

Management Discussion and Analysis

FINANCIAL HIGHLIGHTS

For the financial year ended 30 June 2006, the Group recorded turnover of HK\$360.7 million, representing a 160 per cent increase from the preceding year. The Group's profit attributable to shareholders was approximately HK\$83.2 million (2005: net loss of 150.1 million), and earnings per share for the year was HK2.72 cents (2005: loss per share of HK5.61 cents).

During the year under review, the Company completed the acquisition of the ecological forestry business and the post-acquisition turnover and profit contribution from the newly diversified business was first-time consolidated into the Group accounts. The increase in turnover was mainly attributable to post-acquisition revenue generated from the newly acquired ecological forestry business. For the year under review, the Group's ecological forestry business and garment business accounted for approximately 60.7 per cent and 39.3 per cent, respectively, of the Group's total turnover.

In arriving at the Group's net profit, sharing in profits of joint-venture investment in Nano-technologies in the amount of HK\$1.6 million (2005: sharing in loss of HK\$30.8 million) has been included.

DIVIDEND

The Board of directors has resolved not to recommend any dividend for the financial year ended 30 June 2006.

BUSINESS AND OPERATIONAL REVIEW

The Ecological Forestry Business

The Group's business operations in the ecological forestry business was carried out by Beijing Wan Fu Chun Forest Resources Development Company Limited ("Beijing WFC"), a Sino-Foreign joint venture principally engaged in the business of tree planting and management, manufacture and distribution of forest products such as timber and bark materials. The Company held a 70 per cent effective equity interest in Beijing WFC.

For the first post-acquisition period, the Group's share in net profit contribution from Beijing WFC attributable to the Company's shareholders amounted to approximately HK\$93.8 million. The profit contribution, which has been consolidated into the Group accounts for the financial year ended 30 June 2006, arose mainly from the sale of paper mulberry sapling and also quality pinewood by Beijing WFC. The sale of paper mulberry sapling was undertaken in Beijing WFC's initial stage of business launching to avail working capital and cash resources for future large scale plantation of the modified tree specie *Broussonetia Papyriferalvent*. The Group's turnover in respect of its forestry operations were entirely derived from the PRC.

In addition to the direct sale of saplings, during the post-acquisition period Beijing WFC has also commenced the plantation of the modified tree specie *Broussonetia Papyriferalvent*. The plantation works was carried out in a leasehold agricultural premise in the Shandong province and also certain other leased premises in other regions of the PRC; mainly near the Beijing border. Based on professional survey performed, as at 30 June 2006, the harvestable volume of *Broussonetia Papyriferalvent* being grown was assessed as approximately 805 tons of bark and 5,926 tons of tree trunk. During the current year, post-acquisition profit contribution in the amount of HK\$11.9 million was recorded in respect of the fair value re-measurement gains assessed in terms of harvestable timber which can be obtained by Beijing WFC from its plantation activities rendered during the period. At this stage of new

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commencement of plantation, however, the growth of the *Broussonetia Papyriferalvent* was still in continuance and has not reached their optimal stage for harvest. Therefore, no harvesting of the modified tree specie and sale of the collectible timber has been made during the year.

In respect of the Group's secondary forestry business operation in pinewoods, namely, the Shanxi Xiyang Dongfeng Forest Farm and the Shanxi Xiyang State-run Bixiaguan Forest Farm, both of them being located in Shanxi province, the PRC, during the post-acquisition period, harvesting has been made of approximately 56,000 cubic meters by volume of the pinewoods and sale of the collectible timber. Based on professional survey performed, as at 30 June 2006, the flocks of living pine trees of different maturities grown thereon was assessed to have an aggregate bulk volume of approximately 332,000 cubic meters. Amongst these, approximately 91 per cent by volume of the living pine trees have reached optimal harvestable stage of full maturity and near-maturity. Of these wholesome living pine trees, the Group has vested interests in contracts for the sale of portions of the flocks of approximately HK\$49 million by sales value, the delivery of which has not been completed as at 30 June 2006.

The Garment Business

The Group's core garment business consisted of the design, manufacture and sale of a range of high-end apparel and uniforms. The PRC market remained the most important market segment, accounting for over 90 per cent of the Group's total garment sales. During the year, the turnover generated from the garment business remains stable while the gross product margin normalized and improved from 8.4 per cent in last year to a healthier level of around 13.6 per cent. As a result, the Group succeeded in considerably reducing the net operating loss from its garment operation to approximately HK\$2.6 million for the year ended 30 June 2006.

The improvement was mainly the result of the Group's effort in rectifying its operations and advertising and intensified marketing and promotional campaign, including the appointment of renowned screen celebrity as the brand image ambassador and the roll out of a series of television advertisements to increase customers' brand awareness. In addition, the Group's effort in promulgating a nationwide sales retail network in the PRC and broaden sales channel has enabled the Group to concentrate on products with higher profit margin. Such promotional effort while requires a higher level of overhead outlay on part of the Group over the last two years, was beginning to impart its benefits. Along with the increase in brand awareness, a higher emphasis of sales effort was placed with apparel products under the Group's own branding which generally command higher profit margin than uniform sales. During the year, the Group also introduced to the market the leisure series of apparel to complement the men's suits and uniform product lines; and was well received by the market.

Investment in Nano-technology Business

The Group's share of results of jointly-controlled entities, in the amount of HK\$1.6 million, represents share of operational profits from high-tech investment in Zhongke Nanotech, the Group's joint venture investment vehicle engaged in the development and sales of nano materials and transfer of related technology. Following a period of loss-incurring operational consolidation over the last year, Zhongke Nanotech succeeded in turning around the operation for the current year. The result contribution for the year was derived mainly from the sale of nano metallic paint; nano interior and exterior paint; and nano paste as successfully commercialized by Zhongke Nanotech's second industrialization plant in Suzhou, the PRC. In addition, technology transfer contracts completed during the year includes the technology in the industrial manufacture of nano self-cleansing glass material.

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Selling and distribution expenses

The increase in selling and distribution expenses for the year is mainly the result of the consolidation of post-acquisition expenses incurred in respect of the Group's newly acquired ecological forestry business. These include cost incurred in harvesting pine woods and related storage and transportation charges.

Other operating expenses

The other operating expenses for the current year of approximately HK\$28.3 million include mainly (i) patent amortisation of HK\$9.1 million, (ii) amortization of paper mulberry saplings of approximately HK\$17.8 million, and (iii) research and development cost of approximately HK\$10.5 million.

The significant other operating expenses for last year included: (i) impairment of the Group's investment in software compression technologies and related goodwill balance (HK\$37.1 million); (ii) the impairment of goodwill in respect of high-tech investment in Nano technologies applications (HK\$31.5 million); and (iii) provision for inventories (HK\$13.4 million). These impairment losses are mainly non-recurrent in nature and accordingly the significant reduction in expense incurred for the current year.

LIQUIDITY AND FINANCIAL RESOURCES

As at 30 June 2006, the Group's cash and bank balances, which were principally Renminbi and Hong Kong dollar denominated, amounted to over HK\$284 million. The Group was not exposed to any substantial risk in foreign exchange fluctuations.

As at 30 June 2006, the Group's total borrowings (excluding convertible notes liabilities) amounted to approximately HK\$276.6 million, out of which approximately HK\$220.6 million represents the amortised value of non-interest bearing promissory notes payable and HK\$56.0 million represents current account payable to minority shareholder. The promissory notes have an aggregate nominal value of HK\$230 million. Partial of the Company's promissory notes in the denomination of HK\$130 million are repayable on demand at any time starting from 1 October 2006 and the corresponding amortised value are classified as current liabilities as at 30 June 2006. Settlement is in progress subsequent to 30 June 2006 of the above current portion of the promissory notes which has fallen due. The remaining outstanding portions of the Company's promissory notes are repayable by two installments each of HK\$50 million which shall fall due on 1 April 2007 and 1 July 2007, respectively.

The Group's presently available liquidity resources are sufficient in servicing its promissory notes and other borrowings and meeting its capital commitments. The Group generally finances its operation with internally generated resources. As at 30 June 2006, the Group's net current assets amounted to over HK\$239.5 million as at the reporting end date. The Group's current ratio, expressed as a percentage of current assets to current liabilities, amount to 1.7 times.

The Group has obtained available bank credit facilities which are secured by certain of the Group's pledged bank deposits and corporate guarantees given by the Company. During the year, these available bank credit facilities have been utilised in trade credit financing.

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CAPITAL STRUCTURE

As at 30 June 2006, the capital structure of the Company is constituted exclusively of 3,879,807,600 ordinary shares of HK\$0.10 each. Apart from ordinary shares in issue, the capital instruments in issue of the Company include convertible notes and options to subscribe for shares in the Company.

During the year under review, a total of 206,200,000 new shares have been issued as a result of the exercise of options to subscribe for new shares in the Company. Subsequent to 30 June 2006, options were further exercised for the subscription of an additional 18,000,000 new shares in the Company.

During the year, the Company issued 580,000,000 consideration shares, credited as fully paid, and convertible notes in aggregate principal amount of HK\$210.4 million as consideration for the acquisition of Strong Lead Investments Limited, details of which are set out in the below section on “Material Acquisitions”.

The Company’s convertible notes in aggregate principal amount of HK\$210.4 million are Hong Kong dollar denominated and interest-bearing at a fixed rate of 1.5 per cent per annum. The principal denomination of the convertible notes is convertible in full or in part into ordinary shares in the Company at a conversion price of HK\$0.12 per share. During the year, partial of the principal denomination of HK\$18.6 million of the convertible notes has been converted into 155,000,000 ordinary shares in the Company. Subsequent to 30 June 2006, further conversion has been made of principal denomination of HK\$91.8 million in the convertible notes into 765,000,000 ordinary shares in the Company. After accounting for the above share issues, as at the date of this report, there are 4,662,807,600 ordinary shares in issue with the Company.

The remaining outstanding convertible notes in an aggregate principal amount of HK\$100 million are restricted portion convertible only subsequent to the year 2007. Assuming full conversion is made of these outstanding convertible notes, under the existing capital structure of the Company, the capital base of the Company will be increased to approximately 5,496,140,930 ordinary shares under the existing capital structure of the Company. To accommodate the future expansion and growth of the Group and facilitate the business acquisition, on 8 May 2006, the Company increased its authorized share capital from HK\$500 million to HK\$650 million by the creation of an additional 1,500,000,000 un-issued ordinary shares of HK\$0.10 each in the Company.

As at 30 June 2006, the Group’s gearing ratio, measured on the basis of total borrowings (including convertible notes) as a percentage of total shareholders’ fund, was approximately 61 per cent.

EXPOSURE TO FLUCTUATION IN EXCHANGE RATE

The majority of the Group’s transactions and borrowings are denominated in Hong Kong dollars and Renminbi, and therefore the Group’s exposure to exchange rate fluctuation is relatively insignificant. In general, the Group mainly utilizes its Renminbi income receipt for operating expenditures in China and does not use any financial instruments for hedging purpose.

MATERIAL ACQUISITIONS

During the year, the Company completed the acquisition of Strong Lead Investments Limited, a company incorporated in the British Virgin Islands and held as its sole asset a 70 per cent equity interest in Beijing Wan Fu Chun Forest Resources Development Company Limited, a Sino-Foreign joint venture principally engaged in the business of tree planting and management, manufacture and

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distribution of forest products such as timber and bark materials. The acquisition consideration of HK\$560 million is satisfied by cash consideration and the issuance by the Company of consideration shares; promissory notes and convertible notes. The Company's interest in Strong Lead Investments Limited is accounted for as a subsidiary undertaking and form part of the Group's principal operation. The details of the acquisition, which constitutes a Very Substantial Acquisition under the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Ltd., were disclosed in the Company's circular to its shareholders of 18 April 2006. The financial effect of the acquisition are set out in note 43 "Business Combination" to the financial statements.

SIGNIFICANT INVESTMENTS HELD

The significant investment held by the Group as at 30 June 2006 includes principally a 55 per cent equity interest in Zhongke Nanotech Engineering Center Co., Ltd. (Zhongke Nanotech), a PRC limited liability company engaged in the development and sale of nano material and related products. Zhongke Nanotech is a jointly-controlled entity established amongst the Group, the Chinese Academy of Science and certain other joint venture partners. The headquarter of Zhongke Nanotech is based in Beijing, the PRC, and currently contained a strong research team of over 40 scientific researchers, including Mr. Jiang Lei, the chief scientist of China 863 project in nano-technology, and various senior researchers of doctoral and master's degrees. More than 30 patents of the nano-technology research projects had already been filed. In addition, Zhongke Nanotech also operates a second industrialization plant in Suzhou, the PRC, which is mainly engaged in the production of nano high elastic plastic and nano metallic paint; nano interior and exterior paint; and Nano paste. The Group's interests in Zhongke Nanotech group of companies are accounted for as interests in jointly-controlled entities in the accompanying audited financial statements.

As at 30 June 2006, the Group's aggregate carrying value in respect of its investment in Zhongke Nanotech group of companies, comprising share in net assets, amounted to HK\$28.2 million.

The net sharing in result, after minority interest, in Zhongke Nanotech group of companies for the year ended 30 June 2006 and as reflected in the accompanying audited financial statements amounted to a profit of HK\$1.6 million, as compared to a sharing in net loss of HK\$30.8 million for last year. Following a period of operational consolidation during the last year, the current year improvement in financial performance was mainly attributable to completion of certain technology transfer contracts and the successful commercialization of new products of nano paint and nano paste during the year.

PLEDGE OF ASSETS

The Group's bank borrowing facilities are secured by certain of the Group's pledged bank deposits of HK\$10.9 million and corporate guarantees given by the Company.

CAPITAL COMMITMENTS

As at 30 June 2006, the Group's capital commitments contracted but not provided for principally include approximately HK\$1.1 million in respect of construction contractor cost; and approximately HK\$19.2 million in respect of acquisition of leasehold forest land.

CONTINGENT LIABILITIES

The Company and the Group do not have contingent liabilities of material amounts outstanding as at 30 June 2006.

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EMPLOYEES

At 30 June 2006, the Group employed a total of approximately 750 employees of which 19 staff was employed in Hong Kong. In addition to competitive package offered to the employees, other benefits for eligible candidates include contributions to mandatory provident fund, group medical and accident insurance. On-going training sessions were also conducted to enhance the competitiveness of the Group's human assets. The Company also maintains a share option scheme, pursuant to which share options may be granted to directors, executives and employees of the Company to provide them with incentive interest in the growth of the Group.