

CEO REPORT

Introduction

2004 had been a successful year for Luen Thai. The Group has continued to grow despite the uncertainties in the industry surrounding the quota elimination and many difficulties we had faced. With our state-of-the-art supply chain and manufacturing platform, the Group has been able to capitalise on business opportunities with our key customers. Operationally, the Group took on a number of initiatives to further increase operational efficiency and save costs.

The Company's initial public offering was a tremendous success. Thanks to the effort and diligence of our colleagues, the Company was successfully listed last July on the SEHK and raised US\$80.7 million for strategic expansion purpose of the Group. Luen Thai is already the largest apparel manufacturer listed on the SEHK and is a constituent stock on both Hang Seng Composite Industry Index and Hang Seng Hong Kong SmallCap Index.



Result Review

As part of the reorganisation prior to the initial public offering of the Company, the Group disposed of its entire interests in the Mexican operations, the system consultancy operations and the air cargo operations. The turnover for the year ended 31st December 2004 was US\$553.8 million, representing a slight increase of 1.6% over 2003. The corresponding net income for the year under review also increased from US\$23.6 million in 2003 to US\$30.4 million. This slight increase in the Group's turnover is mainly due to the inclusion of the discontinuing business operations. The aircargo business was disposed of in December 2003 and the Mexico business as well as the system consultancy business were disposed of in May 2004.

In order to understand and appreciate the Group's performance relative to the prior year, the following discussion and analysis will only focus on the Group's continuing business.

In 2004, the Group achieved a net income of US\$32.7 million representing an increase of 28.6% over 2003. Turnover increased from US\$511.7 million for the year ended 31st December 2003 to US\$550.2 million in 2004, representing an increase of 7.5%. The increase in turnover was not as significant due to a reduction in the sales activities of certain low margin business in 2004.

The Group's overall gross profit from the continuing business for 2004 was approximately US\$126.6 million as compared to US\$114.1 million in 2003. The overall gross profit margin in 2004 is 23% as compared to 22.3% in 2003. The Group's operating profit from continuing business for 2004 was approximately US\$40.7 million, representing an increase of 17.3% over 2003.

There was a substantial growth in the sleepwear business in 2004. The turnover of sleepwear business amounted to approximately US\$72.1 million representing a 85% growth over 2003.

In light with uncertainties surrounding the quota and trade regulations, the Group has taken prudent measures in balancing risks associated with quota and other trade restrictions by way of increasing percentage of business to Japan and Europe. In 2004, the Group increased business to Japan and Europe to US\$45 million and US\$47.3 million, representing an increase of 56.9% and 52% when compared to 2003, respectively.

In 2004, the freight forwarding & logistics services recorded a turnover amounted to US\$12 million, representing an increase of 18.2% over 2003. This is mainly due to the increase in new customers.

Operational Review

The Group accomplished a number of initiatives and the following are some of the highlights:

Co-location Strategy

Our Dongguan Supply Chain City represents the Group's long-term partnership strategy with our key customers with design support, product development, logistics and distribution, laboratory testing and production all housed in one site to continuously improve efficiencies and reduce lead time of our customers, suppliers and the Group. The Group signed up a few of our key customers on such co-location partnership in 2004.



Design Support

The Group developed a design and research centre in our Dongguan Supply Chain City that offers an array of design services. Our design team is equipped with capabilities to work on fabric research, washing techniques, or print designs. The design team also has the ability to provide basic fashion design based on fashion theme provided by the customers.



Logistics and Distribution

CTSI Logistics, the Group's logistics division, has been upgrading the operation and facilities in anticipation of closer partnership with our customers in the logistics area. In 2004, CTSI Logistics opened a new distribution centre in Los Angeles enhancing the Group's capability to provide better logistics services in the USA. The Group had been testing innovative logistics arrangements with key retailers and brands to save costs and to reduce lead time.

Relocation of Back Office Support to Low Cost Countries

The Group consolidated and moved certain back office operations from high cost countries to lower cost locations.

Acquisitions and Joint Ventures

It is the Group's strategy in expanding into other apparel product categories by way of selective acquisitions and joint ventures. With the experience in acquiring and managing GJM (the Group's sleepwear division), which the Group acquired in 2002 from Warnaco Inc., the Group entered into active wear segment through the joint venture with Yue Yuen and ladies' career wear through acquisition of Tomwell from Kasper Holdings Inc./Jones Apparel Group, Inc. in 2004. The Group's supply chain and manufacturing platform will support the expansion of Yuen Thai and Tomwell. Acquisitions and joint ventures will remain an important part of the Group's growth strategy.

Corporate Governance

The Group acknowledges the need and importance of corporate governance as one of the key elements in creating shareholders' value. The Group continuously improves its corporate governance policies in accordance with international best practices. As at the date of this report, the Company has formed the Audit Committee and the Remuneration Committee at the Board level.

Audit Committee: The Audit Committee was set up in June 2004 to provide advice and recommendations to the Board. All Committee members are independent non-executive Directors, who each possesses appropriate finance and/or industry expertise to advise the Board. The Audit Committee met two times in 2004 with 100% attendance rate.

Remuneration Committee: The Remuneration Committee was set up in April 2005 with the responsibility of recommending to the Board the remuneration policy of all Directors and the senior management. Majority of the Committee members are independent non-executive Directors.

Investor Relations and Communication

The Group acknowledges the importance of communication with our shareholders. The Group has proactive policy of promoting investor relations through meetings with analysts and participation of international roadshows, investors conferences, company interviews and manufacturing plant visits. All shareholders have no fewer than 21 days notice of the Annual General Meeting at which Directors shall be available to answer questions on the business.

The Group has established various forms of communication channels to improve the transparency of the Group including proactive and timely issuance of press releases so as to inform investors of our latest corporate development. The Group maintains a website (www.luenthai.com) in English and Chinese to disseminate information electronically on a timely basis to all concerned parties.

Financial Results and Liquidity

As at 31st December 2004, the total amount of cash and bank balances of the Group was approximately US\$111.1 million, representing an increase of approximately US\$80.1 million when compared to 31st December 2003. The total bank borrowings at 31st December 2004 was US\$97.4 million, representing a significant increase when compared to US\$33.6 million at 31st December 2003. This increase was mainly due to a new bank loan raised for repayment of certain existing debts before the listing.

As at 31st December 2004, the maturity profile of the Group's bank borrowings spread over two years with US\$43.4 million repayable within one year or on demand and US\$54 million in the second year.

The gearing ratio is defined as net debt (represented by bank borrowings net of cash and bank balances) divided by shareholders' funds. As at 31st December 2004, the Group is in a net cash position. Hence, no gearing ratio is presented.

Foreign Exchange Risk Management

The Group adopts a prudent policy to hedge the fluctuation of exchange rates. Most of the Group's operating activities are denominated in US dollars and Hong Kong dollars. For those activities denominated in other currencies, the Group may enter into forward contracts to hedge its receivable and payable denominated in foreign currencies against the exchange rate fluctuation. As at 31st December 2004, the Group had an outstanding foreign currency exchange commitment to sell GBP1.2 million for HK\$16.4 million.

Contingent Liabilities and Off-Balance Sheet Obligations

The Group is involved in various labour lawsuits and claims arising from the normal course of business. The Directors believe that the Group has substantial legal and factual bases for their position and are of the opinion that losses arising from these lawsuits, if any, will not have a material adverse impact on the results of the operations or the financial position of the Group. Accordingly, no provision for such liabilities has been made in the accounts. In addition, an estimate of its financial effect is not disclosed as it is not practicable to do so.

Human Resources and Social Responsibilities

Luen Thai has a current manpower of approximately 18,000 located in various locations world-wide.

The operation is managed by a professional and multicultural management team whose specialties have been honed in the industry. This executive and management team is aligned to the Group's strategic objectives, business model and corporate values.

As part of our commitment to being a learning organisation, Luen Thai set up technical training schools to support its expansion in our facilities. The schools train new hires in basic sewing machine operations and also existing operators in learning new methods for diversified



product ranges. Conduct of supervisory and management training for supervisors and managers enables enhanced learning in the areas of leadership and management skills.

In 2004, CTSI Logistics, the Group's logistics arm received the Employer of the Year Award from the Society of Human Resources Management Chapter of the Northern Marianas Islands.

The Group offers its staff competitive remuneration schemes. In addition, share options are granted to eligible employees as incentive for their contribution to the Group.

Luen Thai is committed to employee care and adherence to international compliance standards. Our employee care programme satisfies our customers' and stakeholders' social compliance requirements.

Use of Proceeds

The Group raised approximately US\$80.7 million (HK\$625.4 million), net of direct listing expenses from the issue of 227.3 million new ordinary shares in the Company in relation to the share offer on 15th July 2004, including the additional 2.3 million shares issued from the partial exercise of the Over-allotment Option on 4th August 2004. Details of the exercise of the over-allotment option are more particularly described in the Company's announcement dated 4th August 2004.

The net proceeds mentioned above are being applied in accordance with the proposed applications set out in the prospectus. As at 31st December 2004, the following applications were actually made:

- (1) approximately US\$13.3 million (HK\$103.1 million) for new factories in the PRC consisting of:
 - approximately US\$8.2 million (HK\$63.6 million) for the construction of the factories;
 - approximately US\$4.6 million (HK\$35.6 million) for the acquisition of production facilities and machinery; and
 - approximately US\$0.5 million (HK\$3.9 million) to set up a design and development centre;
- (2) approximately US\$3 million (HK\$23.2 million) for upgrading and maintenance of the Group's existing production facilities;
- (3) approximately US\$16.4 million (HK\$127.1 million) for the repayment of existing bank loans.

As at 31st December 2004, approximately US\$48 million (HK\$372 million) of the funds raised were also placed on time deposits with licensed banks in Hong Kong. The Group will continue to apply these funds for their intended use.

In the event that any part of the business plans of the Group does not materialise or proceed as planned, the Directors will carefully evaluate the situation and may re-allocate the intended funding to other business plans and/or to new projects of the Group and/or hold such funds as time deposits for so long as the Directors consider it to be in the best interests of the Group and its shareholders taken as a whole. Should the Directors re-allocate the intended funding to other business plans and/or to new projects of the Group, the Company will make an announcement in due course.

Prospects

Looking forward to 2005, it is anticipated that the global quota and trade-related regulations will continue to pose some short-term uncertainties to the apparel industry. The Group is targeting to grow our market share with selected key customers through closer partnership based on multi-product and co-location strategies. Operation of diversified manufacturing base in different countries will be important in servicing our customers given the current political situation. The Group will continue its cost control measures by way of cost-cutting and increase of operational efficiency. The Group is currently in different stages of negotiation on acquisitions and joint ventures opportunities in different product categories.