

Operations review

Year ended June 30

Breakdown of group turnover*					
	2006	2005	2004	2003	2002
geographical mix (%)					
europa	85	85	84	80	74
asia pacific	12	13	13	18	24
north america and others	3	2	3	2	2
product mix (%)					
women's casual	37	39	39	40	45
women's collection	7	8	7	5	–
women's sports	3	3	2	2	2
edc women	16	13	13	11	10
men's casual	10	11	13	13	11
men's collection	2	2	–	–	–
edc men	2	1	–	–	–
kids & edc youth	7	6	7	8	8
bodywear	3	3	3	3	2
shoes	5	5	6	7	8
accessories	5	5	5	6	7
red earth	1	1	1	2	3
others**	2	3	4	3	4
operation mix (%)					
wholesale	58	58	59	57	57
retail	41	41	40	41	42
licensing and others	1	1	1	2	1
* excludes inter-segment revenue					
** include salon, bed & bath & licensed products such as timewear, eyewear, jewelry, etc.					



Operations review

Regions

“International Presence”

ESPRIT is a true international brand as our products reach out to over 40 countries and different demographics. But we do not rest on this success.

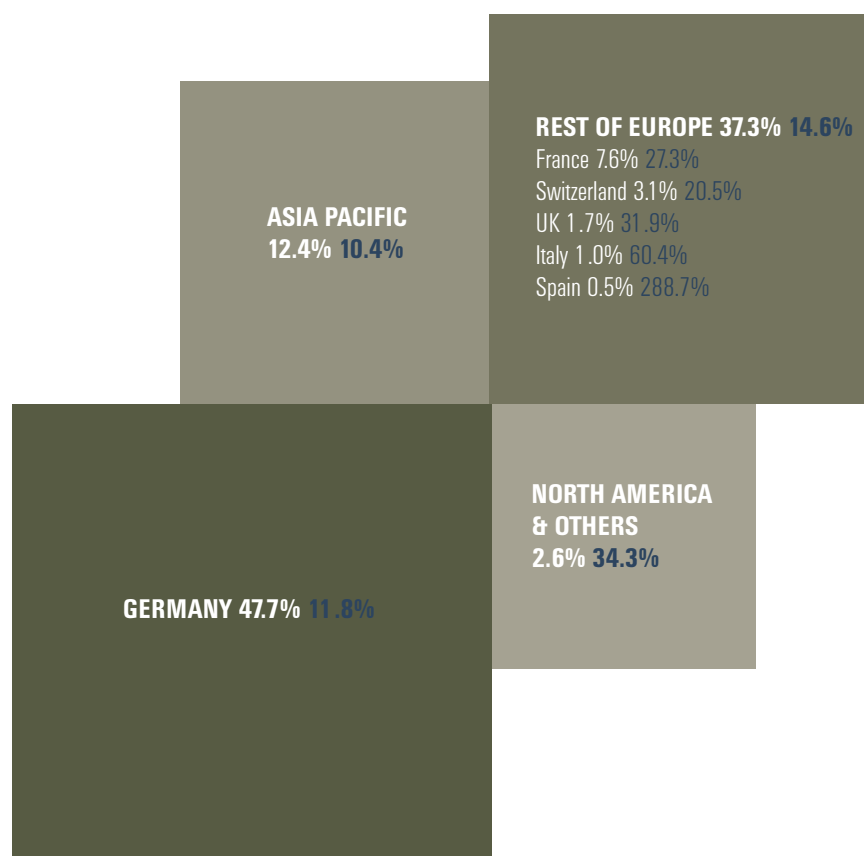
During the financial year, the Group continued to foster Esprit’s penetration in core markets while extending its global presence by entering newer ones.

European turnover grew by 13.0% to HK\$19.86 billion, accounting for 85.1% of the Group’s total turnover. Germany and Benelux remained our core markets, represented 47.7% and 15.0% of the Group’s turnover, and delivered turnover growth of 11.8% and 4.1% respectively. Expansion in Europe was further driven by fast growing markets including France and Switzerland, along with rapid development in new markets including the UK, Italy and Spain.

Asia, represented 9.5% of the Group’s total turnover, continued to post solid turnover growth of 18.1% to HK\$2.21 billion as a result of our continuous effort to explore the untapped potential in the region. During the financial year, the Group successfully entered into India and our product is well received by the local consumers.

North America, represented 2.6% of the Group’s turnover, has laid down a strong turnover growth of 34.3%, with wholesale turnover increased by 24.4% and retail turnover increased by 45.4%. The region also delivered a narrowing operating loss, as a result of the increase in turnover and the continuous improvement in operational efficiency. During the financial year, we opened nine more stores (six in the US and three in Canada), and fostered our brand’s popularity by offering the right assortment of products for this market.

The Group has placed Australasia under the Asia Pacific umbrella, allowing our experienced Asian team to emulate their success in turning around Asia for this particular market. We are diligently preparing a new strategy for our Australasia market, placing emphasis on the distribution channels by converting some of the retail concessions into wholesale formats. With a new team of local management in place, we expect the product offering will also be enhanced to improve the profitability of our Australasia market.



% of Group's turnover
% growth from last financial year

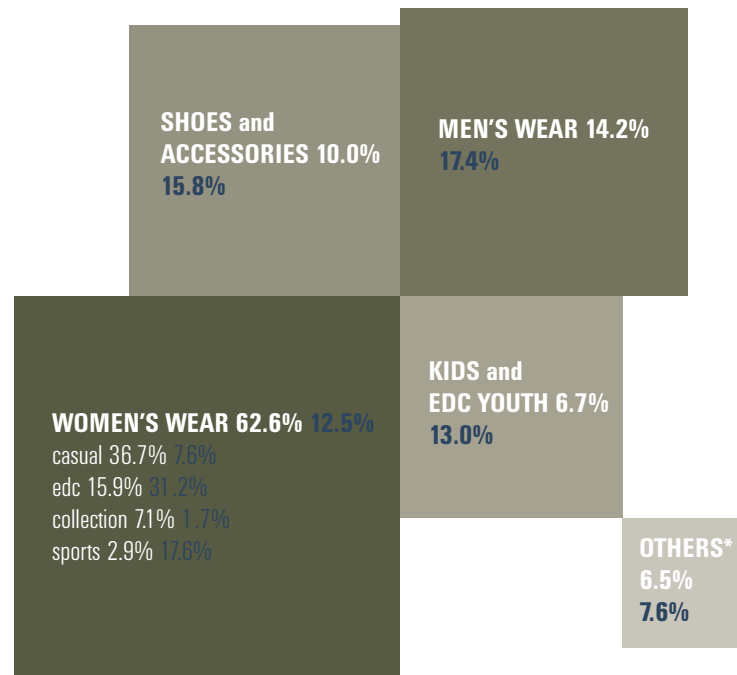
Operations review

Products

Esprit's design team gathers inspiration from the world around us, with a focus on offering newness and modernity to our customers.

Each product line has its own team of designers, buyers, sourcing specialists and project managers. Our market-driven product team is committed to develop fresh quality products at the right product mix and price, creating smart and affordable luxury for our customers. Local country merchandisers and sales teams provide constant feedback to each product team regarding local tastes, trends and customer needs.

Each product team is supported by our global sourcing specialists, working closely with independent suppliers from around the world, including from countries like China, Indonesia, Turkey and Portugal. Our extensive sourcing network allows Esprit to maintain quality products while having the flexibility to place orders with the right fabric suppliers and manufacturers at the right price and location.



* Others include bodywear, Red Earth, salon, bed & bath & licensed products such as timewear, eyewear, jewelry, etc.

% of Group's turnover

% growth from last financial year



Operations review

Products

Offering newness and modernity to our customers remain Esprit's priority. Our dedicated design team creates 12 new and refreshing collections a year for our key product lines, always keeping in mind the importance of offering high price-quality correlation products to our customers. Our diversified and ever-growing product offering serves the fast-changing taste of Esprit's customers, as well as taking into account potential consumers' needs from all over the world.

Women's wear, the core product division which made up 62.6% of the Group's total turnover, recorded 12.5% turnover growth. Among the women's division, turnover from women casual, edc women, women collection and women sports constituted 36.7%, 15.9%, 7.1% and 2.9% of the Group's total turnover with growth rates of 7.6%, 31.2%, 1.7% and 17.6% respectively.

Leveraging on the success in Women's wear, the Group continued to cultivate other product divisions with high growth potentials. Turnover from Men's wear grew by 17.4% and represented 14.2% of the Group's total turnover. Other smaller product divisions, such as shoes, accessories, and kids & edc youth, which formed 5.1%, 4.9% and 6.7% of the Group's total turnover, also reported encouraging turnover growth of 12.2%, 19.8% and 13.0% respectively during the year. The Group achieved approximately 7 times inventory turnover despite the difficult operating environment.

Operations review

Products | the divisions

Women's casual

This line is the largest segment of Esprit's portfolio and has the broadest appeal to most consumers. Casual concentrates on sportswear for everyday life stressing comfortable styles with high quality and affordability.

Men's casual

A range of comfortable, yet authentic and energetic designs offering clothing for men that emphasizes a youthful spirit for every occasion.

Women's collection

This is the most luxurious segment of the Esprit portfolio. Collection targets the customer who prefers the style, quality and taste level of the high-end market and look for this luxury at affordable prices.

Men's collection

Our men's collection provides smart and urban wear for men. The designs combine quality cutting with new fashion highlights and provide the required relaxation fit for the socially conscious after work.

EDC women

One of the fastest growing segments in the company, this division appeals to trend conscious women. edc women maintains an up-to-date mix of items that match women's outgoing lifestyle.

EDC men

The trendy edc men creates youthful looks for young and fun-loving customers. Its sporty element and exceptional details that add fashionable accents allow fashion-conscious individuals to express their own personal style.

EDC youth

Funky and expressive, with a contemporary yet functional style, provides comfortable and casual everyday fashion in a fun and lively environment. edc youth customers are self-confident teenagers who are open to new experiences and seeking a sense of freedom.

Kids

Esprit kids markets a full range of colorful and vibrant children's wear and accessories. These designs combine practicality with fashion and enable mix and match, meaning there is ample room for kids to express their personality through their clothes.

Sports

This line offers coordinated outfits for athletic, sporty customers during sports activities and afterwards. The fabrics, cuts and styles meet the high functional demands of a variety of outdoor and leisure sports activities. All our items are designed to be durable, easy-to-wear, yet maintaining their shape and color through many washings.

Bodywear

Esprit bodywear is designed with a commitment to comfort, quality and innovation. It has an extensive range of classic cotton and fashion underwear and intimate apparel in a variety of styles and fabrics. The products have all the good functional values aiming to provide physical and emotional comfort through good fit and a relaxed wearing experience.

Shoes

Esprit shoes are multi-faceted with options from dress to sporty to casual aiming to offer the right look at the right time for cosmopolitan and trendy men and women.

Accessories

This line offers a broad range of matching chic and stylish accessories including bags, belts and wallets that complement our fashion line. It aims to integrate and reflect the contemporary and easy living lifestyles of our customers.



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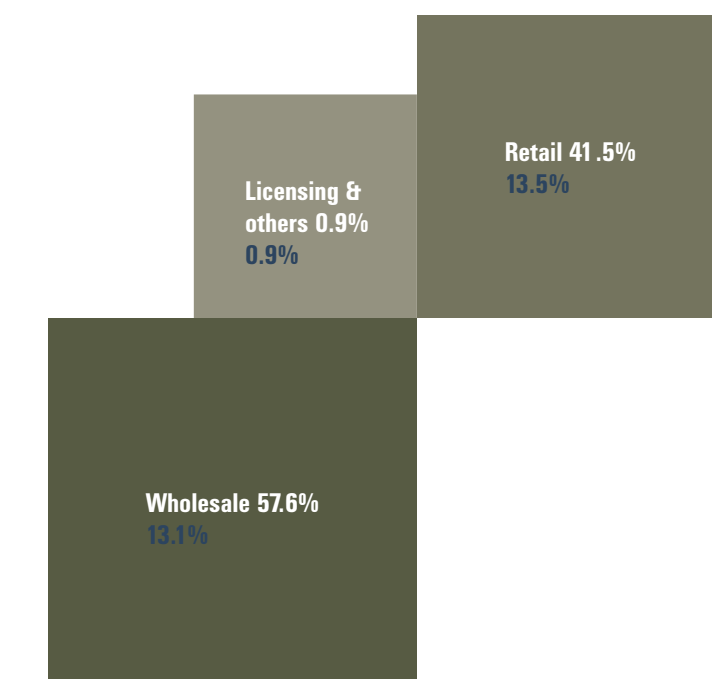
Distribution channels

“Multi-Distribution Network”

Esprit’s multi-distribution channels encompass retail, wholesale and licensing, offering optimal distribution points for different markets and customer groups to facilitate our global expansion.

Wholesale and retail contributed to 57.6% and 41.5% of the Group’s turnover and increased by 13.1% and 13.5% respectively. With operational efficiency and effective cost control, wholesale EBIT¹ margin expanded by 1.9% points to 28.1% while retail EBIT¹ margin remained stable at 12.3%. Our multi-distribution system allows us flexibility in preparing the best combination of distribution channels to suit local market dynamics of different countries. We continue to utilize these channels to illustrate our brand’s market position, brand culture, as well as business philosophy, providing our customers with a memorable shopping experience at Esprit.

¹ Segment EBIT and EBIT margin excluding inter-segment licensing expense.



% of Group's turnover
% growth from last financial year

wholesale turnover (HK\$ MN)

FY 05 06	13,450
FY 04 05	11,889
FY 03 04	9,613
FY 02 03	7,076
FY 01 02	5,220

retail turnover (HK\$ MN)

FY 05 06	9,701
FY 04 05	8,547
FY 03 04	6,545
FY 02 03	5,107
FY 01 02	3,841

Operations review

Distribution channels | wholesale

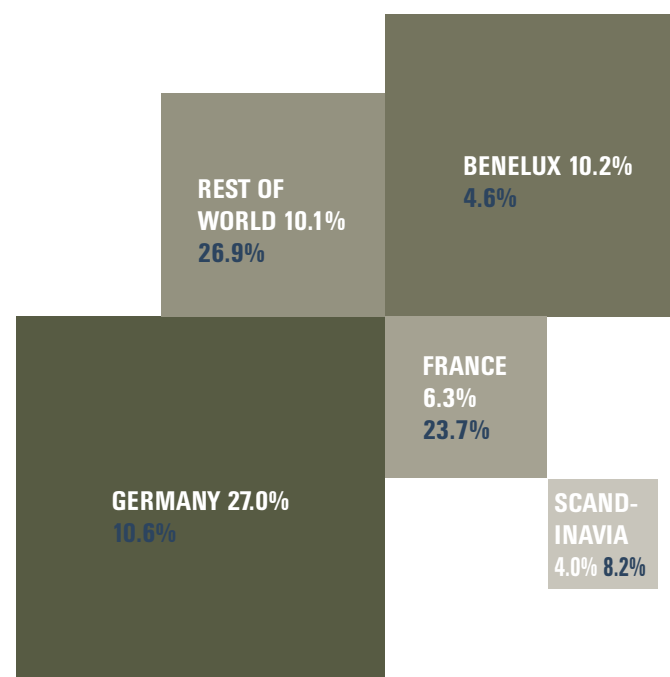
Controlled-space wholesale channels share the look-and-feel of Esprit's directly managed stores. The various controlled-space wholesale formats including shop-in-stores, partnership stores and identity corners are built with Esprit ambience, enabling all customers to enjoy similar shopping experiences.

Wholesale business, which underpinned 57.6% of the Group's total turnover, continued to record double-digit percentage turnover growth of 13.1% to HK\$13.45 billion during the financial year. The turnover growth was mainly driven by the 21.8% net increase in controlled wholesale space (including shop-in-store, partnership store and identity corner), bringing the Group's total to over 540,000m². As at June 30, 2006, the Group had over 11,450 controlled-space wholesale point-of-sales, an increase of over 1,700 from last financial year.

Europe, the Group's core wholesale market which represented 93.3% of the Group's wholesale turnover, delivered 12.3% turnover growth, driven by the net addition of over 1,500 controlled-space wholesale point-of-sales or over 81,800m² controlled wholesale space. Germany remained to be the Group's biggest wholesale country and delivered 10.6% turnover growth. Our new wholesale markets, Spain and Italy registered extraordinary turnover growth of 288.7% and 60.4% respectively. These markets expanded the Group's foothold of our wholesale concept with over 120 and 260 controlled-space wholesale point-of-sales respectively.

Outside of Europe, the Group continued to seek opportunities for further international expansion. Wholesale turnover in Asia grew 30.7% and accounted for 5.5% of the Group's wholesale turnover. The strong wholesale sales growth in Asia was mainly driven by healthy sales growth to our wholesale customers in markets such as China, the Middle East and the Philippines, together with sales contributions from newer wholesale market, India. During the financial year, four franchised stores were opened in India, adding over 900m² controlled wholesale space.

Group wholesale turnover breakdown



% of wholesale turnover

% growth from last financial year

wholesale controlled-space sales area (m²)

FY 05 06	540,025
FY 04 05	443,321
FY 03 04	337,230
FY 02 03	264,838
FY 01 02	153,649

Key wholesale distribution channels

	partnership stores*			shop-in-stores*			identity corners others*		
	no. of stores	sales area	net change	no. of stores	sales area	net change	no. of stores	sales area	net change
	(as at June 30, 2006)	sq.m.	in sales area		sq.m.	in sales area		sq.m.	in sales area
europa	724	148,675	33.0%	3,337	140,405	22.6%	6,146	137,081	16.2%
germany	247	56,774	35.0%	2,626	115,667	21.8%	3,618	81,487	18.6%
the netherlands	68	15,551	10.2%	13	397	85.5%	449	10,731	8.5%
france	146	18,189	74.4%	301	8,341	17.8%	319	8,400	45.9%
belgium	58	13,587	25.1%	81	3,767	14.2%	428	10,227	(2.5%)
scandinavia	46	15,169	28.4%	99	4,252	35.2%	704	10,566	4.9%
austria	87	16,501	11.1%	41	2,003	(10.3%)	131	2,997	69.6%
switzerland	37	7,133	50.5% #	20	1,040	(15.0%)#	190	4,870	7.3%#
italy	24	3,348	205.8%	7	457	41.0%	231	6,000	14.4%
great britain	8	1,836	59.4% #	38	1,962	103.3% #	61	1,437	10.4%#
spain	3	587	(13.0%)	111	2,519	138.5%	15	366	103.3%
asia pacific	221	44,220	25.3%	138	6,437	(27.6%)##	695	63,207	15.2%##
china**	63	24,177	18.1%	13	321	(10.8%)##	612	62,494	14.8%##
middle east	54	7,707	32.1%	5	994	(29.3%)	7	48	n.a.
thailand	29	3,580	34.6%	88	3,461	(12.6%)	21	289	7.4%
philippines	17	2,523	86.6%	-	-	-	-	-	-
korea	-	-	-	-	-	-	22	154	n.a.
japan	2	117	(46.8%)	-	-	-	-	-	-
others	56	6,116	32.3%	32	1,661	(16.9%)	33	222	32.1%
north america	-	-	-	33	-***	-***	165	-***	-***
canada	-	-	-	33	-***	-***	165	-***	-***
group total	945	192,895	31.2%	3,508	146,842	19.0%	7,006	200,288	15.9%

* include Esprit & Red Earth stores/units

** managed by China joint venture or its franchise partners

*** sales area not available

n.a. means not applicable or stores/identity corners opened in FY2005/2006

the net sales areas of partnership stores, shop-in-stores and identity corners of Switzerland and Great Britain as at June 30, 2005 shown in the annual report of FY2004/2005 were erroneously swapped. As at June 30, 2005, the net sales areas of partnership stores, shop-in-stores and identity corners of Switzerland were 4,740 sq.m., 1,224 sq.m. and 4,540 sq.m., respectively, and the net sales areas of partnership stores, shop-in-stores and identity corners of Great Britain were 1,152 sq.m., 965 sq.m. and 1,302 sq.m., respectively. The above net changes in sales area of Switzerland and Great Britain were calculated based on these figures.

classification of certain shop-in-stores and identity corners in China was reviewed. Sales areas of 37,354 sq.m. as at June 30, 2005 were reclassified from shop-in-stores to identity corners. The net changes in sales area of shop-in-stores and identity corners in China were calculated based on the reviewed grouping of shop-in-stores and identity corners.



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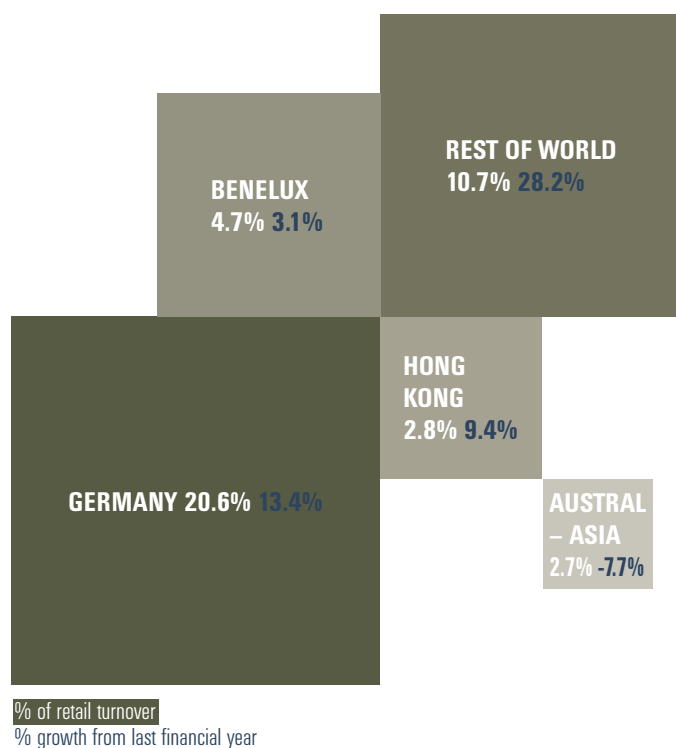
Distribution channels | retail

Retail model is essential to set the ESPRIT brand characteristics and drive awareness. It is an important tool to educate the market of our brand position and business philosophy. The Group follows rational expansion strategy by seeking locations that provide reasonable rates of return rather than mere space expansion to ensure that every penny we spent creates shareholders' value.

retail sales area (m²)

FY 05 06	224,012
FY 04 05	193,361
FY 03 04	170,029
FY 02 03	149,389
FY 01 02	138,928

Group retail turnover breakdown



Our retail turnover grew by 13.5% to HK\$9.70 billion during the financial year, due to a combined effort to improve productivity in existing stores as well as expanding on our retail network.

The Group's comparable-store-sales growth was 9.0% for the full-year. Europe, our core market which accounted for 75.0% of Group retail turnover, posted a strong comparable-store-sales growth of 11.3%. Asia, North America and Australasia recorded a comparable-store-sales growth of 8.8%, 7.0% and -9.3% during the financial year.

Our retail model is essential for establishing the brand's character and for driving awareness to our customers. During the financial year, the Group invested HK\$669.1 million to open approximately 100 new retail stores and to refurbish existing retail stores, bringing our total directly managed retail stores to 668 (FY2004/2005: 631). There was a net opening of 51 Esprit stores and a net closure of 14 Red Earth stores. The Group's total retail space was over 224,000m² (FY2004/2005: over 193,300m²), a net increment of over 30,600m² from FY2004/2005.

Expansion emphasis was placed on both our core markets, such as Germany and Benelux, and high growth markets, such as France and the UK. Outside of Europe, the Group continued its international expansion, and added net selling space of over 1,900m², 2,900m² and 2,600m² in Asia, North America and Australasia respectively.

The Group's online e*shop remains an important part of its retail initiative. During the financial year, the Group extended the e-commerce business to the Netherlands, France and Belgium, bringing us closer to our existing and potential customers within these important demographics.

Key retail distribution channels

(as at June 30, 2006)	directly managed stores*		
	no. of stores	sales area sq.m.	net change in sales area
europa	243	143,660	19.2%
germany	114	82,616	15.2%
the netherlands	37	12,523	16.2%
belgium	19	13,997	13.5%
switzerland	29	8,923	21.1%
austria	8	8,358	26.0%
france	24	9,503	78.1%
great britain	9	5,959	29.7%
denmark	2	1,281	no change
luxembourg	1	500	no change
asia	210	32,834	6.1%
hong kong (incl. macau)	45	14,665	3.5%
taiwan	99	7,895	7.7%
singapore	34	5,533	(12.0%)
malaysia	32	4,741	50.5%
australasia (incl. new zealand)	155	25,557	11.4%
north america	60	21,961	15.7%
canada	46	15,996	4.9%
u.s.	14	5,965	60.1%
group total	668	224,012	15.9%

* include Esprit & Red Earth stores, but exclude Salon

pure

beauty



Operations review

Distribution channels | licensing

The Group's licensing business complements brand penetration worldwide. Licensing activities extend Esprit's lifestyle offerings to different product categories in different markets worldwide. Licensing partners are carefully selected to ensure the creation of credible products that maintain our brand integrity and meet our stringent quality measures.

Esprit continues to build up the licence theme of home, kids, and lifestyle products, with third party's royalty income of HK\$122.6 million, representing approximately 0.5% of the Group's total turnover.

During the financial year, we have signed seven new licensing contracts for product categories including furniture, carpets, wallpaper, cuddly toys, golf and swimwear while expanding the existing licenses into new countries and regions, amongst them Latin America, China and the US. As at June 30, 2006 we were working with around 34 licensees and offering around 30 categories of Esprit licensed products to consumers worldwide.

Key licensed product category

	europa	asia	australasia	north america	latin america
baby carriages	■		■		
baby furniture	■				
bath	■	■	■		
bed	■	■	■	■	
belts				■	
carpets	■				
costume jewelry EDC	■			■	
down	■	■	■		
eyewear	■	■	■	■	
fragrance	■	■	■	■	■
furniture	■				
glassware	■				
golf		■			
home	■	■			■
jewelry	■	■	■		
kid's accessories				■	
kid's bed	■				
kid's shoes			■	■	
kid's wear				■	
outerwear				■	
school	■				
shoes			■		
sleepwear/daywear				■	
socks & tights EDC	■				
socks & tights Esprit	■	■	■	■	■
soft toys	■				
stationery	■				
swimwear				■	
timewear	■	■	■	■	
towels	■	■	■		
umbrellas	■	■	■		
wallpaper	■				

Operations review

Sourcing

The Group outsourced all production requirements to third party suppliers and our diversified global sourcing base remains a strong competitive advantage for Esprit in the marketplace. When determining our sourcing mix, quality, proximity to the markets and costs are the major considerations.

During the financial year, we sourced over two-thirds of our merchandise from Asia, with the remainder primarily coming from Europe. Our cost-efficient buying, which results from economies of scale and our long-term relationship with suppliers, also plays a crucial part in maintaining our cost-of-goods at a competitive level.

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