



MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

OVERALL PERFORMANCE

Turnover

Turnover for the six months ended 30 June 2006 was RMB417.1 million compared to RMB383.2 million for the same period in 2005, representing an increase of 8.85%. Turnover comprises of three different segments: Retail, OEM and Other.

Retail Turnover

Retail turnover is generated from PORTS and BMW Lifestyle branded retail stores operating in China and Hong Kong. As at 30 June 2006, there were 297 PORTS stores in China and Hong Kong. The Company also operates 32 BMW Lifestyle stores in China as at 30 June 2006. Retail turnover generated by these stores in the first half of 2006 was RMB363.9 million, compared to RMB283.9 million for the same period in 2005, representing an increase of 28.18%. This increase was driven mainly by an increase in number of units sold in existing stores as well as an increase in average selling price.

The increase in selling price reflects, in part, the strength of the PORTS and BMW Lifestyle brands in the Chinese market. Management attributes this strength to the continued investment into building the brands via the Company's marketing activities, and the continued positive comments from independent editors and critics within the fashion industry.

OEM Turnover

OEM segment turnover in 1H 2006 continued to suffer from the effects of the U.S. and European safeguard quotas imposed in the second half of 2005. New orders for these markets resumed in 2006, but production lead-time resulted in shipments only during the last 3 months of the period, rather than the full 6 months, which effectively reduced the export volume to 50% of usual levels. Turnover for the OEM segment decreased from RMB72.7 million in 1H2005 to RMB40.1 million in 1H 2006, a decrease of 44.84%. Management expects that OEM exports will continue in the second half of 2006 and will resume to a level comparable to OEM turnover in the second half of 2004.

Other Turnover

Other turnover mainly comprises of turnover from the export of BMW Lifestyle apparel to the global BMW dealer network as well as to BMW Lifestyle boutiques outside China and a limited amount of wholesale sales to retailers inside and outside China. Other turnover amounted to RMB13.1 million in 1H 2006 compared to RMB26.6 million in 1H 2005, representing a decrease of 50.75%. With the resumption of export shipments to BMW dealers in the second half of 2006, management anticipates a significant increase compared with the second half of 2005.

Cost of sales

Cost of sales generally increases and decreases in-line with changes in turnover, but also reflects changes in the business mix of the Company's turnover. Cost of sales in 1H 2006 amounted to RMB106.7 million, compared to RMB134.1 million in 1H 2005, representing a decrease of 20.43%. This decrease is mainly due to the shift in business mix away from the OEM and Other segments. The Company's retail segment enjoys a significantly higher gross profit margin than the OEM and Other segments. The decrease in turnover from the Company's OEM and Other segments, and the increase in turnover from the Company's retail segment contributed strongly to this decrease in cost of sales.

Gross profit

As a result of the factors discussed above, the Company's gross profit increased 24.66% from RMB249.0 million in 1H 2005 to RMB310.4 million in 1H 2006, and the Company's gross profit margin increased from 64.98% in 1H 2005 to 74.42% in 1H 2006. This increase in gross profit margin is mainly due to the shift in business mix away from the OEM and Other segments. The Company's retail segment enjoys a significantly higher gross profit margin than the OEM and Other segments. The decrease in turnover from the Company's OEM and Other segments, and the increase in turnover from the Company's retail segment contributed strongly to the increase in gross profit margin. Further to the shift in business mix, Management decided to raise the average unit retail selling price for the 2006 Spring/Summer collection, which also contributed, in part, to the improvement in gross profit margin.

Retail Gross Profit

Retail gross profit increased 33.99%, from RMB221.8 million in 1H 2005 to RMB297.2 million in 1H 2006, while gross margin increased from 78.13% to 81.67% over the same period. Management decided to raise the average unit retail selling price for the 2006 Spring/Summer collection, which contributed, in part, to the improvement in gross profit margin.

Of the Company's gross profit, retail contributed 95.76% of the total in 1H 2006, compared to 89.07% in 1H 2005, reflecting the impact of the decrease in the contribution from the OEM and Other segments to the overall business of the Company, and the increasing importance of the Company's retail operation.

OEM Gross Profit

OEM gross profit decreased from RMB12.8 million in 1H 2005 to RMB7.7 million in 1H 2006, representing a decrease of 39.84%. Gross margin for the OEM segment improved however, increasing from 17.61% in 1H 2005 to 19.20% in 1H 2006. The increase in gross margin was mainly due to the continued impact of safeguard quotas imposed by the U.S. government in 2H 2005. The Company's OEM orders to Canadian customers generally have a higher gross margin than orders to U.S. customers, and as OEM orders in 1H 2006 were comprised mainly of higher margin Canadian orders, gross margin for the OEM segment increased accordingly.

Gross Profit of Other Turnover

The Company's Other segment turnover comprises mainly of exports of BMW Lifestyle merchandise to BMW AG in Germany and wholesale of PORTS merchandise to boutiques and department stores in Asia and Australia. In 1H 2006, the Other segment continued to suffer the impact from safeguard quotas imposed by the European government in the second half of 2005. Gross profit from other turnover, decreased 61.81%, from RMB14.4 million in 1H 2005 to RMB5.5 million in 1H 2006. Gross margin also decreased from 54.14% in 1H 2005 to 41.98% in 1H 2006. Management is optimistic that the global demand for BMW Lifestyle apparel products will resume in the second half of 2006, and has therefore decided to focus its attention on the continued development of this business. However, in the near term, apprehension from BMW dealers throughout the world towards the possible disruption to the supply of BMW Lifestyle apparel arising from safeguard quotas or other unforeseen circumstances may slow the normal growth of this business segment.

Other operating income

Other operating income increased 55.32% from RMB4.7 million in 1H 2005 to RMB7.3 million in 1H 2006. Other operating income consists mainly of income from store design and decoration services provided to third parties, including department stores that contain new PORTS INTERNATIONAL concessions. The increase was mainly attributable to higher design and decoration income, which increased from RMB2.1 million in 1H 2005, to RMB3.6 million in 1H 2006, representing an increase of 71.43%. This increase in income was mainly due to increased charges to concessionaires applying to open new Ports stores. In addition to increased charges to concessionaires, there was also a meaningful increase in the royalties received from the Company's sunglass licensee.

Profit from operations

As a result of the factors discussed above, the Company's profit from operations increased by 49.19% from RMB70.6 million in 1H 2005 to RMB105.3 million in 1H 2006. The Company's operating margin (profit from operations expressed as a percentage of turnover) increased from 18.42% in 1H 2005 to 25.24% in 1H 2006. The increase in profitability is largely due to improved economies of scale derived from the growth in sales and increases in gross profit margin due to average unit selling price increase in the retail segment.

Operating Expenses

Operating expenses increased from RMB183.2 million in 1H 2005 to RMB213.0 million in 1H 2006, an increase of 16.27%. Operating expenses consisted of distribution expenses, administrative expenses and other operating expenses. The changes in various components are summarized in the following paragraphs.

Distribution expenses

Distribution expenses increased 19.56% from RMB150.3 million in 1H 2005 to RMB179.7 million in 1H 2006. This increase was principally due to increases in rent and salaries and benefits. Rent expense for retail outlets increased 30.41% from RMB74.0 million in 1H 2005 to RMB96.5 million in 1H 2006. This increase was mainly due to an increase in retail turnover, particularly from concessions as the occupancy cost of a concession store is charged at a percentage of turnover. Increases in turnover therefore will result in higher rent paid to the department stores.

Salaries and benefit expenses resulting from the retail operation increased 8.99% from RMB27.8 million in 1H 2005 to RMB30.3 million in 1H 2006. This increase is mainly the result of increased payments to retail sales employees, as commissions on retail sales are offered as incentives to in-store staff. This small increase reflects, in part, the economies of scale inherent to the Company's retail business, as retail turnover during 1H 2006 rose by 28.18%.

Other components of distribution expenses also experienced increases. Depreciation expenses increased 39.33% from RMB8.9 million in 1H 2005 to RMB12.4 million in 1H 2006, mainly due to capital expenditure relating to investment into the Company's production and distribution facilities, and the continued introduction of PORTS flagship retail stores, one of which was opened in Xi'an during 1H 2006. Advertising costs increased 12.80% from RMB12.5 million in 1H 2005 to RMB14.1 million in 1H 2006. This increase is due to the Company's continued investment into building the PORTS and BMW Lifestyle brands, and remained consistent with historical levels at 3.87% of retail turnover. Store and mall expenses also increased 23.81% from RMB8.4 million in 1H 2005 to RMB10.4 million in 1H 2006, mainly due to renovations to upgrade existing department store concessions and mall locations.

Administrative expenses

Administrative expenses decreased 10.33% from RMB18.4 million in 1H 2005 to RMB16.5 million in 1H 2006. This was mainly due to a decrease in administrative salaries and benefits, the largest category of administrative expense, which decreased by 7.06% from RMB8.5 million in 1H 2005 to RMB7.9 million in 1H 2006. This decrease was mainly the result of the allocation of design costs to the North American operation under the Company's design sharing agreement, due to the increase in the volume of business in North America. Other administrative expenses, such as travel and general office expenses, increased by 45.59% reflecting the increased administrative functions. For instance, increased travel in support of the BMW Lifestyle initiative and investor relations activities.

Other operating expenses

Other operating expenses increased 15.07% from RMB14.6 million in 1H 2005 to RMB16.8 million in 1H 2006. This increase was mainly due to an increase in stock provisions, from RMB14.3 million in 1H 2005 to RMB16.8 million in 1H 2006.

Income Tax

The Company's effective income tax rate increased from 2.88% of profit before tax in 1H 2005 to 6.25% of profit before tax in 1H 2006. The increase in income taxes paid was mainly due to the reduction of the income tax rebate as a percentage of total income earned.

Profit attributable to shareholders

The Company's profit attributable to shareholders increased 51.35% from RMB66.6 million in 1H 2005 to RMB100.8 million in 1H 2006. The Company's net profit margin increased from 17.38% in 1H 2005 to 24.18% in 1H 2006. This increase in net profit margin was driven mainly by the shift in business mix during 1H 2006 away from the lower-margin businesses of the OEM and Other segments towards the higher-margin PORTS and BMW Lifestyle retail businesses. The conversion of the majority of the Company's cash reserves into RMB from foreign currencies has also helped to decrease the exchange loss from RMB4.9 million in first half of 2005, to RMB1.1 million during the first half of 2006.

Financial Position, Liquidity and Gearing Ratio

The Group continues to be in a strong financial position, with significant cash and cash equivalents and no bank borrowings. As at 30 June 2006, the Group had approximately RMB330.8 million in cash and cash equivalents and time deposits with major banks, compared with RMB346.9 million as at 31 December 2005. The Group also had access to significant bank loans and overdraft facilities, although these were not utilized. The Group currently has no outstanding bank borrowings. As at 30 June 2006, the Group's gearing ratio was zero, based on no bank debt outstanding and total assets of approximately RMB945.7 million. The Group's gearing ratio was zero as at 31 December 2005. As at 30 June 2006, the current ratio was 5.77, based on current assets of RMB785.0 million and current liabilities of RMB136.0 million.

Acquisitions & Disposals of Subsidiaries & Associated Companies

The Group did not engage in any material acquisitions or disposals of any subsidiaries or associated companies in the six months ended 30 June 2006.

Currency Risk Management

The Group's cash balances and cash generated from normal business operations are mainly deposited in RMB with major Chinese banks, with a small amount in Hong Kong dollars ("HK\$"), United States dollars ("US\$") and the European Union common currency ("Euro") being deposited with other major international banks in China and Hong Kong. The Company continues to minimize exchange losses by reducing foreign currency reserves, and increasing RMB reserves. Management anticipates the continued appreciation of the RMB, which may potentially increase the Group's purchasing power for raw materials sourced outside China. In 1H 2006, the company reported an RMB1.1 million exchange loss compared to RMB4.9 million in 1H 2005.

The Group does not engage in any currency hedging activities as it considers its risk exposure to currency fluctuations to be acceptable. The Group's cost base is mainly denominated in RMB with some Euro and US\$ exposure from raw materials purchased in Europe. Exposure to the fluctuations of the Euro and US\$ are balanced by the receipt of Euros from exports of BMW Lifestyle apparel to BMW in Germany, and the receipt of US\$ from OEM customers in the USA. Currently, revenue from operations is denominated mainly in RMB with some minor Euro and US\$ exposure. In the future, the Company plans to increase the RMB component of cash holdings, thus minimizing the losses due to foreign currency fluctuations and maximizing the benefits from the continued appreciation of the RMB.

Capital Commitments & Contingent Liabilities

As at 30 June 2006, the Group had capital commitments of RMB2.7 million which had been contracted for, and capital commitments of RMB62.5 million, which had been authorized but not contracted for. The Group had no contingent liabilities as at 30 June 2006.

Capital Structure of the Group

The Group requires working capital to support its manufacturing, Retail, OEM and Other operations. In the past, the Group financed its working capital needs principally through net cash inflows from operating activities and from short-term interest-bearing loans. The initial public offering of the Company's shares on 31 October 2003 has provided an additional source of working capital. As at 30 June 2006, the Group had cash and cash equivalents and time deposits of RMB330.8 million, denominated principally in RMB, HK\$, US\$ and Euro, representing a decrease of 4.58% from 31 December 2005. Net cash inflows from operating activities increased 14.02% to RMB56.1 million in 1H 2006, as compared to RMB49.2 million for the same period in 2005. The Group currently has no outstanding interest-bearing debt obligations.

Charges on Assets

As at 30 June 2006, the Group had not charged any of its assets.

Human Resources

As at 30 June 2006, the Group had approximately 4,600 employees. Total personnel expenses, comprising wages, salaries and benefits, amounted to RMB70.0 million in the first half of 2006, compared to RMB61.6 million for the same period in 2005.

Post-Balance Sheet Date Developments

As at the balance sheet date, the directors have declared an interim dividend of RMB0.11 per share based on 547,505,262 ordinary shares in issue as at 30 June 2006, amounting in aggregate to RMB60.2 million to be paid on 31 October 2006 to shareholders of the Company whose names appear on the register of members of the Company at the close of business on 29 September 2006.

Significant Events

There were no significant events in the first half of 2006.