Managing Director's Report

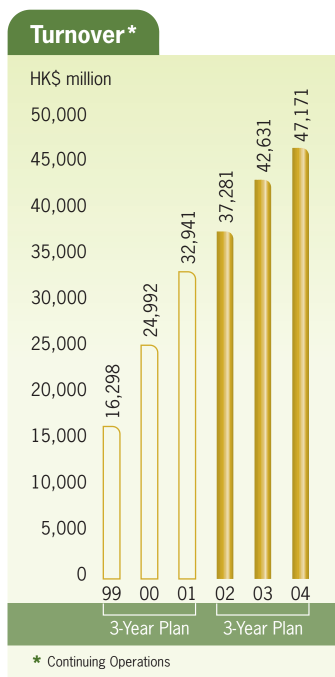
William FUNG Kwok Lun

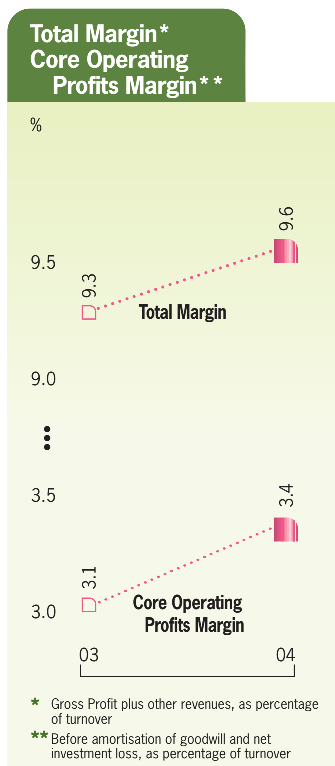
Results Review

2004 was the last year of the Three-Year Plan spanning 2002-2004. In a period filled with unexpected calamities and generally slow growth in the retail markets, the last Three-Year Plan was nevertheless a period of progress for the Group. Despite a slow start, the Group is pleased to report that our results in the year 2004 saw solid growth rates in line with the original Three-Year Plan target.

During the year under review, Profit Attributable to Shareholders increased by 25% to HK$1,530 million. Turnover increased by 11% to HK$47.2 billion, with the growth rate accelerating towards the latter half of the year.

The strong increase in profit was mainly driven by the increased proportion of higher-margin businesses. The Total Margin rate increased from 9.3% to 9.6% during the year. In line with the Three-Year Plan strategy, the Group has been striving to create more added value for our customers along the supply chain. This also led to an increase in our Core Operating Profit Margin from 3.1% to 3.4%. Core Operating Profit increased by 21% to HK$1,595 million as a result.





In terms of non-operating items, the adoption of the Hong Kong Financial Reporting Standard 3 "Business Combinations" during the year has resulted in a change in the accounting policy for goodwill as detailed in the accounts. Because of this, the Group did not have to amortise goodwill relating to acquisitions from 1 January 2004 onwards. Goodwill amortisation charges amounted to HK$26 million in 2003.

Taking into account the above, plus net interest income, contribution from associated companies, tax, and minority interest, profit attributable to shareholders amounted to HK$1,530 million, an increase of 25% over 2003.

Segmental Analysis

The softgoods business accounted for 67% of turnover in 2004, with turnover and operating profits increasing by 11% and 27% respectively. The higher growth rate in profit reflects an increase in demand for our value-added services such as product development, and goods delivered on a landed duty paid basis instead of FOB country of origin.

After two years of high growth, the Group's hardgoods business consolidated its strong base core customers in 2004. Turnover and operating profit increased by 10% and 6% respectively. The Group's business with mainstream retail customers continues to see satisfactory growth in turnover and profits. However, profitability was affected by the poor performance on some specific product lines such as fireworks, which the Company is confident in reversing in the coming Three-Year Plan.

Geographically, United States continued to be the Group's major export market, accounting for 68% of turnover in 2004. The Group has made good progress in growing our business outside of the United States with new customer additions. In Europe, turnover grew at a faster rate of 13%. Operating profit increased by 15%, reflecting an increase in margin that is in line with the rest of the Group.

Sales to Canada and Latin America accounted for 4% and 1% of the total in 2004. Although still small, the Group sees good potential to grow in these markets as they were dominated by large retailers that are conducive to using our services.

Business in Australasia accounted for 4% of the total. Turnover and operating profit saw strong increases of 55% and 71% respectively. The Group has signed up major new customers in Australia and has established a strong presence in that market through working with a number of leading retailers there.

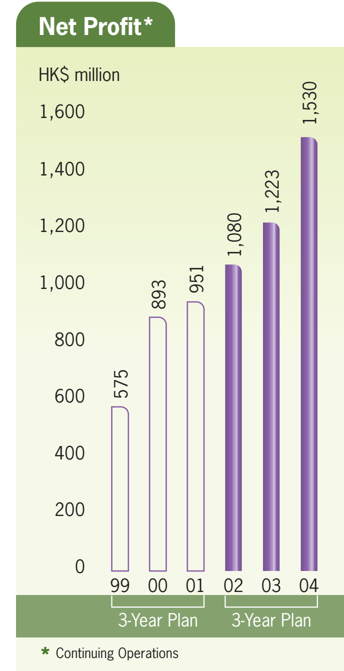
For the Rest of the World, reflecting mainly the Japanese market, saw a moderate increase in turnover of 3%. After a three-year trial, our partnership with Nichimen (renamed Sojitz Corporation in 2004) met with little success. The Group continues to view the Japanese business as a strategic market in the long-term with great eventual potential. We are currently pursuing projects with a few major retailers that may help us reach a breakthrough in this market.

New Business Ventures

The strategy of focusing on margins has been an important part of our Three-Year Plan 2002-2004. In line with this, since 2003 the Group has started to build a brand business in the United States. This is an extension of our role in the supply chain, and is expected to further enhance the Group's profit margin going forward.

Shipments for the Levi Strauss Signature license for tops commenced in Fall 2004 with satisfactory response from retailers such as Wal-Mart and Target. The brand business has yet to contribute to the Group's profitability as startup expenses were incurred for the launch of this brand and other brands such as Disney, Levi's Red Tab tops, Cannon and Royal Velvet with the first shipments planned only for Spring 2005.

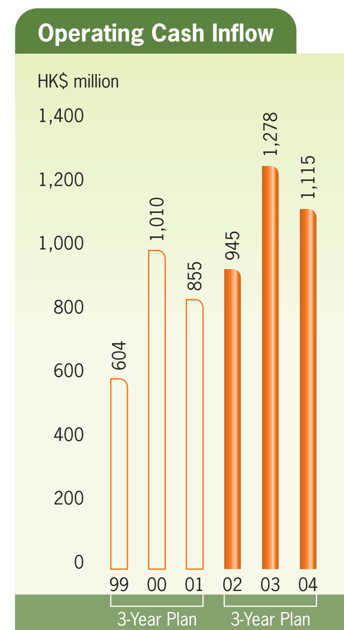
Indications for orders for these new brands are strong and the brand business is expected to be an important contributor to our new Three-Year Plan 2005-2007.



Acquisitions

In the latter half of the year, the Group made several acquisitions of smaller companies that will complement the growth of our business. These included an apparel sourcing company targeting the French specialty store market, and a design-led knitwear trading company with a strong US customer base.

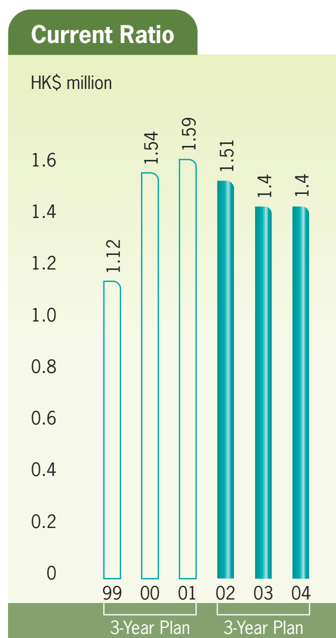
The acquired businesses have total annual turnover of approximately US$128 million and this will be reflected in the Group's turnover going forward in 2005. Integration of these companies is well underway and there are solid prospects of increased growth rates and profitability of these new business units.



Special Dividend

Since the beginning of the Three-Year Plan 2002-2004, the Group has set aside cash reserves of US$300 million earmarked for acquisitions. During this period, the Group's acquisitions efforts met with much less success than expected and were interrupted by external factors such as the SARS epidemic in 2003. The acquisitions that were done as mentioned above were relatively small, and have been generating strong cash flows. Thus, only a small part of our cash reserves were utilised.

The lack of appropriate opportunities to deploy the cash reserves and the low return generated from interest income argue for a return of excess cash to shareholders to create a more efficient capital structure for the new Three-Year Plan 2005-2007. Setting aside a prudent amount for future acquisition needs, the Board has declared a special dividend payout of 25 HK cents per share.



The Group continues to actively seek acquisition opportunities, and going forward this will be funded by the remaining cash reserves, the strong cash flows generated from the core trading business, as well as debt if the need arises. During the year the Group obtained international credit ratings of A3 and A- from Moody's and Standard & Poor's respectively. These ratings are a reflection of the Group's strong financial position.

Financial Position and Liquidity

As indicated above, the Group continues to be in a strong financial position in the period, with more than sufficient cash and cash equivalents amounting to HK$2.1 billion on 31 December 2004. Normal trading operations are well supported by over HK$17 billion in bank trading facilities. In addition, the Group has available bank loans and overdraft facilities of HK$1.5 billion, out of which only HK$243 million has been utilised.

As at 31 December 2004, the Group has no long-term borrowings, therefore the gearing ratio is not applicable. The current ratio was 1.4, based on current assets of HK$8.2 billion and current liabilities of HK$6 billion.

At the end of December 2004, charges on assets amounted to HK$124 million to cover banking facilities in the ordinary course of business.

The Hong Kong Institute of Certified Public Accountants has issued a number of new or revised Hong Kong Financial Reporting Standards ("HKFRS") and Hong Kong Accounting Standards ("HKAS") (collectively referred to as "new HKFRSs") which are effective for accounting periods beginning on or after 1 January 2005.

In the year, the Group has adopted the following new HKFRSs in advance of their effective date:

HKAS 36	Impairment of Assets
HKAS 38	Intangible Assets
HKFRS 3	Business Combinations

The adoption of the HKFRS 3 "Business Combinations" in the year has resulted in a change in the accounting policy for goodwill as detailed in the accounts. In terms of non-operating items, because of this change in accounting policy for goodwill, the Group did not have to amortise goodwill relating to acquisitions from 1 January 2004 onwards. Goodwill amortisation charges amounted to HK$26 million in 2003.

Foreign Exchange Risk Management

Most of the Group's cash balances are deposited in HK$ or US$ with major banks in Hong Kong. The Group has a HK$41 million short-term revolving loan denominated in Japanese Yen as a currency hedge against shares held in Sojitz Corporation (formerly Nissho-Iwai Nichimen), a strategic investment in Japan made during 2001.

Apart from the above, most of the Group's assets, liabilities, revenues and payments are either in HK$ or US$. Therefore, we consider our risk exposure to foreign exchange rate fluctuations minimal.

Capital Commitments and Contingent Liabilities

At the date of this announcement, the Group has long running disputes with the Hong Kong Inland Revenue involving additional assessments of tax totaling approximately HK$633 million regarding certain non-Hong Kong sourced income and expenses for the years of assessment from 1992/1993 to 2003/2004. The disputes were only initiated in 1999, and have been disclosed in the annual report since that year. The Group has been working with its accounting and legal advisors in respect of its dealings with the Hong Kong Inland Revenue in relation to these matters.

The structure of the Group's offshore sourcing and marketing activities was established at the time of the Group's re-listing on the Hong Kong Stock Exchange in 1992 at which time the Group had sought advice from its external professional advisors.

The directors consider that sufficient tax provision has been made in the accounts in this regard and no additional material tax liabilities will finally crystallise.

There are no material contingent liabilities or off balance sheet obligations other than trade bills discounted in the ordinary course of business as set out in the accounts.

Human Resources

As of 31 December 2004, the Group had a total workforce of 6,685, of whom 2,344 were based in our Hong Kong headquarters and 4,341 were located overseas throughout our sourcing network of close to 40 countries and territories.

The Group offers its staff competitive remuneration schemes. In addition, discretionary bonuses and share options are also granted to eligible staff based on individual and Group performance. The Group is committed to nurturing a learning culture in the organisation. Heavy emphasis is placed on training and development, as the Group's success is dependent on the efforts of a skilled, motivated work force. Total staff costs for the year 2004 were HK$1,726 million, compared against HK$1,546 million in 2003.

Review of Three-Year Plan 2002-2004

During the last Three-Year Plan, the Group increased recurring net profit by 61%, and have moved core operating margins from 2.8% to 3.4%. Although these are respectable growth rates amidst a difficult economic environment, this was short of our original target of doubling net profit from the level achieved in 2001. In retrospect, the past Three-Year Plan was a period of consolidating and strengthening of our business position. Of significance was our successful move into higher-margin businesses, including the establishment of a brand business overseas through licensing renowned consumer brand names. The Group also saw an acceleration in its profit growth rate at the end of the three-year period, which provides a strong momentum to carry it forward to the new Three-Year Plan.

Prospects and Three-Year Plan 2005-2007

In the new Three-Year Plan, there are new developments in the macro environment such as the abolition of the apparel quota system by WTO effective from the beginning of 2005. This will lead to changes in the sourcing markets going forward, creating new opportunities for the Group. In particular, many retailers who had traditionally relied on their in-house buying organisations are rethinking their strategy at this juncture, and we are well positioned to gain new customers from this front.

On the sourcing front, markets that were previously disadvantaged by the quota system, such as China and India, will see big growth in the long term. These developments play into our strengths with our heritage and our extensive network of 18 offices in China. The Group's new hub office in Shanghai is scheduled for opening in mid-2005. This 260,000-square-feet office will serve as the nerve centre for our Central China sourcing, and a key destination for overseas buyers. Regardless of short term impediments such as anti-surge safeguards, the long term prospect of China cannot be doubted. The flexible and low-fixed investment business model of the Group will enable us to fully exploit this opportunity regardless of temporary road blocks.

Against this backdrop where the outsourcing trend is stronger than ever, the Group foresees good business growth in the core sourcing business. One of the targets of this Three-Year Plan is to achieve a turnover of US$10 billion by 2007. The new brand business will also be an important part of the Plan and is expected to enhance the overall profitability of the Group.

The Group sees a good start to the new Plan with strong trading conditions and a good flow of new customers from the start of 2005. The brand business will also start to contribute positively, with the launch of the Royal Velvet and Levi's Red Tab lines this year. Our top management team is highly committed to grow business in this Three-Year Plan.

William FUNG Kwok Lun
Managing Director

Hong Kong, 22 March 2005