

MANAGEMENT DISCUSSION AND ANALYSIS

RESULTS REVIEW

Revenue of the Group was approximately US\$661,836,000 for the year ended 31 December 2006, representing an increase of 11.6% as compared to that recorded in 2005. The increase was attributable to our organic growth with existing customers together with the acquisition of On Time. Customer partnerships with D2S business model has proven to be the right one for the Group's operations.

Luen Thai's overall gross profit for 2006 was approximately US\$124,271,000 as compared to US\$113,673,000 in 2005. The overall gross profit margin in 2006 is 18.8% as compared to 19.2% in 2005. The Group's operating profit for 2006 was approximately US\$13,533,000, representing a decrease of 35.8% over 2005. Despite the outstanding performance of the ladies' fashion and sweater divisions, the Group's overall 2006 financial performance was severely affected by the one-time restructuring of our casual wear division. The restructuring required our casual wear division to do order reallocation, to address capacity and product mismatch-related issues when the Group closed one of its three garment manufacturing facilities in the Philippines and ceased its manufacturing operations in Saipan, as it continues to expand operations in China.

The profit attributable to the equity holders of the Company for the year ended 31 December 2006 therefore suffered a significant decline of 81.0% to approximately US\$2,509,000 when compared to that recorded in prior year.

The freight forwarding and logistics services recorded a revenue amounting to US\$13,791,000 in 2006, representing an increase of 16.2% over 2005.

OPERATIONAL REVIEW

The Group accomplished a number of initiatives and the following are some of the highlights:

Relocation of Tomwell

Tomwell, which is engaged in the production of career wear, has relocated and started its operations in the Dongguan Supply Chain City in February 2006 in line with the Group's objective to further reduce operational costs and improve efficiency.

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Design and Development

On Time, to which the Group acquired a total of 50% stake in 2006, has recently set up its development center in the Dongguan Supply Chain City to enhance cross-selling opportunities and provide strong design support capabilities to the Group.

Print Shop

The Luen Thai Print Shop has opened and moved to a bigger facility in the Dongguan Supply Chain City to expand its operations and address the increasing requirements for fashion prints. The new facility houses a showroom, widened work areas and individual offices for every print process, with an estimated total capacity of over 30,000 pairs of prints daily.

One-time Restructuring of Casual Wear Division

As discussed in the Company's announcement in February 2007, the coupling effect of the rationalization of the Group's garment manufacturing facilities in the Philippines which involved the closure of one of our three garment production bases in the Philippines (the "Rationalization") and the cessation of our garment manufacturing operations in Saipan (the "Cessation") was expected to unfavorably affect our results of operations. A significant reduction in profit, which resulted from the total one-off closure and other related expenses we incurred for both the Rationalization and the Cessation, was recorded in the second half of 2006. Despite the costs, the Board of Directors believes that by transferring such operations elsewhere within the Group's network, Luen Thai will be able to improve its operational efficiency in the longer run, considering the elimination of USA import quotas and the relatively higher costs of maintaining garment manufacturing operations in Saipan over other jurisdictions.

Success in Ladies' Fashion and Sweater Divisions

The ladies' fashion division became the profit driver for Luen Thai with record revenue and profit. It has continuously increased its market share on existing and new customers, with particular success in the department store sector in both the USA and UK markets.

The sweater division, Tien-Hu, continues to outperform its budget with record revenue and profit. The integration process has been very smooth and it has been able to leverage the Group's D2S platform in developing new business.

Expansion of Active Wear Division

Yuen Thai, our active wear division and a 50/50 joint venture with Yue Yuen Industrial (Holdings) Limited, launched a manufacturing facility in Cebu, the Philippines in 2006. There were start-up losses incurred by Yuen Thai during 2006 but it has paved a solid foundation for growth in 2007.

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Logistics and Distribution

CTSI Logistics, the Group's logistics division, continues to improve its operations and facilities in anticipation of closer partnership with our customers in the logistics zone. In 2006, CTSI Logistics inaugurated two new Supply Chain Centers in California, USA and in Cebu, the Philippines, in addition to its existing Supply Chain Center in Manila, the Philippines (collectively, the "Centers"). The Centers cover spacious, clean and secure facility powered by intelligent logistics and IT solutions, which is expected to support CTSI Logistics in providing clients with more synergistic and streamlined services that will give it a sharper edge in competing in the global business arena. It is also an integral part of CTSI Logistics' vision of becoming a total logistics solution provider – from warehousing, inventory management, freight forwarding, and distribution to logistics consultancy – a full range of logistics services, which are all available under one roof.



Expansion in Qing Yuan

The Group's second Supply Chain City which is being developed in Qing Yuan, China is getting ready for an increase in production, wherein more management team members are also being transferred to support the planned expansion.

ACQUISITIONS AND JOINT VENTURES

It is the Group's strategy in strengthening its apparel manufacturing and supply chain services capabilities by way of selective acquisitions and joint ventures, which have proven success not only in recent years but even in the past.

On 3 April 2006, Luen Thai acquired a 50% stake in On Time together with its subsidiaries (the "Acquisition"), which is more particularly described in the Company's announcement dated 16 March 2006. On 3 April 2007, the Company sent its exercise notice for the option to purchase additional 10%



interest in On Time which, through its subsidiaries, is principally engaged in the design, sourcing and distribution of garments and other textile products on a worldwide basis. Established in the early 1990s, its headquarter is located in Hong Kong with offices in Asia Pacific. The Acquisition is expected to further enhance Luen Thai's design capabilities, which along with its outsourcing production scale, will speed up turnaround times and bring in more European business to the Group.

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Moreover, the Group entered into a 50%-50% joint venture agreement with Guangzhou Huasheng Garment Company Limited on 5 January 2007, to establish Guangzhou Thai Ying Garment Company Limited (“Thai Ying”). Thai Ying is expected to enhance Luen Thai’s manufacturing capabilities for active wear, more particularly for outerwear jackets, and provide lower cost sample-making support to the Group.



The success of the recent joint ventures and the Acquisition are results of the Group’s established experience of acquiring and managing entities in different segments such as GJM for sleepwear (from Warnaco Inc. in 2002), Tomwell for ladies career wear (from Kasper Holdings Inc./Jones Apparel Group, Inc. in 2004), and Tien-Hu for sweaters (from New Trillion Consultants Limited in 2005).

Acquisitions and joint ventures are one of Luen Thai’s core competencies considering our scale, management and strong customer relationships. We will continue to capitalize on these to become one of the industry leaders and further materialize our D2S business model.

INVESTOR RELATIONS AND COMMUNICATIONS

The Group acknowledges the importance of communication with our shareholders. The Group has proactive policy of promoting investor relations through meetings with analysts and investors, and participation of international roadshows, investors’ conferences, company interviews and manufacturing plant visits. All shareholders have no fewer than 21 days notice of the Annual General Meeting at which Directors shall be available to answer questions on the business.

The Group has established various forms of communication channels to improve the transparency of the Group including proactive and timely issuance of press releases so as to inform investors of our latest corporate development. The Group maintains a website (<http://www.luenthai.com>) in English and Chinese to disseminate information electronically on a timely basis to all concerned parties.

FINANCIAL RESULTS AND LIQUIDITY

As at 31 December 2006, the total amount of cash and bank balances of the Group was approximately US\$107,076,000, representing a decrease of approximately US\$40,962,000 when compared to 31 December 2005. The total bank borrowings at 31 December 2006 was approximately US\$69,434,000, representing a 17.0% decrease when compared to US\$83,687,000 at 31 December 2005.

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As at 31 December 2006, the maturity profile of the Group's bank borrowings spread over five years with approximately US\$31,184,000 repayable within one year or on demand, approximately US\$4,500,000 in the second year, approximately US\$13,500,000 in the second to fifth year, and US\$20,250,000 in more than five years.

The gearing ratio is defined as net debt (represented by bank borrowings net of cash and bank balances) divided by the capital and reserves attributable to the equity holders of the Company. As at 31 December 2006, the Group is in a net cash position. Hence, no gearing ratio is presented.

FOREIGN EXCHANGE RISK MANAGEMENT

The Group adopts a prudent policy to hedge the fluctuation of exchange rates. Most of the Group's operating activities are denominated in US dollars, Hong Kong dollars and Euro. For those activities denominated in other currencies, the Group may enter into forward contracts to hedge its receivable and payable denominated in foreign currencies against the exchange rate fluctuation.

CONTINGENT LIABILITIES AND OFF-BALANCE SHEET OBLIGATIONS

The Group is involved in various labour lawsuits and claims arising from the normal course of business. The Directors believe that the Group has substantial legal and factual bases for their position and are of the opinion that losses arising from these lawsuits, if any, will not have a material adverse impact on the results of the operations or the financial position of the Group. Accordingly, no provision for such liabilities has been made in the financial statements.

HUMAN RESOURCES, SOCIAL RESPONSIBILITIES, AND CORPORATE CITIZENSHIP

Over the years, Luen Thai has steadily enhanced its reputation as an employer of choice through focused, integrated and strategic human resources ("HR") strategies. Operating beyond the traditional HR infrastructure, Luen Thai's Corporate Human Resources Division ("CHR") is consistently aligned to the Group's vision and business goals.

Our corporate values, which center on meeting our customers' needs, help thousands of Luen Thai employees to move in one direction – to achieve our vision of becoming the best apparel supply chain services partner in the world. To do this, Luen Thai opens its communication channels to its employees in order to facilitate an engaging culture, where employees feel a sense of belonging in the Company.

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With about 25,000 employees around the world, Luen Thai continuously strives to provide the best employee care. In addition to providing a safe workplace, Luen Thai has established world class and convenient living environments. Work-life balance and wellness is also encouraged in Luen Thai through the establishment of facilities and activities that support a fulfilling life for all employees.

Opportunities for growth and maximizing career potential are also provided within the organization through regular and formalized learning held across all levels of the organization.

Luen Thai also has a long-standing commitment to diversity as demonstrated by its multi-cultural workforce. This commitment to fairness is also shown through equitable compensation and benefit schemes. Employees' contributions are valued, recognized and rewarded.

CORPORATE SOCIAL RESPONSIBILITY

Luen Thai remains committed to corporate social responsibility by engaging in lawful, transparent and ethical business operations. The Company embraces its responsibilities not only to our employees, customers and stakeholders but also the communities in which we operate.

Management leads the Company in providing support and donations to educational institutions such as Quanzhou Normal University in China and charitable organizations such as Po Leung Kuk and Community Chest of Hong Kong.

AWARDS

On 6 February 2007, Luen Thai was named the Overall Winner of the 2006 People Management Awards organized by the Hong Kong Institute of Human Resource Management and the South China Morning Post in association with Hong Kong University of Science and Technology Business School. The Company was also named the Large Enterprise Category Winner. The awards recognize outstanding people management initiatives that made a difference to the business.



The Company's entry, "Project Supply Chain City HR," highlighted CHR's innovative strategies in recruitment, retention, people capability building and value-added employee services, among others.