Mainland Headwear Holdings Limited

(Stock Code : 1100)

Interim Report 2006

Contents

The Board of Directors (the "Board" or the "Directors") of Mainland Headwear Holdings Limited (the "Company") is pleased to announce the unaudited interim results of the Company and its subsidiaries (collectively, "Mainland Headwear" or the "Group") for the six months ended 30 June 2006 (the "Period") together with comparative figures for the corresponding period in 2005.

Financial Review

For the six months ended 30 June 2006, the Group recorded a turnover of HK$319,494,000, representing an increase of 36.7% when compared with the corresponding period last year. The increase was attributable to the growth in sales across all segments of the manufacturing, trading and retail businesses.

Profit attributable to equity shareholders increased 8.1% to HK$38,883,000 as compared with the first half of 2005. The extent of profit growth was relatively lower than that of turnover, which was primarily due to an increase in manufacturing labor cost as a result of the Group's efforts to retain and strengthen its skilled workforce. The impact was also fuelled by an upsurge in non-fabric raw material cost and an increase in outsourcing to meet the escalating sales demand in the Manufacturing Business. In addition, the Retail Business, which accounted for about 10% of the Group's turnover for the Period, is still in its investment phase and did not contribute to profits during the Period.

The increases in manufacturing costs, coupled with the continued appreciation of the RMB, contributed to the reduction of the gross profit margin of the Group, to 36.4%, for the Period.

Selling and distribution costs more than doubled to HK$20,113,000 as compared with the first half of 2005. The increase was mainly attributable to shop expenses created by the increasing number of stores as a result of the expansion of the Retail Business. Meanwhile, in an effort to strengthen customer relationships and capture additional market share, the Group intentionally chose to fill urgent manufacturing orders and absorb freight expenses. As a result, air freight expenses of HK$1.2 million were incurred during the Period.

Administrative expenses increased by 18%, to HK$60,399,000, as compared to the first half of 2005. This was attributable to the expansion of the Retail Business as well as the establishment of the UK subsidiary in March 2005 and the new Japan office in early 2006.

Business Review

The Manufacturing Business

The Group's Manufacturing Business showed stable performance during the Period. Turnover increased by 21.7% to HK$209,713,000 as the Group received strong orders in the first half of 2006. However, the gross profit margin was adversely affected by the hike in non-fabric raw material costs such as plastic and copper, the rise in labor cost for retaining a skilled labor force and the surge in minimum wages in Shenzhen. These additional expenses were compounded by a substantial increase in the cost of subcontracting work, which was undertaken for orders in excess of production capacity with the aim of maintaining relationships with major customers. In addition, the appreciation of the RMB also put pressure on manufacturing costs. As a result, the gross profit margin decreased to slightly below 32%.

To maximize the return on capital investment and to achieve sustainable business growth over the long term, the Group adopted a prudent approach to expanding its production capacity. In view of the strong orders during the Period, the Group increased its proportion of outsourcing while seeking to improve its productivity in the most cost-efficient way. During the Period, the Group added an additional production line as planned. Twenty digitized embroidery machines have been committed for the second half of 2006 with the aim of controlling subcontracting costs and enhancing the production capacity of the Group.

On 30 June 2006, the Group acquired Kangol Headwear (Panyu) Limited ("Panyu Factory"). Panyu Factory manufactures about 85% of the headwear of the top-tier fashion headwear brand, "Kangol". This acquisition not only helps the Group to extend its product offerings to fashion headwear, which has a higher gross profit margin, but also immediately alleviates pressure on the Group's production capacity.

The Trading Business

During the Period, turnover of the Trading Business significantly increased by 30% to HK$129,597,000. This impressive growth in turnover was attributable to the remarkable sales performance of the private label business, which accounted for 22% of the Trading Business. In addition, the turnover of the European market for the Period also improved significantly compared to the same period in 2005. This was attributable to the establishment of the UK subsidiary in March 2005.

After the loss of the MLB license in the US in late 2004, the Group refocused on the private label business and worked to improve the gross profit margin of other licensing business. The strategic foresight of management in this area of operations has proven to be a fruitful endeavor. Not only did turnover improve during the Period, but the overall gross profit margin of the Trading Business also recovered to slightly above 25%. This narrowed the loss of the Trading Business to HK$1,869,000 as compared to the loss of HK$4,394,000 in the corresponding period last year. Since the private label business is more seasonal than the license business, it is expected that turnover of the Trading Business will continue to grow in the second half of the year. However, the growing private label business, which has relatively lower profit margin than that of the licenses business, is also expected to reduce the average gross profit margin of the Trading Business in the second half of the year.

The Retail Business

For the six months ended 30 June 2006, turnover of the Retail Business increased by about 2.7 times to HK$32,080,000, representing about 10% of the Group's total turnover for the Period. This jump in turnover was attributable to the continued expansion of the LIDS and Sanrio operations. However, whilst the Group was endeavoring to establish an extensive base of quality franchisees, it continued to select franchisees in a prudent manner, leading to a lower-than-expected increase in the number of franchisees and related sales.

The Retail Business recorded an operating loss of HK$6,773,000 for the period under review. However, the improvements in shop level performance were promising as there was encouraging shop-to-shop growth in most of the stores and the overall shop rental to turnover ratio was lower compared to same period last year. These results clearly indicate that the Group's retail operations are moving in the right direction for growth and profitability.

For the LIDS operation, the Group adopted a proactive yet prudent strategy in opening new stores. As at 30 June 2006, the Group had opened a total of 31 self-owned LIDS stores, of which 8 were in Hong Kong and 23 were in the PRC. The Group had a total of 6 franchised shops in the PRC at the end of the Period. Although impressive shop-to-shop growth in sales has helped to lower the shop rental to turnover ratio of most of the stores, high shop rental cost in Hong Kong continued to be a major challenge. To improve the profitability of the operation, the Group continued to take a conservative approach to review and adjust the LIDS shop portfolio in Hong Kong. Operations in the PRC continued to improve and most of the shops now achieve a positive contribution at shop level.

As for the Sanrio operation, the Group had opened 35 self-owned Sanrio stores and had 10 franchised shops in the PRC as at 30 June 2006. Most of the self-owned stores generated positive contributions since opening. However, progress on the whole was behind schedule due to the slower-than-expected expansion of the franchise operation. To enhance the gross profit margin so as to facilitate the expansion of the franchise operation and to improve the overall profitability of the Sanrio business, the Group continues to increase the sourcing of self-developed products locally and work directly with Sanrio licensed vendors to reinforce the cost competitiveness of its products.

In regard to the Kangol specialty stores operation, the Group opened two Kangol stores in the PRC selling Kangol accessory products during the Period to test the market. While the market response has been satisfactory, due to the nature of the niche market in which it operates, the Group will take a conservative approach to opening new Kangol stores.

Prospects

The Group is confident in the market outlook, in particular for 2007 and 2008 as sales of 2008 Olympics headwear is expected to bring new opportunities to the Group.

The acquisition of the Panyu Factory has added to the production capacity of the Group. The Group also plans to further increase production capacity by 20% in 2007 through the addition of new production lines. The remaining capacity requirement will be outsourced.

The pressures on the manufacturing margin are expected to remain in the second half of 2006. However, as the Group has implemented new measures to improve various production and cost efficiencies, it is anticipated that the manufacturing gross profit margin can be maintained at the current level in the second half of 2006. Also, in order to further consolidate its leading position in the headwear industry, the Group is dedicated to extending its product range to fashion headwear. This will help to preserve a higher gross profit margin in the long run.

Regarding the Trading Business, the Group believes the current momentum of growth in turnover will extend into the second half of 2006. However, the gross profit margin will be lower as more private label business is expected in the second half of the year.

On the Retail Business front, the Group will continue to expand its network in the PRC through franchising. The Group aims to increase the numbers of self-owned LIDS stores to 10 in Hong Kong and 26 in the PRC, and franchised stores in PRC to 16 by the end of 2006. The Group also plans to expand its Sanrio network in the PRC to 40 self-owned stores and 40 franchised stores by the end of the year. In addition, the Group will extend the reach of Kangol stores by opening 2 more new stores, resulting in a total of 4 stores in operation by the end of 2006. The Group is dedicated to enriching its store portfolio in order to expedite sales growth.

In light of the robust growth momentum of the Sanrio and LIDS operations, the Group expects these operations to achieve breakeven in late 2006 and in 2007, respectively. Capitalizing on the established retail and distribution platform, including the regional offices and warehouses, the Group is confident that the Retail Business will emerge as a key growth driver in the future and will also play an important role in the Group's operations of the Olympics business.

By leveraging on its clear business and market development strategies, Mainland Headwear is committed to capturing new business opportunities and creating fruitful returns for shareholders.

Acquisition of Panyu Factory

On 30 June 2006, the Group acquired Kangol Headwear (Panyu) Limited ("Panyu Factory") which manufactures headwear of the top-tier fashion headwear brands, including Kangol. There are two parts of considerations: (i) adjusted cash consideration of US$5,720,000; and (ii) an earnout ranging from US$2,475,000 to US$4,800,000 to be calculated by reference to the operating profit of the Panyu Factory for the three years ending 31 December 2010, payable within three years ending 31 December 2011, subject to adjustments of the compensations for any loss in the first year and shortfalls in purchase commitment as detailed below.

According to the sale and purchase agreement, the vendor will compensate the Group for any operating loss up to US$1,200,000 incurred by Panyu Factory in the first year after the acquisition. The vendor has also committed to place purchase orders with Panyu Factory totaling US$20,000,000 in the second and third years after the acquisition.

Goodwill arising from the acquisition amounted to HK$3,203,000, the calculation of which is set out in note 13 to the unaudited interim financial report.

This acquisition will not only help the Group to further penetrate the US market, but also facilitate its planned expansion into the Japanese and European markets, which are more fashion-focused and offer a better profit margin.

Other details of the acquisition have been included in the Company's circular to shareholders dated 14 July 2006.

Liquidity and Financial Resources

Except for the short term bank loan of HK$5.8 million of the newly acquired Panyu Factory, the Group continues to enjoy financing for its operations by internally generated cash flows. The bank loan, in RMB and at fixed interest rate, was secured by the land and building of the factory with a carrying value of HK$20,512,000 as at 30 June 2006.

As at 30 June 2006, the Group had cash and bank balances of approximately HK$104.7 million (31 December 2005: HK$77.7 million). In addition, the Group also had some liquid investments totalling HK$6.2 million (31 December 2005: HK$67.7 million) at the end of the Period under review. Major applications of liquid funds during the Period related to the acquisition of the Panyu Factory and the payment of the 2005 final dividends. Excluding the inventories of HK$26 million of the newly acquired Panyu Factory, inventories of Group remained at a similar level as with 31 December 2005 despite a jump in business volume during the Period. As of 30 June 2006, the turnover of the trade receivables for Manufacturing Business and Trading Business was 68 days as compared to 66 days at 31 December 2005.

About 67%, 24% and 7% of the liquid funds were denominated in US dollars, Renminbi and HK dollars respectively.

As at 30 June 2006, in addition to the HK$5.8 million bank loan of the Panyu Factory, the Group had other banking facilities of HK$91.4 million (31 December 2005: HK$95.3 million), of which HK$87.5 million (31 December 2005: HK$88.5 million) was not utilized. Banking facility in the amount of HK$23.3 million (31 December 2005: HK$27.1 million), of which HK$1.7 million (31 December 2005: HK$1.6 million) was utilized, is secured by inventories, and trade and other receivables of a subsidiary amounting to HK$35.5 million (31 December 2005: 36.8 million) and HK$36.0 million (31 December 2005: HK$71.9 million) respectively as at 30 June 2006.

The Group continued to maintain its gearing ratio (being the Group's net borrowings over its total equity) at zero. In view of the strong financial and liquidity position, it is evident that the Group will have sufficient financial resources to meet its commitments and working capital requirements.

Capital Expenditure

During the Period, the Group spent approximately HK$4.9 million (2005: HK$2.5 million) on additions to plant and equipment to further upgrade its manufacturing capabilities, and HK$2.3 million (2005: HK$2.3 million) on the infrastructure of the retail operation and opening of new stores.

As at 30 June 2006, the Group had authorized capital commitment of HK$22.2 million in respect of manufacturing equipment and construction of a logistics centre. In addition, the Group also had authorized capital commitment of HK$4.5 million in respect of the infrastructure of the retail operation and opening of new retail outlets.

Contingent Liabilities

There has been no development in respect of the tax investigation on Drew Pearson Marketing, Inc, a subsidiary of the Group in the US, as referred to in the 2005 annual report (the "Report") since the date of the Report.

Exchange Risk

Most assets and liabilities of the Group are denominated either in HK dollars, US dollars or Renminbi. The Group estimates that any 2% appreciation of the Renminbi is expected to reduce the gross margin of the manufacturing business by about 0.6%. However, as the businesses in the PRC market grow, the expected positive contribution will provide a hedge against the adverse effect of any appreciation of Renminbi to the manufacturing costs.

Employees and Remuneration Policies

At 30 June 2006, the Group employed a total of 102 (2005: 110) employees in the USA and the UK, 110 (2005: 100) employees in Hong Kong, and 3,708 (2005: 2,600) workers and employees in the PRC. The expenditures for the employees during the Period were approximately HK$70 million (2005: HK$55 million). The Group ensures that the pay levels of its employees are competitive and employees are remunerated based on their position and performance. Key employees of the Group, including Directors, are also granted share options under the share option schemes operated by the Company.

Interim Dividend

The Board has declared an interim dividend of HK3 cents (2005: HK2 cents) per share, payable on or after 17 October 2006.

Closure of Register of Members

The register of members of the Company will be closed from 25 September 2006 to 28 September 2006 (both dates inclusive). In order to qualify for the interim dividend, all transfers, accompanied by the relevant share certificates, must be lodged with the Company's Hong Kong Branch Share Registrar, Tengis Limited, at 26/F, Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong for registration not later than 4:30 p.m. on 22 September 2006.

Moores Rowland Mazars
摩斯倫・馬賽會計師事務所

TO THE BOARD OF DIRECTORS OF
MAINLAND HEADWEAR HOLDINGS LIMITED
(incorporated in Bermuda with limited liability)

Introduction

We have been instructed by the Company to review the interim financial report set out on pages 12 to 24.

Respective Responsibilities of Directors and Auditors

The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of an interim financial report to be in compliance with Hong Kong Accounting Standard 34 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants and the relevant provisions thereof. The interim financial report is the responsibility of, and has been approved by, the directors.

It is our responsibility to form an independent conclusion, based on our review, on the interim financial report and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Review Work Performed

We conducted our review in accordance with Statement of Auditing Standards 700 "Engagements to Review Interim Financial Reports" issued by the Hong Kong Institute of Certified Public Accountants. A review consists principally of making enquiries of group management and applying analytical procedures to the interim financial report and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the interim financial report.

Review Conclusion

On the basis of our review which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial report for the six months ended 30 June 2006.

Moores Rowland Mazars
Chartered Accountants
Certified Public Accountants

Hong Kong
8 September 2006

Condensed Consolidated Income Statement (Unaudited)

For the six months ended 30 June 2006

	Note	Six months ended 30 June 2006 HK$'000	2005 HK$'000
Turnover	3	**319,494**	233,746
Cost of sales		**(203,311)**	(137,945)
Gross profit		**116,183**	95,801
Other income		**5,749**	4,488
Selling and distribution costs		**(20,113)**	(9,552)
Administration expenses		**(60,399)**	(51,268)
Profit from operations		**41,420**	39,469
Finance costs	5(a)	**(21)**	(45)
Profit before taxation	5(b)	**41,399**	39,424
Taxation	6	**(4,599)**	(4,154)
Profit for the period		**36,800**	35,270
Attributable to:			
Equity shareholders of the Company		**38,883**	35,967
Minority interests		**(2,083)**	(697)
Profit for the period		**36,800**	35,270
Dividends	7		
Paid		**31,487**	28,618
Proposed		**8,587**	5,724
Earnings per share	8		
Basic		**HK13.6 cents**	HK12.6 cents
Diluted		**HK13.5 cents**	HK12.0 cents

The notes on pages 17 to 24 form part of the interim financial report.

Condensed Consolidated Balance Sheet (Unaudited)

At 30 June 2006

	Note	30 June 2006 (Unaudited) HK$'000	31 December 2005 (Audited) HK$'000
ASSETS AND LIABILITIES			
Non-current assets			
Property, plant and equipment		**134,599**	112,022
Prepaid premium on leasehold land held for own use under an operating lease		**1,212**	–
Goodwill		**13,465**	10,262
Intangible assets	*13*	**9,741**	–
Deferred tax assets		**10,206**	10,731
		169,223	133,015
Current assets			
Inventories		**132,363**	103,170
Trade and other receivables	*9*	**162,164**	164,988
Amount due from a related company		**768**	768
Short term investments		**6,182**	67,737
Tax recoverable		**2,449**	2,449
Bank balances and cash		**104,661**	77,666
		408,587	416,778
Current liabilities			
Trade and other payables	*10*	**78,388**	67,927
Amounts due to related companies		**1,038**	995
Secured short term bank loan	*11*	**5,825**	–
Taxation		**9,164**	8,269
		94,415	77,191
Net current assets		**314,172**	339,587
Total assets less current liabilities		**483,395**	472,602

Condensed Consolidated Balance Sheet (Unaudited)

At 30 June 2006

	Note	30 June 2006 (Unaudited) *HK$'000*	31 December 2005 (Audited) *HK$'000*
Non-current liabilities			
Long term payables	*13*	**7,879**	–
Post-employment benefits		**720**	691
Deferred tax liabilities		**5,504**	5,939
		14,103	6,630
NET ASSETS		**469,292**	465,972
CAPITAL AND RESERVES			
Share capital	*12*	**28,625**	28,625
Reserves		**438,501**	433,114
Total equity attributable to equity shareholders of the Company		**467,126**	461,739
Minority interests		**2,166**	4,233
TOTAL EQUITY		**469,292**	465,972

The notes on pages 17 to 24 form part of the interim financial report.

Condensed Consolidated Cash Flow Statement (Unaudited)

For the six months ended 30 June 2006

	Six months ended 30 June	
	2006	2005
	HK$'000	*HK$'000*
Net cash from operating activities	**45,983**	13,813
Net cash from/(used in) investing activities	**12,477**	(1,925)
Net cash used in financing activities	**(31,465)**	(27,984)
Increase/(decrease) in cash and cash equivalents	**26,995**	(16,096)
Cash and cash equivalents at the beginning of the period	**77,666**	101,718
Cash and cash equivalents at the end of the period, represented by bank balances and cash	**104,661**	85,622

The notes on pages 17 to 24 form part of the interim financial report.

Condensed Consolidated Statement of Changes in Equity (Unaudited)

For the six months ended 30 June 2006

	Attributable to equity shareholders of the Company								
	Share Capital HK$'000	Share Premium HK$'000	Contributed Surplus HK$'000	Capital Reserve HK$'000	Accum-ulated Profits HK$'000	Exchange Reserve HK$'000	Total HK$'000	Minority Interests HK$'000	Total Equity HK$'000
At 1 January 2005	28,588	93,888	25,878	5,350	262,052	(173)	415,583	–	415,583
Exchange differences	–	–	–	–	–	90	90	–	90
Acquisition of subsidiaries	–	–	–	–	–	–	–	6,214	6,214
Equity settled share-based transactions	–	–	–	998	–	–	998	–	998
Issue of shares on exercise of share options	30	718	–	–	–	–	748	–	748
Profit for the period	–	–	–	–	35,967	–	35,967	(697)	35,270
Dividend paid	–	–	–	–	(28,618)	–	(28,618)	–	(28,618)
At 30 June 2005	28,618	94,606	25,878	6,348	269,401	(83)	424,768	5,517	430,285
Representing:									
2005 proposed interim dividend		–	–	–	5,724	–	5,724		
Reserves		94,606	25,878	6,348	263,677	(83)	390,426		
		94,606	25,878	6,348	269,401	(83)	396,150		
At 1 January 2006	**28,625**	**94,820**	**25,878**	**6,394**	**306,375**	**(353)**	**461,739**	**4,233**	**465,972**
Exchange differences	**–**	**–**	**–**	**–**	**–**	**(2,209)**	**(2,209)**	**16**	**(2,193)**
Equity settled share-based transactions	**–**	**–**	**–**	**200**	**–**	**–**	**200**	**–**	**200**
Profit for the period	**–**	**–**	**–**	**–**	**38,883**	**–**	**38,883**	**(2,083)**	**36,800**
Dividend paid	**–**	**–**	**–**	**–**	**(31,487)**	**–**	**(31,487)**	**–**	**(31,487)**
At 30 June 2006	**28,625**	**94,820**	**25,878**	**6,594**	**313,771**	**(2,562)**	**467,126**	**2,166**	**469,292**
Representing:									
2006 proposed interim dividend		**–**	**–**	**–**	**8,587**	**–**	**8,587**		
Reserves		**94,820**	**25,878**	**6,594**	**305,184**	**(2,562)**	**429,914**		
		94,820	**25,878**	**6,594**	**313,771**	**(2,562)**	**438,501**		

The notes on pages 17 to 24 form part of the interim financial report.

1 Basis of presentation

The interim financial report has been prepared in accordance with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("Listing Rules"), and Hong Kong Accounting Standard ("HKAS") 34 "Interim financial reporting" issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA").

The interim financial report is unaudited, but has been reviewed by Moores Rowland Mazars, the Company's auditors, in accordance with Statement of Auditing Standards 700 "Engagements to review interim financial reports" issued by the HKICPA. Moores Rowland Mazars's independent review report to the Board of Directors is included on page 10.

The financial information relating to the financial year ended 31 December 2005 that is included in the interim financial report as being previously reported information does not constitute the Company's statutory financial statements for that financial year but is derived from those financial statements.

2 Accounting policies

The interim financial report has been prepared in accordance with the same accounting policies adopted in the 2005 annual financial statements.

The Group has not applied any new standards or interpretations that is not yet effective for the current accounting period. The Group has already commenced an assessment of the impact of these new standards and interpretations and considers that they would not significantly impact on its results of operations and financial position.

3 Turnover

The principal activities of the Group are manufacture and sales of headwear products, and sales of licensed products.

Turnover represents sales of goods at invoiced value to customers net of returns and discounts.

4 Segmental information

(a) Business segments

The analysis of the Group's turnover and profit from operations by business segments for the six months ended 30 June is as follows:

	Manufacturing		Trading		Retail		Inter-segment elimination		Consolidation	
	2006	2005	**2006**	2005	**2006**	2005	**2006**	2005	**2006**	2005
	HK$'000	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*	***HK$'000***	*HK$'000*
Turnover from external customers	**157,817**	125,289	**129,597**	99,704	**32,080**	8,753	**–**	–	**319,494**	233,746
Inter-segment turnover	**51,896**	47,093	**–**	–	**–**	–	**(51,896)**	(47,093)	**–**	–
	209,713	172,382	**129,597**	99,704	**32,080**	8,753	**(51,896)**	(47,093)	**319,494**	233,746
Other revenue	**5,288**	405	**167**	368	**294**	6	**–**	–	**5,749**	779
Total	**215,001**	172,787	**129,764**	100,072	**32,374**	8,759	**(51,896)**	(47,093)	**325,243**	234,525
Segment result and contribution from operations	**49,636**	49,571	**(1,869)**	(4,394)	**(6,773)**	(4,710)	**626**	–	**41,620**	40,467
Unallocated operating expenses									**(200)**	(998)
Profit from operations									**41,420**	39,469

(b) Geographical segment turnover

The analysis of the Group's turnover by geographical locations is as follows:

	Six months ended 30 June	
	2006	2005
	HK$'000	*HK$'000*
USA	**239,710**	193,251
Europe	**41,070**	27,533
HK and the PRC	**32,039**	9,645
Others	**6,675**	3,317
Total	**319,494**	233,746

5 Profit before taxation

Profit before taxation is stated after charging/(crediting):

	Six months ended 30 June	
	2006	2005
	HK$'000	*HK$'000*
(a) Financial costs		
Interest on bank loans, overdrafts and other borrowings wholly repayable within five years	**21**	40
Finance charges on obligations under finance leases	**–**	5
	21	45
(b) Other items		
Net income from short term investments	**(4,614)**	(67)
Written back of sundry payables	**–**	(3,709)
Depreciation	**11,947**	9,747
Provision for doubtful debts	**–**	481

6 Taxation

	Six months ended 30 June	
	2006	2005
	HK$'000	*HK$'000*
Hong Kong Profits Tax	**2,941**	3,500
PRC Enterprise Income Tax	**83**	54
Overseas tax	**1,055**	279
Deferred taxation	**520**	321
	4,599	4,154

Hong Kong Profits Tax has been provided at the rate of 17.5% (2005: 17.5%) on the estimated assessable profits arising in Hong Kong for the Period. Provisions for taxation of profits of subsidiaries operating overseas have been calculated at the rates applicable in the respective jurisdictions and based on prevailing legislation, interpretations, and practices in respect thereof.

7 Dividends

	Six months ended 30 June	
	2006	2005
	HK$'000	*HK$'000*
Final dividend paid in respect of 2005 of HK11 cents (2004: HK10 cents) per share	**31,487**	28,618
Proposed interim dividend of HK3 cents (2005: HK2 cents) per share	**8,587**	5,724

The interim dividend proposed after the balance sheet date has not been recognized as a liability at the balance sheet date.

8 Earnings per share

(a) Basic earnings per share

The calculation of basic earnings per share is based on the profit for the six months ended 30 June 2006 attributable to equity shareholders of the Company of HK$38,883,000 (2005: HK$35,967,000) and the weighted average number of ordinary shares of 286,245,531 (2005: 286,052,912).

(b) Diluted earnings per share

The calculation of diluted earnings per share is based on the profit for the six months ended 30 June 2006 attributable to equity shareholders of the Company of HK$38,883,000 (2005: HK$35,967,000) and the weighted average number of ordinary shares of 287,816,561 (2005: 299,266,912) after adjusting for the number of dilutive potential ordinary shares under the share option schemes.

9 Trade and other receivables

	30 June 2006	31 December 2005
	HK$'000	*HK$'000*
Trade and bills receivables	**122,922**	138,685
Deposits, prepayments and other debtors	**39,242**	26,303
	162,164	164,988

9 Trade and other receivables *(continued)*

The ageing analysis of trade and bills receivables (net of specific provisions for bad and doubtful debts) is as follows:

	30 June 2006 **HK$'000**	31 December 2005 HK$'000
0 – 30 days	**50,544**	52,001
31 – 60 days	**43,553**	63,022
61 – 90 days	**20,675**	22,041
Over 90 days	**8,150**	1,621
	122,922	138,685

Trade receivables are due within 30 to 90 days from the date of billing depending on the trading relationship. Credit evaluations of customers are performed by the Group from time to time to minimize any credit risk associated with receivables. In addition, customers with balances that are more than 3 months overdue are requested to settle all outstanding balances before any further credit is granted.

10 Trade and other payables

	30 June 2006 **HK$'000**	31 December 2005 HK$'000
Trade and bills payables	**35,181**	31,294
Accrued charges and other creditors	**43,207**	36,633
	78,388	67,927

The ageing analysis of trade and bills payables is as follows:

	30 June 2006 **HK$'000**	31 December 2005 HK$'000
0 – 30 days	**18,643**	20,618
31 – 60 days	**10,871**	8,242
61 – 90 days	**3,026**	–
Over 90 days	**2,641**	2,434
	35,181	31,294

11 Secured short term bank loan

The short term bank loan is secured by plants and prepaid premium on leasehold land with net book values amounting to HK$19,300,000 and HK$1,212,000 respectively as at 30 June 2006.

12 Share capital

	Number of shares *('000)*	*HK$'000*
Issued and fully paid:		
At 31 December 2005 and 30 June 2006	286,246	28,625

13 Acquisition of subsidiaries

On 30 June 2006, Top Super Investments Limited, a wholly-owned subsidiary of the Company acquired 100% of the issued share capital of Bollman (Hong Kong) Limited ("Bollman HK"). Bollman HK holds 100% of the issued share capital of Kangol Headwear (Panyu) Limited ("Panyu Factory", together "Bollman Subsidiaries") which manufactures and distributes headwear of top-tier fashion headwear brands, including Kangol. There are two parts of considerations: (i) adjusted cash consideration of US$5,720,000; and (ii) an earnout ranging from US$2,475,000 to US$4,800,000 to be calculated by reference to the operating profit of Bollman Subsidiaries for the three years ending 31 December 2010, payable from year 2009 to 2011, subject to adjustments of the compensations for any loss in the first year and shortfalls in purchase commitment as detailed below.

According to the sale and purchase agreement, the vendor will compensate the Group for any operating loss up to US$1,200,000 incurred by Bollman Subsidiaries in the first year after the acquisition. The vendor has also committed to place purchase orders with Bollman Subsidiaries totaling US$20,000,000 in the second and third years after the acquisition.

The acquisition has been accounted for by the purchase method of accounting.

13 Acquisition of subsidiaries *(continued)*

Details of the net assets of Bollman Subsidiaries acquired by the Group were as follows:

	Bollman Subsidiaries' carrying amount and fair value amount before combination *HK$'000*
Assets and liabilities acquired:	
Property, plant and equipment	26,522
Prepaid premium on leasehold land held for own use under an operating lease	1,212
Inventories	26,362
Trade and other receivables	1,642
Bank balances and cash	3,107
Trade and other payables	(13,102)
Secured short term bank loan	(5,825)
	39,918
Intangible assets recognised at acquisition:	
Fair value of purchase orders commitment provided by the vendor	9,741
Total net assets acquired	49,659
Goodwill	3,203
Total consideration and direct costs payable by the Group	52,862
Total consideration and direct costs:	
Cash consideration	44,323
Long term payables:	
Fair value of minimum earnout payables	15,793
Compensation to be provided by the vendor for any operating loss in the first year	(7,914)
Direct costs capitalised	660
	52,862

13 Acquisition of subsidiaries *(continued)*

This acquisition will not only help the Group to further penetrate the US market, but also facilitate its planned expansion into the Japanese and European markets, which are more fashion-focused and offer a better profit margin.

If the acquisition had been completed on 1 January 2006, total of the Group's turnover would have been increased by HK$20,486,000 and profit attributable to equity shareholders for the period would have been decreased by HK$6,597,000.

Since Bollman Subsidiaries were acquired on 30 June 2006, they had no contribution to the Group's turnover, results and cash flows for the period ended 30 June 2006.

14 Capital commitments

At 30 June 2006, the Group had capital expenditure commitments as follows:

	30 June 2006 *HK$'000*	31 December 2005 *HK$'000*
Contracted but not provided for		
– Manufacturing facilities	**17,331**	–
– Computer system for Trading Business	**589**	–
– Retail Business	**2,124**	511
Authorised but not contracted for		
– Manufacturing facilities	**4,894**	21,825
– Computer system for Trading Business	**1,678**	3,046
– Retail Business	**2,365**	6,568
	28,981	31,950

15 Contingent Liabilities

There has been no development in respect of the tax investigation on Drew Pearson Marketing, Inc, a subsidiary of the Group in the US, as referred to in the 2005 annual report (the "Report"), since the date of the Report.

16 Approval of interim financial report

The interim financial report was approved by the Board of Directors on 8 September 2006.

Directors' Interests in Shares and Underlying Shares

As at 30 June 2006, the interests of the Directors in the shares and underlying shares of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")), which had been notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests which they were taken or deemed to have under such provisions of the SFO), or which were recorded in the register required to be kept by the Company under Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies, were as follows:

Long positions in the shares and underlying shares of the Company

	Number of shares				
	Personal interest	Other direct interest	Underlying shares	Total	Percentage of interest
Mr. Ngan Hei Keung	–	193,000,000 *(note)*	–	193,000,000	67.42%
Madam Ngan Po Ling, Pauline	–	193,000,000 *(note)*	–	193,000,000	67.42%

Notes: 193,000,000 shares are legally and beneficially owned by Successful Years International Co., Ltd., a company ultimately and beneficially owned by NHK Trust and NPL Trust as to 40% and 60% respectively. These two trusts are discretionary family trusts settled by Mr. Ngan Hei Keung and the discretionary beneficiaries include Mr. Ngan Hei Keung, Madam Ngan Po Ling, Pauline, and their family members.

Save as disclosed above, none of the Directors or chief executives of the Company had any interests in the shares or underlying shares of the Company or any of its associated corporations as defined in the SFO.

Share Option Schemes

Prior to 23 May 2002, the Company operated an option scheme whereby the Board of Directors could, at their absolute discretion, grant options to employees and Executive Directors of the Company and any of its subsidiaries to subscribe for shares in the Company (the "Old Scheme"). On 23 May 2002, the Old Scheme was terminated and a new share option scheme (the "New Scheme") was adopted, whereby the Board of Directors may, at their absolute discretion, grant options to any eligible employees and non-executive directors of the Company or any of its subsidiaries or any invested entity, any suppliers of goods or services to any member of the Group or any invested entity, and any customers of the Group or any invested entity to subscribe for shares in the Company.

For options granted before 1 September 2001, the exercise price of options was determined by the Board and was the higher of the nominal value of the shares and 80% of the average closing prices of the shares of the Company on the Stock Exchange for the five trading days immediately preceding the date of offer of the options. For options granted after 1 September 2001, the exercise price of the options is the highest of the nominal value of the shares, the closing price of the shares on the Stock Exchange on the date of offer of the options and the average closing price of the shares on the Stock Exchange for the five trading days immediately preceding the date of offer of the options.

The total number of shares which may be issued upon exercise of all options to be granted under the New Scheme and any other share option schemes of the Group may not in aggregate exceed 27,760,053, being 10% of the shares in issue of the Company as at 23 May 2002, the date of adoption of the New Scheme.

The New Scheme will remain in force for a period of 10 years from the date of its adoption. The purpose of the New Scheme is to enable the Group to grant options to selected participants as incentive or rewards for their contributions to the Group.

Unless approved by shareholders in general meeting, the total number of shares issued and which may fall to be issued upon exercise of the options of the New Scheme and the options granted under any other schemes of the Group (including both exercised or outstanding options) to each grantee in any 12-month period shall not exceed 1% of the issued share capital of the Company at the relevant time.

Share Option Schemes *(continued)*

An option may be exercised in accordance with the terms of the New Scheme at any time during the period (which may not expire later than 10 years from the date of offer of that option) to be determined and notified by the Directors to the grantee and in the absence of such determination, from the date of acceptance of the offer of such option to the earlier of the date of which such option lapses in accordance with the terms of the New Scheme and 10 years from the date of offer of that option. A consideration of HK$1 will be payable upon acceptance of the offer.

As at the date of interim report, the total number of shares available for issue, save for those granted but yet to be exercised, under the New Scheme was 2,038,053 shares, which represented 0.7% of the issued share capital of the Company as at 31 August 2006.

At 30 June 2006, the Directors, employees, customers and suppliers of the Group had the following interests in options to subscribe for shares of the Company (market value per share is HK$2.5 at the balance sheet date) granted at nominal consideration under the share option schemes operated by the Company, each option gives the holder the right to subscribe for one share:

	Date of grant	Period during which options exercisable	Exercise price *(HK$)*	Outstanding at 1.1.2006 and 30.6.2006	Market value per share at date of grant *(HK$)*
Old Scheme					
Employees	11.06.2001	11.06.2002-10.06.2009	1.228	404,000	1.54
New Scheme					
Employees	03.07.2002	03.07.2003-02.07.2010	2.700	10,750,000	2.70
	12.02.2003	12.02.2004-11.02.2011	2.205	1,120,000	2.20
	03.06.2003	03.06.2004-02.06.2013	2.300	10,006,000	2.3
				21,876,000	
Customers and suppliers	03.07.2002	03.07.2003-02.07.2010	2.700	1,950,000	2.70
	03.06.2003	03.06.2004-02.06.2013	2.300	600,000	2.30
				2,550,000	

Share Option Schemes *(continued)*

The fair value of services received in return for share options granted are measured by reference to the fair value of share options granted. The estimate of the fair value of the services received is measured based on a Black-Scholes pricing mode. The input into the model were as follows:

Weighted average share price	HK$2.68
Weighted average exercise price	HK$2.29
Expected volatility	25.2%
Expected life	6 years
Risk free rate	3.52%
Expected dividend yield	4%

The expected volatility is based on the historic volatility of share prices of the Company. Expected dividends are based on historical dividends. Changes in the subjective input assumptions could materially affect the fair value estimate.

Share options were granted under a service condition. This condition has not been taken into account in the grant date fair value measurement of the services rendered. There were no market conditions associated with the share option grants.

Apart from the foregoing, at no time during the period was the Company, its holding company, any of its subsidiaries or fellow subsidiaries a party to any arrangements to enable the Company's Directors or chief executive or any of their spouses or children under eighteen years of age to acquire benefits by means of the acquisition of shares in or debentures of the Company, or any other body corporate.

Substantial Shareholders

So far as is known to the Directors or chief executives of the Company, as at 30 June 2006, the following declarations of interests by shareholders (other than Directors) holding 5% or more of the issued share capital of the Company was recorded in the register required to be kept by the Company under Section 336 of the SFO:

	Capacity	Number of shares	Percentage of shareholding
Successful Years International Co., Ltd. *(note)*	Beneficial owner	193,000,000	67.42%
Amex International Trust (Cayman) Ltd. *(note)*	Trustee	193,000,000	67.42%

Note: Successful Years International Co., Ltd. is owned by NHK Trust and NPL Trust as to 40% and 60% respectively. These two trusts are discretionary family trusts settled by Mr. Ngan Hei Keung and the discretionary beneficiaries include Mr. Ngan Hei Keung, Madam Ngan Po Ling, Pauline, and their family members. Amex International Trust (Cayman) Ltd. is the trustee of the two trusts.

The interests of Mr. Ngan Hei Keung and Madam Ngan Po Ling, Pauline in Successful Years International Co., Ltd. are also disclosed in the section headed "Directors' Interests in Shares and Underlying Shares" above.

Save as disclosed above, as at 30 June 2006, the Company had not been notified by any persons (other than Directors) who had interests in the shares and underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or which were recorded in the register required to be kept by the Company under Section 336 of the SFO.

Purchase, Sale or Redemption of the Company's Listed Securities

During the six months ended 30 June 2006, neither the Company nor any of its subsidiaries had purchased, sold or redeemed any of the Company's listed securities.

Code on Corporate Governance Practices

In the opinion of the Board, the Company has complied with the code provisions in the Code on Corporate Governance Practices (the "Code") as set out in Appendix 14 of the Listing Rules during the six months ended 30 June 2006 except for the deviations from Code Provisions A.4.1 and A.4.2 as detailed in the Corporate Governance Report included in the 2005 Annual Report that independent non-executive directors have not been appointed for a specific term; and that the Chairman and the Managing Director (who are also the founders of the Company), are not subject to retirement by rotation.

Model Code for Securities Transactions by Directors

The Company has adopted the Model Code as set out in Appendix 10 of the Listing Rules. All Directors have confirmed, following enquiry by the Company, that they have complied with the required standard set out in Model Code throughout the Period.

Audit Committee

The Company has complied with Rule 3.21 of the Listing Rules in relation to the establishment of an audit committee. The audit committee members comprise all independent non-executive directors. The primary duties of the Audit committee are to review and supervise the financial reporting process and internal control procedures of the Group. The audit committee has reviewed the interim results for 2006.

By Order of the Board
Ngan Hei Keung
Chairman

Hong Kong, 8 September 2006

As at the date hereof, the Board of Directors of the Company comprises seven directors, of which three are Executive Directors, namely Mr. Ngan Hei Keung, Madam Ngan Po Ling, Pauline and Mr. Ho Hung Chu, Peter; and four are Independent non-executive Directors, namely Mr. Leung Shu Yin, William, Mr. Tse Kam Fow, Mr. Lo Hang Fong and Mr. Brandon Liu Tieh Cheng, JP.

Company websites: http://www.mainland.com.hk
http://www.mainlandheadwear.com