

## MANAGEMENT DISCUSSION AND ANALYSIS

### BUSINESS REVIEW

For the six months ended 30th June 2005, the total turnover of the Group was HK\$1,168 million (2004: HK\$1,059 million), representing an increase of about 10%. As the Group concentrated more on its core customers, as well as, rationalisation of production facilities in Mainland China, the Philippines and Macau, turnover for garment manufacturing was maintained at the same level as compared with the corresponding period in 2004. As for garment trading, turnover increased by 59% whereas turnover for branded product distribution was maintained at the same level when comparing with the six-month period last year.

Geographically, the United States of America continued to be the major export market for the Group contributing 81% (2004: 73%) of the total turnover while export sales to Asia and Europe accounted for 13% (2004: 14%) and 6% (2004: 13%) of the total turnover respectively.

Gross profit of the Group rose 42% to HK\$249 million in 2005 (2004: HK\$175 million) mainly due to improvement in production efficiency and effective controls over materials costs and manufacturing costs.

A special management initiative launched in 2004 has aggressively driven down selling, general and administrative expenses including sample and logistics costs. Furthermore, quota cost was totally eliminated following the phase-out of the quota system for the exports of garments to the United States of America in 2005. Accordingly, the total selling, general and administrative expenses decreased by HK\$27 million as compared with the same period last year.

The Group's share of profits of associated companies for the period amounted to HK\$9 million (2004: HK\$4 million). The improvement in financial performance of the associated companies in Thailand and Vietnam was achieved as a result of management initiatives to control costs and to improve the manufacturing production processes that commenced in 2003.

As a result of the positive developments highlighted above, profit attributable to equity holders of the Company for the six months ended 30th June 2005 amounted to HK\$60 million, reflecting a significant turnaround from a loss of HK\$32 million for the six months ended 30th June 2004.

During the period, there were no material acquisitions or disposals of subsidiaries or associated companies.

On 26th January 2005, Hwa Fuh Manufacturing Company (Hong Kong) Limited, a wholly-owned subsidiary of the Company, as tenant and TDB Company Limited ("TDB") as landlord entered into a tenancy agreement in respect of Ground and 2nd to 11th Floors, Tak Dah Industrial Building, 66-72 Lei Muk Road, Kwai Chung, New Territories, Hong Kong for a term of two years commencing on 1st April 2005 to 31st March 2007 at monthly rental of HK\$371,435 (excluding management fee, government rates and government rent) (the "Tenancy Agreement"). As the entire issued share capital of TDB is held by a discretionary trust of which Mr. WANG Kin Chung, Peter ("Mr. Peter WANG") and Ms. WANG KOO Yik Chun ("Madam Koo") (both being Directors) are eligible beneficiaries, the Tenancy Agreement constitutes a continuing connected transaction for the Company under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") and is subject to reporting and announcement requirements. Further details of the Tenancy Agreement are set out in the announcement of the Company dated 28th January 2005.

### FINANCIAL RESOURCES AND LIQUIDITY

During the period, the Group continued to maintain a healthy liquidity position. As at 30th June 2005, cash and cash equivalents amounted to HK\$110 million (2004: HK\$160 million). The short-term bank borrowings and overdrafts of the Group reduced from HK\$253 million as at 30th June 2004 to HK\$94 million as at 30th June 2005. The Group maintained more than sufficient banking facilities and did not have any long term bank borrowings outstanding as at 30th June 2005. Facilities extended to subsidiaries were guaranteed by the Company and other than discounted bills with recourse there were no charges on the Group's assets. As the Group did not have net bank borrowings as at 30th June 2005, no information on gearing ratio as at 30th June 2005 is stated or relevant (2004: 17%).

Most of the Group's receipts and payments were denominated in Hong Kong dollars or in United States dollars. Therefore, the risk exposure to foreign exchange rate fluctuations was not significant. Nevertheless, forward foreign exchange contracts to hedge foreign currency denominated operating expenses for certain overseas manufacturing facilities and proceeds from accounts receivable were entered into from time to time.

## **CONTINGENT LIABILITIES AND CAPITAL COMMITMENTS**

There were no material capital commitments or contingent liabilities at 30th June 2005 which would require a substantial use of the Group's present cash resources or external funding. (Please refer to Note 18 to the condensed financial statements for information concerning certain events subsequent to the accounts date.)

## **HUMAN RESOURCES**

The Group has about 15,000 (2004: 15,700) employees. Fair remuneration packages and benefits are offered to competent staff. Discretionary bonuses are granted to eligible employees with outstanding performance. In addition, a share option scheme has been established since 1997 for the granting of options to full-time employees of the Group for subscribing for shares in the Company.

## **SUBSEQUENT EVENTS**

### **Sale and Purchase Agreement**

On 17th August 2005, the Company announced that Prime-Time Company Limited ("Prime-Time"), a wholly-owned subsidiary of the Company, entered into a conditional sale and purchase agreement (the "Sale and Purchase Agreement") with Ms. Daisy TING pursuant to which Prime-Time had agreed to acquire 1,085,800 shares of Hua Thai Manufacturing Public Company Limited ("Hua Thai") from Ms. Daisy TING (the "Acquisition"), representing approximately 10.86% of the entire issued share capital of Hua Thai. Hua Thai is listed on The Stock Exchange of Thailand and is currently held as to approximately 36.43% of its total issued shares by Prime-Time. The purchase price for the Acquisition is Baht 108,580,000 (approximately HK\$20,758,000), representing Baht 100 (approximately HK\$19.12) per share of Hua Thai.

### **Option Agreement**

On 25th August 2005, the Company announced that Prime-Time had entered into an option agreement (the "Option Agreement") with Madam Koo pursuant to which Prime-Time was granted an option (the "Option"), exercisable by Prime-Time at any time and at its sole discretion, to acquire 362,020 shares of Hua Thai and 451,880 non-voting depository receipts of Hua Thai ("NVDRs") from Madam Koo at Baht 100 (approximately HK\$19.12) per share of Hua Thai and per NVDR (less HK\$1.00), representing approximately 3.62% and 4.52% of the entire issued share capital of Hua Thai, respectively. The consideration payable by Prime-Time for the grant of the Option under the Option Agreement is HK\$1.00. The total exercise price payable by Prime-Time to Madam Koo upon exercise of the Option is Baht 81,390,000 (approximately HK\$15,560,000) less HK\$1.00.

### **The Tender Offer and the further acquisition(s) pursuant to the Tender Offer**

Upon completion of the Acquisition and the exercise of the Option, Prime-Time will hold shares of Hua Thai carrying approximately 50.91% of the total voting rights attached to the issued shares of Hua Thai and NVDRs representing approximately 4.52% of Hua Thai's total issued shares, thereby making Hua Thai a subsidiary of the Company. In such circumstance, Prime-Time will be obliged under the Securities and Exchange Act of Thailand to make a tender offer to acquire all the issued shares of Hua Thai (other than those already owned or agreed to be acquired by Prime-Time) (the "Tender Offer") at a tender offer price not less than the highest price per share of Hua Thai paid by Prime-Time within the 90-day period prior to the Tender Offer.

## Listing Rules Implications

Since Madam Koo is the mother, and Ms. Daisy TING is the spouse, of Mr. Peter WANG, they are connected persons of the Company and therefore the Acquisition and the exercise of the Option constitute connected transactions for the Company. The exercise of the Option, when aggregated with the Acquisition, will result in Hua Thai becoming a subsidiary of the Company and constitute a major transaction for the Company. The potential acceptance of the Tender Offer by any person will constitute connected transactions of the Company under the Listing Rules. Accordingly, the further acquisition(s) pursuant to the Tender Offer will, together with the Acquisition and the exercise of the Option, constitute a major transaction and connected transaction for the Company, and approval will be sought from the independent shareholders of the Company to approve the Acquisition, the exercise of the Option, the making of the Tender Offer and the further acquisition(s) pursuant to the Tender Offer at the special general meeting to be held on 6th October 2005 ("SGM"). Subject to obtaining of such approval and the Sale and Purchase Agreement becoming unconditional, the exercise of the Option is expected to be completed simultaneously with the completion of the Sale and Purchase Agreement. Further details of the Acquisition (including the conditions on which the Sale and Purchase Agreement is subject), the exercise of the Option, the Tender Offer and the further acquisition(s) pursuant to the Tender Offer together with the notice of SGM are set out in the circular of the Company dated 8th September 2005.

## FUTURE DEVELOPMENT

The elimination of the apparel quota system in January 2005 provides promising opportunities to the Group. However, the uncertainty of the business environment after the elimination of the quota system may also speed up price compression at a rate faster than anticipated, which in turn may reduce the profit margin of the Group's products. The uncertain business environment caused by the trade disputes on textile products between the People's Republic of China and the United States of America may continue. We will in any event strive to maintain our position as a leading manufacturer of a wide range of garments including ladies' suits and tailored related separates for women and casual and lifestyle clothes for men. The Group has consolidated its production capabilities and diversified its production locations to other countries with a low cost operating environment while maintaining consistently high quality. The Group's current order book is consistent with the corresponding period last year.

As mentioned above and in Note 18 to the condensed financial statements, the board of Directors of the Company (the "Board") strategically decided to acquire additional interests in Hua Thai. Hua Thai is principally engaged in the manufacture and sale of ladies' suits, outerwear and sportswear. It has production facilities in Thailand and Vietnam. The customers of Hua Thai include a number of major apparel groups in the United States of America and Europe, which are also the Group's customers. The Board believes that the acquisition of additional interests in Hua Thai would generate greater synergy to the Group in terms of work efficiency since the Group and Hua Thai Group have been working closely in past years and the management and staff of Hua Thai have become familiar with the production process, system and corporate culture of the Group. All of these factors are considered important for the Group to continue to maintain the quality of its products and to manage its costs in an effective manner. In the event that Hua Thai becomes a subsidiary of the Company, the Board believes that the Group will be able to further improve the coordination of resources and production engineering processes of Hua Thai with those of the Group. This in turn will enable the Group to maintain a close business relationship with those major customers who are seeking to diversify their procurement geographically, by allocating a portion of such orders to Hua Thai's plants in Thailand and Vietnam.

Going forward, the Group is committed to focusing on its core customers. Product offerings will focus on core competencies and value added services will continue to be tailored to individual customer's needs. The Group will also continue to improve its production efficiency and exercise effective controls over direct and indirect costs.

## INTERIM DIVIDEND

The Directors have resolved to declare an interim dividend of HK\$0.09 per share for the six months ended 30th June 2005 (2004: Nil), amounting to a total of approximately HK\$24,186,000 (2004: Nil). The interim dividend will be payable on Wednesday, 26th October 2005 to shareholders whose names appear on the Register of Members of the Company on Friday, 21st October 2005.