In this Management Discussion and Analysis, we present the business review and explain the financial performance of Tristate Holdings Limited (the "Company") and its subsidiaries (together, the "Group") for the year ended 31 December 2006. The 2005 comparative figures have been restated as a result of the adoption of Hong Kong Accounting Standard 21 (Amendment). Both the general and administrative expenses and the profit attributable to equity holders of the Company have improved by approximately HK$8 million against those reported in 2005.

BUSINESS REVIEW

For the year ended 31 December 2006, the total revenue of the Group was approximately HK$2,858 million (2005: HK$2,694 million), representing an increase of about 6% as compared with the corresponding period of 2005.

During the year 2005, we have included trading in branded products and trading with associated companies, etc. as trading business for business segment presentation purposes. Trading with associated companies in 2005 accounted for more than 70% of the total trading business activities. On 28 October 2005, Hua Thai Manufacturing Public Company Limited ("Hua Thai") became a subsidiary of the Company. The results of Hua Thai for the period from 1 January 2005 to 27 October 2005 were accounted for on an equity basis under share of profit of associated companies in 2005, whereas, its results were consolidated on a line by line basis from 28 October 2005. The trading business activities between the Group and Hua Thai and its subsidiaries (together, the "Hua Thai Group") have since been categorised as garment manufacturing and trading activities for business segment presentation purposes from 28 October 2005. To provide a better basis for comparison, we have reclassified the trading business activities with Hua Thai Group, for the period prior to it becoming a subsidiary of the Company in 2005, as garment manufacturing and trading. Similarly, all trading activities relating to branded product distribution are now included in the branded product distribution and trading segment.

Revenue from garment manufacturing and trading segment increased by 6% as compared with the corresponding period of 2005. This was due to the consolidation of sales revenue from Hua Thai, which became a subsidiary of the Company towards the end of 2005. On a like for like basis, that is, if Hua Thai were a subsidiary of the Company for the full year 2005, the garment manufacturing and trading sales revenue in the year ended 31 December 2006 would have dropped by about 4% as compared with that of the corresponding period in 2005. The decrease in revenue from garment manufacturing was mainly due to severe market competition causing a decline in unit selling price.

During the year 2006, the contribution to both the revenue and profit by the Hua Thai Group was lower than expected because of price pressure from competing manufacturers in other countries and the adverse impact on production costs caused by the increasingly inflationary environment in Thailand and the appreciation of Thai Bahts.

Revenue for branded product distribution and trading segment increased by 9% when compared with the corresponding period of 2005. The commencement of distribution of Fila products by the Group in Mainland China since late 2005 contributed to the increase in revenue from this business segment. Operating results were even healthier, increasing by more than 40% to HK$25 million.

The Group's finance costs increased due to the inclusion of Hua Thai's finance costs for the full year in 2006, cash outlay for the acquisition of Hua Thai shares in late 2005, and the imputed interest on the license fees payable on the brand distribution rights.

Geographically, the United States of America continued to be the major export market for the Group contributing 75% (2005: 80%) of the total revenue while export sales to Asia and Europe accounted for approximately 14% (2005: 12%) and 11% (2005: 8%) of the Group's total revenue respectively. The Group's garment manufacturing revenue is generally subject to seasonality. The management of the Group seeks to minimise the impact of seasonality by focusing on key customers with year-round orders.

Gross profit of the Group decreased by 2% to approximately HK$587 million in 2006 (2005: HK$599 million (as restated)). Selling and distribution expenses increased by 13% as our branded product distribution division expanded into a second brand, Fila. General and administrative expenses, however, decreased by 10% during the year 2006 resulting in an increase in profit from operations of approximately 10% to HK$147 million (2005: HK$133 million (as restated)).

The acquisition of Hua Thai in 2005 resulted in a net gain to the Group of approximately HK$54 million. Without a similar gain in 2006, the profit attributable to equity holders of the Company dropped by about 31% from approximately HK$168 million (as restated) for the year ended 31 December 2005 to approximately HK$115 million in 2006. If we were to exclude the impact of this net gain on acquisition of Hua Thai, profit attributable to equity holders of the Company would have increased by approximately 1%. The increased profitability of our branded product distribution and trading division contributed to the profit attributable to equity holders in 2006.

In early 2006, the Hong Kong Inland Revenue Department ("HK IRD") initiated a tax audit on certain companies of the Group for the years of assessment from 1999/2000 (financial year ended 31 December 1999) to 2004/2005 (financial year ended 31 December 2004). The HK IRD has issued protective assessments to some of these companies for the years of assessment 1999/2000 and 2000/2001. The companies have objected to the protective assessments. During the course of the tax audit, there may be a possibility that assessments for subsequent years will be raised by HK IRD to these companies. Since the tax audit is still at a preliminary fact-finding stage, its outcome cannot be readily ascertained with any degree of accuracy. The management of the Group has reviewed the situation and based on professional advice received considers that sufficient tax related provisions have been made in the consolidated financial statements in respect of the two years' protective assessments which the Group had received.

In late 2006, the Group acquired a piece of land for the establishment of new production facilities in the Hefei Economic and Technological Development Area in Anhui Province, Mainland China. We have planned an initial capital investment in this new production site of approximately HK$31 million, which will be funded by internal resources of the Group. Construction of the first factory building commenced in early 2007 and the Group anticipates that the new factory will be ready for full scale operation during the second half of 2007. Upon full operation of the new factory, it is expected that the Group's operating costs would be further improved.

During the year 2006 and up to the date of this Annual Report, there were no material acquisitions or disposals of subsidiaries or associated companies or investment in associated companies.

Save as disclosed herein, no important events affecting the Group have occurred since the year ended 31 December 2006 and up to the date of this Annual Report.

FINANCIAL RESOURCES AND LIQUIDITY

During the year, the Group continued to maintain a healthy liquidity position. As at 31 December 2006, cash and cash equivalents amounted to approximately HK$331 million (2005: HK$318 million) which were mainly denominated in United States dollars and Chinese Renminbi. The short-term bank borrowings of the Group amounted to approximately HK$164 million as at 31 December 2006 (2005: HK$79 million). The borrowings were denominated in United States dollars and Thai Bahts and were at floating interest rates. The Group maintained sufficient banking facilities and did not have any long-term bank borrowings outstanding as at 31 December 2006. Facilities extended to the subsidiaries were not charged with the Group's assets. As the Group did not have net bank borrowings as at 31 December 2006 and 2005, no information on gearing ratio as at 31 December 2006 and 2005 is provided as such information is not relevant.

Most of the Group's receipts and payments were denominated in Hong Kong dollars, Chinese Renminbi or United States dollars. The management of the Group monitors the related foreign exchange risk exposure closely and will consider hedging significant foreign exchange risk exposure should the need arises.

CONTINGENT LIABILITIES AND CAPITAL COMMITMENTS

Other than disclosed, there were no material capital commitments or contingent liabilities as at 31 December 2006 which would require a substantial use of the Group's present cash resources or external funding.

HUMAN RESOURCES

The Group has about 19,000 (2005: 19,000) employees as of the end of 2006. Fair and competitive remuneration packages and benefits are offered to competent employees. Discretionary bonuses are granted to eligible employees with outstanding performance. In addition, a share option scheme has been established since 1997 for the granting of options to full-time employees of the Group for subscribing for shares in the Company.

FUTURE DEVELOPMENT

The business environment for the year 2007 will remain challenging in view of price compression in the market place. In addition, the rise in labour, energy and material costs and the strengthening of foreign currencies against Hong Kong dollars in certain overseas production sites increases the cost of sales of the Group. Nevertheless, we will continue to strive to maintain our position as a leading manufacturer for a wide range of garments including ladies' suits and tailored related separates for women and casual and lifestyle clothes for men. The Group's current sales orders on hand are consistent with that of the last comparable period.

Going forward, the Group will continue focusing on its core customers and product offerings. The Group will also continue to improve its production efficiency and to exercise stringent controls over direct and indirect costs.