

## Chairman's Statement



We have a solid base to extend our leading position.

**Mr. Ngan Hei Keung**, Chairman

**Ms. Pauline Ngan**,  
Deputy Chairman and Managing Director

On behalf of the Board of Directors of Mainland Headwear Holdings Limited (the "Company"), I am pleased to present the annual results of the Company and its subsidiaries (collectively, "Mainland Headwear" or the "Group") for the year ended 31 December 2004.

### Business Review and Prospect

#### Overview

During the year under review, business conditions were difficult primarily due to surging prices of raw materials that have affected the manufacturing industry as a whole, keen competition in the industry and greater consolidation within the US market. Despite this challenging environment, the Company was able to achieve remarkable results due to stringent cost controls and the creation of synergies between the two Manufacturing and Trading Businesses, translating into better gross profit margins for the Group to better strive in a tough market environment. The Group achieved a profit attributable to shareholders of HK\$83,665,000, an increase of 25% from 2003.

The Group was also named one of Hong Kong's 20 most outstanding enterprises in an initiative organized by the Economic Digest. Separately, Ms. Pauline Ngan earned an Executive Director Award as part of "Directors of the Year Awards 2004" organized by the Hong Kong Institute of Directors, and the Owner-Operator Award in the DHL/SCMP Hong Kong Business Awards 2004. These awards signify public recognition of the Company, and Ms. Pauline Ngan's superb efforts in enhancing operational transparency and striving for continual improvement.

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Zhen Han Industrial City, Buji, Shenzhen

Looking forward, the Group is committed to extend its product lines and expanding its core profit contributor, the Manufacturing Business, to new and existing markets such as Japan and the PRC, while the Retail and Trading Businesses will also eye fresh opportunities. The Group is also expected to continue leveraging on the marketing expertise of its US subsidiaries to increase its direct sourcing customers.

### Financial Review

Mainland Headwear's turnover for the year ended 31 December 2004 amounted to approximately HK\$557 million, representing an increase of 19% as compared to 2003. The increase in turnover was mainly due to new orders from existing and new customers. Net profit attributable to shareholders was HK\$83.7 million, representing an increase of 25% as compared to 2003. Earnings per share increased by 24% to HK29.4 cents. This increase was largely due to stringent cost control measures adopted by the Group as well as synergies between its Manufacturing and Trading Businesses, which improved the gross profit margin and operational efficiency. The selling and distribution costs and administration expenses increased to HK\$11 million and HK\$110.7 million respectively in line with the Group's turnover and also as a result of additional expenses of the new Retail Business.

The Board has recommended the payment of a final dividend of HK10 cents per share for the year ended 31 December 2004, maintaining a dividend payout ratio of over 40%.

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## Business Review

### *The Manufacturing Business*

During the year under review, the Manufacturing Business maintained its leading role as the largest of the Group's businesses in terms of profit contribution. Turnover from this business increased by a remarkable 35% to HK\$355,112,000 as compared to HK\$262,535,000 for the previous year. In particular, sales to the Group's trading subsidiaries in the US, increased by 71% to HK\$110,031,000. The Group's turnover from this business accounted for 44% (2003: 42%) of the Group's total turnover. Gross profit margin was sustained at a healthy level of over 35%.

While the US and Europe continued to be major markets for headwear products in 2004, the Group started exploring other markets, including Japan. Although sales to these new markets were not significant in the year under review, the initial development was encouraging.

The Group was also awarded the manufacturing license for the Beijing 2008 Olympic Games. Beijing 2008 headwear products manufactured by the Group can now be purchased in specialty stores throughout Beijing and Qingdao. So far, public response to the products has been good, but sales are only expected to pick up significantly in late 2006 or 2007. The Group was also awarded China Aerospace's exclusive license to manufacture and supply headwear products.

### *The Trading Business*

The Trading Business generated a turnover of HK\$308,883,000 during 2004, representing an increase of 14% versus the previous year (2003: HK\$271,651,000). This represented 55% (2003: 58%) of the Group's total turnover. Sales of the Trading Business in the US market gained ground in the second half of the year and registered a growth of about 10% for the year whereas sales in the Europe market continued their outstanding performance and registered a growth of 50% for the year. However, gross profit margins in both markets were under pressure due to severe market competition.

The Group is facing tough competition in the US, its single largest market, particularly as the Group lost its MLB license at the beginning of 2005 due to consolidation of the licensed sports headwear market. The Group, however, has been well prepared for this development as, prior to the consolidation, it had changed its market strategy during 2004 and was focusing much more on brands, entertainment and character licenses. The Group is confident its business originating from new licenses will compensate for most, if not all, of the losses from the MLB license.

The US, however, will remain a major market for the Group. Drew Pearson Marketing, Inc. ("DPM"), the Group's wholly owned US subsidiary, will maintain its position as the Group's marketing arm and place greater emphasis on bringing direct sourcing customers to the Group. To ensure the growth opportunities in the Europe market are captured adequately, the Group also plans to re-allocate its resources from Drew Pearson International Inc., the Group's wholly owned US subsidiary serving the Europe market, and establish a foothold in the European market. In the first quarter of 2005, a new marketing subsidiary has been set up in the United Kingdom to better serve customers in Europe, with a clearer understanding of European culture and headwear fashion trends, and a shorter delivery period. The Group's turnover is expected to increase in the coming year as it directly sells to retail outlets from its European office.

### *Retail Business*

The Group's Retail Business generated a turnover of HK\$3,583,000 during 2004, representing 1% of the Group's total turnover. As this business is still in its investment phase, the Group recorded a small negative contribution for the year under review. However, the Group expects its Retail Business to be its main growth driver in the future.

The Group signed a licensing agreement with leading US headwear retailer, HatWorld Inc., in February 2004, allowing the Group to extend its presence in Hong Kong and PRC through the opening of new headwear outlets under the LIDS brand. By the end of 2004, Mainland Headwear's Retail Business had opened 13 "LIDS" stores. "LIDS" stores in Hong Kong and the PRC (Shanghai, Beijing

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and Shenzhen) are located in prime shopping areas and have the same store identity and ambience as "LIDS" stores in the US. In 2005, the Group plans to open about 30 new "LIDS" outlets throughout the PRC and Hong Kong. The stores offer a huge range of headwear of latest fashion and sports brands including Adidas, Kangol, Von Dutch, NASCAR, NBA and NHL. The Group plans to further diversify into retailing other licensed products by leveraging on its retail "LIDS" store operations in 2005.

Riding on the "LIDS" retail platform, the Group has recently acquired a 51% stake in a joint venture with Promotional Partners Worldwide Limited to design, source and sell "SANRIO" products in the PRC through wholesale as well as the operation of its own stores. SANRIO holds major copyrights to many renowned Japanese cartoon characters, including Hello Kitty, Cinnamon Roll, Minna no Tabo, Little Twin Stars, My Melody and Shinkansen. The joint venture is targeted to start contribution to the Group as early as mid-2006 as "SANRIO" products are already highly visible in the PRC market. The Group's commitment of HK\$30 million will be used to open shops as well as to finance the general working capital of the joint venture.

The Group is confident that this diversification will enhance Mainland Headwear's future profitability.

### Prospects

Positioned as a leading headwear designer and manufacturer with a state-of-the-art distribution system, Mainland Headwear is well equipped to further diversify its operations, and generate new income channels.

The Group boosted its production capacities by 30% in the first half of 2004 to meet increasing market demand. Manufacturing facilities are currently running at an average of around 90% capacity, and production capacities may be further strengthened in the future through possible outsourcing as well as extra capital expenditure.

For 2005, the Group has allocated a capital expenditure budget of HK\$21 million to its manufacturing plant and equipment, with the aim of further increasing production capacity by 20%. The Group also plans to recruit more professionals in 2005, to reinforce product design and strengthen quality control and production capability.

The headwear industry is expected to thrive in the coming year, fuelled by continual growth of the US and European economies, coupled with buoyant economic growth in the PRC.

In the coming year, the Group anticipates higher manufacturing costs as a result of a tight labor market in the Pearl River Delta region. In view of these demanding circumstances, the Group will continue to adopt stringent cost control measures, including exploration of new suppliers to cut down material costs, with the goal of sustaining its gross profit margin without compromising on product quality.

### Acknowledgement

The Group is confident and optimistic of generating new income in the coming year as a result of leveraging on these strategies. The Group is committed to establishing a clear vision of global expansion and diversification to achieve sound turnover and profit growth so as to maximize value for shareholders. Central to the Group's success has been the support of our shareholders and commitment of our employees, customers and suppliers.

In closing, I would like to express my deepest appreciation to all these stakeholders for their invaluable contribution to the continued success of the business.

### Ngan Hei Keung

Chairman

Hong Kong  
12 April 2005