Chairman's Statement

Mr. Ngan Hei Keung, *Chairman*
Madam Pauline Ngan,
Deputy Chairman and Managing Director

On behalf of the Board of Directors of Mainland Headwear Holdings Limited (the "Company"), I am pleased to present the annual results of the Company and its subsidiaries (collectively, "Mainland Headwear" or the "Group") for the year ended 31 December 2005.

Business Review and Prospect

Overview

2005 was a challenging year for Mainland Headwear. Despite a less than satisfactory performance in the first half of the year, the Company had a significant turnaround in the middle of the year and the Group's Manufacturing and Trading Businesses showed an impressive improvement in the second half. The Group's turnover for the year increased by 5% to HK$586,717,000 as compared to HK$557,470,000 in 2004.

During the year under review, the Group achieved significant progress in its Retail Business expansion. In March 2005, the Group invested in a joint venture with an exclusive retail license to design, manufacture and sell "SANRIO" products in the PRC. Together with the retail license to operate "Kangol" shops in China and the exclusive distribution rights for "Kangol" headwear in the PRC, both of which commence in 2006, the expansion will help broaden our retail business network, strengthen our brand and widen our customer base.

Looking forward, the Group is dedicated to expanding its Manufacturing Business, the core profit contributor, through market expansion and market diversification. We will also continue our expansion in the Retail Business by exploring new opportunities and taking up new licenses. The management believes that this will provide a solid foundation for the Group's revenue and profit growth.

Financial Review

Mainland Headwear's turnover for the year ended 31 December 2005 amounted to HK$586,717,000, representing an increase of 5% as compared to 2004. The increase in turnover was generated mainly from the existing and new customers of the Manufacturing Business, together with the contribution from the growing Retail Business.

Profit contribution from the Manufacturing Business increased by 4%, while the Group's net profit attributable to equity shareholders was HK$77,772,000, representing a decrease of 3% as compared to 2004. The decrease was mainly attributable to the Trading Business and the negative contribution of the Retail Business during its investment phase. Earnings per share decreased by 4% to HK27.2 cents.

Selling and distribution costs of the Manufacturing and Trading Businesses decreased by 24% as a result of stringent cost control measures. However, the Group's selling and distribution costs and administration expenses increased to HK$24 million and HK$123 million respectively, due to the additional expenses from the expanding Retail Business.

The Board has recommended the payment of a final dividend of HK11 cents per share for the year ended 31 December 2005, maintaining a dividend payout ratio of over 40%.

Business Review

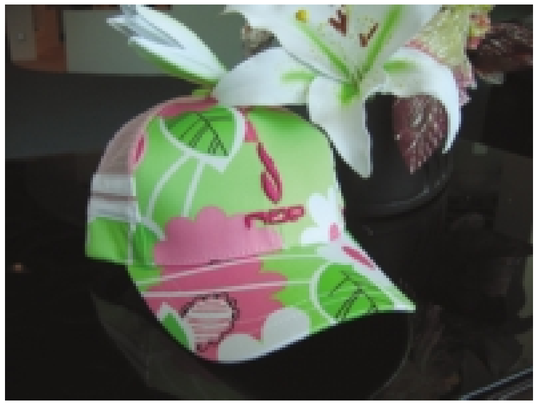
The Manufacturing Business

During the year under review, the Manufacturing Business remained the Group's core profit contributor. Turnover from this business increased steadily by 4% to HK$369,004,000 as compared with HK$355,112,000 of the previous year. Profit contribution increased 4% to HK$94,698,000 as compared with HK$90,780,000 in 2004.

Sales were caught up in the second half of the year due to the delayed deliveries of winter orders to some major US retailers. In addition, the Group continued to secure new customers, including new direct sourcing customers through its subsidiaries in Europe and the US.

During the year under review, sales of headwear for the 2008 Beijing Olympics Games were stable although more significant business is expected from late 2006 onwards. In addition, the newly developed Japan market demonstrated a promising performance with satisfactory growth in orders, though the turnover is still insignificant as compared to the total turnover of the Group.

Dedicated to maintaining the gross profit margin, the Group lowered the cost of materials through an adjustment in purchasing strategy to offset the increase in labour cost in the first half of the year. As at 31 December 2005, the inventory level of raw materials increased by HK$9 million to HK$41.8 million as compared to last year, as a result of the new buying strategy of purchasing fabrics directly from a manufacturer. In the second half of the year, the gross profit margin was adversely affected by the lower selling price resulting from keen competition and appreciation of the RMB in July 2005. However, with stringent cost control measures, the gross profit margin for the year was maintained at a level of over 35%.



Distribution cost was successfully lowered by 24% through better production planning and by shifting part of the export shipment via Yantian port in the PRC starting from the second half of the year. Administration expenses also decreased by 3% as a result of various effective cost control measures. With the decrease in selling, distribution and administration expenses and an increase in investment income, the profit contribution increased by 4%.

During the year under review, capital expenditure of HK$6,895,000 was spent on additions to production plant and equipment, compared to the HK$21 million originally planned. The construction plan for an additional factory building comprising a logistics centre has been delayed and is expected to commence in second half of 2006.

The Trading Business

Turnover of the Group's Trading Business decreased by 5% to HK$293,313,000 during the year, resulting in a profit contribution of HK$751,000 as compared to HK$3,805,000 in 2004. The decrease in turnover was attributable to the loss of the MLB license in the US effective from 1 January 2005. The Group adjusted its business strategy to focus more on non-sports licenses and private label business so as to replace the loss of the MLB business in the US. This strategy began to show results as sales in the second half of the year recovered significantly.

However, as the private label business which has a relatively lower margin, continued to grow, the overall gross profit margin of the Trading Business dropped to slightly below 25% in 2005.

Turnover for the European market increased by nearly 50% to HK$57.4 million in 2005, representing about 20% of the Trading Business. The new UK subsidiary, which was set up in March 2005, recorded a profit in its first year of operation and helped establish closer relationships with European customers. Since the products for the European market are more fashion-focused, the average gross profit margin is slightly higher than that of the US market.

The Retail Business

The Retail Business generated a turnover of HK$30,266,000, representing over 7 times increase as compared to HK$3,583,000 in 2004. As the business is still in its initial investment phase, the Group recorded a loss of HK$11,598,000 for the year. However, the Group is confident that the Retail Business will become one of the main growth drivers of the Group in the future.

As at 31 December 2005, the Group had opened a total of 30 headwear outlets under the "LIDS" brand, of which 9 were in Hong Kong and 21 were in the PRC. With this retail network in both territories, the Group introduced its private label with various designs in order to strengthen its product offering and to increase its profit margin. As the operating costs are lower in China, most of the LIDS outlets there are profitable at shop level. The high shop rental costs in Hong Kong continue to be the major challenge and the Group strengthened its product sourcing to increase its profit margin. Looking forward, the Group will adopt the franchise model in the PRC, control the expansion in Hong Kong and strengthen the wholesale business to increase the revenue and profitability of the operations.

The operations of the LIDS retail license helped to secure more manufacturing and trading business from Hatworld Inc., the licensor and the largest headwear retailer in the US. Also, leveraging on the platform of the LIDS operations, the Group obtained 10-year exclusive rights for distributing "Kangol" headwear, which is the top selling brand in LIDS outlets, in China, and for opening "Kangol" retail outlets and selling "Kangol" branded products.

On 31 March 2005, the Group acquired 51% interest, at a consideration of HK$10,000,000 together with a shareholder's loan of HK$20,000,000, in a joint venture to operate an exclusive retail license to manufacture and sell "SANRIO" products in the PRC. The joint venture acts as an exclusive authority agent of shops in the PRC for the internationally well-known brand Sanrio, and has the right to design, manufacture and sell all Sanrio cartoon character products in the PRC. Sanrio holds the final copyrights of many famous Japanese cartoon characters, including Hello Kitty, the most well-known among consumers, together with Cinnamon Roll, Minna no Tabo, Little Twin Stars, My Melody and Shinkansen.

As at 31 December 2005, a total of 23 Sanrio stores had been opened and most of the outlets performed better than expected in terms of shop level contributions. However, the scale of the business in this first year of operation was not sufficient to cover all the preliminary expenses and back office overheads. A loss of HK$5,245,000 was recorded from the operation in the year under review.

The Group introduced a franchise model for the Sanrio license in the fourth quarter of 2005, and will aggressively expand the franchise business in the second quarter of 2006. Our continued effort to locally source most products will help lower the cost. The venture is expected to achieve breakeven in 2006.

Prospects

Being an outstanding headwear designer, manufacturer and retailer with an unrivalled position in the market, the Group is optimistic as to the outlook for 2006. In view of the satisfactory performance over the past years, the Group will further strengthen its business through market, business and product diversification and new income source generation.

Europe and Japan are the target markets for growth of the Manufacturing Business in 2006. The Group set up an office in Japan in January 2006 to fully capture the market potential there. As these two markets are more fashion-focused, the Group will continue to strengthen its product design capability and expand its product range. Together with the offices in Japan, Europe and US, the Group endeavours to extend its market coverage network and expects optimistic business growth.

For 2006, the Group has allocated a capital expenditure budget of approximately HK$21.8 million for production plant improvements, which includes adding three production lines in 2006 and the planned construction of an additional factory building comprising a logistics centre. This is expected to increase the production capacity by 20% by the end of 2006 and another 35% in 2007. For 2006, the Group also plans to outsource some of its production procedures with the aim of further increasing its production capacity.

With continued appreciation of the RMB and labour shortages in the Pearl River Delta region unlikely to ease, the gross profit margin of the Manufacturing Business is expected to be under pressure in 2006. The Group endeavours to maintain the gross profit margin above 35% by various cost cutting and efficiency improvement measures. In this regard, a bonus incentive scheme, which also acts as a retention program for skilled labour, has been introduced in 2006 to improve production efficiency.

For the Trading Business, the Group will focus on margin improvement by increasing marketing efforts in specialty store channels and by adding licenses to its license portfolio. New licenses added in early 2006 include New York City and Pabst, which should help to increase the revenue and the gross profit margin of the Trading Business.

To further strengthen the retail network, the Group will continue to increase the number of owned LIDS outlets and SANRIO stores to 36 and 48 respectively by the end of 2006.

In addition, the Group will invest HK$1.6 million to open 10 "Kangol" fashion accessories stores in 2006. The first "Kangol" store is opened in early April 2006 in Shenzhen.

In 2006, the Group is committed to expanding its retail business through a franchise model, to adding new licenses to its portfolio and to increasing its revenue through wholesale operations. It is expected that the Retail Business will achieve breakeven in 2006.

Acknowledgement

The Group will pursue the vision of global expansion and diversification to achieve sound turnover and profit growth, with the aim of maximising shareholders' value. Supportive shareholders, dedicated staff members, loyal customers and suppliers are the keys to the Group's remarkable success.

On behalf of Mainland Headwear, I would like to express my heartfelt gratitude to all of our stakeholders for their invaluable contribution to the continued success of the business.

Ngan Hei Keung
Chairman

Hong Kong
6 April 2006