financial review

International Financial Reporting Standards ('IFRS')

As part of our continous effort to improve transparency and quality of disclosure for our shareholders, the capital markets and other users of our financial reports globally, the Group adopted the IFRS in preparation for its financial statements this year. Please refer to note 1 and note 2 to the financial statements for details.

Had the Group prepared its consolidated financial statements for the year ended June 30, 2004 under HKGAAP, the Group estimates that the profit attributable to shareholders for the year then ended would have been lowered by approximately HK$130 million, mainly representing the amortization of trademarks of HK$105,065,000.

Turnover Breakdown	Germany	Benelux	France	Scandinavia	Others
FY2003/2004	51%	17%	6%	4%	22%
FY2002/2003	51%	16%	4%	3%	26%
% growth from last year	32%	37%	70%	64%	18%

Turnover

Germany remains to be our biggest market accounting for 51% of total turnover and recording 32% growth. The Group achieved significant growth outside Germany this financial year. France and Scandinavia both recorded stellar year-on-year growth of 70% and 64% respectively while Benelux also recorded 37% of growth.

Margins

Gross margin reached 52.1%, up 2.2% points from a year ago. The results were driven by our strong brand, the implementation of a market-driven and fresh product strategy, and the associated better full-price sell-through. Regionally, the most noticeable increase was in Europe. Gross profit margin for this region jumped from 45.3% to 48.2%.

Earnings before interest, taxation, depreciation and amortization (EBITDA) margin came in at 19.6%, up 2.7% points from a year ago. Total operating expenses dropped to 34.5% of turnover, down from 35.2% a year ago. Rental costs, one of the largest operating costs components, dropped 0.8% points to 8.3% of turnover. Despite the addition of staff members, staff costs decreased slightly by 0.1% points from 13.0% of turnover to 12.9%. Productivity enhancement from European retail operation and profitability improvements in underperforming retail markets (Hong Kong, Canada, U.K. and Taiwan) helped drive the operating margin expansion. The improvement was partly offset by a one-time restructuring charge of red earth's Australian operation of approximately HK$50 million. Operating profit (EBIT) margin increased 2.9% points to 17.6%.

Depreciation expenses were HK$342.2 million, 25.5% higher than last year. The higher depreciation was due mainly to the retail stores expansion and the associated capital expenditure. We believe that the Esprit trademarks should be regarded as intangible assets with an indefinite useful life as described in IAS 38. We engaged an internationally recognized appraiser who is of the opinion that the Esprit trademarks are capable of creating economic value over an indefinite period. Accordingly, Esprit trademarks are no longer amortized but subject to annual impairment testing. Please refer to note 4(a) to the financial statements for details.

Net profit

Net profits were up 55.4%, growing from HK$1.29 billion to HK$2.00 billion and net profit margin increased 1.8% points to 12.2%. The Group's effective tax rate was 32.1%, 6.3% points lower than the 38.4% for FY2002/2003 when a non-recurring tax refund from Germany amounting to approximately HK$130 million is excluded. Halving the total operating losses from the four retail markets, namely Hong Kong, Taiwan, U.K. and Canada, contributed to the improvement while our efforts in implementing efficient tax strategies worldwide also started to bear fruit.

Liquidity and financial resources

Net cashflow from operating activities for the year increased by 25.9% to HK$1,982.5 million. During the year, the Group spent HK$662.0 million on capital expenditure for new store openings, store upgrading, new IT systems developments and new global business headquarter in Ratingen, Germany, utilized HK$180.9 million on the acquisition of the Swiss licensee, and another HK$971.5 million on dividend payments in December 2003 and April 2004. We have also repaid in full all long-term bank borrowings in the second half of the financial year equivalent to HK$806.7 million. The Group's financial position remains very strong with its net cash balance (cash and bank equivalent net of bank borrowings) increasing to HK$1.76 billion from HK$1.32 billion a year ago.

As at June 30, 2004, the Group has no long-term bank borrowings and did not pledge any assets as security for overdraft and/or short-term revolving facility. Our debt to equity ratio, expressed as a percentage of interest bearing external borrowings over shareholders' funds of HK$5.41 billion, is 0%. The current ratio (current assets divided by current liabilities) stands at 1.7 (FY2002/2003: 1.9).

Foreign exchange risk management

To minimize our foreign exchange exposure, the Group entered into foreign exchange forward contracts with large and reputable financial institutions to reduce credit risks. Forward contracts decreased from HK$375.2 million to HK$367.1 million in FY2003/2004.

In addition to entering into forward contracts, we hedged our foreign currency risks with suppliers by asking them to quote and settle in Euros.

Dividend policy

The Board of Directors is pleased to recommend a final dividend of 48.0 Hong Kong cents per share (FY2002/2003: 32.5 Hong Kong cents), an increase of 47.7% from last year. The dividend payout ratio, including the interim dividend paid and the proposed final dividend for the year, was approximately 40%. It is the intention of the Group to maintain a stable dividend payout ratio and distribute dividend to our shareholders that is broadly in line with our earnings growth.

The Board of Directors, after considering our net cash position, operating cash flow and capital needs, also recommended a special dividend of 50.0 Hong Kong cents per share to be distributed to our shareholders this year.

Human resources

The Group has employed both full-time and part-time employees and has over 6,700 positions world-wide (after converting the part-time positions into full-time positions based on working hours). Therefore, as at June 30, 2004, the number of employees of the Group exceeds 6,700. The most significant personnel increase was in the sales-related department. About 800 new employees were hired as a result of the strategic expansion of retail operations. The takeover in Switzerland also added about 160 employees to our global workforce.

We strive to be an attractive company for the talented and motivated. The Group places heavy emphasis on staff training and development in order to realize the potential within every one of our employees. Our remuneration package is performance-based and takes into account business performance, market practice and competitive market conditions. Share options and discretionary bonuses are granted to staff that achieve outstanding performance.

The Group promotes inter-company communication and we welcome ideas and feedback from staff. Through quarterly newsletters and the Group's global intranet, we aim to improve company-wide communication, thereby connecting our 6,700+ employees around the world to the Esprit family.

IT infrastructure

To improve the quality and efficiency of our operations, updated retail and merchandising systems as well as global financial systems are being installed across business divisions and geographical regions. Uniform information systems will provide us with more capabilities to manage our inventory, sales and forecasting, and enable us to have more speedy access to market information.

Significant investments

In December 2003, the Group acquired Bollag-Guggenheim & Co. AG in Switzerland and thereby regained full distribution rights of ESPRIT apparel and related products in Switzerland and Italy.

The Group has committed approximately HK$300 million for the new head office in Hong Kong, comprising inter alia, approximately 73,000 sq.ft. of office space and a prominent signage space at the top of the building.