
Chairman's Statement & Management Discussion and Analysis

To Shareholders,

On behalf of the board of directors of the Group, I hereby present the annual report for the year ended 31 December 2004.

DIVIDEND

The directors do not recommend the payment of any dividend for the year ended 31 December 2004 (2003: Nil).

FINANCIAL RESULTS

Turnover decreased by HK$29.4 million (i.e. about 12%) over last year to HK$209 million as a result of the substantial drop in turnover derived from manufacture and sale of garments by the Group in light of strict sale orders selection processes conducted by the management in the year. However, the Group's gross profit margin increased to 13.3% as compared with 8.9% last year because of the successful cost control carried out in the year.

The Group had recorded a dramatic narrowing down of loss for the year to HK$11.6 million this year as compared with HK$43.3 million loss incurred in 2003, which represented a substantial decrease of about HK$31.7million or approximately 73%. Taking into account the significant annual depreciation of about HK$11.9 million incurred by the Group and the further improvement in debtors turnover period, we had generated net cash inflow from operating activities of HK$15.4 million in 2004 (2003: HK$6.9 million).

Compared with last year, distribution costs and administrative costs reduced by about HK$3 million (i.e. about 20%) and approximately HK$3 million (i.e. about 13%) respectively under stringent and continuous cost control measures adopted by the management. Finance costs dropped by about HK$1.6 million (i.e. about 29%) when compared with last year because we had repaid about HK$10 million of the Group's short-term bank loan in the year to cut down unnecessary finance charges. Under conservative receivables management conducted in the year, only approximately HK$1 million (2003: HK$10 million) bad debts were written off or provided for which represented a decrease of about HK$9 million when compared with last year.

REVIEW OF OPERATION

Fabric Processing

Turnover derived from provision of fabric processing services during the year was about HK$78.9 million (2003: HK$75.5 million) which had increased by about 4.6% when compared with last year. Average gross profit margin was only about 11% (2003: 24%). The operating results improved only by about HK$0.6 million, resulting in an operating loss of about HK$5.2 million when compared with an operating loss of about HK$5.8 million last year. Competition in the textile industry and dyeing factories situated in Pearl River Delta was still very keen and intense, especially after the People's Republic of China (the "PRC") was given accession to World Trade Organization. The stiff competition in the year led to a drop of average fabric processing charges by about 6.5%. In addition, during the period under review, the

CRB index recorded its new high. Raw materials and oil prices increased continuously and posed heavy pressure on operating results of fabric processing section. The management of the dramatic increase in processing costs presented a severe challenge to the Group in 2004. For fabric processing section, coal is the essential fuel of production, particularly in generating electricity and water steam for the use of the dyeing factory. The huge upsurge of coal price had therefore drastically pulled up the fabric processing costs in the year. The globalization of world economies and the adoption of open door policy by most developing countries reinforced the intense competition for thin profit margin in manufacturing industries. Therefore, we will adopt a more conservative approach in the area of cost control in future. Nowadays, some apparel buyers in the United States of America (the "United States") have established their own buying teams and offices to purchase textile products directly from manufacturers in the PRC. Most of them were state-owned enterprises and therefore can accept a dramatically low selling price without heavy pressure on their financial capacity. We noted that our customers in this section, most of which being local fabric traders, were also under heavy impact by competition from the PRC's counterparts during these few years. In this respect, they demanded a very stringent and harsh quality standard from us to differentiate their products from those manufactured by the state-owned factories in order to protect their profit margins. We noted that the frequency and amounts of claims of defectiveness and low quality against us had increased substantially during these few years (excluding sales generated in the PRC where defective claims are still not a common practice in textile industry). Accordingly, we had switched our selling strategy to target at purchase orders from the direct buyers and buying offices instead of local fabric traders. In addition, these direct buying offices were willing to issue letters of credit to us with which we became more secure to receive money from them. In future, we will be more focused on exploring purchase orders from more direct buyers and gradually not rely on local fabric traders as our core customer base. In addition to switching our focus on direct buying offices in future, we will concentrate on sale of self-processed fabrics to these buying offices. The profit margin will become higher through these activities so that we can combat the huge rise in coal prices. Moreover, international price of cotton had decreased a lot since the early of 2004 due to overshooting of its price in 2003. This gave us a golden opportunity to expand this line of business from 2004 onwards. Furthermore, textiles quota policy has just been abolished by the government of United States since 1 January 2005, the ultimate exporting mechanism is still unknown, some of our buyers have held up their purchase orders in short-term until the picture becomes clearer. To capture the huge potential of economic development in the PRC and to reduce the portion of defective claims, effort will be made to capture more orders in the PRC by expanding the PRC domestic sales team. We will also gradually adjust up our average processing charges to our customers to match with the increase in raw material prices and the upcoming global inflation.

Sale of Fabrics

The turnover and results of this section had gradually improved and were satisfactory in 2004. Turnover derived from sale of fabrics slightly decreased by HK$1.6 million or 1.9% over last year. Gross profit margin of this segment is 14.7% (2003: 8%), resulting in an operating profit of HK$0.7 million generated by this section in 2004 (2003: operating loss of about HK$3.3 million). Almost all subsidiaries of this section had successfully turned around and made profit in the relevant period. Ching Fong Textiles Limited had resumed its operation since 1 August 2004 after about a year of restructuring. In addition, Alpha Textile International Limited had commenced operation since 1 September 2004. On the other hand, Rich Tide (Ching Hing) International Limited became dormant on 1 August 2004 because of the expiry of the cooperation agreement between its operating shareholder and us. In future, we will continue to form strategic alliance with salespersons with high marketing caliber in order to widen our exposure and knowledge over different types of dyed fabrics in textile industry. In this respect, a joint venture company will be formed with them with majority of shareholding held by us. For safety purpose, they were all required to sign cooperation agreements with the Group and to undertake to share any possible losses derived from the joint venture companies. We consider that this kind of cooperation can provide an incentive platform to the joint venture partners and simultaneously reduce our risk exposure. In addition, all joint venture companies were obliged to pay a sum of management fee to the holding company. They shared part of the Group's administrative expenses and partly released the costs burden upon the holding company. We also sold dyed fabrics processed by the Group's dyeing factory situated in Zhongshan, the PRC. Raw fabrics were purchased and then processed by us according to customers' requirements. Our records showed that the average amounts of defective claims for these orders were smaller and less frequent than those lodged for provision of fabric processing services. Profit margins were also higher because mark-ups were also added for sale of raw fabrics as well. Therefore, as we had mentioned above, the dyeing factory in Zhongshan, the PRC will increase the portion on sale of self-processed fabrics to direct buying offices in future.

Garment Manufacturing and Trading

Turnover in this section decreased by about 40.9% to about HK$45.2 million (which mainly composed of income generated from garment trading business) when compared with last year (2003: HK$76.5 million). Gross profit margin improved substantially to about 14% (2003: gross loss of 6%). As we had mentioned in 2003 annual report, we had downsized the garment manufacturing factory due to its continual loss-making. Effort was then made to establish nine retailing stores in the PRC to sell garments with self-registered brands. However, due to stiff competition in retailing businesses in this respect, the stores could not turn around to profit in first half of 2004. We had therefore completely close down all retailing stores to limit our losses. Since labour-intensive industries, like operating a garment manufacturing factory, will continue to be over-supply in the northern PRC and therefore create intense competition on us, we will not spare any more resources in garment manufacturing at this moment. For the garment trading business, we had already adopted a very stringent approach in order selection processes due to globally stiff competition. In addition, we focused on purchase orders with relatively high margins to compensate the risk premium borne. Most of the purchase orders have to be settled by cash to protect us from bad debts. Accordingly, the turnover of garment trading had decreased substantially in the year. However, with economic climate being gradually improved in 2005, we noted that customers' orders for garment trading is becoming more promising, especially for us with deep connection with production plants in countries in Southeast Asia. We expect that import and export disputes between the PRC and the United States will be very frequent after the abolishment of quota system since 1 January 2005. This would create a favourable environment for us with strong back-up of production bases in Southeast Asia like Bangladesh.

PROSPECT AND OUTLOOK

Consistent with 2004, the Group will adopt the following approaches to maintain a steady pace of development in 2005:

1. Continuous cautious production and administrative cost control to strengthen the survival ability;

2. Continues vertical integration of Group's operation in textile industry to maximise our profit margin;

3. Continuous concentration of the Group's resources on textile industry to maximise the efficiency of the Group's financial resources; and

4. Continuous exploration of the PRC domestic textile market to tap the high-speed growing potential of the PRC economy.

In summary the following goals are set for 2005:

1. Increase the portion of sale of self-processed fabrics;

2. Increase the average unit fabric processing charges;

3. Increase the portion of provision of fabric processing services to domestic PRC customers;

4. Reduce direct processing costs of the dyeing factory in Zhongshan, the PRC further;

5. Increase the turnover derived from garment trading;

6. Increase the turnover derived from trading of dyed fabrics (excluding self-processed fabrics); and

7. Establish a small weaving factory situated inside the existing dyeing factory in Zhongshan, the PRC, if financially feasible.

LIQUIDITY AND FINANCIAL RESOURCES

During the year, the Group generated HK$15.4 million of net cash from operating activities as compared to HK$6.9 million for 2003. The increase in net cash inflow generated from operating activities was primarily due to tight control in cost and reduction of debtors turnover period. Bank borrowing reduced by about HK$16.3 million as compared to 2003. Such measure enabled us to reduce the finance cost by 29% as compared with 2003 to HK$3.9 million for 2004.

At 31 December 2004, the Group had total assets of HK$186 million which were financed by current liabilities of HK$79 million, long-term liabilities of HK$14 million and shareholders' equity of HK$93 million. Accordingly, the Group's ratio of debt to total assets and debt to equity were 50% (2003: 52%) and 99% (2003: 109%), respectively. In the environment of unclear economic outlook, the Group succeeded in reducing the gearing ratio to a safer level.

The Group financed its operation by internal cash resources and bank financing. During the year, no new equity shares had been issued for fund raising.

At 31 December 2004, the Group had cash on hand, bank deposits and bank balances for an aggregate amount of about HK$36.7 million (of which about HK$23.8 million was pledged with banks for banking facilities of the Group), which we consider sufficient for normal daily operation and expansion.

APPRECIATION

I wish to extend my sincerest thanks and appreciation to staff at all levels within the Group and my fellow directors for their collective efforts, loyalty and continuing support to the Group during the year.

Yiu Ching On
Chairman

Hong Kong, 14 April 2005