



Number of Shoebox
Points-of-Sale **increased by 54**





Management Discussion and Analysis

Turnover by channel

For the year ended 31 December 2005				
<i>HK\$'000</i>	Daphne	Adidas- Original Collection	Shoebox	Total
Stores	1,131,503	30,497	75,207	1,237,207
Counters	241,742	147,537	–	389,279
Others	200,855	–	–	200,855

BUSINESS REVIEW

Benefiting from the strong demand driven by the booming economy and the expanding purchasing power of the consumers in China, the Group's turnover surged by 47% to HK\$2,622,677,000 during the year under review (2004: HK\$1,788,539,000).

Profit attributable to shareholders increased by 44% to HK\$254,593,000 (2004: HK\$176,220,000) as compared with the previous year. The remarkable growth was attributable to the increase of high margin orders, outstanding performance of our brand business and improved economies of scale during the year. Basic earnings per share were HK15.72 cents (2004: HK11.33 cents).

OEM Business

OEM business continued to be one of the Group's core business segments. During the year under review, this segment recorded a 10% growth in turnover to HK\$795,336,000 (2004: HK\$721,724,000), which accounted for 30% of the Group's total turnover. The continuous improvement of the US market has also driven the OEM business up and brought in a lot of new orders.

During the year, the Group has secured more higher margin orders by changing customer mix and implemented effective cost control measures. As a result, the gross profit margin and the operating margin of our OEM business stood at 24% and 14% (2004: 22% and 9%) respectively. Operating profit of our OEM business also increased by 71% to HK\$112,849,000 (2004: HK\$66,083,000). We expect raw material costs to continue to increase moderately in the near future, however, since we typically commence production only after confirmation of orders, we will be able to effectively control our production costs and maintain a reasonable profit margin. During the year, we stepped up development of overseas markets, but the US market remained as our major export market accounting for 29% of the Group's total turnover.



Management Discussion and Analysis

Brand Business

The Group's brand business remains as the business segment that yields the higher profit margin. This business segment includes the Group's own brands – “Daphne” and “Shoebox”. The Group also has the exclusive retail shop right in China for the “Adidas – Original Collection”. Given the strength of these brands, the Group determines to broaden its customer base and coverage of the entire country by continuing to invest in opening more points-of-sale. During the year under review, turnover of the brand business increased by 71% from last year's to HK\$1,827,341,000 (2004: HK\$1,066,815,000), accounting for 70% of the Group's total turnover. Turnover from “Daphne” increased substantially by 60% to HK\$1,574,100,000 (2004: HK\$986,878,000), making up 60% of the Group's total turnover. Turnover from “Shoebox” was HK\$75,207,000 (2004: HK\$12,190,000), accounting for 3% of the Group's total turnover. Turnover from the “Adidas – Original Collection” was HK\$178,034,000 (2004: HK\$67,747,000), accounting for 7% of the Group's total turnover.

“Daphne” Business

As the China economy continues to grow, the market for high quality consumer goods also prospers. Since the “Daphne” brand was introduced in 1990, the brand has developed itself into a prestigious brand that is very well received by the female customers in China. During the year under review, our extensive sales and distribution network has substantially increased the total turnover for “Daphne”. In order to promote the “Daphne” brand image further, the Group has looked at various channels. “Daphne” is one of the first brands to launch new products on the “Promotional Catwalk” by professional models in China. The Group continues to sponsor music video productions of pop artists to promote its products. After 15 years' of consistent brand building and marketing efforts, “Daphne” now enjoys a premium brand reputation. Last year, the Group re-launched the young collection with a new approach to the market by calling it “Daphne D18” which was an instance success, capturing the hearts of millions of young female customers in China. The Group sees a huge potential in the young female footwear market because consumers in this segment of the market have strong purchasing power and have strong appetite for stylish shoes. Since the debut of “Daphne D18”, the Group has added 275 new “Daphne D18” points-of-sale. The Group has also





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appointed “S.H.E”, a popular girl group of entertainers from Taiwan, as the spokeswomen for “Daphne D18”. The remaining collections of “Daphne” are now being carried in the “Daphne D28” points-of-sale which continue to target female customers aged between 26 and 50. The Group is confident that, by providing products tailored for female customers of different age groups can further expand the “Daphne” brands and raises the Group’s market share of ladies footwear in China.

As at 31 December 2005, “Daphne” owned over 1,443 points-of-sale across the country, including 1,070 stores and 373 counters, a significant increase of 421 points-of-sale more than at the end of 2004 (2004: 725 stores and 297 counters).

“Shoebox” Business

The Group stepped up development of the “Shoebox” brand last year in the attempt to extend its reach to the mass market. Opening new “Shoebox” stores in busy locations and strategically locating outlets inside hypermarket chains, the Group has created an extensive customer base for the “Shoebox” brand. Although the “Shoebox” business has yielded satisfactory results, it recorded a slight loss of HK\$2,751,000 during the year as has been forecasted during this investment period. The Group is reasonably pleased with the overall market response to the “Shoebox” brand and that the loss from the year-to-year comparison of the “Shoebox” operation has narrowed. The Group is hopeful of the “Shoebox” operation to start bringing in profit in the next financial year.

During the year under review, “Shoebox” has opened 54 new stores at major cities across China, including Beijing, Shanghai, Wuhan, Yangzhou, Suzhou and Guangzhou.

“Adidas – Original Collection” Business

The Group obtained an exclusive China retail shop right from Adidas on its “Original Collection” in September 2002. During the year, the Group opened 2 new Adidas stores, bringing the total numbers to 10. The number of counters, which are located in major cities including Shanghai, Beijing and Guangzhou, also increased from 30 to 81. In addition to Adidas securing the sponsorship contract for the 2008 Beijing Olympics Games, the brand can expect to see its image further enhanced in China. The 2008 Beijing Olympics Games will also boost the demand for athletic and casual footwear and apparels in China, and that indicates considerable business potentials for the Group.



Management Discussion and Analysis

Turnover and operating profits/(loss) by brand

For the year ended 31 December 2005				
<i>HK\$'000</i>	Daphne	Adidas- Original Collection	Shoebox	Total
Turnover	1,574,100	178,034	75,207	1,827,341
Operating Profit/(Loss)	204,858	7,364	(2,751)	209,471

Development of Infrastructure

The Group's new processing plants in Fujian and Jiangsu started operations last year. The current utilisation rates in these two plants are only approximately 60%, which have rooms for further expansion to meet the increase in production demand. Two additional production lines at the Anhui production plant had also started operations.

In addition, the Group had decided to build its own distribution network across China to support the increasing demand in the domestic sales operations. Two logistics centres located in Shanghai and Fujian have started operating in the last 24 months which have improved the Group's supply chain services by providing much faster transportation from point to point. Two additional logistics centres located in Beijing and Shenyang are expected to commence operation in the first half of 2006. These two new centres will also employ the state-of-the-art storage systems to maintain the inventory hence making the production planning even more efficient, as well as to track the status of inventory at almost on the real time basis. The Group's new multi-million-dollar ERP system is now in operation mode providing a solid infrastructure foundation to support the Group's goal in building the nationwide sales and distribution network.

FINANCIAL REVIEW

Result Performance

For the year ended 31 December 2005, the Group's turnover increased by 47% over the previous year to reach HK\$2,622,677,000 (2004: HK\$1,788,539,000). Profit attributable to shareholders amounted to HK\$254,593,000 (2004: HK\$176,220,000), representing an increase of 44% as compared with the previous year. Gross profit margin surged to 44% from 38% last year, while net profit margin remained at 10%. The increases were mainly attributable to the flourishing domestic sales and the OEM business. The Group will continue to implement cost control initiatives to ensure better returns.



Management Discussion and Analysis

During the year, the basic earnings per share of the Group were HK15.72 cents, which is 39% higher than last year's. The Board recommended the payment of a final dividend of HK2.5 cents per share for the year ended 31 December 2005. Together with the interim dividend of HK2.5 cents per share, the total dividends for the year would amount to HK5.0 cents.

Financial Resources and Liquidity

As at 31 December 2005, the Group maintained a healthy cash position with cash and cash equivalents of HK\$146,467,000 (2004: HK\$126,893,000) and unutilised banking facilities of HK\$114,343,000 (2004: HK\$69,577,000). The Group's current ratio, being the proportion of total current assets divided by the total current liabilities, improved to 1.70 as at 31 December 2005 from 1.60 as at 31 December 2004.

The gearing ratio of the Group, calculated on the basis of interest bearing bank borrowings of HK\$133,062,000 (2004: HK\$98,527,000) over shareholders' equity of HK\$744,207,000 (2004: HK\$533,720,000), maintained at 18% as at both 31 December 2005 and 31 December 2004.

The existing available cash and bank balances are considered adequate to meet the Group's liquidity and operating requirements.

Foreign Exchange Rate Exposure

The Group's monetary assets, liabilities and transactions are mainly denominated in Hong Kong dollars, Renminbi, US dollars and New Taiwanese dollars. The management believes that the Group's working capital is not exposed to any significant risk from currency exchange rate fluctuation. Foreign exchange risks arising from transactions denominated in foreign currencies are managed by the Group's treasury with the use of foreign exchange forward contracts, whenever necessary, with major and reputable financial institutions.

Pledge of Assets

As at 31 December 2005, the Group's short-term bank loans of HK\$71,753,000 (2004: HK\$46,827,000) were secured by certain land use rights and leasehold buildings of total net book value of HK\$13,613,000 (2004: nil); a bank deposit of HK\$6,000,000 (2004: nil) and available-for-sale financial assets with nil (2004: nil) carrying value.



Management Discussion and Analysis

Significant Capital Investments

During the year, the Group invested HK\$156,945,000 (2004: HK\$102,443,000) in establishing new production plants and facilities and logistics centres, adding new production lines, procuring equipment, new office spaces and etc.

The Group intends to achieve its goal to have 5,000 points-of-sale by 2010, has chosen to invest strategically in establishing a nationwide sales and distribution network. Two new logistics centres are planned to be constructed in Chengdu and Guangdong, bringing a total of six logistics centres owned and managed by the Group. The new investments including the addition of new office spaces for brand business are estimated to be HK\$130,000,000.

Material Acquisitions and Disposals

There were no material acquisition and disposal of subsidiaries and associated companies during the year ended 31 December 2005.

Contingent Liabilities

As at 31 December 2005, the Group had no significant contingent liabilities.

Human Resources

As at 31 December 2005, the Group has over 24,000 (2004: 19,000) employees in Hong Kong, Taiwan and China. Staff expenditure for the year under review amounted to HK\$374,140,000 (2004: HK\$295,832,000). The Group is an equal opportunity employer, with the selection and promotion of individuals based on suitability for the position offered. The remuneration and benefits of the Group's employees are kept at competitive levels and employees are rewarded on a performance related basis with the general framework of the Group's salary and bonus system, which is reviewed annually. A wide range of benefits, including medical coverage, retirement plans and share options are also provided to employees.

PROSPECTS

OEM Business

As the US economy continues to improve, the Group also stepped up its efforts to develop different overseas markets. A steady growth is expected for the OEM segment in the coming years where the US market will remain as the Group's largest export market.



Management Discussion and Analysis

Brand Business

The Group will continue to expand the sales network of “Daphne” to penetrate further into the China market. Encouraged by the positive consumer response to “Daphne D18”, the Group is consciously considering launching other new product series such as kid footwear, to attract different types of customers. “Daphne” brand is also being licensed to other manufacturers to develop different categories such as handbags, wallets, and other footcare products. A most recent addition to this category of products is the eyewear products, which not only target to be sold in China but will also be sold throughout other Asian countries. The eyewear product venture will provide a strategic channel to position the “Daphne” brand to other countries outside China, which has been one of the missions of the Group. The success of the eyewear product venture will see other accessories such as watches and other fashionable consumer products to be added to this category in the near future.

The Group will continue to invest strategically in promoting the “Daphne” brand. One of the notable investments in 2006 is the film “I Love Daphne” (the name of the film has yet to be confirmed) starring the famous actor Mr Ritchie Ren (任賢齊) and the famous actress Ms Rene Liu (劉若英). In addition, Ms Rene Liu has also been appointed as the spokeswoman for “Daphne D28” to promote the “Daphne” brand in China. As a popular Taiwanese actress, Ms Rene Liu was also appointed as the spokeswoman for the Taiwan market where the Group begins to develop the market. The first “Daphne” store in Taiwan will be opened in the first half of 2006.

The booming economy in China has created a huge potential for good quality footwear for the lower income households. Taking advantage of the situation the Group diversified into this market to reach the mass majority. As a result the “Shoebox” brand was established in May 2004. In the initial development stage of the brand, the Group focused on expansion of sales network to achieve economies of scale. The Group plans to open at least 70 stores in 2006 and also to extend its coverage to second and third tier cities. As pointed out earlier, the Group is confident that “Shoebox” will turn around to be profitable in 2006.

Capitalising on the 2008 Beijing Olympics Games, the Group intends to expand the “Adidas – Original Collection” points-of-sale from the current 91 to 300 points-of-sale by 2008. This will be the biggest opportunity in the coming two years; the Group has also decided to allocate more resources in the marketing activities to maximise on the return of this extravaganza event to further expand its market share.



Management Discussion and Analysis

Turnover per square foot by brand

	For the year ended 31 December 2005 HK\$
Daphne	144.04
Adidas – Original Collection	195.11
Shoebox	36.38

Development of Infrastructure

The Group remains very positive with the economies in China, the US and Taiwan. The expansion of the sales and distribution network encompassing the Warehouse Management System will link the inventory status and the points-of-sale from various cities together. This will ensure that the resources are centralised and become more efficient. By the end of 2007 the Group expected to have six logistics centres in operations.

Looking forward, the Group will continue to expand its brand and product portfolios to further enrich its product series. The Group will also consider introducing other new brands and types of consumer products to enhance its business profile. In the coming years, the Group will be actively developing its international markets.

Our success lies on the support of our business partners, staff, management and shareholders. The Group will strive to bring its businesses to the new heights and to generate satisfactory returns to the shareholders.



Management Discussion and Analysis

DAPHNE SALES AND DISTRIBUTION NETWORK IN CHINA



Central China		
Chengdu Regional Office	59 Stores	10 Counters
Changsha Regional Office	57 Stores	11 Counters
Xinjiang Regional Office	33 Stores	5 Counters
Xian Regional Office	31 Stores	12 Counters

Northern China		
Beijing Regional Office	34 Stores	27 Counters
Zhengzhou Regional Office	81 Stores	23 Counters
Jinan Regional Office	72 Stores	35 Counters
Tianjin Regional Office	32 Stores	26 Counters

Eastern China		
Nanjing Regional Office	66 Stores	37 Counters
Shanghai Regional Office	105 Stores	21 Counters
Hangzhou Regional Office	66 Stores	19 Counters

Southern China		
Fuzhou Regional Office	46 Stores	7 Counters
Guangzhou Regional Office	103 Stores	50 Counters
Nanning Regional Office	39 Stores	15 Counters
Nanchang Regional Office	34 Stores	5 Counters

North Eastern China		
Harbin Regional Office	69 Stores	15 Counters
Changchun Regional Office	35 Stores	11 Counters
Shenyang Regional Office	108 Stores	44 Counters



Management Discussion and Analysis

SHOEBOX SALES AND DISTRIBUTION NETWORK IN CHINA



Central China
6 Stores

Northern China
12 Stores

Eastern China
29 Stores

Southern China
14 Stores

North Eastern China
14 Stores



Management Discussion and Analysis

ADIDAS – ORIGINAL COLLECTION SALES AND DISTRIBUTION NETWORK IN CHINA



Central China	
2 Stores	15 Counters

Northern China	
17 Counters	

Eastern China	
6 Stores	26 Counters

Southern China	
1 Stores	9 Counters

North Eastern China	
1 Stores	14 Counters