

MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS REVIEW

For the year ended 31 December 2005, the total sales turnover of Tristate Holdings Limited (the “Company”) and its subsidiaries (the “Group”) was approximately HK\$2,684 million (2004: HK\$2,530 million), representing an increase of about 6% as compared with 2004.

Despite price compression, turnover for garment manufacturing segment increased by 3% as compared with 2004. The steady turnover reflected the Group’s strategy of concentrating more on its core customers, as well as rationalisation of production facilities in Mainland China, Thailand, Vietnam and the Philippines. In October 2005, Hua Thai Manufacturing Public Company Limited (“Hua Thai”) became a subsidiary of the Company and since then, Hua Thai and its subsidiaries (collectively the “Hua Thai Group”) contributed both to the net profit and sales turnover in respect of garment manufacturing segment of the Group.

As for garment trading segment, the increase in turnover by 17% was mainly attributable to increase in trading of garments purchased from Hua Thai Group prior to Hua Thai became a subsidiary of the Company.

Turnover for branded product distribution segment increased by 2% when comparing with 2004. The Group secured the Mainland China distribution rights of the Italian sportswear brand, Fila, during 2005. Distribution of Fila products by the Group in Mainland China commenced in late 2005.

Geographically, the United States of America continued to be the major export market for the Group contributing 80% (2004: 71%) of the total turnover while export sales to Asia and Europe accounted for 12% (2004: 12%) and 8% (2004: 17%) of the total turnover respectively.

Gross profit of the Group rose 19% to approximately HK\$589 million in 2005 (2004: HK\$493 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 driven down selling, general and administrative expenses including sample and logistics costs. Furthermore, quota cost was eliminated following the phase-out of the quota system for the exports of garments to the United States of America in 2005. The above cost savings were partially offset by consolidating Hua Thai Group’s selling, general and administrative expenses after it became a subsidiary of the Company.

During the year 2005, the Group entered into a conditional sale and purchase agreement and an option agreement respectively to acquire an additional 19% equity interest in Hua Thai. The sale and purchase agreement and the option agreement were both completed on 28 October 2005 and the Group’s interest in Hua Thai thereby increased from 36.43% to 55.43%, turning Hua Thai from being an associated company of the Company to becoming a subsidiary of the Company. The Group was obliged under the Securities and Exchange Act of Thailand to make a tender offer to acquire all the remaining issued shares of Hua Thai. As at the close of the tender offer on 15 December 2005, shareholders representing approximately 41.53% equity interest in Hua Thai accepted the tender offer. Upon closing of the tender offer, the Group’s interest in Hua Thai increased from 55.43% to 96.96%. Hua Thai Group is principally engaged in the manufacture and sale of ladies’ suits, outerwear and sportswear. The ordinary shares of Hua Thai are listed on The Stock Exchange of Thailand.

As the ordinary shares of Hua Thai were trading at a price lower than its fair value, the Group was able to pay an acquisition price less than the fair value of the net assets acquired. The Group recognised a net gain of approximately HK\$54 million from this acquisition of Hua Thai. Since the acquisition, the assets and liabilities of Hua Thai are consolidated in the accounts of the Group.

Prior to Hua Thai became a subsidiary, the Group accounted for Hua Thai Group’s results under share of profits of associated companies which amounted to approximately HK\$21 million during the period from 1 January 2005 to 27 October 2005 (for the year ended 31 December 2004: HK\$18 million). The improvement in financial performance of Hua Thai Group was achieved as a result of management initiatives to control costs and to improve the manufacturing production processes.

As a result of the positive developments highlighted above, profit attributable to equity holders of the Company for the year 2005 amounted to approximately HK\$160 million (2004: HK\$52 million).

FINANCIAL RESOURCES AND LIQUIDITY

During the year, the Group continued to maintain a healthy liquidity position. As at 31 December 2005, cash and cash equivalents amounted to approximately HK\$318 million (2004: HK\$182 million) which were mainly denominated in United States dollars. The short-term bank borrowings of the Group amounted to approximately HK\$79 million as at 31 December 2005 (2004: HK\$3 million). The borrowings were denominated in United States dollars and Thai Baht and mainly at fixed rates. The Group maintained sufficient banking facilities and did not have any long-term bank borrowings outstanding as at 31 December 2005. Facilities extended to the subsidiaries were not charged with the Group's assets. As the Group did not have net bank borrowings as at 31 December 2005 and 2004, no information on gearing ratio as at 31 December 2005 and 2004 is stated or relevant.

Most of the Group's receipts and payments were denominated in Hong Kong dollars or in United States dollars. 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 accounts receivable were entered into from time to time.

CONTINGENT LIABILITIES AND CAPITAL COMMITMENTS

There were no material capital commitments or contingent liabilities as at 31 December 2005 which would require a substantial use of the Group's present cash resources or external funding.

HUMAN RESOURCES

The Group has about 19,000 (2004: 13,000) 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.

FUTURE DEVELOPMENT

The elimination of quota system in January 2005 together with the economic growth and improvement in consumer sentiment in the United States of America, our largest export market, provides immense 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 garment manufacturing segment. The uncertain business environment caused by the trade disputes on textile products between Mainland 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 countries with a low cost operating environment while maintaining consistent high production quality. The Group's current sales orders on hand are consistent with that of last year.

The directors of the Company (the "Directors") believe that the acquisitions of additional interest in Hua Thai would generate synergy to the Group in terms of work efficiency, because the Group and Hua Thai 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. The Directors believe 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 could enable the Group to maintain a close business relationship with those customers who are seeking to diversify their procurement geographically, by allocating a portion of such orders to Hua Thai's production 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.