam and Hong Kong, the Group could flexibly allocate orders to the factories in different regions based on factors such as the type of quotas required and the profit margin of the orders. However, the US government started to impose quotas on textile products exported from Vietnam in July 2003. Since then, our Vietnam factory began to operate in an extremely difficult environment as the allocation of US quota to us was always not sufficient for our export purposes. As we anticipated that the situation would not be changed in foreseeable future, we decided to close the factory to contain costs. Operation had actually stopped since December 2003 and we formally applied to close down the factory in March 2004. It followed that we received and completed less orders than in previous year.

The Group's profit earned in the first half of the financial year was also partially offset by the provision of impairment of HK$1.5 million in relation to the amount due from an associate and the net loss of approximately HK$5 million of the Thailand operation. For the year ended 31st March, 2004, loss per share was HK2 cents (as restated 2003: loss per share HK16 cents).

Although the Group experienced tough time in the second half of the financial year as a result of the operational restructuring undertook by the Group, our management believed that such restructuring was necessary in order to keep cost under control and to make us becoming more competitive in the long-term. The closure of an unfavourable operation was also appropriate as it would eliminate the possibility of consolidating any losses that may arise in future.

## LIQUIDITY AND CAPITAL RESOURCES

At 31st March, 2004, the Group was in a healthy liquidity position, with cash on hand of HK$16 million and net current assets of HK$46 million. The comparative figures at 31st March, 2003 were HK$17 million and HK$52 million, respectively. Most of the funds were held in Hong Kong and US dollars.

The Group believes that it can continue to finance its operations with its operating cashflow and available banking facilities of over HK$133 million, out of which HK$10 million had been utilized at 31st March, 2004. The banking facilities were secured by corporate guarantees given by the Company. The Group's gearing ratio computed as total borrowings over shareholders' fund was 6.9% at 31st March, 2004 (2003: 5.6%).

The Group's borrowings were of short-term nature, carrying interests at floating rates. As interest rates remained at low level during the period, the Group's net finance cost for the period under review amounted to HK$0.5 million (2003: HK$0.7 million).

The Group does not have any significant exposure to foreign currency fluctuation and had not found it necessary to make foreign currency hedging arrangements during the year ended 31st March, 2004. However, as salary expenses for the Group's production workers are mainly paid in Renminbi, the Directors are evaluating and closely monitoring the potential impact of Renminbi appreciation. The Directors are reviewing financial instruments that could minimize such potential impact of the Group.

## CHARGE ON GROUP ASSETS

At 31st March, 2004, the Group did not have any assets pledged for general facilities.

## CONTINGENT LIABILITIES

At 31st March, 2004, the Company had contingent liabilities in relation to corporate guarantees given to banks in connection with facilities granted to subsidiaries of the Group amounting to HK$106 million (2003: HK$116 million).

## CAPITAL EXPENDITURES AND COMMITMENTS

At 31st March, 2004, capital commitments of the Group amounted to approximately HK$29 million in relation to the acquisitions of computerized knitting machines. The acquisitions were largely funded by secured banking facilities or finance lease. The maturity dates of the banking facilities and the finance lease vary from 4 to 4.5 years.

## HUMAN RESOURCES

At 31st March, 2004, the Group had approximately 1,380 employees. The size of the workforce is expected to remain more or less the same in the coming year. Remuneration of employees is based on their performance, experience and prevailing industry practice, with remuneration policies and packages being reviewed on a regular basis. Bonuses are linked both to the performance of the Group as well as to that of the individual as recognition of their contribution to the Group. At the date of this report, there is no plan to grant any shares of the Company under the share option scheme adopted by the Company on 9th November, 2001.

## FUTURE PROSPECTS

The results of the Group for the financial year of 2003 reflected the fiercely competitive environment and difficult circumstances in which the Group operated. While the Group focused on improving the performance of its existing business, proactive steps had also been taken to pursue products and production diversification through investments in computerized knitting machines and the expansion of our Hong Kong factory.

The management looks to the financial year of 2004 with optimism and believes that it will be a year of rejuvenation and growth. The Group will continue to pursue the positive steps taken in 2003. Save and except for the 83 sets computerized knitting machines which have started operation since April and May respectively, the Group also purchased additional 11 sets computerized knitting machines in June. Out of the 94 sets computerized knitting machines, 42 sets are located in our expanded Hong Kong factory which opened in April 2004 for producing knitted-to-shape garments with Hong Kong origin. It is expected that with the use of computerized knitting machines, the Group will be able to provide its customers with a wider selection of garment products that cater to their different needs. This change in products mix may also improve the Group's margin in the long-term. As stated in our interim report, we would seek way to better control our labour cost in anticipation of the possible revaluation of the Renminbi. The use of computerized knitting machines is consistent with such policy and our aim to lift operational efficiency.

**FUTURE PROSPECTS** *(Continued)*

From a strategic point of view, as US and other WTO members may still continue to apply other anti-dumping measures and the "Product-Specific Safeguard" mechanism to restrain the import of textile products from China after the lifting of quotas on textile and apparel products in 2005 if they consider that such import would disrupt their internal markets, the expansion of our Hong Kong production, if successful, could diversify our production to minimize the uncertainties and risks associated with such trade restraint measures. Given CEPA promised stronger economic ties between Hong Kong and mainland China, the rejuvenation and growth of the Hong Kong factory could provide an excellent basis for penetrating into the market of mainland China when the management considers it appropriate in the future.

In light of changed market conditions, it is essential that we continue to be market-driven and remain committed to delivering high-quality products at fair prices, and most important of all, to strive for future growth and increase shareholders return. To achieve this, it is necessary to have flexible production strategies to leverage off the synergies and utilize the competitive advantages at our different production bases so as to complete customers' orders most cost effectively. We applied to close our Vietnam factory in March 2004 as a result of the loss of competitive edge there. Before formally withdrew our operation in Vietnam, significant strides were made towards restructuring our PRC and Hong Kong production scale by introducing the use of computerized knitting machines so as to make sure that we remained as a competitive and flexible company. Such positive step, however, was not reflected in the results of the financial year of 2003. We will continue the production restructuring at the PRC and Hong Kong factories and we expect that the potential contributions from the new production lines launched in the early of the financial year of 2004 will become more material by the end of the year. Further, with the operation of our new Thailand factory and the opening of our new Bangkok office, the Group aims to continue to strengthen the sales and production teams there so as to win market share without sacrificing profit margins.

Economic recovery appears to be gathering momentum globally although the operating environment is expected to continue to be challenging. The Group believes that many of the positive and innovative actions it is pursuing are positioning it well to deliver acceptable operating results over the medium-term. The management will continue to seek to maximize the advantage afforded by our new production lines, while at the same time, maintain a regime of strict cost control and further lift operational efficiency. The financial year of 2004 will be full of challenges, but our management team will continue to work diligently with the determination to succeed and the aim of making significant and positive impact on shareholders value.