Management Discussion and Analysis

Operational and Financial Review

The Group is principally engaged in the manufacture and sale of knitted fabrics and is one of the major suppliers of knitted fabrics in the market. The Group's merchandise was sold to various garment manufacturers, many of whom are suppliers to international fashion apparel brand operators that sell garment products to the consumers in the United States of America and other countries. The Group has vertically integrated its operations, which include marketing and sales, research and development, production processes, including knitting, fabrics dyeing and yarn dyeing, and final processes, such as setting and pre-shrinking.

Turnover

For the financial year ended 31 December 2004, the Group recorded a turnover of approximately HK$1,315.7 million (2003: HK$1,101.6 million), representing an increase of approximately 19.4% in comparison to the previous financial year. The increase in turnover was mainly attributable to the general increase in demand for the Group's fabrics in the basic, functional and novelty series and the increase in sales to customers in Singapore and Taiwan which accounted for about 54.8% and about 18.5% of total turnover, respectively. In addition, a new yarn dye production line commenced operation in September 2004, which recorded a turnover of about HK$12.1 million as at 31 December 2004. The Group has also entered into the PRC local market since the third quarter of 2004 and recorded a turnover of about HK$18.1 million as at 31 December 2004.

Gross Profit

The gross profit of the Group was approximately HK$313.9 million, representing an increase for the year ended 31 December 2004 of approximately 12.6% in comparison to the gross profit of approximately HK$278.7 million in the previous financial year. The gross profit margin slightly decreased from approximately 25.3% in the previous year to approximately 23.9% in the year ended 31 December 2004. The slight decrease in gross profit margin was due to the combined effect of the increase in purchase cost of cotton yarn in the first half-year of 2004 and the increase in depreciation charges of the newly established production facilities, including the yarn dyeing production line, power and steam generating plant, and water and sewage treatment plant, which offset the corresponding increase in the selling price of fabrics and the improvement of operating efficiency by a reduction in subcontracting production process.

Net Profit

The Group's net profit attributable to shareholders for the financial year ended 31 December 2004 was approximately HK$105.8 million (2003: HK$96.4 million), representing a year-on-year increase of approximately 9.8%. Net profit margin for the year ended 31 December 2004 was approximately 8.0% (2003: 8.7%). The decrease in net profit margin was principally attributable to the decrease in gross profit margin.

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Other Revenue and Expenses

Other revenue of approximately HK$6.6 million mainly comprised approximately HK$5.7 million in shipping and handling charges earned by Kam Hing International Shipping Limited, a wholly-owned subsidiary of the Company. Selling and distribution costs of approximately HK$83.1 million mainly comprised HK$75.6 million in shipping and delivery costs, representing an increase of approximately 33.6% in comparison to the previous year. The increase in selling and distribution costs was principally due to delivery orders from further afield and rising freight costs. Administrative expenses increased 10.3% year-on-year to approximately HK$101.9 million and mainly comprised salaries, entertainment expenses, traveling and accommodation, staff welfare, bank charges, depreciation, and postage and courier expenses. The increase was basically in line with the increase in turnover and partly due to the fact that more staff were employed to enhance production and more marketing and communication efforts were spent on customer liaison and sales solicitation.

During the year under review, the Group recorded an aggregate provision for doubtful debts and bad debts written off of approximately HK$2.2 million, which represented only approximately 0.16% of the Group's turnover for the same year. Finance costs of approximately HK$15.9 million for the year ended 31 December 2004 comprised mainly interest on short-term trust receipt loans, term loans from bank and finance lease interests. Finance costs increased by 53.2% as compared with the previous year mainly due to the increase in working capital requirement as a result of the increase in the Group's operations and the increase in bank financing for the acquisition of production equipment, particularly the yarn dyeing machinery.

Liquidity and Financial Resources

As at 31 December 2004, the Group had net current assets of approximately HK$147.9 million (2003: HK$123.4 million). The Group maintains a strong financial position by financing its operations with the proceeds from the Company's initial public offering (the "IPO") and internally generated resources. As at 31 December 2004, the Group had cash and bank deposits of approximately HK$124.8 million (2003: HK$57.7 million). The current ratio of the Group was 1.3 (2003: 1.3).

The total bank borrowings of the Group as at 31 December 2004 were approximately HK$358.8 million (2003: HK$270.6 million). The Group's net debt gearing ratio (bank borrowings net of cash on hand and bank deposits to equity) was approximately 38.7% (2003: 68.2%).

Debtors' turnover period, inventory turnover period and creditors' turnover period for the year were 53.7 days, 84.6 days and 47.7 days respectively. The debtors' turnover period decreased slightly from 55.3 days in the previous financial year to 53.7 days in the current financial year. This was due to the discounting of bills receivable to financial institutions. The increase in the inventory turnover period from 78.3 days to 84.6 days was attributable to the increase in inventory in anticipation of the increase in production demand of fabrics in the coming period and the establishment of a new yarn dye production line during the year ended 31 December 2004. The creditors' turnover period further decreased slightly from 55.0 days to 47.7 days due to arrangements with some suppliers for purchase discounts on early settlement.

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Financing

As at 31 December 2004, the total banking and loan facilities of the Group amounted to approximately HK$755 million (2003: HK$705 million), of which approximately HK$429 million (2003: HK$206 million) was utilized.

As at 31 December 2004, the Group's long-term loans were maintained at approximately HK$53.5 million. Long-term finance lease payable was increased from approximately HK$32.0 million as at 31 December 2003 to approximately HK$42.0 million as at 31 December 2004 because the Group has made further additions to plant and machinery. The acquisition of these fixed assets were principally financed by way of finance leases. As at 31 December 2004, the Group's long-term bank loans comprised loans drawn down by Panyu Kam Hing Textile Dyeing Co., Limited and Kam Hing Piece Works Limited, both are wholly-owned subsidiaries of the Company, which were not secured by any assets of the Group but by corporate guarantees provided by other members within the Group.

Dividend

The Board has resolved to recommend the payment of a final dividend of HK1.6 cents per share in respect of the year ended 31 December 2004 to shareholders whose names appear on the register of members of the Company on 23 May 2005 subject to the approval of the shareholders regarding the payment of the final dividend at the annual general meeting. The final dividend is based on 25% of the net profit of the second half year of 2004.

Capital Structure

Since the listing of the Company's shares on the Stock Exchange on 23 September 2004, there has been no change in the capital structure of the Company. The share capital of the Company comprises only ordinary shares.

Foreign Exchange Risk and Interest Rate Risk

For the year ended 31 December 2004, the Group was not subject to any significant exposure to foreign exchange rates risk as the majority of the transactions of the Group were denominated in US dollars, Hong Kong dollars or Renminbi. Hence, no financial instrument for hedging was employed.

Approximately 89% of the Group's sales were denominated in US dollars. The remaining sales were denominated in Hong Kong dollars and Renminbi. The majority of the Group's cost of sales and capital expenditures were denominated in US dollars, Renminbi and Hong Kong dollars. Since the exchange rate of US dollars and Renminbi has been relatively stable in recent years, the directors do not anticipate future currency fluctuations to cause material operational difficulties or liquidity problems for the Group. Hence, the Group did not enter into any arrangements to hedge its foreign exchange exposure.

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All bank borrowings of the Group were denominated in US dollars, Hong Kong dollars or Renminbi on either a fixed interest rate basis, an inter-bank borrowing interest rate basis or a prime rate basis. The Board is of the opinion that the Group is not subject to any significant interest rate risk.

Charge on the Group's Assets

As at 31 December 2004, certain plant and machinery and motor vehicle of the Group with an aggregate net book value of approximately HK$148.6 million (2003: HK$77.3 million) were under finance leases.

In addition, certain of the bank's short term bank loans were secured by pledged bank deposits of the Group of HK$7.9 million. Subsequent to the balance sheet date, the pledge over the bank deposits was released.

Capital Expenditure

During the year, the Group invested approximately HK$261.1 million in fixed assets, of which approximately 37.6% (2003: 71.0%) was used for the purchase of plant and machinery, approximately 57.9% (2003: 27.6%) was used for the construction of new factory premises and the remaining was used for the purchase of other fixed assets.

As at 31 December 2004, the Group had capital commitments of approximately HK$96.7 million (2003: HK$35.7 million) in respect of fixed assets, which are to be funded by the IPO proceeds and net proceeds from internal resources.

Staff Policy

The Group had 2,064 employees in the PRC, and 118 employees in Hong Kong, Macau and Singapore as at 31 December 2004. Remuneration packages are generally structured by reference to market terms and individual qualifications. Salaries and wages are normally reviewed on an annual basis based on performance appraisals and other relevant factors. Discretionary bonuses are offered to the Group's staff depending on their performance and the results of the Group.

The Group operates a defined contribution retirement benefits scheme under the MPF Ordinance as well as medical insurance for all its employees in Hong Kong. Also, the Group is obliged to provide its employees in the PRC with welfare schemes covering various insurance and social benefits. Staff benefits are also provided to the staff working in other countries according to the respective countries' statutory requirements.

The Company maintains a share option scheme, pursuant to which share options are granted to select eligible executives, with a view to providing senior management an appropriate incentive package for the growth of the Group.

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In addition to weekly and monthly internal training, the Group also contracted Zhongshan University, the PRC to provide management training to senior staff. External course subsidies are also provided to certain employees.

Contingent Liabilities

As at 31 December 2004, the Company had contingent liabilities in relation to guarantees given to banks to secure credit facilities granted to certain subsidiaries amounting to approximately HK$429 million. The Group also had bills discounted with recourse of approximately HK$106.4 million (2003: HK$62.4 million).

Major Customers and Suppliers

In the year ended 31 December 2004, sales to the five largest customers accounted for approximately 60.9% (2003: 65.4%) of the total sales of the Group and sales to the largest customer included therein accounted for approximately 30.8% (2003: 36.2%).

Purchases from the five largest suppliers accounted for approximately 39.3% (2003: 27.5%) of the total purchases for the year and purchases from the largest supplier included therein accounted for approximately 10.9% (2003: 6.9%).

None of the directors, their respective associates (as defined in The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules")) or shareholders of the Company who own more than five percent of the issued share capital of the Company had any interest in the Group's five largest customers and/or suppliers during the year under review.

Segment Information

In the year ended 31 December 2004, sales to the three largest regions (Singapore, Taiwan and Hong Kong) accounted for approximately 82.8% (2003: 85.7%) of the total sales of the Group and sales to the largest region (Singapore) included therein accounted for approximately 54.8% (2003: 58.2%) of the Group.

As at 31 December 2004, the Group's assets located in Hong Kong and the PRC (other than Hong Kong and Macau) accounted for approximately 25.9% (2003: 30.5%) and 74% (2003: 69.4%) of the total assets of the Group, respectively. Capital expenditure in the PRC (other than Hong Kong and Macau) during the year ended 31 December 2004 accounted for approximately 97.7% (2003: 98.4%) of the total capital expenditure of the Group.