MANAGEMENT DISCUSSION AND ANALYSIS

Business Review

The retail environment for the year ended 28 February 2006 was a mixed year. The economy in Hong Kong was recovering, unemployment rate was declining and there were expectations of increased economic activities following the opening of a major theme park in Hong Kong. As a result of the positive economic environment, rent and wages increased. However, the retail sentiment was subsequently undermined by the swift and continued increase in interest rate which is believed to have affected consumer spending power, unfavourable weather and less than expected Mainland travelers to Hong Kong.

In line with its plan, the Company added a total of 58,000 sq. ft. of new sales area during the year ended 28 February 2006. As at 28 February 2006, the Company's total sales area was 294,000 sq. ft. (excluding French Connection stores operated by FCUK IT Company, a 50% owned joint venture), representing an increase of 24.6% compared to the total sales area of 236,000 sq. ft. as at 28 February 2005. Sales from retail operation increased by 23.2% to HK$1,245.4 million for the year ended 28 February 2006 (2005: HK$1,011.3 million).

The "I.T" in Festival Walk and Pacific Place added 9,000 sq. ft. more sales area for the sale of high end international brands. The comparable stores sales of "I.T" recorded a 15.3% growth as compared to the year ended 28 February 2005. Sales of products of international brands increased by 33.0% to HK$578.9 million (2005: HK$435.1 million), which accounted for 44.0% (2005: 41.8%) of total sales. Sales of products of in-house and licensed brands increased by 18.6% to HK$666.5 million (2005: HK$562.1 million), which accounted for 50.7% (2005: 54.0%) of total sales. The percentage shift in the sales of international brands against in-house and licensed brands was mainly attributable to the increase in new sales footage for the international brands. The prolonged increase in interest rate might have also weakened the purchasing power of the in-house and licensed brands customer group. The overall comparable stores sales of the Company decreased by 2.6% as compared to the year ended 28 February 2005.

Gross profit increased by 22.0% to HK$774.2 million in the year ended 28 February 2006 (2005: HK$634.5 million). The gross profit margin of retail operation slightly declined to 61.1% (2005: 62.3%). The decrease in gross profit margin was mainly due to the shift in product mix to international brands, which comparatively have a lower margin than in-house and licensed brands, and a slightly deeper discount being offered from the in-house and licensed brands.

Rental expenses (including rental charge, rented premises management fee, rates and government rent) increased by 34.4% to HK$282.5 million for the year ended 28 February 2006 (2005: HK$210.2 million), which was in line with the increase of weighted average sales area for store in operation during the year. The weighted average sales footage for stores in operation for the year ended 28 February 2006 increased by 35.8% to 273,000 sq. ft. (2005: 201,000 sq. ft.). As a percentage of total sales, rental expenses slightly increased to 21.5% (2005: 20.2%).

Resulting from the increase in sales footage, staff cost (excluding the share-based compensation in respect of Pre-IPO share options and share options) for the year ended 28 February 2006 increased by 27.4% to HK$217.2 million (2005: HK$170.5 million). As a percentage of total sales, staff cost (excluding share-based compensation) was maintained at 16.5% (2005: 16.4%).

Other operating overheads (excluding rental expenses, staff costs, share-based compensation and depreciation) as a percentage of total sales improved to 6.8% (2005: 7.3%).

During the year ended 28 February 2006, share-based compensation of HK$13.9 million (2005: HK$1.3 million) was charged to the income statement. After accounting for the aforementioned share-based compensation, the net profit for the year ended 28 February 2006 was HK$122.3 million (2005: HK$111.4 million), an increase of 9.8%. Excluding the share-based compensation, the net profit of the year ended 28 February 2006 would have increased by 20.8% to HK$136.2 million (2005: HK$112.7 million).

Net sales of G.S-i.t Limited ("GSIT") (50% owned joint venture) increased by 126.8% to HK$210.2 million in the year ended 28 February 2006 (2005: HK$92.7 million), as a result of increased brand recognition of I.T in the PRC market. A total of 60,000 sq. ft. new sales footage was added in the PRC during the year, representing an increase of 48.8% as compared to the previous year. The multi-brand mega store concept was well received by customers and franchisees and therefore GSIT continued to apply this concept in building its distribution network during the year. Out of the 60,000 sq. ft. new sales footage that was added, 46,000 sq. ft. was opened as directly managed multi-brand mega stores. Multi-brand stores housing the Company's in-house/licensed brands were also opened in Shenyang, Nanjing and Macau by franchisees during the year ended 28 February 2006. As at 28 February 2006, GSIT had 122 points of sales (including 11 French Connection stores, operated by a 50% joint venture with French Connection) with a sales footage of 183,000 sq. ft. in the PRC (2005: 93 stores (including one French Connection store) with a sales footage of 123,000 sq. ft.) and 23 stores in Taiwan (2005: 12 stores).

Operating Profit and Earnings (Excluding the Share-Based Compensation) Before Interest, Taxation, Depreciation and Amortisation Expenses (EBITDA)

EBITDA for the year ended 28 February 2006 increased by 10.3% to HK$196.8 million (2005: HK$178.5 million). Because of the decrease in gross profit margin, EBITDA as a percentage of total sales decreased to 15.0% for the year ended 28 February 2006 (2005: 17.1%).

Operating profit decreased by 0.8% to HK$148.0 million for the year ended 28 February 2006 (2005: HK$149.3 million). Excluding the share-based compensation, operating profit for the year ended 28 February 2006 would have increased by 7.5% to HK$161.9 million (2005: HK$150.6 million).

Share of Results of Jointly Controlled Entities

Share of profit of jointly controlled entities was HK$4.2 million (2005: loss of HK$8.9 million).

Cash Flows

Net cash generated from operating activities was HK$137.3 million for the year ended 28 February 2006 (2005: HK$140.2 million). Net cash used for investing activities was HK$134.1 million (2005: HK$162.6 million). For the year ended 28 February 2006, HK$77.1 million (2005: HK$60.5 million) was used for additions to furniture and equipment and HK$41.5 million (2005: HK$42.0 million) was used to finance the operation of jointly controlled entities. Net cash used for financing activities for the year ended 28 February 2006 was HK$140.3 million (2005: net cash inflow of HK$531.0 million), HK$71.4 million was received from issuance of shares for the year ended 28 February 2006, HK$44.6 million of dividends were paid to shareholders and long-term bank loans of HK$145.0 million were repaid.

Inventory

Inventory turnover days for the year ended 28 February 2006 were 84 days (2005: 75 days). Due to the unfavourable weather and the sluggish retail sentiment, there was a variance to the budgeted sales growth and the inventory turnover days increased.

Liquidity and Capital Resources

As at 28 February 2006, total cash and bank balances amounted to HK$425.6 million (2005: HK$579.7 million) and the total liabilities were HK$135.8 million (2005: HK$288.7 million). As at 28 February 2006, shareholders' equity was HK$747.3 million (2005: HK$599.1 million).

As at 28 February 2006, the Group had aggregate banking facilities of approximately HK$312.5 million (2005: HK$369.1 million) for overdrafts, bank loans and trade financing, of which approximately HK$235.1 million (2005: HK$122.2 million) was unutilised.

As at 28 February 2006, charges on assets amounted to HK$0.75 million, which was the bank deposit pledged for letters of guarantee issued by banks in lieu of rental deposits (2005: HK$54.9 million, comprising bank deposits of HK$17.8 million and inventories of HK$37.1 million held under trust receipts bank loan arrangements).

The Company had no bank borrowings as at 28 February 2006 (2005: HK$182.1 million). The current ratio as at 28 February 2006 was 5.4 (2005: 3.1).

Contingent Liabilities

As at 28 February 2006, letters of guarantee issued by banks in lieu of rental deposits amounted to HK$16.6 million (2005: HK$12.2 million).

Use of Proceeds

The proceeds from the issuance of new shares by the Company in March 2005, net of listing expenses, were approximately HK$514.9 million. For the year ended 28 February 2006, net proceeds were utilised in the following manner:

	Per Prospectus HK$'000	Amount Utilised HK$'000	Balance as at 28 February 2006 HK$'000
Expansion of retail network in Hong Kong	320,000	86,500	233,500
Expansion of retail network in the PRC and Taiwan	90,000	20,000	70,000
Repayment of bank loans	95,000	95,000	–
Working capital	9,900	9,900	–
	514,900	211,400	303,500

The unutilised balance was placed as short-term bank deposits in commercial banks in Hong Kong.

Employment, Training and Development

The Group had a total of 1,283 employees as at 28 February 2006 (2005: 1,279). Training courses were regularly organised for employees to enhance technical and product knowledge as well as to update industry quality standards. The Group offered competitive remuneration packages to its employees, including basic salaries, allowances, insurance and bonuses. In addition, share options were granted based on individual performances.

Future Outlook

To further enhance the Company's brand portfolio and competitiveness, the Company will continue to introduce attractive and high valued imported brands, such as A Bathing Ape, Beams T and Baby Jane. New in-house brands, marketed within a more affordable price range with strong value for money attributes, are expected to be launched both in Hong Kong and in the PRC in winter 2006, which would further broaden the Company's customer base.

The multi-brand mega store concept has been a successful business model for the Group. It not only provides a pleasurable retail environment and product variety to customers, but also allows such stores to be an anchor tenant within the respective shopping malls or locations which enables the Company to enjoy more competitive rental terms. With the success of mega multi-brands store in apm, Cleveland Street and Festival Walk in Hong Kong and Oriental Plaza in Beijing and Plaza 66 in Shanghai, the Company intends to further refine this concept in Hong Kong, Beijing and Shanghai to set it as a model for other cities in the PRC.

The Board believes that the increase in rental expenses will be moderate although staff costs are expected to increase in the coming years. Despite signs of improvement in the domestic economy, oil prices and interest rates are expected to continue its rising trend. In addition, the supply of suitable retail locations is becoming more limited. Based on these factors, the Company expects to adopt a comparatively moderate expansion pace in Hong Kong for the year ending 28 February 2007. Approximately 30,000 to 40,000 sq. ft. of new sales area is expected to be added in the coming year.

The Company has obtained a Sub-Licence to open and operate the first Saks Fifth Avenue department store in the PRC. Saks Fifth Avenue sells distinctive luxury fashion men's, women's and children's wearing apparel, shoes and accessories, cosmetics and perfume, jewellery, home furnishings, gift items and other high end merchandises. Demand for luxurious products continues to rapidly increase in the PRC. Through the opening and operation of the first Saks Fifth Avenue department store in the PRC, the Company will be able to gear up into the market of distributing well known and luxurious high end international labels in the PRC.

The Company is vigorously expanding its presence in other regions. Three "http://www.izzue.com" stores were opened in Saudi Arabia in April 2006. "http://www.izzue.com" and "5cm" will be launched in Thailand in June 2006. More stores will be opened progressively in these two countries in the coming years. Discussion is underway with other potential franchisees in the South East Asia. The Company believes that a meaningful wholesale business will enhance the overall margin and brand recognition and is therefore dedicated to further expanding its franchising network.

GSIT will continue to expand its presence in the PRC. The distribution network in Beijing will be further strengthened in 2006 and 2007, to capitalise on the anticipated rise in sales as a result of the 2008 Olympics in Beijing. GSIT expects to also extend its direct retail network outside Beijing, Shanghai and Hangzhou, by opening a 10,000 sq. ft. "I.T" in Xian in June 2006 and a 8,000 sq. ft. multi-brand store in Shekou, Shenzhen in July 2006 respectively. Furthermore, GSIT will become the sole distributor of Kenzo, LVMH group, and take over its distribution network in the PRC. At least eight Kenzo free-standing stores/concession counters will be added in GSIT's directly managed distribution network by September 2006. GSIT will aggressively introduce well-established high end international brands and designers' labels to the market and strengthen its brand portfolio as well as its distribution network. Despite the competitiveness of the retail market in Taiwan, GSIT expects to introduce more up-and-coming brands to expand its market share in Taiwan.