MANAGEMENT DISCUSSION AND ANALYSIS

FINANCIAL PERFORMANCE

The Group's turnover for the year ended 30 September 2004 amounted to approximately HK$380,409,000, representing an increase of approximately 12% over last year. Net profit attributable to shareholders was approximately HK$66,897,000, representing a decrease of approximately 27% over last year.

The increase in turnover was mainly due to the commencement of the operation of the two yarn spinning plants in the second half of the fiscal year. Manufacture and sale of yarns amounted to approximately HK$39,660,000 during the year. The turnover for the provision of fabric processing services, and the manufacture and sale of fabrics remained stable during the year under review.

The gross profit margin of the Group decreased from approximately 42% in 2003 to approximately 31% in 2004, which was mainly attributable to the upsurge in production expenses and the new business operation in manufacture and sale of yarns, which bears a comparatively lower gross profit margin than the fabric processing services.

Decrease in net profit attributable to shareholders was mainly due to the losses arising from the new business undertakings of two plants in manufacture and sale of yarns which commenced operation in March 2004. In order to reduce the risk arose from the unexpected surge in cotton prices, the Group kept a considerably high level of inventory even during the period of high prices. Nevertheless, the subsequent and continuous plunge in cotton prices resulted in a downward adjustment in the selling prices of the products. As a result, the high level of expensive inventory and the under-utilization of such plants were detrimentally affected the profit of the Group. Moreover, in order to attain a higher production capacity in fabric processing, the Group initiated a restructuring programme during the year, to dispose of old machinery and to acquire new ones. The Group registered a loss in production volume during the restructuring process, thus brought forth additional pressure on the profit of the Group.

Analysis by Customer Geographical Regions

During the year under review, sales to customers located in the Greater China significantly increased from approximately 15% in 2003 to approximately 31% in 2004. It was mainly attributable to the launching of two yarn spinning plants in the second half of the fiscal year. Yarns manufactured by the two yarn spinning plants were all sold to the PRC customers. The Philippines market continued to be the dominating customers of the Group, accounted for approximately 54% of the Group's total turnover. Customers from Africa, Australia and North America contributed to the remaining 15%.

With respect to the segment results contribution, due to the substantial losses arising from the manufacture and sale of yarns, the segment result of the Greater China dropped significantly as compared to last year. Decrease in the contributions of other regions was mainly due to the surge in production expenses.

MANAGEMENT DISCUSSION AND ANALYSIS

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

At 30 September 2004, the Group had current assets of approximately HK$205,094,000 (30 September 2003: HK$231,997,000) and current liabilities of approximately HK$171,144,000 (30 September 2003: HK$134,137,000). The current ratio (calculated as current assets to current liabilities) decreased from 1.73 as at 30 September 2003 to 1.20 as at 30 September 2004, owing primarily to decreased cash and cash equivalents, and increased short-term bank borrowings. The gearing ratio (calculated as the total bank borrowings to total shareholders' equity) had increased from 0.10 as at 30 September 2003 to 0.35 as at 30 September 2004. These ratios were at reasonably adequate levels as at 30 September 2004, although they indicated deterioration in liquidity. The Group had sufficient funds to meet its short-term and long-term liabilities.

During the year under review, the Group principally met its funding requirements by cash flows from operations and bank borrowings. The total bank borrowings increased by approximately HK$110,189,000.

At 30 September 2004, the Group had total bank borrowings of approximately HK$148,585,000, of which approximately HK$112,835,000 was short-term bank borrowings and approximately HK$35,750,000 was long-term bank borrowings. Approximately 66% of the total bank borrowings was subject to fixed interest rates while approximately 34% was subject to floating interest rates. There are no seasonal adjustments with respect to the Group's borrowings.

During the year, a total of 2,840,000 ordinary shares were issued upon the exercise of warrants. As a result of the new issue of shares as referred to above, the total number of issued shares of the Company as at the date of this report is 774,452,000.

CAPITAL EXPENDITURE AND MATERIAL ACQUISITION

During the year under review, the total capital expenditure of the Group was approximately HK$94,826,000, which was incurred as follows:

- approximately HK$54,689,000 for the expansion of fabric processing production capacity;
- approximately HK$22,350,000 for the completion of the yarn spinning plant annexed to the existing fabric processing factory at Shishi, Fujian Province; and
- approximately HK$17,787,000 for the acquisition of cotton processing and yarn spinning plant at Lianyungang, Jiangsu Province.

In addition, the Company contributed approximately HK$7,900,000 to its newly established joint venture company, Shenyang Huafeng, during the year under review.

MANAGEMENT DISCUSSION AND ANALYSIS

CAPITAL EXPENDITURE AND MATERIAL ACQUISITION (continued)

For the year, a subsidiary of the Company acquired the entire issued share capital of Elite League Investments Limited ("Elite League") for a cash consideration of HK$78,000,000. The principal asset of Elite League was 100% equity interest in Lingfeng, a company established in the PRC. Lingfeng is principally engaged in the provision of fabric processing services with an annual processing capacity of approximately 36,000 tonnes. Further details of the acquisition are set out in the Company's circular dated 20 October 2004 to its shareholders in connection with the acquisition.

FOREIGN EXCHANGE EXPOSURE

The sales and purchases of the Group were mainly denominated in US dollars and Renminbi. Bank borrowings were denominated in Renminbi and Hong Kong dollars. As the exchange of US dollars against Renminbi and Hong Kong dollars were relatively stable during the year under review, the Group's exposure to currency exchange risk was minimal.

CONTINGENT LIABILITIES

The Group did not have any significant contingent liabilities as at 30 September 2004 (2003: Nil).

At 30 September 2004, the Company had provided corporate guarantees to the extent of HK$50,000,000 (2003: Nil) for banking facilities granted to a subsidiary, which were utilised to the extent of HK$50,000,000 (2003: Nil).

PLEDGE OF ASSETS

The Group's bank borrowings are secured by certain of the Group's leasehold land and buildings, and plant and machinery with a total carrying value of approximately HK$83,781,000 at 30 September 2004 (2003: HK$4,320,000), and corporate guarantees given by a subsidiary of the Company and the Company respectively.

EMPLOYMENT INFORMATION

At 30 September 2004, the Group had a total of 2,345 (30 September 2003: 752) employees in Hong Kong, Macau and the PRC. The Group's emoluments policies are formulated on the performance of individual employee and on the basis of the salary trends in various regions, and are reviewed periodically.

For the year ended 30 September 2004, the total staff costs (including Directors' emoluments) amounted to approximately HK$21,858,000 (2003: HK$16,835,000).

The Company also maintains a share option scheme for the purpose of providing incentives and rewards to the eligible participants for their contributions to the Group. No share options were granted during the year.

MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS DEVELOPMENT AND OUTLOOK

During the year under review, the Group accomplished a number of significant business expansion plans, which successfully fortified its already established operations. Capitalizing on the internal resources of the Group, the Group has also captured invaluable market opportunities to facilitate further business acquisition, hence, boosting the aggregate production capacity.

The new plants came into operation include:

- Shenyang Huafeng (53.6% owned subsidiary of the Company): principally engages in sourcing and fabric processing of corduroy; fabric processing and printing of muslin. Total annual processing capacity reaches approximately 20 million meters;

- Fenghua Textile (wholly-owned subsidiary of the Company): principally engages in yarn spinning (65,000 spindles) with an annual production capacity of approximately 12,000 tonnes; and

- Lianyungang Huafeng (wholly-owned subsidiary of the Company): principally engages in cotton processing and yarn spinning (40,000 spindles) with an annual production capacity of approximately 7,000 tonnes.

- Lingfeng (wholly-owned subsidiary of the Company): principally engages in fabric processing with an annual processing capacity of approximately 36,000 tonnes.

With a solid operation platform firmly in place, the Group is well-poised to embark on global expansion. The recent collaboration with renowned Italian shirting fabrics processor MVB marked the beginning of our penetration into the European markets, making us one step closer to attain our goal of international reach. The 51% owned JV, specializes in manufacturing of premium shirting fabrics, has an estimated annual production capacity of approximately 6 million meters.

The Group registered a record business turnover during the year. This reflected the success of a series of initiatives implemented, which has proved to be effective and beneficial to the operation. Driven by the surge in production capacity, the business activity of the Group has gathered momentum during the year, and the Group is fully geared to extend its foothold to new markets across the board. The Group will remain very conscious of the changing global market environment to secure a competitive edge over its counterparts.

In the future, the Group will continue to focus on the development of its core business in fabric processing. The development will be facilitated through acquisition of related business with growth potential or capacity expansion of the Group's existing operations. Such investments will be funded by bank borrowings and internal resources. We remain confident that the Group's business will continue to grow strongly and profitably.