

Chairman's Statement

On behalf of the Board of Directors (the "Board") of Good Fellow Group Limited (the "Company"), I am pleased to present the annual report of the Company for the financial year ended 30 June 2005.

RESULTS AND DIVIDENDS

For the financial year ended 30 June 2005, the Group recorded net loss attributable to shareholders of HK\$150.2 million, equivalent to loss per share of HK\$5.61 cents. The directors do not recommend the payment of a dividend in respect of the current year.

BUSINESS REVIEW

Looking back over the past year, the Group's operation has experienced severe trial and challenges. The garment business remained the Group's key revenue generator while the competition in the retail garment industry in the People's Republic of China (the "PRC") remained fierce. Meanwhile, the retirement of Mr. Ng Leung Tung, the Company's former deputy chairman and executive director, from direct participation in garment operation and management for reason of personal health concern; and the unfavourable emerging factors of group customer orders in the PRC adopting the form of open bid tender which negatively affected profit margin, all had implications on the Group's operation. The Group has reorganised its garment operational structure in early 2005 to accentuate the brandname effect of "Good Fellow", and to widen a nationwide retail network in order to seize up the retail garment market. In March 2005, the Group appointed Mr. Tony Leung Ka-Fei, a famous Hong Kong artiste, as the image ambassador of the Group's "Good Fellow" branding, with the signing ceremony held in the Great Hall of the People; and participated in the 13th CHIC EXPO, in order to promote brand name recognition and customer-soliciting channels. The event has attracted comprehensive news coverage by CCTV and other news media and has achieved desirable results.

During the year, the Group has realigned its business methodologies by promulgating a more extensive sales network in the PRC on a franchised agency basis. At this stage, such efforts involve the deployment of additional resources and more patience. The Board is however confident that the efforts of the management team will eventually turn-around the Group's operation. In addition, the Group has already appointed alternative official of sufficient caliber to attend to the previously applicable duties of Mr. Ng Leung Tung. To facilitate smooth transition, retention was made of the advisory expertise of Mr. Ng by his re-designation as non-executive director of the Company, with a view to taking advantage of his extensive experience in the garment industry and provide professional advice to the Group. The Group is also pleased to be advised that Mr. Ng is in recovery.

THE GARMENT BUSINESS

The Group carries through with its pursuit of excellence in quality in its production of high-end garment products, and over the years have won the support and endorsement from its customers. Owing to the increasing change-over in the purchasing mode of group customer orders in the PRC, which involves the shift from price negotiation to open bid tender which aggravate price-cutting amongst competing bidders; eventually mitigating the final selling prices of the orders; the Group's gross profit margin and customer orders volume were consequently crippled. In order to maintain the Group's market share, the Group has rectified its operational management in early 2005, strengthened marketing team and intensified promotion effort, with an aim to foster a nationwide sales retail network and broaden the sales channels. During the year, through a series of promotional and business soliciting activities, the Group has succeed in setting up a number of sales outlets of "Good Fellow" branding in major sales areas and cities across the country in franchised provincial and municipal levels, including

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Beijing, Hebei, Inner Mongolia, Shandong, Shanxi, Jiangsu, Fujian, Guangdong, Henan, Yunnan, Guizhou, Anhui, Xinjiang and etc. The franchised agency operational mode involves mainly the deployment of experienced and resourceful participating agents as intermediaries to establish sales management and logistics centres in respective franchised areas, and to regulate and administer sales outlets in respective selling points, with an aim to attaining effective resource distribution and sharing of benefits while diversifying the Group's operational exposures.

To increase market competitiveness of the Group's branding, the Group's operational management team strived for systematic management in various business areas such as strategic business promotion, brand image management, product development and design, merchandising procurement, logistics management and customer services. As new fashionable style products lines are being launched, the Group has made effort in refining value-added design of garment products, including the incorporation of 'Nano-technology application' function as a spotlight of garment product sales. The Group's initiatives in bolstering its sales and marketing include the appointment of famous artiste as ambassador for the Group's brand image and the roll-out of series of television commercials and exhibitions to enhance its brand awareness and market share in the PRC. While the Group's efforts rendered in these directions shall necessitate a higher level of expenditure outlay over the foreseeable future, they are rendered with anticipation that benefits will be reaped over the longer run through the achievement of a larger scale and more robust sales foundation.

The Group has enjoyed over the years wide recognition in its product quality and forged close cooperation relationships with many government authorities and organizations in the PRC. The Group is the designated garment manufacturer of the Supreme Court of the PRC, the Supreme People's Procuratorate, the Inspection and Quarantine of Goods Bureau of the PRC, the Ministry of Public Security Bureau of the PRC and certain banking institutions. The Group's experience and goodwill gained from years of cooperation with PRC government departments shall continue to serve its competitive edge among the industry. After the adjustment of management and sales strategies in the previous periods, the Group look forward to a re-bounce in this year, and to maintain its leading position in the industry.

INVESTMENT IN NANO-TECHNOLOGY BUSINESS

The Group's investment in Nano-technology was made through a strategic alliance with the top-notch Chinese Academy of Science in establishing Zhongke Nanotech Engineering Center Co., Ltd. ("Zhongke Nanotech"). Since then, the international recognition of Nano-technology as the core foundation supporting other major developments in the 21st century has continued to grow. New applications with the use of Nano-technology are being continually invented in the international arena. Notwithstanding its brief period since establishment, Zhongke Nanotech has fast established itself as leading developer of Nano-technology in the PRC. The technological foundation of Zhongke Nanotech has already reached its maturity and the viability of various Nano-technology applications developed by Zhongke Nanotech has been demonstrated by actual commercial utilization. Zhongke Nanotech was honored to have received the contract to supply the self-cleansing nano glass for the outer cylindrical glass wall of the prestigious PRC State Emporium in Beijing. In addition, various collaboration contracts in the development of Nano-technology applications have also been signed with leading PRC manufacturers across different industries, including textile, medical goods and biotechnology products.

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Against a background of profitable operation in the preceding year, Zhongke Nanotech underwent a operational consolidation during the year while the construction of factory and industrialisation plant facilities in Zhongke is still in the continual progress stage and variations in profitability is foreseeable. A loss sharing from Zhongke Nanotech was posted to the Group for the current year as certain proposed business contracts are still in negotiation and have not proceeded to the stage where revenue can be recognized. The Board is of the view that seizing a share in this fast growing horizon will be proven a strategic foresight over the long run. The Beijing headquarter of Zhongke Nanotech currently contained a research team of over 40 scientific researchers and various senior researchers of doctoral and master's degrees. It is anticipated that the second phase of Zhongke's Yougfeng plant in Beijing, measuring 22,000 sq. meter will be handed over in August 2006 for serving as scientific research and testing centre. More than 30 patents of the nano-technology research projects had already been filed. Presently, the first phase of construction of Zhongke Nanotech's industrialization plant in Suzhou province has already drawn its completion, with large-scaled production of Nano high elastic material already commenced. As an important construction material, the technical performance of Nano high elastic material produced by Zhongke Nanotech has exceeded international standard in terms of important measures of elasticity, durability and anti-inflammability, etc., and has versatile applications throughout various sectors. The second industrial product to be launched by the Suzhou plant will be the Nano metallic paint; Nano interior and exterior paint; and Nano paste that will have very wide applications as surface coating in various industries by virtue of its superior anti-oxidation and self-cleansing properties.

With the very strong technical foundation from association with the top-notch Chinese Academy of Science as well as self-owned patents, the Group looks forward to satisfactory growth in financial performance of Zhongke Nanotech in the future.

PROPOSED INVESTMENT IN FORESTRY BUSINESS

On 26 October 2005, the Company entered into a conditional sale and purchase agreement pursuant to which the Company may acquire the entire shareholding interest in an investment company, the sole asset of which consist of a 70 per cent equity interest in a sino-foreign joint venture company principally engaged in the business of tree planting and management, manufacture and distribution of forest products such as timber and wood pulp. The Sino-Foreign JV has obtained a registered patent underlying accelerated plant growth and operates by making use of the modified tree species *Broussonetia Papyriferalvent* in its plantation process that can be applied to ecological and forestry purposes. The favorable chemical characteristic of the modified tree species may serve to improve soil quality and fertile. Since the plantation can be carried out on infertile land, the area of cultivatable agricultural land will be greatly enhanced. The accelerated growth period of *Broussonetia Papyriferalvent* appears to offer a solution to the high domestic demand in wood pulp from the paper making industry in the People's Republic of China.

In accordance with the conditional sale and purchase agreement, a guarantee undertaking has been given to the Company of aggregate profits on part of the Sino-Foreign JV of no less than HK\$200 million for the ensuring two years, for which the Company will be able to enjoy a 70 per cent share. The Board believes that this proposed new investment has huge growth potential that in turn will maximize shareholders' value. The proposed investment is subject to; among other things, the approval of the Company's shareholders in general meetings and information on this new proposed investment will be distributed to the Company's shareholders in due course.

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OUTLOOK

Looking forward, there are challenges and opportunities ahead. The Board anticipates the competition in the PRC's apparel market will continue to be severe. The Group will review its marketing strategy periodically and adjust to the market environment as warranted. As mentioned before, the Group has escalated its marketing and promotional activities in appointing a new internationally renowned celebrity as spokesman for the Group's products in the larger area in the PRC. The Group's active expansion into of its reach in the PRC market through the establishment of more outlets in various provinces has already proceeded to important cities such as Beijing, Shandong and Shanxi, providing a strong backbone to gear up for future growth momentum.

To complement the highly competitive apparel market, the Board considers diversification of business into new arenas will be in the best interests of the shareholders. The Group will continue to take initiative in identifying other business opportunities in new emerging industries that will broaden its revenue sources. During the year, the Company completed a top-up placing and subscription of new shares and raised new issue proceeds of approximately HK\$95 million. With availability of adequate cash resources, the Group is well poised to seize new business opportunities that the Board will assess as promising. Meanwhile, the garment business will continue to provide the Group with a reliable revenue base. The Group will continue to devote sales and marketing efforts to substantiate its market share in the PRC amid fierce competition from local and foreign apparel brands.

The Board sees the Group as heading on the right track. Leveraged on the Group's competitive strength and seasoned experience in its chosen fields, the Board believes that with dedicated endurance the Group will succeed in turning around its operation and attain greater achievements in the future.

APPRECIATION

On behalf of the board, I would like to express our gratitude to the shareholders, customers, suppliers and professional advisors for their support over the past year, and to sincerely thank our management and staff for their dedication and diligence.

Ng Leung Ho

Chairman

Hong Kong, 28 October 2005