Management Discussion and Analysis

OPERATIONAL AND FINANCIAL REVIEW

The Group is principally engaged in the manufacture and sale of finished woven fabrics targeting at mid to high-end market in the PRC. The Group has vertically integrated its production process, which include research and development, raw fabric weaving, dyeing and setting, cloth finishing such as pattern pressing and calendaring. The Group's products are used for manufacturing men's and women's fashions such as outer garments, eider down wear, trousers, windbreakers, jackets and sports wears; and household products such as sofa and curtain.

Turnover

For the financial year ended 30 June 2005, the Group recorded a turnover of approximately HK$605,815,000 (2004: HK$420,692,000), representing an increase of approximately 44.0% in comparison to the previous financial year. The increase in turnover was attributable to (i) the market demand of down, men and ladies' wear increased with the number of customers; (ii) the Group's participation in textile fairs in France, Hong Kong and Shanghai; (iii) the well-established distribution network around the major textile markets in the PRC; (iv) the smooth implementation of second dyeing production line which increased the production capacity of the Group; and (v) increase in number of prestigious overseas customers.

Gross Profit

The gross profit margin of the Group slightly increased from about 28.8% in the previous year to about 29.1% in the current year. The slight increase in gross profit margin was due to the smooth implementation of the second dyeing production line; hence the cost of sales was lowered due to the economies of scale of production.

Net Profit

The Group's net profit attributable to shareholders for the financial year ended 30 June 2005 was approximately HK$94,795,000 (2004: HK$75,354,000), approximately 25.8% more than that in 2004. Net profit margin for the year ended 30 June 2005 was approximately 15.6% (2004: 17.9%). The decrease in net profit margin compared with previous year was due to the increase in the effective tax rate as a result of the expiration of tax holidays of a major subsidiary of the Group in the PRC.

Expenses

Selling and distribution expenses amounted to approximately HK$19,210,000 (2004: HK$14,136,000), representing approximately 3.2% (2004: 3.4%) of turnover for the year ended 30 June 2005. The slight decrease in percentage of turnover was due to the diminishment of the commission rates paid to the major distributors in the current year.

Administrative expenses amounted to approximately HK$16,551,000 (2004: HK$10,071,000), representing approximately 2.7% (2004: 2.4%) of turnover for the year ended 30 June 2005. Administrative expenses increased by approximately 64.3% when compared with that of 2004. It was mainly due to the hiring of additional management professional and related expenses and the establishment of sales liaison offices in Shanghai, Shishi and Guangzhou and the operation of administration office in Hong Kong for the whole year.

Other operating expenses amounted to approximately HK$1,292,000 (2004: HK$1,389,000), representing approximately 0.2% (2003: 0.3%) of turnover for the year ended 30 June 2005, were maintained at the same level with that of 2004.

Finance costs of approximately HK$2,952,000 (2004: HK$1,773,000). Increase in amount was due to the interest payment of the convertible notes (the "CB One") and the amortisation of the costs incurred in connection with its issue on straight line basis over its term.

Dividend

An interim dividend of HK1.0 cent per ordinary share was paid to shareholders during the year. The Board recommends the payment of a final dividend of HK1.5 cents per ordinary share in respect of the year, to shareholders whose names appear on the register of members on 18 November 2005 if approved at the forthcoming annual general meeting. This recommendation has been incorporated in the financial statements as an allocation of retained profits within the capital and reserves section of the balance sheet.

FUTURE PLANS AND PROSPECTS

As a result of the constant improvement of quality of life in the PRC, the demand for fashionable clothes and quality fabrics increases. In order to diversify the customer base of the Group and tap the market potential, the Group plans to strengthen its distribution network to the other textile markets in the PRC and overseas textile markets. The Group continues its expansion of its distribution network by, on one hand, establishing sales outlets or appointing distribution agents in the new distribution locations and, on the other hand, concreting its existing sales and marketing team in order to further promote the Group's products.

To cope with the expected growth in demand of the Group's products and the establishment of the second dyeing production line in May 2004, the Group had commenced its weaving capacity expansion in the current year. The new plant and machinery had been installed and completed test run in May 2005 and begun the production in June 2005. The aggregated weaving production capacity is expected to increase from 7.9 million meters to 12.9 million meters per annum; from which, 20% of fabrics for dyeing process can be self supplied. To certain extent, the new weaving factory ensures steadier supply and better quality control of raw fabrics for the dyeing process, which in turn, will reduce production costs and shorten the production cycle.

As a result of the continuous change in the trend of the textile and garment markets, the Group keeps continuing to put effort in research and development of new products and improvement of existing products in order to meet the dynamic market needs.

LIQUIDITY AND FINANCIAL RESOURCES

As at 30 June 2005, the Group had net current assets and total assets less current liabilities of approximately HK$282,310,000 (2004: HK$152,736,000) and HK$453,876,000 (2004: HK$305,145,000), respectively. The Group maintains a strong financial position by financing its operations with the CB One and internally generated resources. As at 30 June 2005, the Group had cash and bank deposits of approximately HK$285,613,000 (2004: HK$156,066,000). The current ratio of the Group was approximately 398.5% (2004: 303.2%).

Shareholders' fund of the Group as at 30 June 2005 was approximately HK$378,099,000 (2004: HK$305,145,000). As at 30 June 2005, the total bank borrowings of the Group, repayable within 12 months from the balance sheet date, were denominated in RMB24,910,000, based on an exchange rate of HK$1.00 = RMB1.06, equivalent to HK$23,500,000 (2004: HK$32,642,000) and the CB One, due on 6 December 2007, was denominated in US$10,000,000, equivalent to HK$78,000,000, based on an exchange rate of US$1.00 = HK$7.80 (2004: Nil), together giving a gross debt gearing (i.e. total borrowings/net assets) of approximately 26.8% (2004: 10.7%).

The financial health of the Group has been strong throughout the year as indicated by the above figures.

FINANCING

As at 30 June 2005, the total banking and loan facilities of the Group amounted to about HK$34,528,000 (2004: HK$32,642,000), of which, HK$32,839,000 (2004: HK$32,642,000) was utilized. The CB One, denominated in US$10,000,000 equivalent to HK$78,000,000, based on an exchange rate of US$1.00 = HK$7.80, was also fully received by the Group.

The Board believes that the existing financial resources will be sufficient to meet future expansion plans and, if necessary, the Group will be able to obtain additional financing with favourable term.

USE OF PROCEEDS FROM THE COMPANY'S INITIAL PUBLIC OFFERING

The net proceeds from the Company's issue of new shares at the time of its listing on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") in September 2003, after deduction of related expenses, amounted to approximately HK$77,100,000. These proceeds were substantially applied up to 30 June 2005 in the following manner and in accordance with the proposed applications set out in the Company's prospectus dated 28 August 2003 (the "Prospectus"):

– as to approximately HK$56,000,000 for construction of additional production line for fabric dyeing and its ancillary facilities;

– as to approximately HK$5,000,000 for expansion of distribution network and promotion of the Group's products and trademark;

– as to approximately HK$5,000,000 for product development (including the establishment of a new research and development centre and acquisition of research and development facilities); and

– as to approximately HK$9,100,000 for general working capital of the Group.

The remaining net proceeds as at 30 June 2005 were placed with banks in the PRC as deposits. The Board is of the opinion that the remaining proceeds will be applied in the future for their intended uses as set out in the Prospectus.

CAPITAL STRUCTURE

For the year ended 30 June 2005, the share capital of the Company comprises ordinary shares. The Group had the CB One as at 30 June 2005 and up to the date of this annual report.

FOREIGN EXCHANGE RISK AND INTEREST RATE RISK

For the year ended 30 June 2005, the Group was not subject to any significant exposure to foreign exchange rates risk as the majority of the transactions of the Group were denominated in Renminbi. Hence, no financial instrument for hedging was employed.

All bank borrowings and the CB One of the Group were denominated in Renminbi and US dollar, respectively, and at fixed rate basis. The Board is of the opinion that the Group is not subject to any significant interest rate risk.

CHARGE ON GROUP'S ASSETS

As at 30 June 2005, certain leasehold land and buildings, and plant and machinery of the Group with aggregate net book values of approximately HK$73,571,000 (2004: HK$55,859,000) and approximately HK$26,572,000 (2004: HK$37,635,000), respectively, were pledged to banks to secure bank facilities granted to the Group.

CAPITAL EXPENDITURE

During the year, the Group invested approximately HK$37,601,000 (2004: HK$61,056,000) in fixed assets, of which 17.9% (2004: 42.5%) was used for purchase of plant and machinery, 81.6% (2004: 55.5%) for construction of new dormintories and the remaining was used for purchase of other fixed assets.

As at 30 June 2005, the Group had capital commitments of approximately HK$20,897,000 (2004: HK$472,000) in respect of fixed assets, which are to be funded by internal resources.

STAFF POLICY

The Group had 513 employees in the PRC and 4 employees in Hong Kong as at 30 June 2005. The Group offers a comprehensive and competitive remuneration, retirement scheme and benefit package to its employees. Discretionary bonus is offered to the Group's staff depending on their performance. The Group is required to make contribution to a social insurance scheme in the PRC. Also, the Group and its employees in the PRC are each required to make contribution to fund the endowment insurance and unemployment insurance at the rates specified in the relevant PRC laws and regulations. The Group has adopted a provident fund scheme, as required under the Mandatory Provident Fund Schemes Ordinance, for its employees in Hong Kong.

The Group also provides periodic internal training to its staff.

Each of the independent non-executive directors is appointed for a term of 1 year commencing from 1 September each year.

CONTINGENT LIABILITIES

At the balance sheet date, the Group and the Company did not have any significant contingent liabilities.