錦藝紡織科技國際有限公司

# ART TEXTILE TECHNOLOGY INTERNATIONAL COMPANY LIMITED

(incorporated in the Cayman Islands with limited liability)

(Stock Code：565)

# Interim Report 2006

# Corporate Information

## BOARD OF DIRECTORS

Mr. Chen Jinyan *(Chairman)*
Mr. Chen Dong *(Chief Executive Officer)*
Ms. Kong Ping
Mr. Huang Yongfeng*
Mr. Yu Zhong Ming*
Mr. Lo Kin Chung*

* *Independent Non-executive Director*

## COMPANY SECRETARY

Ms. Yeow Mee Mooi

## AUDITORS

Deloitte Touche Tohmatsu

## PRINCIPAL BANKERS

Standard Chartered Bank
Bank of China
Fuzhou City Commercial Bank
China Merchants Bank

## HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS IN HONG KONG

Room 2402, 24th Floor
Wing On Centre
111 Connaught Road Central
Hong Kong

## REGISTERED OFFICE

Cricket Square
Hutchins Drive
P.O. Box 2681
Grand Cayman KY1-1111
Cayman Islands

## PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Butterfield Fund Services (Cayman) Limited
Butterfield House
68 Fort Street
P.O. Box 705
George Town
Grand Cayman KY1-1107
Cayman Islands

## HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Tricor Investor Services Limited
26th Floor
Tesbury Centre
28 Queens Road East
Wanchai
Hong Kong

## SHARE LISTING

The Stock Exchange of Hong Kong Limited
(Stock code: 565)

# Independent Interim Review Report

Deloitte.
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**TO THE BOARD OF DIRECTORS OF**
**ART TEXTILE TECHNOLOGY INTERNATIONAL COMPANY LIMITED**
*(incorporated in the Cayman Islands with limited liability)*

We have been instructed by the Company to review the interim financial report set out on pages 3 to 14.

## DIRECTORS' RESPONSIBILITIES

The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of an interim financial report to be in compliance with Hong Kong Accounting Standard 34 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants and the relevant provisions thereof. The interim financial report is the responsibility of, and has been approved by, the directors.

It is our responsibility to form an independent conclusion, based on our review, on the interim financial report, and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

## REVIEW WORK PERFORMED

We conducted our review in accordance with Statement of Auditing Standards 700 "Engagements to Review Interim Financial Reports" issued by the Hong Kong Institute of Certified Public Accountants. A review consists principally of making enquiries of group management and applying analytical procedures to the interim financial report and, based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the interim financial report.

## REVIEW CONCLUSION

On the basis of our review which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial report for the six months ended 31 December 2006.

**Deloitte Touche Tohmatsu**
*Certified Public Accountants*
Hong Kong

9 March 2007

The Board of Directors (the "Board") of Art Textile Technology International Company Limited (the "Company") is pleased to announce the unaudited condensed consolidated interim financial statements of the Company and its subsidiaries (the "Group") for the six months ended 31 December 2006 (the "Period"), that were reviewed by the auditors and the audit committee of the Company, together with the comparative figures for the previous corresponding period are as follows:

## Condensed Consolidated Income Statement

For the six months ended 31 December 2006

| | | Six months ended | |
|---|---|---|---|
| | | **31.12.2006** | 31.12.2005 |
| | | **(unaudited)** | (unaudited) |
| | *NOTES* | ***HK$'000*** | *HK$'000* |
| Turnover | | **294,635** | 276,526 |
| Cost of sales | | **(210,493)** | (196,871) |
| Gross profit | | **84,142** | 79,655 |
| Other income | | **3,323** | 1,634 |
| Selling and distribution costs | | **(8,190)** | (8,425) |
| Administrative expenses | | **(8,866)** | (6,276) |
| Other expenses | | **(516)** | (1,555) |
| Loss on changes in fair value of convertible notes | | **(824)** | (570) |
| Finance costs | *4* | **(553)** | (580) |
| Profit before tax | | **68,516** | 63,883 |
| Income tax expense | *5* | **(18,776)** | (20,341) |
| Profit for the period | *6* | **49,740** | 43,542 |
| Dividend paid | *7* | **8,766** | 13,148 |
| EARNINGS PER SHARE | *8* | | |
| – Basic, Hong Kong cents | | **5.67** | 4.97 |
| – Diluted, Hong Kong cents | | **4.73** | 4.07 |

# Condensed Consolidated Balance Sheet

At 31 December 2006

| | NOTES | 31.12.2006 (unaudited) HK$'000 | 30.6.2006 (audited) HK$'000 |
|---|---|---|---|
| NON-CURRENT ASSETS | | | |
| Property, plant and equipment | 9 | **143,639** | 145,166 |
| Prepaid lease payments – non-current portion | | **14,269** | 14,012 |
| Pledged bank deposits | | **–** | 39,007 |
| | | **157,908** | 198,185 |
| CURRENT ASSETS | | | |
| Inventories | | **16,017** | 28,163 |
| Trade and other receivables | 10 | **56,829** | 61,306 |
| Prepaid lease payments – current portion | | **327** | 317 |
| Pledged bank deposits | | **43,355** | 4,314 |
| Bank balances and cash | | **420,517** | 340,735 |
| | | **537,045** | 434,835 |
| CURRENT LIABILITIES | | | |
| Trade and other payables | 11 | **65,625** | 56,592 |
| Dividend payable | | **2** | – |
| Tax liabilities | | **13,645** | 17,112 |
| Bank borrowings, secured | | **16,600** | 16,074 |
| Convertible notes | 12 | **83,234** | – |
| | | **179,106** | 89,778 |
| NET CURRENT ASSETS | | **357,939** | 345,057 |
| | | **515,847** | 543,242 |
| CAPITAL AND RESERVES | | | |
| Share capital | 13 | **8,766** | 8,766 |
| Dividend reserve | | **8,766** | 8,766 |
| Other reserves | | **498,315** | 442,720 |
| | | **515,847** | 460,252 |
| NON-CURRENT LIABILITY | | | |
| Convertible notes | 12 | **–** | 82,990 |
| | | **515,847** | 543,242 |

# Condensed Consolidated Statement of Changes in Equity

For the six months ended 31 December 2006

| | Share capital HK$'000 | Share premium HK$'000 | Merger reserve HK$'000 | Exchange reserve HK$'000 | Statutory reserve fund HK$'000 | Dividend reserve HK$'000 | Share option reserve HK$'000 | Retained profits HK$'000 | Total HK$'000 |
|---|---|---|---|---|---|---|---|---|---|
| At 1 July 2005 | 8,766 | 69,369 | 136 | 32 | 34,013 | 13,148 | – | 254,597 | 380,061 |
| Exchange difference on translation of overseas operations recognised directly in equity | – | – | – | 7,926 | – | – | – | – | 7,926 |
| Profit for the period | – | – | – | – | – | – | – | 43,542 | 43,542 |
| Total recognised income for the period | – | – | – | 7,926 | – | – | – | 43,542 | 51,468 |
| Transfer | – | – | – | – | 5,318 | – | – | (5,318) | – |
| Final dividend paid | – | – | – | – | – | (13,148) | – | – | (13,148) |
| Proposed interim dividend | – | – | – | – | – | 8,766 | – | (8,766) | – |
| At 1 January 2006 | 8,766 | 69,369 | 136 | 7,958 | 39,331 | 8,766 | – | 284,055 | 418,381 |
| Exchange difference on translation of overseas operations recognised directly in equity | – | – | – | 1,833 | – | – | – | – | 1,833 |
| Profit for the period | – | – | – | – | – | – | – | 48,804 | 48,804 |
| Total recognised income for the period | – | – | – | 1,833 | – | – | – | 48,804 | 50,637 |
| Transfer | – | – | – | – | 5,126 | – | – | (5,126) | – |
| Interim dividend paid | – | – | – | – | – | (8,766) | – | – | (8,766) |
| Proposed final dividend | – | – | – | – | – | 8,766 | – | (8,766) | – |
| At 30 June 2006 | 8,766 | 69,369 | 136 | 9,791 | 44,457 | 8,766 | – | 318,967 | 460,252 |
| Exchange difference on translation of overseas operations recognised directly in equity | – | – | – | 12,844 | – | – | – | – | 12,844 |
| Profit for the period | – | – | – | – | – | – | – | 49,740 | 49,740 |
| Total recognised income for the period | – | – | – | 12,844 | – | – | – | 49,740 | 62,584 |
| Transfer | – | – | – | – | 6,179 | – | – | (6,179) | – |
| Recognition of equity-settled share-based payments | – | – | – | – | – | – | 1,777 | – | 1,777 |
| Final dividend paid | – | – | – | – | – | (8,766) | – | – | (8,766) |
| Proposed interim dividend | – | – | – | – | – | 8,766 | – | (8,766) | – |
| **At 31 December 2006** | **8,766** | **69,369** | **136** | **22,635** | **50,636** | **8,766** | **1,777** | **353,762** | **515,847** |

The statutory reserve fund is a reserve required by the relevant People's Republic of China (the "PRC") laws applicable to the Group's PRC subsidiaries.

# Condensed Consolidated Cash Flow Statement

For the six months ended 31 December 2006

| | Six months ended | |
|---|---|---|
| | **31.12.2006** | 31.12.2005 |
| | **(unaudited)** | (unaudited) |
| | ***HK$'000*** | *HK$'000* |
| Net cash from operating activities | **81,104** | 64,290 |
| Net cash used in investing activities | **(1,636)** | (4,115) |
| Net cash used in financing activities | | |
| New bank borrowings | **5,000** | – |
| Dividend paid | **(8,764)** | (13,148) |
| Repayments of bank borrowings | **(4,956)** | (3,900) |
| Other financing cash outflow | **(1,133)** | (630) |
| | **(9,853)** | (17,678) |
| Net increase in cash and cash equivalents | **69,615** | 42,497 |
| Cash and cash equivalents at beginning of the period | **340,735** | 240,387 |
| Effect of foreign exchange rate changes | **10,167** | 5,493 |
| Cash and cash equivalent at end of the period represented by bank balances and cash | **420,517** | 288,377 |

# Notes to the Condensed Consolidated Financial Statements

For the six months ended 31 December 2006

## 1. BASIS OF PREPARATION

The condensed consolidated financial statements have been prepared in accordance with the applicable disclosure requirements of Appendix 16 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and with Hong Kong Accounting Standard 34 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA").

## 2. PRINCIPAL ACCOUNTING POLICIES

The condensed consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments, which are measured at fair values, as appropriate.

In the current interim period, the Company and its subsidiaries (collectively referred to as the "Group") has applied, for the first time, a number of new standards, amendments and interpretations ("new HKFRSs") issued by the HKICPA, which are effective for the current accounting period. The adoption of the new HKFRSs had no material effect on how the results for the current or prior accounting periods have been prepared and presented. Accordingly, no prior period adjustment has been required.

The accounting policies adopted in the condensed consolidated financial statements are consistent with those followed in the preparation of the Group's annual financial statements for the year ended 30 June 2006. In addition, the Group has applied the following accounting policies during the current interim period:

**Share-based payment transactions**

*Share options granted to employees of the Company*

The fair value of services received determined by reference to the fair value of share options granted at the grant date is recognised as an expense in full at the grant date when the share options granted vest immediately, with a corresponding increase in equity (share option reserve).

## 2. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

**Share-based payment transactions (Continued)**

At the time when the share options are exercised, the amount previously recognised in share option reserve will be transferred to share premium. When the share options are forfeited after the vesting period or are still not exercised at the expiry date, the amount previously recognised in share option reserve will be transferred to retained profits.

**Accounting standards not yet effective**

The Group has not early applied the following new standard, amendment or interpretations that have been issued by the HKICPA but are not yet effective. The directors of the Company anticipate that the application of these standard, amendment or interpretations will have no material impact on the result and financial position of the Group.

| | |
|---|---|
| HKAS 1 (Amendment) | Capital Disclosures[1] |
| HKFRS 7 | Financial Instruments: Disclosures[1] |
| HK(IFRIC)-Int 10 | Interim Financial Reporting and Impairment[2] |
| HK(IFRIC)-Int 11 | HKFRS 2 – Group and Treasury Share Transactions[3] |

1 Effective for annual periods beginning on or after 1 January 2007.
2 Effective for annual periods beginning on or after 1 November 2006.
3 Effective for annual periods beginning on or after 1 March 2007.

## 3. SEGMENT INFORMATION

No analysis on business segment is provided as substantially all the Group's turnover and segment results were derived from the manufacture and sale of finished woven fabrics.

## 4. FINANCE COSTS

| | **Six months ended** | |
|---|---|---|
| | **31.12.2006** | 31.12.2005 |
| | ***HK$'000*** | *HK$'000* |
| Interest on bank borrowings wholly repayable within five years | **553** | 580 |

## 5. INCOME TAX EXPENSE

| | Six months ended | |
|---|---|---|
| | **31.12.2006** | 31.12.2005 |
| | ***HK$'000*** | *HK$'000* |
| Current tax: | | |
| PRC Enterprise Income Tax ("EIT") | **18,776** | 20,341 |

No provision for Hong Kong Profits Tax has been made as the Group had no assessable profits arising in Hong Kong for both periods.

Fuzhou Huaguan Knitting and Sprining Co., Ltd. ("Fuzhou Huaguan") and Fuzhou Huasheng Textile Co., Ltd. ("Fuzhou Huasheng") are subsidiaries established in the PRC which are exempted from the EIT for two years starting from their first profit-making year of operations and thereafter are eligible for 50% relief from EIT for the following three years under the income tax law of the PRC. The first profit-making years of Fuzhou Huaguan and Fuzhou Huasheng were year ended 31 December 1999 and 31 December 2005, respectively. The tax relief expired on 31 December 2003 and the tax rate applicable to Fuzhou Huaguan was 27% for the period ended 31 December 2006. Fuzhou Huasheng was still in the tax exemption period and, accordingly, no provision for EIT has been made.

No provision for deferred taxation has been recognised in the condensed consolidated financial statements as the amount involved is insignificant.

## 6. PROFIT FOR THE PERIOD

| | Six months ended | |
|---|---|---|
| | **31.12.2006** | 31.12.2005 |
| | ***HK$'000*** | *HK$'000* |
| Profit for the period has been arrived at after charging (crediting): | | |
| Depreciation and amortisation of property, plant and equipment | **9,615** | 11,626 |
| Interest income | **(2,011)** | (1,626) |
| Release of prepaid lease payments | **163** | 157 |

## 7. DIVIDEND PAID

| | Six months ended | |
|---|---|---|
| | **31.12.2006** | 31.12.2005 |
| | ***HK$'000*** | *HK$'000* |
| Dividend recognised as distribution during the period: | | |
| Final, paid – HK1.0 cent per share (2005: HK1.5 cents per share) | **8,766** | 13,148 |

The directors have determined that an interim dividend of HK1.0 cent per share (2005: HK1.0 cent) should be paid to the shareholders of the Company whose names appear in the Register of Members on 4 May 2007.

## 8. EARNINGS PER SHARE

The calculation of the basic and diluted earnings per share is based on the following data:

| | Six months ended | |
|---|---|---|
| | **31.12.2006** | 31.12.2005 |
| | ***HK$'000*** | *HK$'000* |
| Earnings: | | |
| Profit for the period and earnings for the purposes of basic earnings per share | **49,740** | 43,542 |
| Effect of dilutive potential ordinary shares in respect of convertible notes | **824** | 570 |
| Earnings for the purposes of diluted earnings per share | **50,564** | 44,112 |
| | ***'000*** | *'000* |
| Number of shares: | | |
| Number of ordinary shares for the purposes of basic earnings per share | **876,558** | 876,558 |
| Effect of dilutive potential ordinary shares in respect of: | | |
| Share options | **96** | – |
| Convertible notes | **192,616** | 206,540 |
| Weighted average number of ordinary shares for the purposes of diluted earnings per share | **1,069,270** | 1,083,098 |

## 9. MOVEMENTS IN PROPERTY, PLANT AND EQUIPMENT

During the period, the Group incurred approximately HK$3,742,000 (1.7.2005 to 31.12.2005: HK$6,266,000) on the construction of its new manufacturing plant in the PRC in order to increase its manufacturing capacity. Details of capital commitments were disclosed in note 15.

## 10. TRADE AND OTHER RECEIVABLES

The Group allows an average credit period ranges from 45 days to 180 days to its trade customers. The following is an aged analysis of trade receivables at the balance sheet date:

| | **31.12.2006** | 30.6.2006 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| 0–60 days | **48,693** | 56,761 |
| 61–90 days | **4,685** | 2,072 |
| Over 90 days | **2,162** | 809 |
| Trade receivables | **55,540** | 59,642 |
| Other receivables | **1,289** | 1,664 |
| | **56,829** | 61,306 |

## 11. TRADE AND OTHER PAYABLES

The following is an aged analysis of trade payables at the balance sheet date:

| | **31.12.2006** | 30.6.2006 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| 0–60 days | **39,685** | 40,001 |
| Other payables | **25,940** | 16,591 |
| | **65,625** | 56,592 |

## 12. CONVERTIBLE NOTES

| | **31.12.2006** | 30.6.2006 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Convertible notes – unlisted | **83,234** | 82,990 |

On 6 December 2004, the Company issued the 1.5% original tranche 1 secured convertible notes ("CN") of US$10,000,000 to Credit Suisse (Hong Kong) Limited ("Credit Suisse"), an independent investor.

The CN bears interest at 1.5% per annum, which is payable semi-annually in arrears and is repayable on 6 December 2007.

Credit Suisse has an option to convert the CN into ordinary shares of the Company, at any time between the date of issue of the CN to the maturity date of 6 December 2007 at either of the following options:

(i) fixed conversion price of HK$0.8579 or

(ii) floating conversion price being 91% of the average of any 4 consecutive closing prices per share as selected by the bondholder during the 30 consecutive business days immediately prior to the date on which the conversion notice is received by the Company.

Details of the CN are set out in an announcement made by the Company on 8 December 2004. The ordinary shares to be issued upon such conversion rank pari passu in all respects with the ordinary shares of the Company in issue on the relevant conversion date.

Pursuant to a deed of assignment dated 3 December 2004, Credit Suisse will deposit the subscription funds for the CN into 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 of 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 31 December 2006, an amount of US$5,000,000, equivalent to HK$39,000,000 (30 June 2006: US$5,000,000, equivalent to HK$39,007,000) was maintained in the Account.

## 12. CONVERTIBLE NOTES (CONTINUED)

The CN is measured at fair value at each balance sheet date. Fair value of the conversion option of the CN is determined with reference to the quoted market prices of the Company's shares at the balance sheet date. During the period ended 31 December 2006, the fair value (excluding changes attributable to the benchmark interest rate) of the CN decreased by HK$2,014,000.

Unless previously redeemed, converted or purchased and cancelled, the CN will be redeemed by the Company at its principal amount of US$10,000,000, equivalent to HK$78,000,000 on 6 December 2007.

## 13. SHARE CAPITAL

| | Number of shares | Nominal value *HK$'000* |
|---|---|---|
| Ordinary shares of HK$0.01 each | | |
| *Authorised:* | | |
| At 1 July 2006 and 31 December 2006 | 2,000,000,000 | 20,000 |
| *Issued and fully paid:* | | |
| At 1 July 2006 and 31 December 2006 | 876,557,583 | 8,766 |

## 14. SHARE-BASED PAYMENT TRANSACTIONS

The Company has a share option scheme for eligible directors of the Company, employees and other participants of the Group. Details of the share options outstanding during the period are as follows:

| | Number of share options |
|---|---|
| Outstanding at 1 July 2006 | 38,250,000 |
| Granted during the period | 24,200,000 |
| Lapsed during the period | (3,000,000) |
| Outstanding at 31 December 2006 | 59,450,000 |

## 14. SHARE-BASED PAYMENT TRANSACTIONS (CONTINUED)

The options granted during the period entitle the holders to subscribe for shares in the Company at the exercise price of HK$0.45 per share during the period from 2 January 2007 to 1 January 2012.

The closing price of the Company's shares immediately before 4 December 2006, the date of grant of the options, was HK$0.45.

The fair value of options determined at the date of grant using the Black-Scholes option pricing model was HK$1,777,000. The Group recognised an expense of HK$1,777,000 as share-based payment expense for the six months ended 31 December 2006.

The following assumptions were used to calculate the fair value of share options granted during the period:

| | |
|---|---|
| Weighted average share price at the date of acceptance | HK$0.455 |
| Weighted average exercise price | HK$0.45 |
| Expected life of options | 5 years |
| Expected volatility | 27% |
| Expected dividend yield | 5.50% |
| Risk free rates | 3.79% |

The Black-Scholes option pricing model has been used to estimate the fair value of the options. The variables and assumptions used in computing the fair value of the share options are based on the directors' best estimate. The value of an option varies with different variables of certain subjective assumptions.

## 15. CAPITAL COMMITMENTS

| | **31.12.2006** | 30.6.2006 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Capital expenditure contracted for but not provided in the condensed consolidated financial statements in respect of buildings | **559** | 1,902 |

At 31 December 2006, the Group had commitments for future research cost of HK$338,000 (30 June 2006: HK$400,000) payable under a non-cancellable consultancy agreement which will expire on 31 March 2009.

# 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 Period, as a result of the purchase of dyeing auxiliary facilities for producing functional fabrics at the beginning of 2006, the varieties of down wear, sports wear and household products with different nature are increased; which led to the increase in the market expansion and selling prices of particular types of products. In addition, the weaving plant in Changle City provides steady supply and good quality control of raw fabrics for the dyeing process; as a result, the production cycle is shortened.

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

**Turnover**

For the Period, the Group recorded a turnover of approximately HK$294,635,000 (2005: HK$276,526,000). The increase in turnover was attributable to the increased market demand of down wear, sports wear and household products with the number of customers and the varieties of functional fabrics produced by the dyeing auxiliary facilities with higher selling prices.

**Gross Profit**

The gross profit margin of the Group of approximately 28.6% in the Period was maintained at the same level as that in the previous year of approximately 28.8%. 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 Period**

The Group's profit for the Period was approximately HK$49,740,000 (2005: HK$43,542,000), approximately 14.2% more than that in 2005. Net profit margin for the Period was approximately 16.9% (2005: 15.7%). The increase in net profit margin compared with previous year was due to more functional fabrics with higher selling prices penetrated into the market and the effectiveness of cost control implemented during the Period.

**Expenses**

Selling and distribution costs amounted to approximately HK$8,190,000 (2005: HK$8,425,000), representing approximately 2.8% (2005: 3.0%) of turnover for the Period. The slight decrease in percentage of turnover was mainly due to the drop in transportation charges as a consequence of a change in delivery means of products to customers.

Administrative expenses amounted to approximately HK$8,866,000 (2005: HK$6,276,000), representing approximately 3.0% (2005: 2.3%) of turnover for the Period. Administrative expenses increased by approximately 41.3% when compared with that of 2005. It was mainly due to the charge of the grant of share option during the Period.

Other expenses amounted to approximately HK$516,000 (2005: HK$1,555,000), representing approximately 0.2% (2005: 0.6%) of turnover for the Period. The decrease in amount was because the coupon payment of the convertible notes (the "CN"), incorporated in previous period balance, included in loss on changes in fair value of the CN in this period.

Loss on changes in fair value of the CN amounted to approximately HK$824,000 (2005: HK$570,000), representing approximately 0.3% (2005: 0.2%) of turnover for the Period. The increase in amount was due to the inclusion of the coupon payment of the CN for this period.

Finance costs, comprised of interest payments of bank borrowings only, amounted to approximately HK$553,000 (2005: HK$580,000) were maintained at the same level with that of the corresponding period in 2005.

## 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 concentrate 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 and more stable than those 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$16,000,000 in the near future for purchase of a piece of land adjacent to the plant in Changle City and some machineries for producing more varieties of functional fabrics. The Group has been targeted on these three products as its main production since the mid of 2006.

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 31 December 2006, the Group had net current assets and total assets less current liabilities of approximately HK$357,939,000 (30 June 2006: HK$345,057,000) and HK$515,847,000 (30 June 2006: HK$543,242,000), respectively. The Group maintains a strong financial position by financing its operations with internally generated resources. As at 31 December 2006, the Group had cash and bank deposits of approximately HK$463,872,000 (30 June 2006: HK$384,056,000). The current ratio of the Group was approximately 299.8% (30 June 2006: 484.3%).

Shareholders' fund of the Group as at 31 December 2006 was approximately HK$515,847,000 (30 June 2006: HK$460,252,000). As at 31 December 2006, the total bank borrowings of the Group, repayable within 12 months from the balance sheet date, denominated in RMB16,600,000, were equivalent to approximately HK$16,600,000 (30 June 2006: HK$16,074,000) and the CN of US$10,000,000, due on 6 December 2007 and be measured at fair value, equivalent to HK$83,234,000 (30 June 2006: HK$82,990,000), together giving a gross debt gearing (i.e. total borrowings/shareholders' fund) of approximately 19.4% (30 June 2006: 21.5%).

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

## Financing

As at 31 December 2006, the total banking and loan facilities of the Group amounted to approximately HK$31,600,000 (30 June 2006: HK$30,680,000), of which, HK$23,133,000 (30 June 2006: HK$22,545,000) 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 31 December 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 31 December 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 Period, the share capital of the Company comprises ordinary shares. The Group had the CN as at 31 December 2006 and up to the date of this interim report.

## Foreign Exchange Risk and Interest Rate Risk

For the Period, 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 Period. 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 substantially at fixed rate basis. The Board is of the opinion that the Group is not subject to any significant interest rate risk.

## Charge on Group's Assets

As at 31 December 2006, certain leasehold interests in land, buildings and plant and machinery of the Group with aggregate amount of approximately HK$35,655,000 (30 June 2006: HK$38,791,000) were pledged to banks to secure bank facilities granted to the Group; together with the bank deposits of the Group of approximately HK$4,355,000 (30 June 2006: HK$4,314,000).

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 31 December 2006, an amount of US$5,000,000 (30 June 2006: US$5,000,000) was maintained in the Account.

## Staff Policy

The Group had 428 employees in the PRC and 3 employees in Hong Kong as at 31 December 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.

## Closure of Register of Members

The register of members of the Company will be closed from 3 May 2007 to 4 May 2007, both days inclusive, during which period no transfers of shares shall be effective. In order to qualify for the entitlement to the interim dividend, all transfer of shares, accompanied by the relevant share certificates and the appropriate transfer forms, must be lodged with the Company's branch share registrar in Hong Kong, Tricor Investor Services Limited at 26th Floor, Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong, no later than 4:30 p.m. on 2 May 2007. Dividend warrants will be dispatched to the shareholders of the Company on or before 25 May 2007.

## Directors' Interests in Shares and Underlying Shares

At 31 December 2006, the interests of the directors and their associates in the shares and underlying shares of the Company and its associated corporations, as recorded in the register maintained by the Company pursuant to Section 352 of the Securities and Futures Ordinance ("SFO"), or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code"), were as follows:

### LONG POSITIONS

**(a) Ordinary shares of HK1.0 cent each of the Company**

| Name of director | Capacity | Number of issued ordinary shares held | Approximate shareholding percentage |
|---|---|---|---|
| Mr. Chen Dong | Held by controlled corporation *(Note)* | 581,910,000 | 66.39% |

*Note:* The shares are held by Talent Crown Investment Limited, a company incorporated in the British Virgin Islands, the entire issued share capital of which is beneficially owned by Mr. Chen Dong. Mr. Chen Dong is the younger brother of Mr. Chen Jinyan and both are the executive directors of the Company.

**(b) Share options**

| Name of director | Capacity | Number of options held | Number of underlying shares |
|---|---|---|---|
| Mr. Chen Jinyan | Beneficial owner | 8,500,000 | 8,500,000 |

Other than as disclosed above, none of the directors nor their associates had any interest or short positions in any shares or underlying shares of the Company or any of its associated corporations as at 31 December 2006.

## Directors' Rights to Acquire Shares or Debentures

Save as disclosed under the section headed "Share option scheme", at no time during the Period was the Company, its holding company or any of its subsidiaries a party to any arrangements to enable the directors of the Company to acquire by means of acquisition of shares in, or debt securities, including debentures, of the Company or any other body corporate.

## Substantial Shareholders

As at 31 December 2006, the register of substantial shareholders maintained by the Company pursuant to Section 336 of the SFO shows that other than the interests disclosed in the section headed "Directors' interests in shares and underlying shares" above, the following shareholders had notified the Company of relevant interests in the issued share capital of the Company.

### LONG POSITIONS — ORDINARY SHARES OF HK1.0 CENT EACH OF THE COMPANY

| Name of shareholder | Capacity | Number of issued ordinary shares held | Approximate shareholding percentage |
|---|---|---|---|
| Veer Palthe Voute NV | Held by controlled corporation *(Note 1)* | 52,795,000 | 6.02% |
| Credit Suisse Group | Held by controlled corporation *(Note 2)* | 43,868,097 | 5.00% |

*Notes:*

1. These shares were beneficially held by Veer Palthe Voute NV whose ultimate holding company is Allianz Aktiengesellschaft.

2. These shares were beneficially held by Credit Suisse Group.

Other than disclosed above, the Company has not been notified of any other relevant interests or short positions in the issued share capital of the Company as at 31 December 2006.

## Share Option Scheme

Particulars of the Company's share option scheme are set out in note 25 to the consolidated financial statements of the Company's 2006 annual report.

As at 4 December 2006, the Company further granted 24,200,000 share options to the Company's director and employees under the share option scheme. At 31 December 2006, the number of shares in respect of which options had been granted and remained outstanding under the share option scheme was 59,450,000, representing approximately 6.78% of the shares of the Company in issue at that date.

The following table disclosed movements in the Company's share options during the Period:

| Grantee | Date of grant | Exercise period | Exercise price *HK$* | Outstanding at 1.7.2006 | Granted during the Period | Exercised during the Period | Lapsed during the Period | Outstanding at 31.12.2006 |
|---|---|---|---|---|---|---|---|---|
| Director | | | | | | | | |
| Mr. Chen Jinyan | 23.12.2003 | 23.12.2003 to 22.12.2013 | 0.612 | 4,000,000 | – | – | – | 4,000,000 |
| | 4.12.2006 | 2.1.2007 to 1.1.2012 | 0.450 | – | 4,500,000 | – | – | 4,500,000 |
| | | | | 4,000,000 | 4,500,000 | – | – | 8,500,000 |
| Employees | 23.12.2003 | 23.12.2003 to 22.12.2013 | 0.612 | 34,250,000 | – | – | (3,000,000) | 31,250,000 |
| | 4.12.2006 | 2.1.2007 to 1.1.2012 | 0.450 | – | 19,700,000 | – | – | 19,700,000 |
| | | | | 34,250,000 | 19,700,000 | – | (3,000,000) | 50,950,000 |
| Granted Total | | | | 38,250,000 | 24,200,000 | – | (3,000,000) | 59,450,000 |

## Purchase, Sale or Redemption of the Company's Listed Securities

During the Period, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

## Code on Corporate Governance Practices

The Company is committed to achieve the best corporate governance practices as a listed company. The Board believes that high standards and rigorous corporate governance practices can improve the accountability and transparency of the Company. Consequently, during the Period, the Company complied with the Code on Corporate Governance Practices (the "CG Code") contained in Appendix 14 of the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules").

## Model Code for Securities Transactions by Directors

The Company has adopted the Model Code set out in Appendix 10 to the Listing Rules as the code of conduct regarding directors' securities transactions. All directors of the Company have confirmed upon specific enquiry that they have complied with the required standard set out in the Model Code throughout the Period.

## Audit Committee

The Company has an audit committee with terms of reference revised in September 2005 to align with the provision of the CG Code as set out in Appendix 14 of the Listing Rules for the purpose of reviewing and providing supervision on the financial reporting process and internal controls of the Group. The audit committee comprises three members, all being independent non-executive directors of the Company.

During the Period, the audit committee reviewed the accounting principles and practices adopted by the Group and discussed auditing, internal control and financial reporting matters, such as the review of the interim report with the management.

On behalf of the Board
**Chen Jinyan**
*Chairman*

Hong Kong
9 March 2007