# MANAGEMENT DISCUSSION AND ANALYSIS

## ANALYSIS OF RESULTS

### Turnover

The Group's turnover for the year ended 31 March 2006 increased by 0.9% to approximately HK$341 million, from HK$338 million for the previous year. The small change in turnover reflects the solid customer base of the Group.

In this year, the Group focused its business entirely on knit-to-shape garments, as it slowly phased out the non knit-to-shape garment production. The US remained the Group's core market. The Group's sales to US were HK$304 million (2005: HK$296 million), representing an increase of 2.7%.

More and more of the Group's sales are now made by the automated production division. The Group believes that as it adds more computerized knitting machine, it will be able to present itself as an efficient producer in heterogeneous knit-to-shape garments, and at the same time a skillful producer in more complex knitwear garments given its long history in embroidery, sowing in beads, and complex knitting patterns.

### Profitability

The Group recorded a profit of HK$800,000 for the year ended 31 March 2006. This represents a complete turnaround from a loss of HK$29 million for the year ended 31 March 2005. The Group accomplished this profitability by improving its gross margin, which increased to 8.8% (2005: 8%). Despite the increase in raw material cost, energy cost, and labour cost, the Group managed to be profitable on account of the extensive utilization of the computerized machinery. During the peak season, the computerized machine enabled the Group to better manage its high sub-contracting costs.

In addition to the ability to control production cost, the Group benefited significantly with the elimination of a substantial portion of quota expenses. The quota charges of HK$20 million that the Group paid for in the previous year was extensively reduced in the current year. The only significant item that offset the lower selling and administrative expenses was the increase in depreciation charges in respect of the utilization of the computerized machinery.

One significant cost that increased in the year ended 31 March 2006 was interest charge. Due to the use of the banking facilities, the Group incurred HK$4.1 million in interest charges (2005: HK$2.2 million).

## LIQUIDITY AND CAPITAL RESOURCES

As at 31 March 2006, total amount of cash and bank balances of the Group were approximately HK$10 million, representing an increase of 11% when compared to 31 March 2005. As the Group believes that its profitability now is improving, its cashflow position is expected to improve. Most of the funds were held in Hong Kong dollars and US dollars. As at 31 March 2006, net current assets were HK$1 million (31 March 2005: HK$3 million).

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In the year ended 31 March 2006, the Group acquired property, plant and equipment totaling HK$37 million, of which HK$8.1 million was financed by finance leases. Due to the significant capital expenditures, the Group's use of banking facilities reached HK$50 million. The Group also received an advance of HK$17 million from two of its Directors. The Group has sought to obtain the loans from the Directors on account that the amounts were borrowed at terms that are more favorable than those offered by any banks, and without incurring any cost in securing any assets of the Group. The Group has available banking facilities totaling HK$107 million (31 March 2005: HK$210 million) which were secured by corporate guarantees given by the Company. The Group's gearing ratio computed as total borrowings over shareholders' fund was 54% as at 31 March 2006 (31 March 2005: 34%).

The Group's sales were principally denominated in US dollars while purchases were transacted mainly in Hong Kong dollars and US dollars. The Group's expenditures in China, the location of its production facilities, are denominated in the Chinese Yuan. In 2005, the Chinese government changed its policy regarding the alignment of the Yuan relative to the US dollars. However, in terms of the Group's expenditures that are denominated in the Yuan as compared to its overall purchases in Hong Kong and US dollars, and in view of the minor adjustments expected to the Yuan in the short term, the Group believes that its currency exposure is minimal and immaterial.

The Group's borrowings and cash balances were principally denominated in Hong Kong dollars. No financial instruments were used for hedging purposes.

## DIVIDENDS

The Directors have resolved not to recommend the payment of any dividend for the year ended 31 March 2006 (31 March 2005: nil).

## CHARGE ON GROUP ASSETS

As at 31 March 2006, certain machinery of the Group with an aggregate value of approximately HK$3 million (31 March 2005: approximately HK$3.5 million) was pledged to secure the banking facilities utilized by the Group.

## CONTINGENT LIABILITIES

As at 31 March 2006, the Company had issued corporate guarantees to banks in connection with facilities granted to certain subsidiaries amounting to HK$65 million (31 March 2005: HK$183 million).

## CAPITAL EXPENDITURES AND COMMITMENTS

During the year ended 31 March 2006, the Group had incurred capital expenditures of HK$37 million (2005: HK$41 million). There were no capital commitments outstanding as at 31 March 2006 (2005: outstanding commitment was HK$28 million).

## EMPLOYEES AND REMUNERATION POLICIES

As at 31 March 2006, the Group had approximately 1,162 (2005: 1,057) employees. The Group's remuneration package is structured to commensurate with individual responsibilities, qualification, experience and performance.

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## FUTURE PROSPECTS

The Directors strongly believe that the controlled growth strategy of the Group should continue for some years. In light of the looming inflationary pressure in the US economy, the threat of continuing interest rate rise, the persistently high oil prices, the volatility of the US textile import policy, the Directors strongly believe that a more prudent approach to management and development is the right approach. As a reflection of its policy of managing growth in a controlled manner, the Group expects its sales performance over the current and next few years to be stable.

During the year, the Group has set up a representative office in the US. The Group believes that with this presence in the US, it will be able to improve its name recognition in its customer base. With many US retailers looking to buy their products from manufacturers, the Group believes that it needs to begin to develop brand awareness within the US garment industry. The orders placed by the current customers of the Group are mainly for fall/winter knitwear products rather than spring/summer knitwear products. This seasonality leads to an acute fluctuation in the Group's sales as turnover in the first 6 months of each financial year tends to be twice as large as that in the latter 6 months. In order to reduce this fluctuation, the Group is looking to have its U.S. representative office to approach new customers so as to enlarge the customer base of the Group which the Directors believe that will place the Group in a more favorable position in soliciting orders for spring/summer knitwear products. It is expected that the US representative office will accomplish these goals for the Group.

As the Group is under constant pressure to reduce its labour cost, it is also considering to investing in more computerized machinery. Having lived through the periods of drastic changes to the markets and customer preferences of the Group's knit-to-shape garments, the Group believes that its ability to survive and to overcome the adversity can be attributed to its solid background, foundation, and quality of its products. The Group is determined to find all means of reverting to its past profitability, but without compromising on its reputation of producing quality products and creating value for its customers.