

FUTURE PLANS AND USE OF PROCEEDS

FUTURE PLANS

The Group has experienced substantial growth in sales and profits over the past few years through the continuous efforts in product innovation and upgrading technology. The Directors intend to adopt the following strategies to further the growth of the Group:

1. Expansion of cotton yarn production facilities

The Directors believe that growth in the PRC cotton textile market will continue in the near future due to demand for quality cotton products and increase in purchasing power in the PRC. The Directors intend to expand the cotton yarn production capacity of the Group through purchase and/or construction of new production and ancillary facilities.

The new production and ancillary facilities for cotton yarn spinning operations will be constructed on the site of Yongle Production Plant as Phase II expansion. The budget for the expansion is approximately RMB77.0 million, of which approximately RMB37.5 million will be used for construction of factory premises and the remaining RMB39.5 million for purchase of plant and machinery for combed cotton yarn production.

As mentioned in the paragraph headed “Production facilities”, the Group currently has only approximately 32,700 spindles of combed cotton yarn production facilities, representing approximately 20.92% of its total cotton yarn production capacity. It is also mentioned in the section headed “Financial Information” that combed pure cotton yarns generally has higher gross margin than pure carded cotton yarns. The Directors consider that increase in the production output of combed pure cotton yarn will improve its overall profitability of cotton yarn products.

The Phase II expansion will double the existing cotton yarn production capacity of Yongle Production Plant by approximately 32,700 spindles and is capable of producing different combed pure cotton yarn products with yarn count ranging from 32 to 120. The construction work will commence in the third quarter of 2011 and is expected to complete in 12 to 14 months. To fund the expansion, the Group intends to apply approximately RMB56 million out of the proceeds of the New Issue, representing approximately 56% of the net proceeds of the New Issue, and the remaining balance of approximately RMB21 million by the Group’s internal resources.

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Set out below is a summary of Yongle Production Plant Phase II expansion:

	RMB
Budget:	
Factory premises	37.5 million
Plant and machinery	<u>39.5 million</u>
	<u><u>77.0 million</u></u>
Financing:	
Net IPO proceeds	56.0 million
Internal resources	<u>21.0 million</u>
	<u><u>77.0 million</u></u>
Commencement time:	2011 3rd quarter
Estimated construction time:	12–14 months
No. of spindles added:	32,700 spindles
Count range of cotton yarn produced:	32 to 120

2. **Improvement of production efficiency and product quality by upgrading existing cotton yarn production facilities**

The Group's sales volume is limited by its existing cotton yarn production capacity. In anticipation of the growing demand for cotton textile products, the Group intends to further strengthen, enhance its existing cotton yarn production and ancillary facilities for cotton yarn production to enhance production efficiency and product quality.

In order to further increase the output of combed pure cotton yarn products in addition to expansion plan mentioned above, the Group plans to enhance the carded cotton yarn production facilities in Guang Hua Plant for production of combed cotton yarn products. The Directors consider that the further increase in production output of combed pure cotton yarn not only allows the Group to capture customers' demand in cotton yarn products but also facilitates the Group to develop new grey fabrics with these combed cotton yarn products.

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The budget for the enhancement work will be approximately RMB40.0 million and will be used for purchase and installation of new cotton yarn production facilities. For these purposes, the Group intends to apply approximately RMB24.0 million out of the proceeds of the New Issue, representing approximately 24% of the net proceeds of the New Issue, and the remaining balance of approximately RMB16.0 million will be financed by the Group's internal resources.

Set out below is a summary of Guang Hua Production Plant facilities:

	RMB
Budget:	
Plant and machinery	<u><u>40.0 million</u></u>
Financing:	
Net IPO proceeds	24.0 million
Internal resources	<u><u>16.0 million</u></u>
	<u><u>40.0 million</u></u>
Commencement time:	2012 3rd quarter
Estimated construction time:	3 months

3. Ensuring a stable supply of quality lint cotton by maintaining a reasonable level of lint cotton reserve

The Group sources lint cotton from a number of sizable cotton processing plants in the PRC. Since these cotton processing plants have readily accessible network of cotton farmers and plantation group, with the storage capacity of the centralised lint cotton warehouse, the Directors intend to devote more financial resources to maintain a reasonable level of lint cotton reserve for the Group's operations in order to achieve better control in production cost and consistency in quality. In general, the production cycle for a single cotton yarn product is approximately 4 days whereas the production cycle for a single grey fabric product is approximately 7 days on top of cotton yarn production.

The Group intends to apply approximately RMB16.5 million, representing approximately 17% of the net proceeds of the New Issue for this purpose. As at 31 December 2010, the Group had lint cotton inventory level of approximately RMB10,698,350 or approximately 582 tonnes in its raw material inventory.

For illustrative purposes, given the average price of various of lint cotton was approximately RMB28,109 (or RMB24,875 net of 13% VAT) per ton as quoted in the CC Index for the five months of 2011, it would have allowed the Group to purchase approximately 663 tonnes of lint cotton. Hence, it would have increased the Group's lint cotton inventory level by about 114% and would provide cotton for yarn production for approximately 12 days based on the current level of production. Although the Group may obtain discount to the CC Index prices

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by entering into bulk purchase arrangement with its suppliers, the discount obtained from lint cotton suppliers may vary from case to case. For prudence sake no discount is made to the average price to illustrate the effect on increase in the Group's inventory level.

4. Expansion and diversification of product range

One of the key elements for maintaining future growth and competitiveness is the Group's commitment to expand its product range and to improve its product quality.

With collaboration from its customers and suppliers, the Group plans to develop and introduce higher count cotton yarn and related grey fabric products in the future in order to enhance its product mix and hence profitability.

The Group will primarily focus on the development of higher count combed pure cotton yarn products with count number ranging from 80 to 120. As illustrated in the Group's turnover and gross margin analysis in the section headed "Financial Information", combed pure cotton yarn in general has a higher gross margin than that of carded pure cotton yarn. Hence, the Directors consider that the development of higher count combed pure cotton yarn model will improve the overall profitability of the Group's cotton yarn products.

In addition, since cotton yarns are the raw materials of grey fabric production, the introduction of higher count combed pure cotton yarn products also provides new material choices for development of new grey fabric product models so as to broaden the Group's grey fabric product offering.

In order to facilitate the quality control work for future product development and commercial production, the Group will plan to set up a testing laboratory in Yongle Production Plant. The budget will be approximately RMB5.0 million, including laboratory premises construction, testing equipment purchase and staff training expenditure. The Group intends to apply approximately RMB3.6 million, representing approximately 3% of the net proceeds, and the remaining balance of approximately RMB1.4 million will be financed by the Group's internal resources.

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Set out below is a summary of the setup of new testing laboratory:

	RMB
Budget:	
Factory premises	1.2 million
Plant and machinery	3.0 million
Staff training	<u>0.8 million</u>
	<u><u>5.0 million</u></u>
Financing:	
Net IPO proceeds	3.6 million
Internal resources	<u>1.4 million</u>
	<u><u>5.0 million</u></u>
Commencement time:	2012 2nd quarter
Estimated construction time:	6 months

USE OF PROCEEDS

It is estimated that the net proceeds of the New Issue, after deducting underwriting fees and estimated expenses payable by the Group in connection thereto, will be approximately HK\$119.2 million. To implement the Group's future plans as set out in the preceding paragraph, the Group currently intends to apply such net proceeds as follows:

- approximately HK\$66.6 million (equivalent to approximately RMB56.0 million and representing 56% of the net proceeds) for expansion of cotton yarn production facilities;
- approximately HK\$28.6 million (equivalent to approximately RMB24.0 million and representing 24% of the net proceeds) for improvement of production efficiency and product quality by upgrading existing cotton yarn production facilities;
- approximately HK\$19.7 million (equivalent to approximately RMB16.5 million and representing 17% of the net proceeds) for maintaining a reasonable level of lint cotton reserve to ensure a stable supply of quality lint cotton; and
- approximately HK\$4.3 million (equivalent to approximately RMB3.6 million and representing 3% of the net proceeds) for expansion and diversification of product range.

To the extent that the net proceeds of the New Issue are not immediately used for the above purposes, the Group will deposit such net proceeds into short term deposits with authorised financial institutions and/or licensed banks in Hong Kong and/or China. According to the funding plan set forth above, the Group intends to fund the balance through internal cash resources. The Group currently believes that the net proceeds of the New Issue, when combined with internal cash resources, are sufficient for the uses set forth above.

The net proceeds from the sale of the Sale Shares by the Selling Shareholders are estimated at approximately HK\$34.9 million, after deducting the underwriting fees and commissions and estimated expenses payable by the Selling Shareholders in relation to the Share Offer. The Group will not receive any of the net proceeds from the sale of the Sales Shares by the Selling Shareholders.