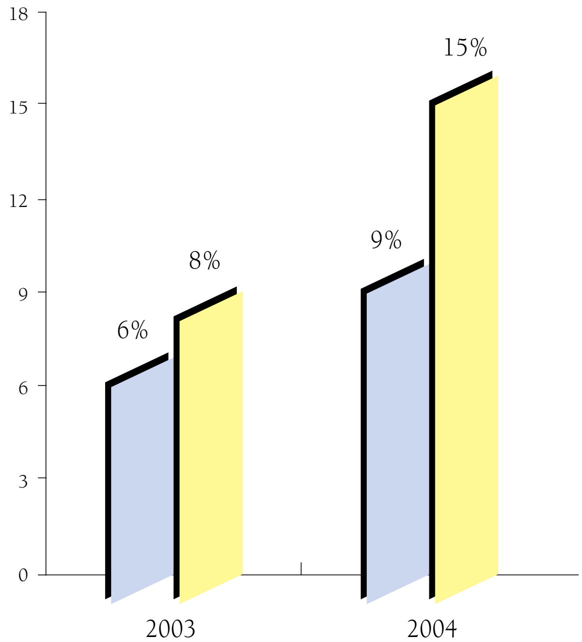
Management Discussion and Analysis

BUSINESS REVIEW

Driven by the strong growth in sales in the PRC and steady performance of export sales, the Group's turnover surged by 27.1% to HK$1,788,539,000 during the year (2003: HK$1,407,007,000).

Profit attributable to shareholders increased by 112.5% to HK$176,220,000 (2003: HK$82,935,000). The higher profit margins of the sales in the PRC and enhanced economies of scale were the main reasons behind the Group achieving higher growth in profit than in turnover. Basic earnings per share was HK11.33 cents (2003: HK5.51 cents).



OEM Business

One of the Group's core business segments, OEM business recorded steady performance during the year. Its turnover decreased slightly by 4.8% to HK$721,724,000 (2003: HK$757,856,000), which accounted for 40.4% of the Group's total turnover. The decrease in turnover was mainly due to the Group's decision to direct more resources to boosting its brand business, which enjoyed higher profitability, in a bid to foster the Group's overall business growth. Although raw material prices increased by around 2% during the year, through implementing various cost control measures and striving to secure more orders with higher profit margins, the operating profit of the Group's OEM business increased by 41.2% to HK$66,083,000 (2003: HK$46,811,000). During the year, the Group started receiving orders from Europe, while the U.S. remained as its major overseas export market.

Though raw material prices are expected to continue on a mild upward trend in the short term, the Group which only produces upon receipt of orders is able to respond more effectively to the price fluctuation. This enables the Group to better control production costs while maintaining reasonable profitability.

达芙妮 DAPHNE

Daphne PRC Selling Point Distribution

Central China

Chengdu Regional Offices	45 Specialty Stores	10 Counters
Changsha Regional Offices	40 Specialty Stores	7 Counters
Xinjiang Regional Offices	16 Specialty Stores	3 Counters
Xian Regional Offices	14 Specialty Stores	12 Counters

Northern China

Beijing Regional Offices	34 Specialty Stores	49 Counters
Zhengzhou Regional Offices	57 Specialty Stores	15 Counters
Jinan Regional Offices	61Specialty Stores	27 Counters

Eastern China

Nanjing Regional Offices	48 Specialty Stores	38 Counters
Shanghai Regional Offices	79 Specialty Stores	19 Counters
Hangzhou Regional Offices	54 Specialty Stores	19 Counters

Southern China

Fuzhou Regional Offices	54 Specialty Stores	6 Counters
Guangzhou Regional Offices	67 Specialty Stores	35 Counters
Nanning Regional Offices	29 Specialty Stores	11 Counters

North Eastern China

Harbin Regional Offices	42 Specialty Stores	13 Counters
Changchun Regional Offices	24 Specialty Stores	6 Counters
Shenyang Regional Offices	61 Specialty Stores	27 Counters

Management Discussion and Analysis

Brand Business

The Group managed three brands including its own-brand – "Daphne" ladies' footwear, the new own-brand – "Shoebox" footwear and the "Adidas – Original Collection" products. Turnover of brand business increased by 64.3% to HK$1,066,815,000 (2003: HK$649,151,000), constituting 59.6% of the Group's total turnover. During the year, sales from "Daphne" increased by 52.0% to HK$986,878,000, making up 55.1% of the Group's total turnover (2003: HK$649,151,000). Sales from "Shoebox" was HK$12,190,000, accounting for 0.7% of the total turnover. Sales from the "Adidas – Original Collection" business reached HK$67,747,000, constituting 3.8% of the total turnover.

"Daphne" – Own-Brand Ladies' Footwear Business

As the Chinese economy continues to grow, market demand for consumer goods follows to increase. That and the growing spending power of female consumers have created a female footwear market laden with growth potential. "Daphne" business recorded a high growth in the year at the Group's effort to expand its sales and distribution network, and increase sales per store to enhance cost effectiveness. At the end of 2004, "Daphne" had more than 1,500 selling points in the PRC (including 725 specialty stores and 297 counters), 283 more compared to 2003 (2003: 500 specialty stores and 239 counters).

The success of "Daphne" was not only attributable to the Group's extensive sales and distribution network, but also rested on the well-established position of the brand and effective brand marketing strategy. Leveraging the recognized brand name of "Daphne" and heeding the strong consumption power of teenagers, the Group started to launch a new separate outlet chain – "Daphne D18" for Daphne's young collection, targeting female customers aged between 15 and 25. With other product lines of Daphne as "Daphne 28" targeting female customers aged between 26 and 50, the addition of the new outlet chain will enrich the brand and enable the Group to expand its customer base and increase its share in the ladies' footwear market in the PRC.

"Shoebox" – New Own-Brand Footwear Business

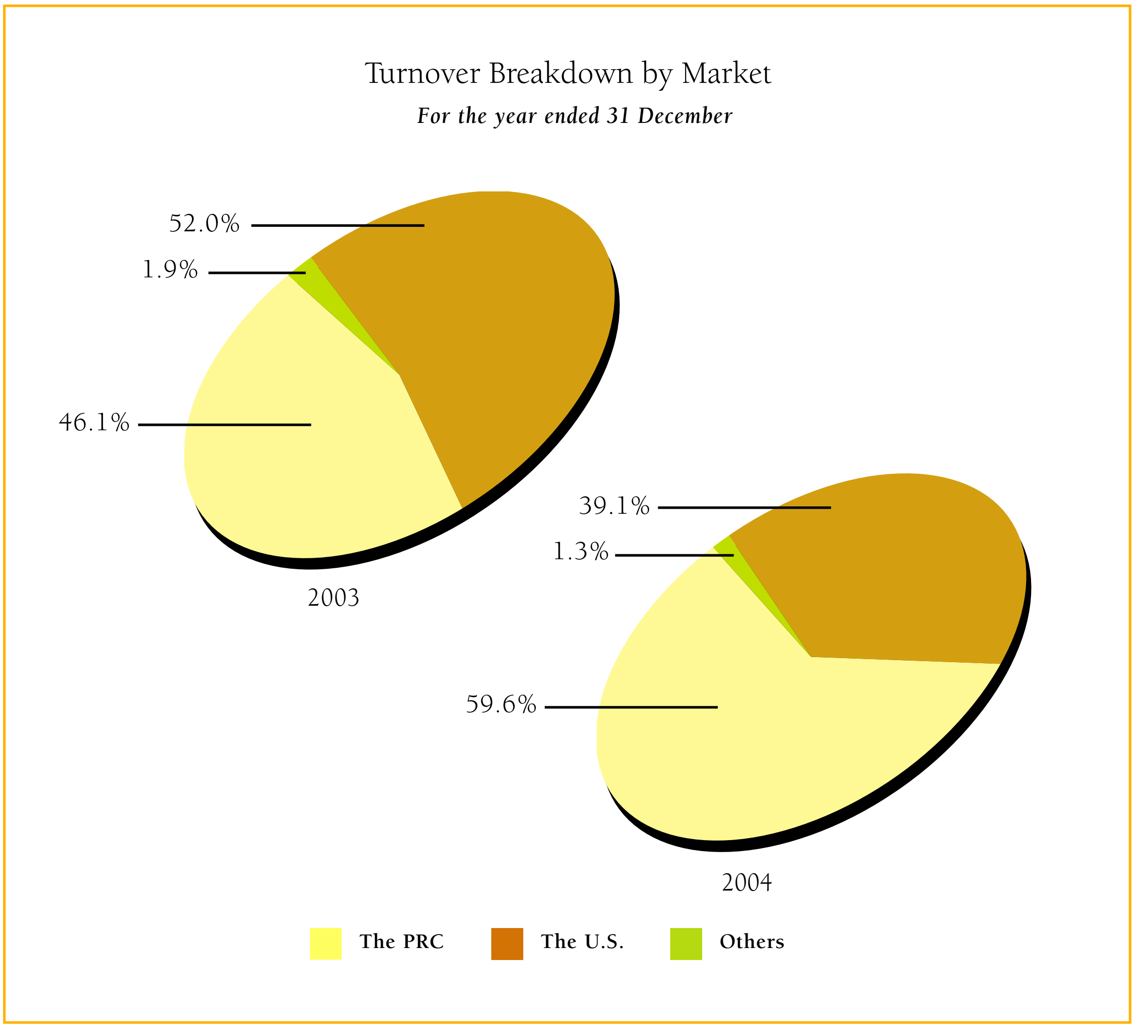
Seize the mass market of footwear in the PRC, the Group launched a new brand – "Shoebox" in May 2004. Through opening "Shoebox" mega stores, some of which located inside chain hypermarkets like "Carrefour" and "Hymall" etc., the Group has broadened its income base.

By the end of 2004, "Shoebox" had 21 mega stores opened in cities including Beijing, Shanghai, Wuhan, Yangzhou and Suzhou. Though the business is still in its development stage, market response has been better than expected, pointing to huge potential in the high quality low-priced footwear market in the PRC.

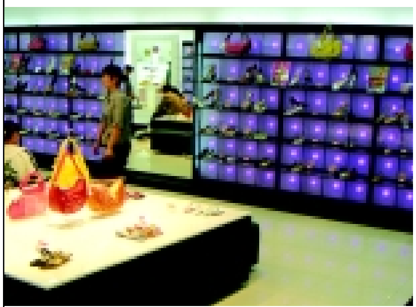
Adidas – Original Collection Business

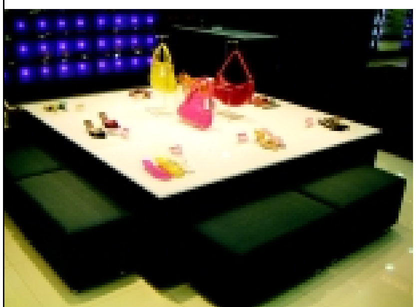
In the past, the Group has been managing the business by appointing agent to operate the "Adidas – Original Collection" business. In 2004, the business of the "Adidas – Original Collection" entered into a more established stage and the Group stepped up expanding this business on its own to boost revenue.

To capture the ever-rising demand for athletic and casual footwear products and apparel of prestigious brands in the PRC, the Group opened 5 more specialty stores during the year, bringing the total number of stores to 8 by the end of 2004. The number of "Adidas – Original Collection" counters also increased from 12 to 30. These selling points are located in major cities including Shanghai, Beijing and Guangzhou.



Management Discussion and Analysis





Development of Infrastructure

During the year, the Group set up two production plants in Fujian and Jiangsu. In addition, the Group's production facilities in Anhui commenced extensive manufacturing operations during the year with the current utilisation rate of approximately 60%, indicating they have sufficient capacities to cater to massive new orders. Two new production lines were added to the production facility in Anhui, and two more would be installed in 2005. Moreover, the Group completed the construction of its logistics centre in Shanghai with a total capital investment of approximately HK$12,000,000. To further reduce warehousing, transportation and freight costs, the Group will open more logistics centres in the coming year. The constructions of the logistics centres in Beijing and Fujian are expected to be completed in 2005, and those in Shenyang, Guangdong and Chengdu are estimated to be completed by 2006. The Group's goal is to build a sales and distribution network with nation-wide coverage in the PRC.

FINANCIAL REVIEW

Results Performance

For the year ended 31 December 2004, the Group's turnover increased by 27.1% over the previous year (2003: HK$1,407,007,000) to reach HK$1,788,539,000. Profit attributable to shareholders amounted to HK$176,220,000 (2003: HK$82,935,000), representing an increase of 112.5% as compared with the previous year. Gross profit margin increased to 38.3% from 29.7% last year, while net profit margin surged to 9.9% from 5.9% last year. These outstanding results were mainly attributable to the Group's proactive efforts in expanding its sales and distribution business in the PRC and maintaining a steady export business, while implementing stringent cost control.

During the year, basic earnings per share of the Group was approximately HK11.33 cents, representing approximately 2.1 folds of that of last year. The board of directors recommended the payment of a final dividend of HK2.0 cents per share for the year ended 31 December 2004. Together with the interim dividend of HK1.5 cents per share, the total dividends for the year would amount to HK3.5 cents.

Liquidity and Financial Resources

As at 31 December 2004, the Group maintained a healthy cash level with cash and cash equivalents of HK$126,893,000 (2003: HK$146,680,000) and unutilized banking facilities of HK$69,577,000 (2003: HK$54,384,000). The Group's current ratio, being the proportion of total current assets against total current liabilities, maintained at a stable level of 1.63 in 2004 compared to 1.64 in 2003.

As a result of the remarkable profit generated from operation, total debt to equity ratio as at 31 December 2004 was 0.93 compared to 0.94 last year, which was calculated by dividing total liabilities of HK$495,050,000 (2003: HK$378,151,000) by the total shareholders' equity of HK$534,514,000 (2003: HK$402,910,000).

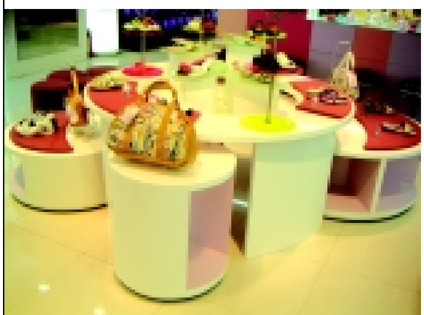
Reflecting continuous improvement in the quality of the Group's assets, the gearing ratio of the Group decreased from 27.4% to 18.4% as at 31 December 2004. Computation of the gearing ratio was based on the total borrowings of HK$98,527,000 (2003: HK$110,313,000) divided by shareholders' equity of HK$534,514,000 (2003: HK$402,910,000).

All of the bank borrowings as at 31 December 2004 were short-term in nature, repayable within one year and were denominated in New Taiwanese dollars, US dollars, Renminbi and Hong Kong dollars. Interest on these bank borrowings was charged based on fixed rates.

Treasury Policies

It is the Group's treasury management policy not to engage in any highly leveraged or speculative derivative products. In this respect, the Group continued to adopt a conservative approach to financial risk management working towards decreasing its gearing position. The Group's monetary assets, liabilities and transactions are primarily denominated in Hong Kong dollars, Renminbi, US dollars and New Taiwanese dollars. During the year, the Group entered into forward foreign exchange contracts to hedge its foreign currencies against fluctuations in exchange rates. As at 31 December 2004, the Group had commitments amounting to HK$475,332,000 (2003: HK$230,100,000) in respect of forward foreign exchange contracts entered into with banks in the PRC and Taiwan.

Management Discussion and Analysis



Contingent Liabilities

As at 31 December 2004, the Group had no significant contingent liabilities.

Significant Capital Investments

During the year, the Group invested approximately HK$21,892,000 in establishing logistics centres in Shanghai, Beijing, Shenyang, Fujian, Guangdong and Chengdu. The construction of the logistics centre in Shanghai was completed in 2004, while the remaining logistics centres are expected to be completed in 2005 and 2006 respectively. The Group also set up a manufacturing plant in Fujian and a processing plant in Jiangsu during the year at registered capitals of HK$23,400,000 and HK$2,820,000 respectively. In addition, during the year, the Group planned to renovate certain regional offices in the PRC at a total estimated expenditure of HK$47,800,000.

The Group expects all the above investments will be financed by internal resources and short-term bank borrowings.

Human Resources

As at 31 December 2004, the Group had over 19,000 employees in Hong Kong, Taiwan and the PRC. Staff expenditure during the year ended 31 December 2004 was HK$295,832,000 (2003: HK$241,559,000). The Group recognizes the importance of human resources for sustaining its strong growth and as a result, it ensures that employee remuneration is maintained at competitive levels complemented by performance-based bonuses, retirement pension contribution and share options.

During the year, the Group granted 80,000,000 share options to its employees.

PROSPECTS

OEM Business

As the economic outlook in the U.S. remains positive, the Group expects a steady growth in its OEM business in the coming year, with a high single digit or low double-digit sales growth rate as its goal. The U.S. market will remain as the Group's largest export market in the coming year, and the Group will strive to secure new customers and orders with higher profit margins as well as actively expanding other overseas markets such as Europe and Japan.

Brand Business

The Group will continue to expand the sales network of "Daphne" to effect further penetration of the market by the brand and commit more resources to brand promotion. One of the strategies is to consider making a film associated with the "Daphne" brand. The film will help to strengthen consumer recognition of the "Daphne" brand and boost its value. Besides, the Group opened its first "Daphne D18" specialty store in April 2005. It aims to increase the number of "Daphne D18" specialty stores to 20 by the end of 2005. To effectively expand into the young ladies footwear market, the Group appointed a young pop music band "S.H.E" as "Daphne D18" brand spokespersons.

The fact that 70% of the population in the PRC belongs to the low-income group reflects the ever-rising demand for diverse footwear products at reasonable prices. This translates into huge market opportunities for "Shoebox". During the two years' expansion period of this year and the next, the Group will embark on expanding the sales network of "Shoebox", opening more mega stores and extending the brand's market coverage to second and third tier cities. The aim of these moves is to expand the Group's customer base and achieve continuous business growth. In the absence of mega stores of similar nature in the market, "Shoebox" stands out as one of the few brands managed to provide a comfortable shopping environment, reasonably priced products and high quality services in the sector. The management has confidence in the future development of this business segment.

To seize the immense opportunities arising from the 2008 Beijing Olympics, the Group plans to accelerate the expansion of the "Adidas – Original Collection" specialty outlets to open not less than 50 stores every year, bringing the total number to 300 in 2008. With this mega sports event boosting the demand for athletic and casual footwear and apparel of prestigious brands, the Group looks forward to reaping considerable business returns.

Development of Infrastructure

The Group has no other significant capital investment plans apart from the construction of logistics centres. With China sustaining a promising economic outlook, the Group is planning to optimize its well-established sales and distribution network to aid the diversification of its brands and product ranges. It intends to grow its core businesses through introducing new brands and other consumer products.

Management Discussion and Analysis

In 2004, the Group started implementing an Enterprise Resources Planning system (the "ERP") to help it improve and speed up the financial and management reporting process. The more effective use of resources by the Group has resulted in enhanced profitability. As at 31 December 2004, the second phase of the project has been completed, allowing the Group to realise linkage of selling points in certain cities and integration of the Group's Warehouse Management System and Point-of-sale System. The Group will commence the third phase of the project expanding application of the ERP system to the sales network of other distribution points. The full implementation of the system is scheduled to be completed on or before the end of 2005.

The persistent outstanding performance of the Group is the result of the hard work and dedication of all our employees. Adhering to this empowering corporate culture, the management will strive to bring the Group's businesses to new heights and generate satisfactory returns to shareholders.