

MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS AND FINANCIAL REVIEW

The Group's mission is to become one of Greater China's leading supply chain services providers and distributors in the apparel and footwear industry. For the six months ended 30 June 2006, the Group has performed astoundingly well, despite unfavourable circumstantial conditions surrounding the textile and garment industry.

During this period, the Group's turnover and profit attributable to the equity holders of the Company surged by about 59.1% to about HK\$262.8 million and about 52.3% to about HK\$35.0 million respectively, as compared to the corresponding period last year. This outstanding performance is attributable to the Group's unique business model, which ensures strong R&D support, excellent customer services, high quality control/standards and an expandable business scale. Meanwhile, the Group's solid customers' relations and its multinational and experienced management team definitely enhanced its exponential business expansion within a short frame of time.

Supply Chain Services

During the period under review, the Group continued to build on its supply chain core business, which accounted for about 90.0% of its aggregate turnover. The turnover during this period surged by about 48.7% to about HK\$236.5 million, as compared to the corresponding period last year.



The significant growth in this business' turnover is attributable to the Group's consistently widened customer base and their gradually enlarged orders with the Group. The Group's customer base includes renowned international brands, such as *United Colors of Benetton*, *Sisley*, *Morgan*, *Moschino*, *See By Chloé*, *R.E.D.Valentino*, *DKNY Jeans*, *Diesel*, *Quiksilver*, *Lafuma*, *Lotto*, *Salewa* and *Sergio Tachinni*. Meanwhile, the Group's successful completion of its production bases and operation complex in Yangzhou and Nanjing, PRC, respectively, has hugely empowered the Group's ability to (i) provide customers with enhanced comprehensive value-added supply chain services; (ii) further supplement outsourced production processes with increased mass production capabilities thereby strengthening the Group's dual operation model, and (iii) service sophisticated orders requiring higher product quality and short delivery time.

As the Group's showcase to its international branded business partners, the Group's new facilities in Yangzhou and Nanjing, PRC, has unquestionably positioned the Group to attract a wider customer base and broaden the Group's collaboration platform with its business/joint venture partners. The Board honestly believes that completion of these facilities has allowed the Group to capitalize optimally on these investments during the period under review.

Distribution and Retailing

Given tremendous rising demand for premium consumer products in the PRC, the Group began to develop its downstream business in mid 2004, which witnessed its distribution and retailing of apparel and footwear products under the *Stonefly* brand. Since then, the Group has, through self-operation and through the appointment of authorized franchisees, covered about 24 points of sale throughout the PRC, via the establishment of a joint venture, set up on a 50:50 basis with Stonefly S.p.A., a renowned international comfort footwear leader.

Backed with *Stonefly* brand's success in the Greater China region, the Group continued to work closely with its existing branded customers to develop its downstream business. In December 2005, the Group began its distribution and retailing of apparel and footwear products under the *Lotto* brand, and established a joint venture, set up on a 50:50 basis with Lotto Sport H.K. Limited, a long term customer of the Group and a renowned international sportswear leader. Since then, the Group has successfully appointed authorized franchisees to cover over 45 points of sale throughout the PRC and Hong Kong.

During the period under review, turnover of the Group's distribution and retailing business, accounting for about 9.9% of the Group's aggregate turnover, achieved an outstanding growth of about 333.4% to about HK\$26.1 million, as compared to the corresponding period last year.

Licensing

To capitalize on the Group's well-established customers' relationship and generate additional turnover, the Group has, during the period under review, maintained its business expansion to include licensing operations, which product range covers the accessories market, namely eyewear and timepiece products under the brand name of *Morgan*.

Gross margins

During the period under review, the Group's gross margin continued to improve from about 34.9% to about 36.0% as compared with the same period last year. The Group's overall gross margin increase is mainly attributable to the gross margin increase in its distribution and retailing business. Meanwhile, the gross margin on the Group's supply chain services achieved a slight increase for the same period.

The gross margin of the Group's distribution and retailing business has improved from about 32.3% to about 37.6%, as compared to the corresponding period last year. Such gross margin increase is mainly attributable to the Group's transformation to its existing wholesale vis-a-vis retail distribution model from its "pure" wholesale distribution model, as compared with the same period last year and the Group's acute execution of policies to maximise local products' sourcing within the PRC during this period.



Meanwhile, despite unfavourable factors, which include fuel costs' increase, raw materials and labour costs hike and pricing pressures exerted by RMB's appreciation, the Group's supply chain services managed to attain a slight gross margin increase from about 35.0% to about 35.8%, as compared with the same period last year. This witnessed the Group's successful minimisation of adverse circumstantial impact through stringent cost control and improved operational efficiency.

Operating expenses

During the period under review, the Group's distribution costs surged by about 194.1% to about HK\$10.1 million, as compared to the corresponding period last year. The substantial increase in the Group's distribution costs is mainly attributable to the Group's vast distribution and retailing business expansion, of which distribution costs is a key cost component. In fact, the Group's distribution costs of its distribution and retailing business increased to about HK\$6.8 million for the six months ended 30 June 2006, which represents about 655.6% increase, as compared with the same period last year. These distribution costs mainly comprise (i) advertising costs; (ii) staff salaries and emoluments; (iii) rental and shop expenses/overheads; and (iv) travelling expenses.

The Group's administrative expenses increased by about 40.9% to about HK\$35.1 million for the period under review, as compared with the same period last year. The administrative expenses increase is attributable to the Group's higher expenses in staff salaries and emoluments, given more human resources are required to cope with the Group's vast expansion. Meanwhile, additional depreciation in respect of the new facilities completed in Nanjing, PRC, has increased the Group's administrative expenses during the period.

Finance costs

Finance costs increased by about 106.3% to about HK\$10.0 million, as compared to the corresponding period last year. This substantial finance costs' increase is mainly attributable to the global interest rates' hike and a higher level of bank borrowings necessary to finance the Group's vast expansion.

PROSPECTS

Given globalization, which has dynamically transformed the competitive landscape of apparel industry, has opened the gateway for international brands to source for the best products and services at the best price to find new markets for penetration and in light that the PRC is the world's biggest factory and largest domestic consumption market and thereby the No. 1 target for international brands to capture resources and market share, the Group has seized the opportunity to take advantage of these immense opportunities, whilst leveraging on its global vision and vast PRC network. This witnessed the Group's consistent focus on the establishment of strategic alliances and joint ventures with key international branded clients to increase collaboration level to capitalise on the immense opportunities and potential in the PRC.

Following successful pre-listing establishment of joint ventures with *Morgan*, *Lotto* and *Stonefly*, the Group has currently established the following two individual joint ventures, to expand its supply chain services business and its distribution and retailing business respectively.

As at 30 August 2006, the Group entered into an agreement to establish a 50:50 joint venture with Mountain Experience Beteiligungs Gesellschaft M.B.H. ("MEB"), a global sports and mountaineering products provider, to operate a PRC production and technological center for the manufacture of products sold under the trademarks *Salewa*, *Dynafit* and *Silvretta*, with the vision to develop high-tech garment manufacturing techniques. Based on the agreement, MEB shall also support this new joint venture to obtain the "GORETEX" certification from



W.L. Gore & Associates, which certification application has already commenced. Leveraged on the famous and established brand-names held by MEB, MEB's diverse customer and established network and MEB's minimum guaranteed orders of *Salewa* products from this new joint venture, the Group's supply chain services business will be positively enhanced.

As at 1 September 2006, the Group entered into an agreement to establish a joint venture on a 50:50 basis with Benetton Group S.p.A., an international apparel leader, which provides its apparels and leisure-wear under the brand names of *United Colors of Benetton*, *Undercolors*, *Sisley*, *012*, *Playlife* and *Killer Loop*, with a view to, through self-operation, cover over 150 points of sale throughout the PRC within the next 5 years. Under the agreement, the joint venture shall become Benetton Group S.p.A.'s exclusive distributor in the PRC for all items of men and women's apparel and accessories under the brand of *Sisley* and will have the non-exclusive right to use the *Sisley* trademark to manufacture and outsource *Sisley* products in the PRC. The set up of this new joint venture will not only create synergy between the Group and Benetton Group S.p.A., but will in fact earmark a paradigm shift, upon which the Group's ambition to broaden its scope of services through downstream developments in close collaboration with its key branded customers is categorically land-marked.

Ambitioned to increase operational efficiency, the Group has also, during the period under review, joined Lawson Software (formerly Inertia), a global provider of IT enterprises applications, as one of its customer in the PRC and Hong Kong. The implementation of Lawson Software's M3 fashion enterprise suite, a leading ERP solution tailored specifically to the fashion industry, will allow greater information transparency within the Group's supply chain management system, thereby reducing operation costs, facilitate business flow and optimize management.

Meanwhile, to strengthen the Group's dual operation model in support of its exponential expansion, the Group's annual production capability is anticipated to increase to about 2.2 million pieces, given the impending completion of its new facilities in Phase III of Yangzhou, PRC, in September 2006

Finally, the Group has also entered into various memoranda of intention to set up strategic alliances and joint ventures with several renowned European brands to further enhance its supply chain services as well as its distribution and retailing business.

USE OF PROCEEDS FROM INITIAL PUBLIC OFFERING

The Company issued 250,080,000 shares (inclusive of those shares issued upon the exercise of the over-allotment option) at HK\$1.7 per share by way of placing and public offer (as set out in detail in the Prospectus) on 13 July 2006. The net proceeds after relevant expenses deduction amounted to about HK\$100.4 million, which the Company intends to apply in accordance with the proposed allocation as stipulated in the Prospectus.

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

As at 30 June 2006, the Group had cash and cash equivalents of about HK\$146.2 million (31 December 2005: HK\$84.6 million) and total bank borrowings of about HK\$371.9 million (31 December 2005: HK\$246.6 million), of which 84.4% constituted short-term bank borrowings and 15.6% constituted long-term bank borrowings. Besides, 5.2% of the total bank borrowings was subject to fixed interest rates, whilst 94.8% thereof was subject to floating interest rates. The Group's bank borrowings were primarily denominated in RMB, HK dollars, Euro and US dollars. As at 30 June 2006, 17.1%, 26.8%, 1.0% and 55.1% of the Group's total bank borrowings were denominated in RMB, HK dollars, Euro and US dollars respectively. The substantial increase in the Group's bank borrowings was mainly attributable to the significant increase in short-term trade



finance that the Group required to fund its working capital requirement, which is higher during the peak of the seasonal demand cycle from May to August annually. As at 30 June 2006, the nature of the Group's total bank borrowings were as follows:

| | 30 June 2006 | 31 December 2005 |
|------------------------------------|-------------------------|---------------------|
| | HK\$'000 | HK\$'000 |
| Bank overdrafts | 11,499 | 9,288 |
| Bills discount loans | 120,849 | 67,912 |
| Trust receipt loans | 97,583 | 104,794 |
| Packing loans | 81,676 | 13,755 |
| Current-portion of term loans | 2,434 | 4,598 |
| Total short-term borrowings | 314,041 | 200,347 |
| Long-term borrowings | 57,882 | 46,244 |
| Total bank borrowings | 371,923 | 246,591 |

With bank borrowings' increase, the Group's net gearing ratio (which is calculated on the basis of total bank borrowings (net of cash and cash equivalent) over the total shareholders' equity of the Company) increased from 1.09 as at 31 December 2005 to 1.23 as at 30 June 2006. The net gearing ratio of 1.23 is considered high. Apart from the seasonal demand cycles' impact on the increase in bank borrowings to fund the Group's working capital requirement, the Board believes that the Group's net gearing ratio will significantly improve to a reasonably adequate level in light of funds raised during the Company's listing on 13 July 2006.

As at 30 June 2006, the Group had current assets of about HK\$503.7 million (31 December 2005: HK\$328.4 million) and current liabilities of about HK\$421.3 million (31 December 2005: HK\$285.9 million). The current ratio (which is calculated on the basis of current assets over current liabilities) improved slightly from 1.15 as at 31 December 2005 to 1.20 as at 30 June 2006. The current ratio of 1.20 is considered healthy and indicates the Group's sound liquidity.

FOREIGN EXCHANGE EXPOSURE

The majority of the Group's sales, purchase and operating expenses were denominated in RMB, HK dollars and US dollars. Although the Group has been and will continue to be exposed to foreign currency exchange risks, the Board does not expect future currency fluctuations to materially impact the Group's operations. The Group has not adopted formal hedging policies and no instruments have been applied for foreign currency hedging purposes during the period under review.

CAPITAL EXPENDITURE

During the period under review, the Group's total capital expenditure amounted to about HK\$14.2 million, of which about HK\$5.7 million was used in the construction of the new facilities in Phase III of Yangzhou, PRC and about HK\$2.4 million and about HK\$0.3 million of which were used in leasehold improvement and buildings respectively. As for the balance of about HK\$4.3 million and about HK\$1.5 million, they were used on furniture, fixture & equipment and on plant and machinery for the Group's production capacity expansion respectively.

CHARGES ON ASSETS

As at 30 June 2006, the Group's bank deposits of about HK\$41.0 million, available-for-sale securities of about HK\$4.8 million, leasehold land and building with an aggregate net book value of about HK\$129.2 million and plant and machinery with an aggregate net book value of about HK\$3.5 million were pledged to secure banking facilities granted to the Group.



CONTINGENT LIABILITIES

As at 30 June 2006, the Group had no material contingent liabilities.

EMPLOYMENT INFORMATION

As at 30 June 2006, the Group had about 1,530 employees in total, and they stationed mainly in the PRC, Hong Kong and Europe. The Group's emolument policies, which are reviewed periodically, are linked to the performance of the individual employees and are based on the salary trends prevailing in the aforesaid regions.

In addition, the Group maintains a share option scheme for the purpose of providing incentives and rewards to eligible participants based on their respective contributions to the Group.