

Directors' Report

The directors present the annual report and audited financial statements for the year ended 31st December, 2005.

PRINCIPAL ACTIVITIES

The Company is an investment holding company. The Group is engaged principally in the manufacture and sale of footwear products. The activities of its associates, jointly controlled entities and principal subsidiaries are set out in notes 16, 17 and 34, respectively, to the financial statements.

RESULTS AND APPROPRIATIONS

The results of the Group for the year ended 31st December, 2005 are set out in the consolidated income statement on page 26.

The directors did not recommend the payment of an interim dividend. The directors recommend the payment of a final dividend of Hong Kong 1cent per ordinary share to the shareholders on the register of members on 17th May, 2006, amounting to US\$943,000.

PROPERTY, PLANT AND EQUIPMENT

Certain of the Group's buildings were revalued at 31st December, 2005. The revaluation resulted in a surplus over book values amounting to US\$1,630,000, which has been credited directly to the revaluation reserve.

The Group continued its plant replacement policy and expended US\$2,773,000 on new plant and machinery during the year.

Details of these and other movements during the year in the property, plant and equipment of the Group are set out in note 14 to the financial statements.

SHARE CAPITAL

Details of the share capital of the Company are set out in note 25 to the financial statements.

During the year, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

DISTRIBUTABLE RESERVES OF THE COMPANY

As at 31st December, 2005, the Company's reserves available for distribution to shareholders consisted of accumulated profits, dividend reserve and contributed surplus, totalling approximately US\$22,683,000 (2004: US\$23,088,000).

PEGASUS
INTERNATIONAL

Directors' Report

Under the Companies Act 1981 of Bermuda (as amended), the contributed surplus account of the Company is available for distribution. However, a Company cannot declare or pay a dividend, or make a distribution out of contributed surplus if:

- (a) the Company is, or would after the payment be, unable to pay its liabilities as they become due; or
- (b) the realisable value of the Company's assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium accounts.

DIRECTORS

The directors of the Company during the year and up to the date of this report were:

Executive directors:

Mr. Wu Chen San, Thomas (*Chairman*)
Mr. Wu Jenn Chang, Michael (*Deputy Chairman*)
Mr. Wu Jenn Tzong, Jackson
Mr. Yang Chih Chieh, Arthur
Mr. Ho Chin Fa, Steven

Independent non-executive directors:

Ms. Fang Yen Ling
Mr. Lai Jenn Yang, Jeffrey (appointed on 22nd June, 2005)
Mr. Liu Chung Kang, Helios
Mr. Chang Ho Hsi (resigned on 22nd June, 2005)

In accordance with Clause 87(1) of the Company's Bye-laws, Mr. Wu Jenn Tzong, Jackson retire by rotation and, being eligible, offer himself for re-election at the forthcoming annual general meeting.

In addition, in accordance with Clause 86(2) of the Company's Bye Law, Mr. Lai Jenn Yang, Jeffrey, the newly appointed director, also retire and being eligible, offer himself re-election at the forthcoming annual general meeting.

The terms of office of non-executive directors are subject to retirement by rotation in accordance with the provisions of the Company's Bye-laws.

The Company has received, from each of the independent non-executive directors, an annual confirmation of his independence pursuant to Rule 3.13 of the Rules Governing the Listing Securities on The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). The Company considers all of the independent non-executive directors are independent.

Directors' Report

DIRECTORS' SERVICE CONTRACTS

Each of the executive directors has entered into a service contract with the Company for a term of three years commencing 25th September, 1996 and continuing thereafter until terminated by either party giving to the other party a period of advance notice in writing ranging from three to six months.

None of the directors being proposed for re-election at the forthcoming annual general meeting has an unexpired service contract with the Company or any of its subsidiaries which is not determinable by the Group within one year without payment of compensation, other than statutory compensation.

DIRECTORS' INTERESTS IN SHARES

At 31st December, 2005, the interests of the directors and their associates in the shares, underlying shares or debentures of the Company and its associated corporation, as recorded in the register maintained by the Company pursuant to Section 352 of the Securities and Futures Ordinance (the "SFO"), or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by the Directors of Listed Companies, were as follows:

Long positions

(a) *Ordinary shares of HK\$0.10 each of the Company*

Name of director	Capacity	Number of issued ordinary shares held	Percentage of the issued share capital of the Company
Wu Jenn Chang, Michael	Beneficial owner	8,000,000	1.09%
Wu Jenn Tzong, Jackson	Beneficial owner	1,000,000	0.14%
Yang Chih Chieh, Arthur	Family (note 1)	7,193,970	0.98%
		16,193,970	2.21%

PEGASUS
INTERNATIONAL

Directors' Report

- (b) Ordinary shares of the associated corporation of the Company
Pegasus Footgear Management Limited (note 2)

Name of director	Capacity	Number of issued ordinary shares held	Percentage of the issued share capital of the associated corporation
Wu Chen San, Thomas	Beneficial owner (note 3)	3,235	16%
Wu Jenn Chang, Michael	Corporate (note 4)	6,470	32%
Wu Jenn Tzong, Jackson	Corporate (note 5)	6,470	32%
Yang Chih Chieh, Arthur	Corporate (note 6)	474	2%
		16,649	82%

Notes:

1. Mr. Yang Chih Chieh, Arthur is deemed under the SFO to be interested in the said shares held by his wife.
2. Pegasus Footgear Management Limited is the holding company of the Company.
3. The shares are jointly held by Mr. Wu Chen San, Thomas and Mrs. Peggy Wu, a married couple.
4. The shares are entirely held by M. W. Investment Limited, a company owned by Mr. Wu Jenn Chang, Michael.
5. The shares are entirely held by J. W. Investment Limited, a company owned by Mr. Wu Jenn Tzong, Jackson.
6. The shares are entirely held by A & M Management Limited, a company jointly owned by Mr. Yang Chih Chieh, Arthur and his wife.

Save as disclosed above, at 31st December, 2005, none of the directors nor their associates had any interests or short positions in the shares, underlying shares or debentures of the Company or any associated corporation.

SHARE OPTIONS

Particulars of the Company's share option scheme are set out in note 26 to the financial statements.

No share options were granted or exercised during the year ended 31st December, 2005. As at 31st December, 2005, no share options of the Company were outstanding.

Directors' Report

ARRANGEMENTS TO ACQUIRE SHARES OR DEBENTURES

At no time during the year was the Company, its holding company or any of its subsidiaries, a party to any arrangements to enable the directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE

No contracts of significance to which the Company, its holding company or any of its subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

SUBSTANTIAL SHAREHOLDERS

As at 31st December, 2005, the register of substantial shareholders maintained by the Company pursuant to Section 336 of the SFO shows that, other than the interests disclosed in "Directors' Interest in Shares", the following shareholder had notified the Company of relevant interest in the issued share capital of the Company.

Long position

Ordinary shares of HK\$0.10 each of the Company

Name of shareholder	Capacity	Number of issued ordinary shares held	Percentage of the issued share capital of the Company %
Pegasus Footgear Management Limited (Note)	Beneficial owner	468,743,940	64

Note: Details of the directors' interests in Pegasus Footgear Management Limited are disclosed under the section headed "Directors' Interests in Shares".

Save as disclosed above, the Company has not been notified of any other relevant interests or short position in the issued share capital of the Company as at 31st December, 2005.

MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31st December, 2005, the largest customer of the Group accounted for approximately 56% of the Group's turnover. The five largest customers accounted for approximately 87% of the Group's turnover. For the year ended 31st December, 2005, the aggregate purchases attributable to the Group's five largest suppliers were less than 30% of total purchases.

Directors' Report

None of the directors, their associates or any shareholder of the Company which, to the knowledge of the directors, owned more than 5% of the Company's issued share capital had any interest in the share capital of any of the five largest customers of the Group.

EMOLUMENT POLICY

The emolument policy of the employees of the Group is set up by the board of directors on the basis of their merit, qualifications and competence.

The emoluments of the directors of the Company are decided by the board of directors, as authorised by shareholders at the annual general meeting, having regard to the Group's operating results, individual performance and comparable market statistics.

The Company has adopted a share option scheme as an incentive to directors and eligible employees, details of the scheme are set out in note 26 to the financial statements.

SUFFICIENCY OF PUBLIC FLOAT

The Company has maintained a sufficient public float throughout the year ended 31st December, 2005.

PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's Bye Law or the laws of Bermuda, which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

AUDITORS

A resolution will be submitted to the annual general meeting to re-appoint Messrs. Deloitte Touche Tohmatsu as auditors of the Company.

On behalf of the Board
Wu Chen San, Thomas
CHAIRMAN
Hong Kong, 20th April, 2006