MANAGEMENT DISCUSSION AND ANALYSIS

Operating Results and Financial Position

For the six months ended 30th June 2004, the total turnover of the Group was HK$1,059 million (2003: HK$1,211 million), a decrease of 13% comparing with last year. The decline in turnover from manufacturing and trading operations by 15% and 9% respectively against the previous year was mainly caused by: (1) a focus on core customers, (2) discontinuance of loss making garment types, (3) rationalisation of production facilities and (4) discontinuance of orders which require the acquisition of expensive quotas. As for retailing business, the turnover was up by 26% from HK$47 million to HK$59 million.

Geographically, US continued to be the dominant market for the Group contributing 73% (2003: 71%) of the total turnover while export sales to Europe and Asia accounted for 13% (2003: 15%) and 14% (2003: 14%) of the total turnover respectively.

Gross profit of the Group for the half year decreased from HK$215 million in 2003 to HK$175 million in 2004. The decrease was mainly attributed to (i) the adjustment to the cost of sales for 2003 taken up in the current period (see Note 3 to the Condensed Consolidated Profit and Loss Account for further details), (ii) a decrease in turnover and (iii) the narrowing of the profit margin.

During 2004, management imposed greater control over quota, sample and logistics costs. Further, the operation mode of the retailing business in Mainland China was changed from direct retailing to franchising. This resulted in a substantial reduction in shop expenses. Accordingly, the total selling and distribution expenses decreased by HK$40 million during the period.

The share of the profit of the Group's associated companies for the period amounted to HK$4 million (2003: loss of HK$6 million). The turnaround in performance was achieved as a result of significantly higher sales, even production loading and cost restructuring in the Thailand associated companies.

During the period, there were no material acquisitions or disposals of subsidiaries or associated companies.

The loss attributable to shareholders for the period was HK$32 million which decreased by HK$12 million when compared to last year. If the adjustment relating to cost of sales for 2003 was eliminated from the current period, then the loss attributed to shareholders for current period would be HK$11 million.

Accounting Procedures and Internal Controls

Following the discovery in 2004 of certain accounting errors relating to 2003 (see Note 3 to the Condensed Consolidated Profit and Loss Account), management has appointed a team of consultants to undertake an in-depth review of the Group's accounting system to identify the cause of the errors. As a result of this review, new and improved procedures have been implemented for the accounting of purchases with a view to preventing recurrence of such errors or to facilitate their early detection.

Financial Resources and Liquidity

During the period, the Group continued to have a healthy liquidity position. Cash and bank balances amounted to HK$160 million as at 30th June 2004. The short-term bank loans and overdrafts of the Group as at 30th June 2004 amounted to HK$253 million. The gearing ratio was 17% as at 30th June 2004, based on the ratio of total net bank borrowings to total shareholders' equity of the Group. The net bank borrowing decreased from HK$114 million at 30th June 2003 to HK$93 million at 30th June 2004.

The Group had unutilized banking facilities of HK$631 million as at 30th June 2004. Save as disclosed in the unaudited interim accounts, the Group did not create any charges on its assets to secure the banking facilities during the period.

During the period, the Group entered into a number of forward exchange contracts to hedge its foreign currency denominated operating expenses for overseas manufacturing facilities against the fluctuation of exchange rates.

Contingent Liabilities and Capital Commitments

There were no material capital commitments or contingent liabilities as at 30th June 2004 which would require a substantial use of the Group's present cash resources or external funding.

Human Resources

The Group has about 15,700 (2003: 19,800) employees. Fair remuneration packages and benefits are offered to competent staff. Discretionary bonus will be granted to eligible employees with outstanding performance. In addition, a share option scheme has been established since 1997 for the granting of options to full-time employees of the Group for subscribing for shares in the Company.

OUTLOOK

The market conditions for the second half of 2004 and beyond remain challenging. After the elimination of quota system in 2005, it is anticipated that the business environment for garment manufacturing will become more volatile and uncertain. Mainland China as a production base has a competitive advantage because of its low cost base and supply of skilled labor. With its network of modern manufacturing facilities in Mainland China, the Group is well positioned to capitalize on this new development. At the same time, the Group's matured production sites in the Philippines, Thailand and Vietnam will enable key customers to diversify their procurement requirements geographically during a time of uncertainty as a safeguard against the development of new restraints on China exports.

Tristate will continue serving its core customers across Ladies Career, Related Separates, Moderate and Men's and Ladies' Outerwear segments. As customers are consolidating their suppliers in favor of larger manufacturers, Tristate is winning market share in several areas. However, high quality complex manufacturing operations are a challenge in the face of price compression.

Going forward, the Group is committed to focusing on core customers. Product offerings will focus on core competencies and value added services will continue to be tailored to individual customer needs. At the same time, the Group will continue to improve its production efficiency and exercise effective controls over direct and indirect costs. In this regard, a special management initiative has been launched to aggressively drive down selling, general and administrative expenses.

Looking ahead, with the continuous improvement in worldwide economic conditions and the strong backup of Mainland China to Hong Kong, management is confident that Tristate is well positioned to meet the challenges that lie ahead.

INTERIM DIVIDEND

The Directors have resolved not to declare an interim dividend for the six months ended 30th June 2004 (2003: Nil).