Management Discussion and Analysis

BUSINESS AND OPERATIONAL REVIEW

Operation Overview

Turnover of the Group for the year ended 31 March 2004 amounted to US$183,747,000 (2003: US$174,390,000). Despite the outbreak of the Severe Acute Respiratory Syndrome epidemic ("SARS") in some of our key markets during the first half of the financial year, the Group has shown exceptional resilience and resistance to the adverse impact brought about by SARS. Total turnover for the year increased by 5.4%.

The management continued to adopt a more structured and rational promotion strategy to improve sales without forgoing profit margin. Gross margin for the year ended 31 March 2004 was 52.8%, comparing to 53.3% for the year ended 31 March 2003. The slight decrease in gross margin was due to decrease in gross margin in South Korea as a result of more sales promotional activities undertaken during the year in South Korea. Gross profit increased by 4.4% to US$97,002,000 (2003: US$92,906,000).

Profit from operations for the year ended 31 March 2004 was US$15,167,000 (2003: US$13,144,000). The increase in profit from operations was mainly attributed to increase in gross profit of the Group. Selling expenses amounted to US$70,257,000 (2003: US$71,892,000), representing a decrease of US$1,635,000, which was mainly attributed to decrease in commission paid to franchisees by US$3,499,000 as a result of decrease in the number of franchised outlets in South Korea, which was partly offset by increase in rental charges on directly operated shops and department store counters of US$860,000 and increase in sales staff costs of US$1,173,000. Administrative expenses for the year ended 31 March 2004 amounted to US$11,403,000 (2003: US$8,325,000). The increase in administrative expenses was mainly due to increase in staff costs and professional fees.

Finance costs for the year ended 31 March 2004 amounted to US$1,459,000 (2003: US$1,992,000). The decrease in finance costs was mainly due to reduction in bank loans.

Net profit attributable to shareholders increased by 15.1% to US$11,240,000 (2003: US$9,765,000).

Apparel Sales and Retail

About 97.5% (2003: 97.7%) of the Group's turnover was attributed to sales of apparel for the year ended 31 March 2004. Sales generated from retail and distribution of apparels amounted to US$179,092,000 for the year ended 31 March 2004 (2003: US$170,418,000). This represents a growth of 5.1%. Most of the sales have been generated from the retail operation in Asia. As at 31 March 2004, the Group had 412 retail outlets with total shop floor area of about 385,000 square feet.

Sales in Taiwan contributed to about 63.2% (2003: 60.8%) of the Group's turnover. Sales in Taiwan increased by 9.6% to US$116,175,000 (2003: US$106,013,000). The increase in sales was mainly attributed to the Group's leading position in Taiwan and its continuous effort in expanding its product ranges. During the year, the management continued to focus their effort in improving profit margin. The Group adopted tight cost control measures and engaged in structured and rational promotion activities to improve the profit margin. The management also reviewed regularly the performance of each retail outlet. To improve overall efficiency and profitability, under-performing outlets were closed or relocated to more promising locations. As a result of the improvements in sales and gross margin, operating profit derived from the Taiwan market increased by 40.9% to US$13,355,000 (2003: US$9,481,000). During the year ended 31 March 2004, the Group closed 21 outlets and opened 39 new outlets in Taiwan and had 221 retail outlets (2003: 203) as at 31 March 2004.

The Group has established a strong position in South Korea. Sales attributed to that market represented 21.6% (2003: 26.0%) of the total turnover of the Group. Sales in South Korea amounted to US$39,693,000 (2003: US$45,267,000) for the year ended 31 March 2004, recording a decrease of 12.3%. The drop in sales is attributable to a general decline in consumer spending in South Korea because of the tightening of consumer credit in South Korea during the year. Profit margin had also dropped slightly. As a result, the Group had scaled back its aggressive expansion plan. The Group had focused on rationalizing its operation. Under-performed franchised shops were closed. During the year, 27 new shops were opened and 37 shops were closed. As at 31 March 2004, the Group had 105 retail outlets in South Korea. Operating profit attributed to the South Korean market decreased to US$911,000 (2003: 2,467,000) mainly because of the decrease in sales.

For the year ended 31 March 2004, sales in Singapore amounted to US$14,898,000 (2003: US$11,798,000) and represented 8.1% (2003: 6.8%) of the Group's turnover. Operation in Singapore had improved and while the operation still recorded an operating loss of US$66,000 for the year (2003: a loss of US$652,000), the performance of this market will continue to improve. During the year, 4 new shops were opened and 1 shop was closed. The Group had 34 retail outlets (2003: 31) as at 31 March 2004.

The operation in Philippines was steady and sales for the year ended 31 March 2004 decreased slightly by 2.3% to US$6,175,000 (2003: US$6,322,000). The Philippines operation recorded an operating profit of US$331,000 (2003: US$520,000). The Philippines market contributed to about 3.4% (2003: 3.6%) of the total turnover of the Group. The Group opened 3 new outlets and closed 3 outlets during the year. The Group had 41 retail outlets (2003: 41) in Philippines as at 31 March 2004.

The retail operation in Malaysia was only set up in August 2002. During the year ended 31 March 2004, the Group continued to develop this market and 5 new shops were opened. As the operation was still in the development stage, sales derived from this operation represented only 1.2% (2003: 0.5%) of the total turnover of the Group and amounted to US$2,151,000 (2003: US$1,018,000) for the year ended 31 March 2004. An operating loss of US$97,000 (2003: a loss of US$15,000) was incurred for the Malaysian operation. As at 31 March 2004, the Malaysian operation had 10 (2003: 5) retail outlets.

Licensing Operation

The licensing operation provides a steady revenue stream to the Group through licensing of the "Hang Ten" trademark and other trademarks owned by the Group to independent licensees. For the year ended 31 March 2004, revenue generated from the licensing operation amounted to US$4,655,000 (2003: US$3,972,000) and represented about 2.5% (2003: 2.3%) of the Group's total turnover.

Capital Structure

During the year, the Company issued 745 million ordinary shares at an issue price of HK$0.017 per share as consideration for the acquisition by the Group of 2.99% equity interest in ILC International Corporation. As at 31 March 2004, 63,695 million ordinary shares and 3,453 convertible preference shares were in issue. Total shareholders' funds amounted to US$41,864,000 (2003: US$28,916,000) as at 31 March 2004.

Liquidity and Financial Resources

The Group generally financed its operation by internally generated cashflow and banking facilities provided by its bankers.

For the year ended 31 March 2004, the Group generated US$26,918,000 (2003: US$17,526,000) of cash from operations. As at 31 March 2004, the Group had cash and bank balances amounted to US$12,406,000 (2003: US$7,493,000) and listed funds, which were readily convertible into cash, amounted to US$6,205,000 (2003: US$5,982,000).

As at 31 March 2004, the Group had financial facilities provided by banks amounting to approximately US$29,597,000, of which US$5,891,000 had been utilized. Certain of the banking facilities were secured by the pledge of 620,681 shares of ILC International Corporation, an indirect subsidiary of the Company and land and building with a net book value of US$719,000. Total indebtedness as at 31 March 2004, comprising bank loans and overdrafts of US$4,650,000 (2003: US$19,723,000) and loans from shareholders of US$16,400,000 (2003: US$16,400,000) amounted to US$21,050,000 (2003: US$36,123,000) and represented 23.9% (2003: 43.9%) of the total assets of the Group.

The loans from shareholders are unsecured and are due for repayment in the year 2011.

Subsequent to the balance sheet date, the Group has received a sum of lump sum upfront licensing fee of US$10,620,000 from Itochu Corporation pursuant to a trademark licence agreement entered into between a subsidiary of the Company and Itochu Corporation on 7 May 2004. The liquidity position of the Group has further been strengthened.

Contingent Liabilities

The Group had certain contingent liabilities with respect to withholding tax and value added tax in Taiwan. After taking relevant professional advice, no provision is considered necessary and no provision has been made for those contingent liabilities.

HUMAN RESOURCES

As at 31 March 2004, the Group had approximately 1,480 full time employees of which 1,010 were based in Taiwan. About 1,300 employees were engaged in sales and marketing functions. The Group offers its employees competitive remuneration packages based on industry's practices and performance of individual employees. The Company had also adopted a share option scheme to which employees may participate. 1,211,000,000 options were granted to certain employees of the Group subsequent to the balance sheet date.