

Management Discussion and Analysis

OPERATIONAL AND FINANCIAL REVIEW

The Group is principally engaged in the manufacture and sale of finished woven fabrics targeting at mid to high-end markets both in the PRC and overseas. The Group vertically integrates its production process, which include research and development, raw fabric weaving, dyeing and setting, cloth finishing such as pattern pressing and calendaring. The Group's products are used for manufacturing down wear, sports wear, household products such as sofa and curtain and men's and women's fashions.

During the year, dyeing auxiliary facilities for producing functional fabrics were purchased to increase the varieties of down wear, sports wear and household products with different nature, which in turn, boost the market expansion and increase selling prices in certain extent. In addition, the new weaving plant in Changle City commenced the production in June 2005 which increased weaving production capacity to 13,700,000 meters in the current year; from which, 26.6% (2005: 20.0%) of fabrics for dyeing process can be self supplied. The new weaving factory ensures steadier supply and better quality control of raw fabrics for the dyeing process, whilst, shortens the production cycle.

To be in line with the Group's efforts in expanding markets, the Group participated in the textile fairs held in Paris, France and Shanghai, the PRC, during the year so as to promote and sell its products to local and overseas customers.

Turnover

For the financial year ended 30 June 2006, the Group recorded a turnover of approximately HK\$615,767,000 (2005: HK\$605,815,000), which was maintained at the same level as the previous financial year. The increase in turnover was attributable to the market demand of down wear, sports wear and household products increased with the number of customers and the functional fabrics produced by the dyeing auxiliary facilities with higher selling prices.

Gross Profit

The gross profit margin of the Group of approximately 29.2% in the current year was maintained at the same level as that in the previous year of approximately 29.1%. It is due to the steady self-supplied raw fabrics productivity for dyeing process with better quality control and shorter production cycle.

Profit for the Year

The Group's profit for the financial year ended 30 June 2006 was approximately HK\$92,346,000 (2005: HK\$94,795,000), approximately 2.6% less than that in 2005. Net profit margin for the year ended 30 June 2006 was approximately 15.0% (2005: 15.6%). The decrease in net profit margin compared with previous year was due to loss on disposal of a number of old model rapier looms and their auxiliary facilities and the change of the fair values of the convertible notes (the "CN").



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Expenses

Selling and distribution costs amounted to approximately HK\$18,221,000 (2005: HK\$19,210,000), representing approximately 3.0% (2005: 3.2%) of turnover for the year ended 30 June 2006. The slight decrease in percentage of turnover was mainly due to the decrease in sales commission as a result of less sales quantity in the current year.

Administrative expenses amounted to approximately HK\$14,190,000 (2005: HK\$16,551,000), representing approximately 2.3% (2005: 2.7%) of turnover for the year ended 30 June 2006. Administrative expenses decreased by approximately 14.3% when compared with that of 2005. It was due to the decrease in directors' remuneration as a result of the retirement of the executive director, Mr. Chen Qinzhi, in May 2005 and tighter cost control policy.

Other expenses amounted to approximately HK\$4,527,000 (2005: HK\$1,292,000), representing approximately 0.7% (2005: 0.2%) of turnover for the year ended 30 June 2006. The increase in amount was due to loss on disposal of a number of old model rapier looms and their auxiliary facilities and more resources contributed in the research and development of new fabrics and improvement of existing fabrics.

Loss on changes in fair value of the CN amounted to approximately HK\$9,765,000 (2005: Nil), representing approximately 1.6% (2005: Nil) of turnover for the year ended 30 June 2006. The upsurge was due to the change in the fair value of the CN and its full year coupon payments as a result of the new accounting standards as set out in note 2 that implemented in this year. Coupon payments for the year ended 30 June 2005 was included in finance costs.

Finance costs amounted to approximately HK\$1,063,000 (2005: HK\$2,952,000). The current year balance comprises of interest payments of bank borrowings only. The previous year balance comprised of interest payments of bank borrowings and the coupon payments of the CN and the amortization of the costs incurred in connection with its issue on straight line basis over its term. The coupon payments of the CN in the current year were included in loss on changes in fair value of the CN.

Dividend

An interim dividend of HK1.0 cent per ordinary share was paid to shareholders during the year. The Board recommends the payment of a final dividend of HK1.0 cent per ordinary share in respect of the year, to shareholders whose names appear on the register of members on 30 November 2006 if approved at the forthcoming annual general meeting. This recommendation has been incorporated in the financial statements as an allocation of retained profits within the capital and reserves section of the balance sheet.

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FUTURE PLANS AND PROSPECTS

As a result of the constant improvement of quality of life in the PRC, the demand for fashionable clothes and quality fabrics increases. In order to diversify the customer base of the Group and tap the market potential, the Group continuously strengthens its distribution network to the other textile markets in the PRC and overseas textile markets. The Group persists in its market expansion by maintaining good and close relationship with distribution agents and valuable customers and concreting its present sales and marketing team.

To maintain the competitiveness of the Group's products in the market, more resources will be concentrated to produce down wear, sports wear and household products rather than on men's and women's fashions, since the selling prices and profit margins of these three products are higher than that of men's and women's fashions as a result of popular production technology of the latter. To cope with the change in product kind, the Group prolongs to invest approximately HK\$50,000,000 for expansion in its weaving production line, purchase of a piece of land adjacent to the plant in Changle City and installation of new state-of-the-art dyeing auxiliary facilities for producing more varieties of functional fabrics. The Group targets to produce these three products as its main production in the future.

On account of the continuous change in the trend of the textile and garment markets, the Group keeps putting effort in research and development of new products and improvement of existing products in order to meet the dynamic market needs.

LIQUIDITY AND FINANCIAL RESOURCES

As at 30 June 2006, the Group had net current assets and total assets less current liabilities of approximately HK\$345,057,000 (2005: HK\$243,624,000) and HK\$543,242,000 (2005: HK\$453,876,000), respectively. The Group maintains a strong financial position by financing its operations with internally generated resources. As at 30 June 2006, the Group had cash and bank deposits of approximately HK\$384,056,000 (2005: HK\$285,613,000). The current ratio of the Group was approximately 484.3% (2005: 357.6%).

Shareholders' fund of the Group as at 30 June 2006 was approximately HK\$460,252,000 (2005: HK\$378,099,000). As at 30 June 2006, the total bank borrowings of the Group, repayable within 12 months from the balance sheet date, denominated in RMB16,556,000, were equivalent to HK\$16,074,000 (2005: HK\$23,500,000) and the CN of US\$10,000,000, due on 6 December 2007 and be measured at fair value, equivalent to HK\$82,990,000 (2005: HK\$75,777,000), together giving a gross debt gearing (i.e. total borrowings/shareholders' fund) of approximately 21.5% (2005: 26.3%).

The financial health of the Group has been strong throughout the year as indicated by the above figures.



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FINANCING

As at 30 June 2006, the total banking and loan facilities of the Group amounted to about HK\$30,680,000 (2005: HK\$34,528,000), of which, HK\$22,545,000 (2005: HK\$32,839,000) was utilized.

The Board 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 term.

USE OF PROCEEDS FROM THE COMPANY'S INITIAL PUBLIC OFFERING

The net proceeds from the Company's issue of new shares at the time of its listing on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") in September 2003, after deduction of related expenses, amounted to approximately HK\$77,100,000. These proceeds were substantially applied up to 30 June 2006 in the following manner and in accordance with the proposed applications set out in the Company's prospectus dated 28 August 2003 (the "Prospectus"):

- as to approximately HK\$56,000,000 for construction of additional production line for fabric dyeing and its auxiliary facilities;
- as to approximately HK\$5,000,000 for expansion of distribution network and promotion of the Group's products and trademark;
- as to approximately HK\$5,000,000 for product development (including the establishment of a new research and development centre and acquisition of research and development facilities);
- as to about HK\$123,000 for the establishment of an e-commerce platform for managing logistics and information exchange between the Group and its distribution agents and for business to business e-commerce; and
- as to approximately HK\$9,100,000 for general working capital of the Group.

The remaining net proceeds as at 30 June 2006 were placed with banks in the PRC as deposits. The Board is of the opinion that the remaining proceeds will be applied in the future for their intended uses as set out in the Prospectus.

CAPITAL STRUCTURE

For the year ended 30 June 2006, the share capital of the Company comprises ordinary shares. The Group had the CN as at 30 June 2006 and up to the date of this annual report.

FOREIGN EXCHANGE RISK AND INTEREST RATE RISK

For the year ended 30 June 2006, the Group was not subject to any significant exposure to foreign exchange rates risk as the majority of the transactions of the Group were denominated in Renminbi; which was relatively stable during the year. Hence, no financial instrument for hedging was employed.

All bank borrowings and the CN of the Group were denominated in Renminbi and US dollar, respectively, and at fixed rate basis. The Board is of the opinion that the Group is not subject to any significant interest rate risk.

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CHARGE ON GROUP'S ASSETS

As at 30 June 2006, certain leasehold interests in land, buildings and plant and machinery of the Group with aggregate amount of approximately HK\$38,791,000 (2005: HK\$100,143,000) were pledged to banks to secure bank facilities granted to the Group; together with the bank deposits of the Group of approximately HK\$4,314,000 (2005: HK\$6,226,000).

Pursuant to a deed of assignment dated 3 December 2004, Credit Suisse (Hong Kong) Limited ("Credit Suisse") will deposit the subscription funds for the convertible notes to an account of DB Trustees (Hong Kong) Limited (the "Account"). The Company will charge the Account and all moneys (including interest) from time to time standing to the credit to the Account, by way of fixed charge, in favour of DB Trustees (Hong Kong) Limited (who acts as security trustee for Credit Suisse) as continuing security for the payment and discharge of all moneys owing by the Company to Credit Suisse. At 30 June 2006, an amount of US\$5,000,000 (2005: US\$5,000,000) was maintained in the Account.

CAPITAL EXPENDITURE

During the year, the Group invested approximately HK\$12,694,000 (2005: HK\$37,601,000) in property, plant and equipment, of which 7.0% (2005: 17.9%) was used for purchase of plant and machinery, 91.3% (2005: 81.6%) for construction of new dormitories and warehouse and the remaining was used for purchase of other assets.

As at 30 June 2006, the Group had capital commitments of approximately HK\$1,902,000 (2005: HK\$20,897,000) in respect of property, plant and equipment and prepaid lease payments, which are to be funded by internally generated resources.

STAFF POLICY

The Group had 420 employees in the PRC and 3 employees in Hong Kong as at 30 June 2006. The Group offers a comprehensive and competitive remuneration, retirement scheme and benefit package to its employees. Discretionary bonus is offered to the Group's staff depending on their performance. The Group is required to make contribution to a social insurance scheme in the PRC. Moreover, the Group and its employees in the PRC are each required to make contribution to fund the endowment insurance and unemployment insurance at the rates specified in the relevant PRC laws and regulations. The Group has adopted a provident fund scheme, as required under the Mandatory Provident Fund Schemes Ordinance, for its employees in Hong Kong.

The Group also provides periodic internal training to its staff.

Each of the independent non-executive directors is appointed for a term of 1 year commencing from 1 September each year.

CONTINGENT LIABILITIES

At the balance sheet date, the Group and the Company did not have any significant contingent liabilities.