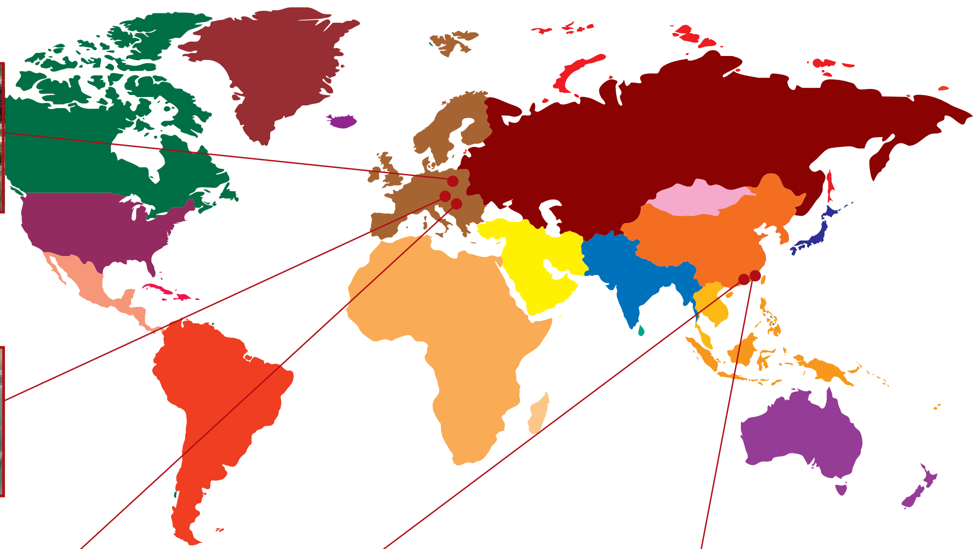
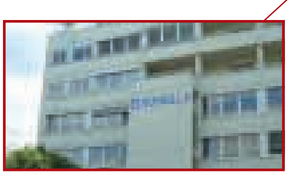
# Management Discussion and Analysis

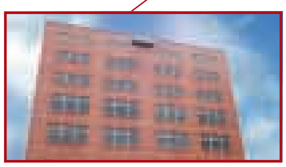
Goller Textilmaschinen GmbH, Germany



THEN Maschinen GmbH, Germany



Xorella AG, Switzerland



Hong Kong Headquarters

China Headquarters

## OPERATING RESULTS

For the year ended December 31, 2005, the consolidated turnover of the Group was approximately HK$2,012 million (2004: HK$1,744 million) representing an increase of 15% as compared with the previous year. The net profit for the year was approximately HK$219 million (2004: HK$235 million) representing a decrease of 7% as compared with last year. Basic earnings per share for the year amounted to 39.0 HK cents (2004: 41.9 HK cents).

## DYEING AND FINISHING MACHINE MANUFACTURING

***Fong's National Engineering Company, Limited, Fong's National Engineering (Shenzhen) Co., Ltd., THEN Maschinen GmbH, THEN Maschinen (HK) Ltd, Xorella AG and Xorella Hong Kong Limited***

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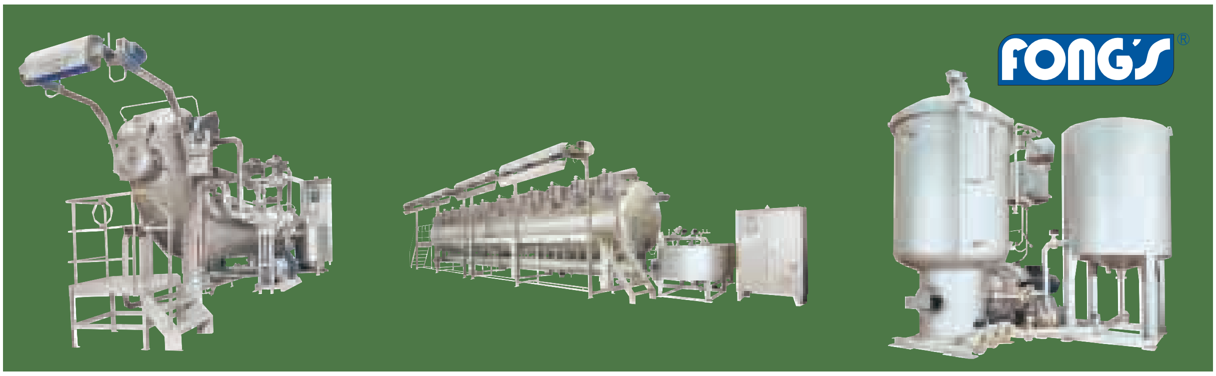
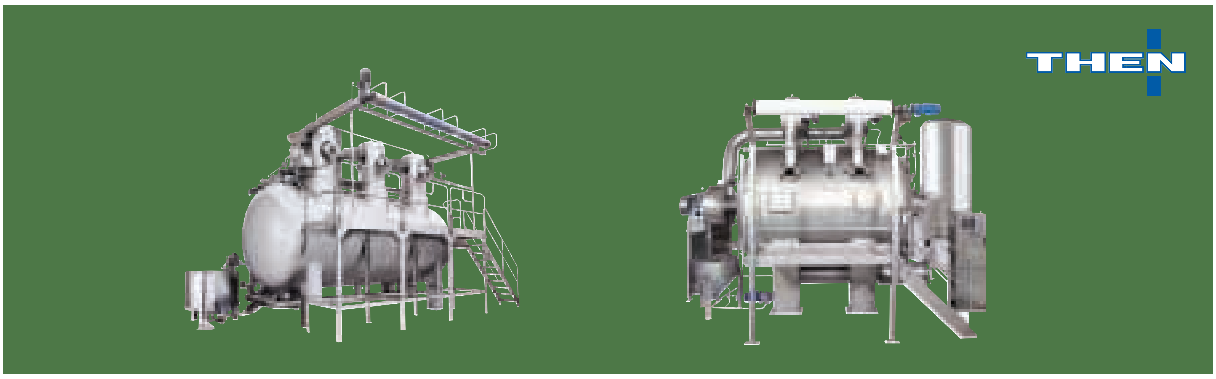



ECO-88D

ECO-6

ALLWIN




Bigstar

Airflow Synergy SYN 500


CONTEXXOR® Plus

CONTEXXOR® LTC-S


Washing Range Effecta

PLEXXOR®

Plexxor Co., Limited

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*ITMA Asia 2005*

*ShanghaiTex 2005*

The dyeing and finishing machine manufacturing remains the core business and principal profit earner of the Group. The turnover of this segment achieved an increase of 21% to approximately HK$1,163 million (2004: HK$963 million) for the year under review and accounted for 58% (2004: 55%) of the Group's consolidated turnover. However, the segment results decreased 12% to approximately HK$129 million (2004: HK$146 million) which were mainly attributable to external factors and poor performance in our European subsidiaries during the year.

With regards to external factors, the well publicized trade and quota dispute between China and the USA as well as the EU dragged out through almost all of 2005 which greatly disrupted the textile export trade of China, the largest geographical market for this division, in the second half of 2005. Consequently, overall machine sales in the second half of 2005 actually decreased by approximately 17% compared to the first half of 2005.

Secondly, the sales of THEN dyeing machines amounted to approximately HK$203 million which accounted for 17% of the segment turnover but however resulted in a loss of approximately HK$29 million. Furthermore, the losses have been attributable to poor execution of the turnaround efforts of THEN Maschinen GmbH in addition to the external factors mentioned. In particular, during the year, delays were experienced in rebuilding the sales force and in implementing inter-company sourcing strategy to reduce production costs.

Nevertheless, we expect the turnaround efforts of THEN Maschinen GmbH to be back on track in the coming year and we will be expecting sales growth in the coming year and that the operations will become profitable within the year.

Thirdly, our 80% owned subsidiaries, Xorella Hong Kong Limited and Xorella AG both engaging in the business of yarn conditioning equipment, recorded a turnover of only approximately HK$46 million (2004: HK$65 million). The consolidated loss was approximately HK$4 million (2004: HK$2 million). Again, the poor performance has

# Management Discussion and Analysis

been attributable to both the external factors as mentioned and secondly strategic errors were made in the marketing management for the Asian markets. However, having identified the problems, corrective actions are already in place and we expect a solid rebound in the performance of this division in the coming year.

Furthermore, apart from its continued efforts in consolidating relationships with the existing customers and securing new ones, the Group has also been placing great emphases on exploring new overseas markets in Latin America, Europe, the Middle East and South Asian countries including India, Bangladesh, Pakistan, Turkey and Thailand. The Group has also strengthened its sales strategies by maintaining close cooperation with sales agents who have a better understanding of the overseas markets.

For the year under review, the sales from the overseas markets accounted for 40% of the turnover (2004: 35%), it also represents 15% out of the 21% sales growth. The encouraging double-digit growth trend is expected to continue in the coming years. The Group anticipates that the overseas markets will continue to show encouraging contributions to the Group's turnover and profit in the coming years.

The Group believes that the total global textile machinery demand will maintain steady growth in the coming years as the textile trade dispute is basically settled. Together with its continuous expansion of customer bases from China to overseas markets, the Group is optimistic about our business future.

## STAINLESS STEEL TRADING

***Fong's Steels Supplies Company Limited***

For the year ended December 31, 2005, the turnover of stainless steel trading segment reached approximately HK$646 million (2004: HK$654 million) and accounted for 32% (2004: 38%) of the Group's consolidated turnover. The segment results decreased 21% to approximately HK$64 million (2004: HK$81 million) as the stainless steel prices have become relatively stable during the second half of 2005 resulting in profit margins closer to the norms of stable price conditions.

In addition, during the year under review, the management lowered the level of inventory and shortened the account receivables recovery period, so as to reduce the risk exposures on the volatile stainless steel prices.

The management believes that the stainless steel prices are likely to stabilize at the present level after peaking in mid 2005. It is anticipated that this trading segment will experience a modest growth with gross profit margins at the present level in the coming year.

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*Tycon Alloy Manufacturing Plant*

*Workshop of Tycon Alloy*

### STAINLESS STEEL CASTING

***Tycon Alloy Industries (Hong Kong) Co., Ltd.***
***and Tycon Alloy Industries (Shenzhen) Co., Ltd.***

This segment had a satisfactory performance for the year under review. The turnover amounted to approximately HK$203 million (2004: HK$127 million), representing an increase of 60% over last year. It accounted for 10% (2004 7%) of the Group's consolidated turnover. The segment results increased 65% to approximately HK$28 million (2004: HK$17 million).

The improvement in profitability has mainly been attributed to the increased sales volume as well as our effective cost saving measures adopted and sharing of raw material costs increases with customers.

In the coming year, we will deploy necessary resources to expand the scale of the current production and to increase operational efficiency and reduce costs. Our objective for this is to manufacture quality products to meet the customers' requirements while at the same time making use of our competitive price and products to enlarge our market share gradually.

It is anticipated that this segment will continue to achieve healthy growth in the coming year and maintain its profit contribution to the Group.

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Monforts Fong's Manufacturing Plant

Thermefix 338 Continuous Dyeing Range

## JOINTLY CONTROLLED ENTITY

***Monforts Fong's Textile Machinery Co. Limited ("Monforts Fong's")***

The management continued fostering business growth through a host of expansion initiatives in 2004 and 2005. Such accomplishments included launched new products, extended production capacity to complement growth in production volume and enhanced brand awareness. Such proactive strategies yielded remarkable business progress in turnover.

For the year under review, the turnover of Monforts Fong's was approximately HK$434 million (2004: HK$300 million), representing an increase of 45% over that of last year. However, the Group's share of profit after tax increased slightly to approximately HK$32 million (2004: HK$31 million) mainly due to lower selling prices and higher raw material costs.

The management will continue to increase the overall productivity and enhance the quality of products and services. The management remains prudently optimistic of the future business growth.

## ASSOCIATES

***Foshan East Asia Company Limited (a 30% owned associate)***

During the year under review, the sales revenue of woven color fabrics conducted by Foshan East Asia Company Limited declined 8% to approximately HK$192 million (2004: HK$208 million) and the Group's share of profit after tax was approximately HK$2.1 million (2004: HK$1.5 million).

The sales and profit remained stable during the year under review. The Group believes that Foshan East Asia Company Limited will continue to contribute positively to the Group's overall results.

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## HUMAN RESOURCES

As at December 31, 2005, the Group had a total of approximately 3,300 employees spreading among China, Hong Kong, Germany, Switzerland and Thailand. For the year under review, staff costs, including directors' remuneration were approximately HK$174 million (2004: HK$144 million).

Employees are remunerated based on their performances, experience and prevailing industry practice. The Group's remuneration policies and packages were reviewed by its management on a regular basis. Bonus and rewards may also be awarded to employees based on performance evaluation, with an aim to encourage and reward staff to achieve better performance. Other employee benefits available for eligible employees include retirement benefits scheme and share option scheme.

## LIQUIDITY AND CAPITAL RESOURCES

Traditionally, the Group generally finances its operations through internally generated funds and banking facilities provided by its principal bankers and other financial institutions. The Group successfully maintained a strong and healthy liquidity and financial position during the year under review.

As at December 31, 2005, net of borrowings, the Group's net cash and bank balance amounted to approximately HK$106 million. In 2005, there was no gearing ratio shown as the Group had a net cash and bank balance. The current ratio was 2.85 reflecting a satisfactory and healthy liquidity level.

As at December 31, 2005, bank and other borrowings amounted to approximately HK$207 million of which approximately 76% were secured by certain assets of the Group. 76% of the bank borrowings were sourced from Hong Kong and the remaining were sourced from PRC. 97% of the borrowings were denominated in Hong Kong dollars and the remaining was denominated in US dollars. The bank borrowings of the Group are predominantly subject to floating interest rates.

As at December 31, 2005, the cash and bank balance amounted to approximately HK$313 million of which approximately 41% were denominated in Hong Kong dollars, 32% in Renminbi, 13% in US dollars, 10% in Swiss France, 2% in Euro and 2% in Japanese Yen.

The Group conducts most of its business transactions in currencies of US dollars, Hong Kong dollars and Renminbi. As these currencies remained relatively stable during the year under review, the Group has limited exposure to foreign exchange rates fluctuations.