Mr. Ngan Hei Keung
Chairman
Madam Pauline Ngan
Deputy Chairman and Managing Director

On behalf of the Board of Directors of Mainland Headwear Holdings Limited (the "Company"), I am pleased to present the annual results of the Company and its subsidiaries (collectively, "Mainland Headwear" or the "Group") for the year ended 31 December 2006.

Business Review and Prospects

Overview

The Group has made several strategic moves in its business development in 2006.

In June 2006, the Group acquired Panyu Factory which manufactures fashion headwear for various well-known brands. This enables the Group to expand its product range and enter the fashion brand headwear market.

In December 2006, the Group disposed of the business and the related assets and liabilities of Drew Pearson Marketing, Inc. ("DPM"), a subsidiary of the Group, to Concept One, one of the major headwear distributors in the US. As part of the transaction, Concept One has entered into a seven-year manufacturing agreement with the Group. DPM accounted for about 81% of the turnover of the Group's Trading Business and about 35% of the Group's turnover for the year.

These transactions signify the focus of the Group on its core competence - the Manufacturing Business.

Financial Review

For the year ended 31 December 2006, the Group recorded a 27% increase in turnover, which was attributable to the growth in turnover of all the businesses. Profit attributable to equity shareholders of the Group amounted to HK$86,970,000, representing an increase of about 12% compared to that of the previous year. Excluding the profit on disposal of DPM in the amount of HK$8,047,000, profit attributable to equity shareholders remained at similar level as in 2005 due to the lower gross profit margin of the Manufacturing Business, the first year negative contribution from the Panyu Factory, which was expected when the acquisition was made, and the loss of the Retail Business. Earnings per share was 30.4 HK cents (2005: 27.2 HK cents).

The sharp increases in selling and distribution costs and administration expenses over the previous year were mainly attributable to the expansion of the Retail Business and the newly acquired Panyu Factory. Expenses of the other operations remained at similar levels as last year due to stringent cost control measures.

The Board has recommended the payment of a final dividend of 11 HK cents per share for the year ended 31 December 2006. In view of the cash received from the disposal of DPM, the Board has recommended the payment of a special dividend of 5 HK cents per share. The Directors also propose to make a bonus issue of one new share of HK$0.10 each credited as fully paid for every ten shares held on the Register of Members on 16 May 2007.

Business Review

The Manufacturing Business

The Manufacturing Business remained the major contributor to the Group's operating profit during the year under review. Turnover recorded an increase of 26% to HK$465,101,000. However, the profit contribution of HK$94,377,000 remained at a similar level as last year due to the decrease in gross profit margin and the first-year loss of the Panyu Factory.

The Panyu Factory, when acquired by the Group in June 2006, mainly manufactured fashion headwear for a limited number of the industry's top brands and the utilization rate of the facilities was low. Taken into account of the time required for the build up of new customer base, the operating loss of the Panyu Factory in the first year of its acquisition has been expected and will be deducted from the balance of the unpaid consideration up to US$1,200,000 in accordance with the acquisition agreement. Post acquisition loss incurred by Panyu Factory during the year amounted to HK$7,391,000.

Although the Panyu Factory has not provided an immediate positive financial contribution, the acquisition will be beneficial to the Group in the long term, as it enables the Group to expand its product range to knitted headwear and other fashion headwear items which are not within the product range of the Group's factory in Shenzhen. The Panyu Factory manufactures about 85% of the headwear of the top-tier fashion headwear brand, Kangol. Riding on Kangol's unique market position in the industry, the Panyu Factory enables the Group to expand its clientele in the fashion headwear markets and create added value for customers through manufacturing a greater range of higher quality headwear products. This will help the Group to further penetrate the US market and will facilitate the Group's planned expansion to the Japan and Europe markets which are more fashion-conscious.

After the acquisition, various measures have been or planned to be taken to improve the contribution and cost efficiency of the Panyu Factory. At the same time, versatile marketing measures have been implemented in order to boost sales. It is expected that these measures will be fully implemented in the second quarter of 2007 and improvements in contribution are expected in 2007.

Gross profit margin of the Manufacturing Business has dropped by about 5% as compared to last year to slightly above 30% partly due to the increase in cost of sales and partly due to the lower gross profit margin achieved by the Panyu Factory. As noted in the 2006 Interim Report, the gross profit margin of the factory in Shenzhen has been adversely affected by the increases in staff cost and material costs and the appreciation of Renminbi. In the second half of the year under review, the gross profit margin of the factory in Shenzhen was maintained at about 32%. The lower gross profit margin of the Panyu Factory was mainly due to the under-utilization of capacity which is expected to improve in 2007.

During the year, capital expenditure of the Manufacturing Business of HK$16,860,000 was made on production facility improvements.

The Trading Business

Turnover increased by 11% to HK$324,606,000 as a result of improving businesses in the US and Europe markets, accounting for about 44% of the Group's turnover.

About 81% of the turnover for the year was attributable to the trading operation in the US, which was carried out by the Group's wholly owned subsidiary, DPM. On 31 December 2006, the Group disposed of the business and the related assets and liabilities of DPM to Concept One, which will become one of the top three headwear distributors in the US after the transaction. As part of the transaction, Concept One and the Group have entered into a seven-year manufacturing agreement with annual minimum purchase commitment of US$20 million to US$35 million (or 65% of Concept One's total annual purchases if that is lower) to the Group for seven years commencing 1 May 2007.

The Trading Business in Europe continued to grow steadily with turnover increasing 8% year on year. However, the gross profit margin and the profit contribution have been reduced due to keen competition and the increasing portion of private label business.

The Retail Business

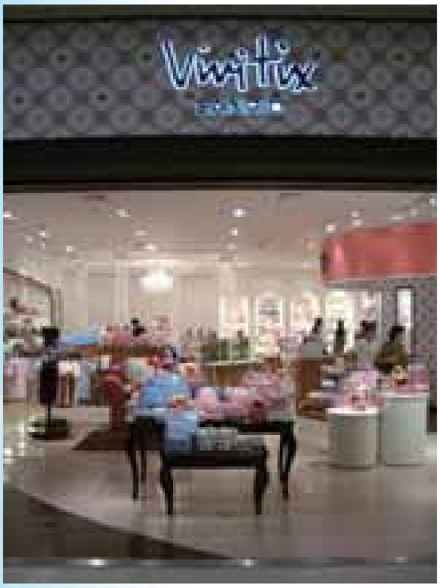
Turnover of the Retail Business increased significantly by 143% to HK$73,687,000, accounting for about 10% of the Group's turnover. This is attributable to the business expansion and the encouraging same-store sales growth for both the LIDS and Sanrio operations.

The gross profit margins of both the LIDS and Sanrio operations have improved as compared to last year. However, the improvements in gross profit and same-store sales growth were not sufficient to cover the additional administration costs of the Sanrio operation which was a full year operation in 2006 as compared to a half year operation in last year. As a result, an operating loss of HK$13,261,000, before minority interests, was recorded for the year.

LIDS reported turnover of HK$30,007,000, representing an increase of 55% over the previous year. Average same-store growth of 18% over the previous year has been recorded.

The Group opened 5 new LIDS stores during the year and at 31 December 2006 had a total of 38 LIDS outlets, 9 of which were in Hong Kong and 29 in the PRC. In addition, there were 13 franchised stores in the PRC.

During the year, the Group continued to improve the same-store sales growth and the gross profit margin by focusing on own brand business and introducing other fashion headwear brands. Other related fashion accessory items have also been added to the product categories starting from November 2006 with the aim of increasing sales per shop. However, the operation in Hong Kong continued to be affected by the high rental costs. Despite improvements in gross profit margin and same-store sales growth, the Hong Kong operation still had a negative contribution. The PRC own shop operation and contribution at shop level were in line with expectation.



The performance of the Sanrio operation has been very encouraging, with turnover soaring to almost four times that of last year to HK$43,680,000. Same-store sales growth was 20% over the same period.

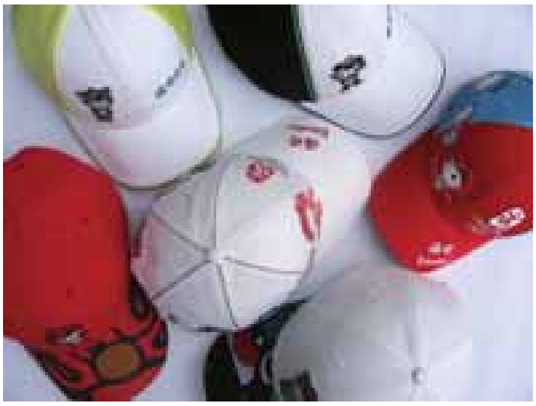
In order to provide customers with a better product range, the Group has augmented the Sanrio product mix with improved product quality and design. As local development and sourcing of products is the key to improve gross profit margin and ensure a broader customer appeal, the Group continued to invest in this area in the year under review. While a solid backend platform has now been established, the operation has not yet achieved the economy of scale needed to provide a contribution to the Group.

During the year, the Group opened additional 20 own Sanrio stores, bringing the total number of own outlets to 44 as at 31 December 2006. In addition, the Group had a total of 30 franchised stores in the PRC at 31 December 2006. The franchise operation has been behind plan as a prudent approach has been adopted in the selection of franchisees.

Various marketing initiatives have been implemented to boost sales, including a customer loyalty program and the exploration of new distribution channels through collaboration with other business partners of Sanrio. Also, a more established product development and sourcing team and a stabilized supply chain now in place enables the Group to improve the product mix and control product costs in a more effective way. The Group expects to reap the fruits of the 2006 investments starting in 2007 and, with the end of the investment phase, the Sanrio operation is expected to enjoy healthy growth.

Prospects

The Manufacturing Business



The Manufacturing Business will continue to face challenges in view of the cost pressures on gross margin and the recent slowdown in US economic growth, which has affected orders from US customers in the first quarter of 2007. With continued appreciation of the RMB and labour shortages in the Pearl River Delta region unlikely to ease, the gross profit margin of the Manufacturing Business will continue to be under pressure. However, the Group endeavours to maintain its net profit margin by various cost cutting and efficiency improvement measures.

In addition to the manufacturing and distribution license for the headwear of the 2008 Beijing Olympics, the Group continues to explore business opportunities for new headwear manufacturing and distribution licenses of other high profile events. In March 2007 the Group obtained the worldwide exclusive manufacturing rights, together with the exclusive distribution rights in Greater China and Japan, for FIFA branded headwear. This is expected to bring in substantial manufacturing orders during the term of the license from 2007 to 2014, in particular in 2010 and 2014 when the next two World Cups are held.

The negative contribution from the Panyu factory after the acquisition is expected to be temporary, and the Group will strengthen cost control and solicit more orders with a view to improve its utilization rate and generate positive contribution in the near future.

Riding on the competent marketing team to obtain new business and the talented design team, the Group will further strengthen its research and development investment, with a view to offering more value-added services and gaining more business.

To prepare for the additional orders committed by Concept One for the next seven years as part of the disposal of DPM, a new factory is being built adjacent to the existing Shenzhen factory. This will increase the production capacity by up to 40% eventually. Capital expenditure of HK$20,000,000 has been planned for this new factory.

The Trading Business

Following the disposal of DPM, the Trading Business of the Group remains active in Europe. The Group will continue to grow the Trading Business in Europe through expanding the license portfolio, the distribution network and the private label business. In addition, the UK subsidiary will also extend to be the marketing arm of the Manufacturing Business.

The Retail Business

The Group is optimistic about the retail business due to the thriving economic growth in the PRC, with customer spending expected to further increase.

While the number of own LIDS outlets is expected to remain at the current level, the Group will continue to expand the LIDS operation through franchising in the PRC. In Hong Kong, where rental cost pressure remains the major concern, the Group will look prudently at expanding the retail network. To improve the gross profit margin and the profit contribution, the Group targets to increase the sales mix of own brand products from the current 20% to 50% by 2008. This will also help to expand the franchise operation.

For the Sanrio operation, now that the product development team is established and the supply chain stabilized, the target is to increase the sales mix of locally developed and sourced products against import products from the current 20% to about 50% in 2007. This will improve the profit margin and also help to expand the distribution and franchising business. While the number of own outlets will be kept at the current level, additional 8 franchised outlets are planned in the first half of 2007. In 2007, the Group will also collaborate with various business partners of Sanrio to expand the distribution business through different channels and to increase the product range to cover co-brand items, with the aim of increasing sales and brand awareness and promoting growth momentum.

Acknowledgement

The Group will continue to work diligently to improve turnover and profit growth, with the aim of generating lucrative returns for our shareholders whose support, along with that of dedicated staff members, loyal customers and suppliers, is key to the Group's remarkable success. On behalf of Mainland Headwear, I would like to express my heartfelt gratitude to all stakeholders for their invaluable contribution to the continued success of the business.

Ngan Hei Keung
Chairman

Hong Kong
16 April 2007