Management Discussion and Analysis

The financial year of 2005/2006 was a challenging year to our Group. On one hand, our Group benefited from such positive factors as expansion of production capacity, technological advancement and rapid expansion of the PRC market. On the other hand, our Group faced such negative factors as rising production costs and appreciation of Renminbi, which eroded the profit of our Group. Nevertheless, our Group will strive to improve the profit margin by diversifying the source of income and exercising effective cost controls in order to respond to the support of our shareholders.

Management Discussion and Analysis

BUSINESS REVIEW

Eagle Nice (International) Holdings Limited (the "Company") and its subsidiaries (together the "Group") is principally engaged in the manufacture of sportswear for men, women and children on an OEM (an acronym for "original equipment manufacturer", which produces or customises products according to the design supplied by the customers) basis. The sportswear manufactured and sold by the Group can broadly be divided into tracksuits, sport pants, jackets, sweaters and T-shirts. The Group mainly manufactures products under international brandnames such as **Nike**, **adidas** and **Puma**. During the year under review, the major markets of the Group's products continued to be the People's Republic of China (the "PRC"), Japan and South Korea.

With the great effort of the management and assistance from Yue Yuen Industrial (Holdings) Limited ("Yue Yuen" – stock code: 551), the financial year of 2005/2006 was a changing and improving year for the Group which had undergone the following changes and improvements in operations.

On production side, with the commencement of operation of the new production plant in Shantou, the PRC (the "New Production Plant") in September 2005, the Group has been able to greatly increase its production capacity in order to meet the growing orders from our customers. The New Production Plant comprises a 7-storeyed industrial complex with gross floor area of approximately 67,000 square meters together with ancillary facilities including a basketball court and a carport. The production capacity of the New Production Plant is approximately 1.5 times of that of the old factory when it is fully operated by the financial year ending 31 March 2008. Nearly half of the gross floor area of the old factory which were under operating leases are no longer in use.

Moreover, with a view to improving the production workers' working efficiency, during the year under review, the production processes were reorganised from traditional production (i.e. different parts of a product manufactured by different production teams) to assembly production lines (i.e. each worker performs a particular job which must be completed before the product moves to the next position in the line). Furthermore, in order to exercise better control of the workers' working efficiency, a control system had been implemented on trial stage, which is a time control system to ensure that the workers could complete their jobs within a predetermined time limit.

Besides, stable product quality and timely delivery of our products to customers are our main concerns in the production processes. In order to exercise better control of the materials quality and ensure timely delivery of materials by the suppliers, in January 2005, a liaison office was established in Taiwan, where most of the materials are purchased, so that our staff in Taiwan can make better communication with the suppliers in Taiwan.

In respect of technology, with the assistance from Yue Yuen, the first phase of the implementation of the Enterprise Resource Planning System (the "ERP System") had been nearly completed during the year under review, which has greatly improved the efficiency of handling sales orders and purchase orders, the accuracy of calculation of materials need, the scheduling of materials purchases, and the control over materials consumption.

With respect to research and development, during the year under review, we started the planning of establishment of a Research and Development Centre. To diversify the source of income of our Group and provide better services to our customers, we are no longer satisfied to being just an OEM manufacturer. We have started to equip our Group to be an ODM manufacturer (an acronym for "original design manufacturer", which owns and/or designs in-house products that are branded by the customers). In the first stage, we plan to invest approximately HK$5 million for the establishment of the Research and Development Centre, purchase of equipment, and recruitment of competent staff. It is expected that the Research and Development Centre will commence operation in 2007.

As one of the major business partners of the international brands, our Group as well as our customers are very concerned with the welfare and health of our staff. Not only can a good working environment raise the working efficiency of our staff but also assist in attracting mature labour and recruiting sufficient workforce to fill the expanded capacity of the New Production Plant. In September 2005, the Group entered into an agreement with a third party to acquire a building in Shantou, the PRC, which is adjacent to the New Production Plant, with a total gross floor area of approximately 18,000 square meters. Such property will be designed as a recreational complex equipped with various facilities for our staff such as training room, multi-function meeting room, canteen and health centre. It is expected the building can be put into use in the last quarter of 2006.

Management Discussion and Analysis

BUSINESS REVIEW (continued)

In respect of geographical markets, the PRC has become a dominant market of the Group as the proportion of the Group's sales to the PRC market grew from approximately 39% for the year ended 31 March 2005 to approximately 49% for the year ended 31 March 2006. Such trend is expected to continue in the coming years. In the PRC, rising affluence, rising popularity of sports, impact of the 2008 Beijing Olympics and low penetration rate of sportswear in cities are driving demands for sportswear. Therefore, the PRC market has become the focal point for leading sportswear brands which have encountered limited growth opportunities in the mature American and European markets. The PRC market is the most promising of the emerging markets for the international sportswear brands. The PRC market is expected to be a significant earning driver for the Group.

FINANCIAL REVIEW

For the year ended 31 March 2006, revenue of the Group increased from approximately HK$451 million to approximately HK$519 million, an increase of approximately 15%. The increase was mainly attributed to an increase in the orders placed by customers as a result of the effort of the Group's marketing team supported by an expansion of the Group's production capacity.

Gross profit of the Group for the year ended 31 March 2006 was approximately HK$126 million compared to approximately HK$129 million achieved during the year ended 31 March 2005. The gross profit margin of the Group was approximately 24% for the year ended 31 March 2006 compared to approximately 28% for the year ended 31 March 2005, a decrease of approximately 4%. The decrease in gross profit margin was mainly attributed to (i) rising materials costs resulting from increasing crude oil price and inflation; (ii) an increase in production overhead owing to the commencement of operation of the New Production Plant; (iii) an increase in transportation costs due to increasing crude oil price; and (iv) appreciation of Renminbi resulting in a rise in production costs of our Group's factories in the PRC.

Administrative costs of the Group for the year ended 31 March 2006 increased by approximately 37% to approximately HK$36 million compared to approximately HK$26 million for the year ended 31 March 2005 as a result of an increase in staff costs due to employment of additional staff and additional expenses incurred by the Taiwan liaison office established in January 2005.

With the repayment of all outstanding bank borrowings during the year ended 31 March 2005, no finance costs were incurred during the year under review compared to approximately HK$189,000 incurred during the year ended 31 March 2005.

The provision for tax for the year ended 31 March 2006 increased to approximately HK$15 million compared to approximately HK$9 million for the year ended 31 March 2005. The increase was resulted from additional tax provision of approximately HK$7 million made for the previous financial years.

LIQUIDITY AND FINANCIAL RESOURCES

During the year under review, the Group continued to maintain a healthy liquidity position. The Group generally finances its operations with internally generated resources and banking facilities provided by its bankers. As at 31 March 2006, the Group had cash and cash equivalents amounted to approximately HK$215 million mainly denominated in Hong Kong dollars and US dollars. (31 March 2005: approximately HK$323 million). As at 31 March 2006, the Group had no outstanding borrowings (31 March 2005: nil). As at 31 March 2006, the Group had aggregate banking facilities of approximately HK$160 million (31 March 2005: approximately HK$160 million) and were secured by (i) certain property, plant and equipment, and prepaid land lease payments owned by the Group; (ii) pledged deposits of the Group; (iii) corporate guarantees executed by the Company; and (iv) unlimited corporate guarantees executed by three subsidiaries of the Company. No banking facilities were utilised by the Group as at 31 March 2006 (31 March 2005: nil).

The management believes that the existing financial resources will be sufficient to meet future expansion plans and, if necessary, the Group will be able to obtain additional financing with favourable terms. There is no material effect of seasonality on the Group's borrowing requirements.

1 December 2005 is an important and meaningful day to our Group. The opening ceremony of the New Production Plant was held on that day. It was our pleasure that over hundred of guests including our business partners, senior management of Yue Yuen and government officials of Shantou Municipal Government attended the opening ceremony.

Management Discussion and Analysis

LIQUIDITY AND FINANCIAL RESOURCES (continued)

As at 31 March 2006, the Group's gearing ratios represented by total liabilities as a percentage of the Group's total assets amounted to approximately 8.4% (31 March 2005: approximately 9.8%).

For the year ended 31 March 2006, the Group was not subject to any significant exposures to foreign exchange rate risk. Hence, no financial instrument for hedging was employed.

As at 31 March 2006, the Group did not have any significant contingent liabilities (31 March 2005: nil). As at 31 March 2006, the Company had given corporate guarantee to banks to the extent of approximately HK$164 million (2005: approximately HK$164 million) for banking facilities granted to certain subsidiaries of the Company, which were not utilised at the balance sheet date.

SIGNIFICANT INVESTMENTS

As at 31 March 2006, there was no significant investment held by the Group (31 March 2005: nil).

FUTURE PLAN AND PROSPECTS

The sportswear industry in Asia, particularly in the PRC, is expected to demonstrate a strong momentum in the coming future to propel the business of the Group to greater heights. The Group will also try to penetrate into new markets such as Europe and the United States.

In addition to placing great efforts in securing more orders from international brands, the Group will continue to improve the production efficiency by automating more of its production process; and to expand its production capacity by acquiring further plant and machinery in order to capture the growing demand and orders.

Our Group will always have the interests of our shareholders in mind and will use our best efforts in enhancing the Group's profitability in the long run and generating fruitful returns to our supportive shareholders.

Management Discussion and Analysis

EMPLOYEES AND REMUNERATION POLICIES

As at 31 March 2006, the Group employed a total of approximately 4,900 employees including directors (31 March 2005: approximately 4,700). Total staff costs including directors emoluments were approximately HK$90 million for the year under review (31 March 2005: approximately HK$79 million).

The employees are remunerated based on their work performance, professional experiences and the prevailing industry practice. The Group also makes contributions to the statutory mandatory provident fund scheme for the employees of the Group in Hong Kong and to the central pension scheme for the employees of the Group in the PRC.

MATERIAL ACQUISITION OR DISPOSAL OF SUBSIDIARIES AND ASSOCIATED COMPANIES

There was no material acquisition or disposal of subsidiaries and associated companies during the year ended 31 March 2006 (31 March 2005: nil).