# MANAGEMENT DISCUSSION AND ANALYSIS

The following management discussion and analysis should be read in conjunction with the unaudited interim financial information of Li Ning Company Limited (the "Company") and its subsidiaries (the "Group") for the six months ended 30 June 2005, together with the accompanying notes included in this interim report.

## BUSINESS OVERVIEW

The Group is one of the leading sports brand enterprises in the People's Republic of China (the "PRC") with its own branding and capabilities of product research, development and design, supply chain management, marketing, distribution and retail networks.

- Our products comprise sports footwear, apparel and accessories for sports and leisure use.

- Our products are principally sold under our own proprietary LI-NING brand and the KAPPA brand, which was exclusively licensed to us in the PRC and Macau.

- We have established an extensive distributorship and retail network with a nationwide infrastructure of retailed outlets in the PRC. Our merchandises are sold through distributors which operate franchised LI-NING and KAPPA retail outlets under our supervision. We also operate our directly-managed retail stores and concession counters.

- Our international sales of LI-NING brand are focused in Spain and Russia through our overseas distributors.

- We operate our supply chain management by subcontracting the production of a majority of our products to independent contract manufacturers in the PRC, with a small portion of our sports apparels being manufactured in-house. Such production mode has enabled us to focus principally on brand building.

## FINANCIAL REVIEW

### Highlights

The Group's unaudited consolidated results for the six months ended 30 June 2005 were very encouraging, as exemplified by the major performance indicators set out below:

| | **Six months ended 30 June** | | |
|---|---|---|---|
| | **2005** | 2004 | ***Period-on-period change (%)*** |
| **Profit and loss account items *(unaudited)*** | | | |
| *(Expressed in RMB'000 unless otherwise stated)* | | | |
| Turnover | **1,104,307** | 788,667 | **40.0** |
| Gross profit | **530,630** | 361,545 | **46.8** |
| Profit for the period | **78,784** | 54,875 | **43.6** |
| Profit attributable to equity holders | **78,313** | 54,903 | **42.6** |
| Earnings per share — basic *(RMB cents) (Note 1)* | **7.65** | 7.28 | **5.1** |
| **Selected financial ratios *(unaudited)*** | | | |
| Gross profit margin *(%)* | **48.1** | 45.8 | |
| Margin of profit attributable to equity holders *(%)* | **7.1** | 7.0 | |
| Effective tax rate *(%)* | **34.1** | 36.9 | |
| Debt to equity holders' equity ratio *(%) (Note 2)* | **0.9** | 10.7 | |
| Average inventory turnover *(days) (Note 3)* | **97** | 124 | |
| Average accounts receivable turnover *(days) (Note 4)* | **39** | 33 | |
| Average trade payables turnover *(days) (Note 5)* | **65** | 71 | |

*Notes:*

1. *The calculation of earnings per share is based on the Group's profit attributable to equity holders of the Company for the six months ended 30 June 2005 of RMB78,313,000 (2004: RMB54,903,000) and the weighted average of 1,023,038,000 (2004: 753,891,000) shares issued during the period.*

2. *The debt to equity holders' equity ratio is expressed as a percentage of total outstanding borrowings over equity holders' equity.*

3. *The calculation of average inventory turnover (days) is based on the average of opening and closing balances of inventory divided by cost of sales and multiplied by the number of days during the relevant period.*

4. *The calculation of average accounts receivable turnover (days) is based on the average of opening and closing balances of accounts and notes receivable divided by turnover and multiplied by the number of days during the relevant period.*

5. *The calculation of average trade payables turnover (days) is based on the average of opening and closing balances of trade payables divided by total purchases and multiplied by the number of days during the relevant period.*

## Turnover

For the six months ended 30 June 2005, the Group's turnover increased over the corresponding period last year by 40.0% to RMB1,104,307,000, which was driven by (i) the rapid expansion of our sales channels; (ii) success of our expanded product range; as well as (iii) defined and clear brand marketing strategy and promotion efforts.

*Breakdown of turnover by product category*

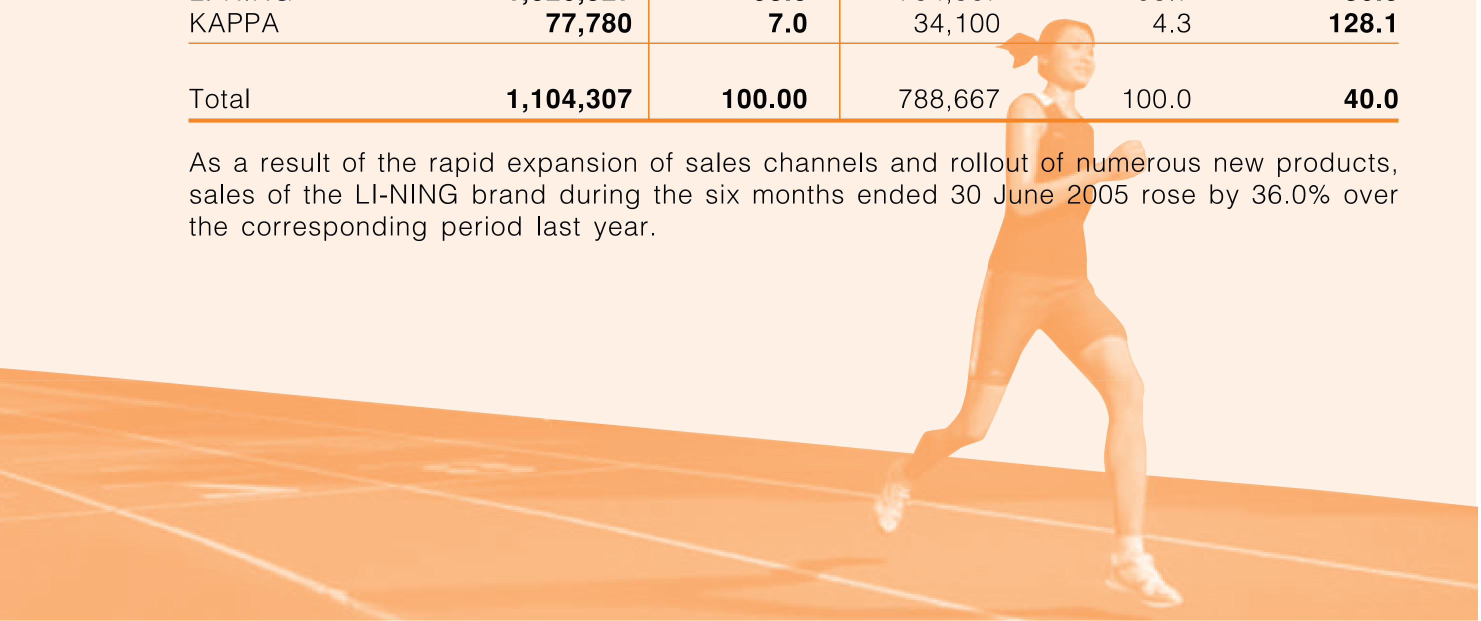
| | **Six months ended 30 June** | | | | |
|---|---|---|---|---|---|
| | **2005** | | 2004 | | |
| | ***RMB'000*** | ***% of total turnover*** | *RMB'000* | *% of total turnover* | ***Period-on-period change (%)*** |
| Footwear | **366,773** | **33.2** | 238,147 | 30.2 | **54.0** |
| Apparel | **648,936** | **58.8** | 454,328 | 57.6 | **42.8** |
| Accessories | **88,598** | **8.0** | 96,192 | 12.2 | **(7.9)** |
| Total | **1,104,307** | **100.0** | 788,667 | 100.0 | **40.0** |

The launching of new styles in footwear and apparel products boosted the Group's sales. In particular, significant improvements in footwear designs combined with a realignment of the pricing of major products and reinforced product marketing efforts led to a strong growth of 54.0%. The sales of apparel products increased by 42.8%. Sales of accessories decreased by 7.9% over the corresponding period last year as a result of the Group's reduced emphasis on accessories.

*Breakdown of turnover by brand*

| | **Six months ended 30 June** | | | | |
|---|---|---|---|---|---|
| | **2005** | | 2004 | | |
| | ***RMB'000*** | ***% of total turnover*** | *RMB'000* | *% of total turnover* | ***Period-on-period change (%)*** |
| LI-NING | **1,026,527** | **93.0** | 754,567 | 95.7 | **36.0** |
| KAPPA | **77,780** | **7.0** | 34,100 | 4.3 | **128.1** |
| Total | **1,104,307** | **100.00** | 788,667 | 100.0 | **40.0** |

As a result of the rapid expansion of sales channels and rollout of numerous new products, sales of the LI-NING brand during the six months ended 30 June 2005 rose by 36.0% over the corresponding period last year.



*Percentage of turnover by sales channel*

| | Six months ended 30 June | |
|---|---|---|
| | **2005** | 2004 |
| | ***% of total turnover*** | *% of total turnover* |
| PRC market | | |
| Distributor sales | **76.4** | 75.2 |
| Concession sales | **11.7** | 11.6 |
| Retail store sales | **10.6** | 10.8 |
| International markets | **1.3** | 2.4 |
| Total | **100.0** | 100.0 |

*Percentage of turnover by geographical location*

| | | Six months ended 30 June | |
|---|---|---|---|
| | | **2005** | 2004 |
| | *Note* | ***% of total turnover*** | *% of total turnover* |
| **LI-NING brand** | | | |
| PRC market | | | |
| Beijing and Shanghai | | **8.5** | 9.9 |
| Central region | *1* | **11.8** | 12.3 |
| Eastern region | *2* | **23.3** | 22.2 |
| Southern region | *3* | **11.9** | 11.3 |
| Southwestern region | *4* | **7.9** | 8.1 |
| Northern region | *5* | **14.6** | 13.5 |
| Northeastern region | *6* | **12.0** | 13.1 |
| Northwestern region | *7* | **1.7** | 2.9 |
| International markets | | **1.3** | 2.4 |
| **KAPPA brand** | | | |
| PRC market | | **7.0** | 4.3 |
| Total | | **100.0** | 100.0 |

*Notes:*

1. *Central region includes Hubei, Hunan and Jiangxi.*

2. *Eastern region includes Zhejiang, Jiangsu and Anhui.*

3. *Southern region includes Guangdong, Guangxi, Fujian and Hainan.*

4. *Southwestern region includes Sichuan, Chongqing, Guizhou, Yunnan and Tibet.*

5. *Northern region includes Shandong, Hebei, Henan, Tianjin, Shanxi and Inner Mongolia.*

6. *Northeastern region includes Liaoning, Jilin and Heilongjiang.*

7. *Northwestern region includes Shaanxi, Xinjiang, Gansu, Qinghai and Ningxia.*

**Cost of sales and gross profit**

For the six months ended 30 June 2005, cost of sales amounted to approximately RMB573,677,000 (2004: RMB427,122,000). The overall gross profit margin on sales during the period rose to 48.1% as compared to 45.8% for the corresponding period last year due to a deliberate realignment of our pricing strategy and the success of our new product research and development efforts. Gross profit margins of footwear, apparel and accessories were approximately 47.4%, 48.9% and 44.5% respectively.

**Distribution and administrative expenses**

For the six months ended 30 June 2005, distribution expenses amounted to approximately RMB331,476,000 (2004: RMB213,291,000). Distribution expenses primarily comprised advertising and promotional expenses, salaries and benefits of sales staff, rental and renovation expenses of retail stores, sponsorship and other promotional expenses, which increased from 27.0% of the turnover for the corresponding period last year to 30.0% this year. This increase is primarily due to: (i) increases in the number of sales staff; (ii) additional overhead costs for new directly-managed retail stores and concession counters; and (iii) increased spending on marketing and advertising expenses for brand building.

Our administrative expenses of approximately RMB84,703,000 (2004: RMB56,112,000) for the six months ended 30 June 2005 primarily comprised staff costs, office rentals, depreciation of office premises and other general expenses. Administrative expenses as a percentage of turnover increased from 7.1% in the corresponding period last year to 7.7% this year, which was primarily due to the additional employee costs as a result of the implementation of IFRS 2 “Share-based Payment” as well as an increase in management staff as a result of the realignments of internal management and business organization structure in line with the Group’s long-term strategy.

### Other operating expenses

Other operating expenses amounted to approximately RMB11,959,000 (2004: RMB11,440,000) for the six months ended 30 June 2005. The breakdown of other operating expenses is set out below:

| | Six months ended 30 June | | | | |
|---|---|---|---|---|---|
| **Other operating expenses** | **2005** | | 2004 | | ***Period-on-period change (%)*** |
| | ***RMB'000*** | ***% of total*** | *RMB'000* | *% of total* | |
| Provision for doubtful debts | **2,563** | **21.4** | 2,973 | 26.0 | **(13.8)** |
| Provision for obsolete and slow-moving inventories | **8,492** | **71.0** | 4,747 | 41.5 | **78.9** |
| Others | **904** | **7.6** | 3,720 | 32.5 | **(75.7)** |
| Total | **11,959** | **100.0** | 11,440 | 100.0 | **4.5** |

Other operating expenses primarily comprised provision for doubtful debts, provision for obsolete and slow-moving inventories, loss on disposals of property, plant and equipment and other operating expenses.



### Finance costs and taxation

For the six months ended 30 June 2005, our finance cost position reversed from an expense of RMB1,957,000 for the corresponding period last year to an income of RMB6,355,000, which was primarily attributable to (i) decrease in interest expenses on bank borrowings as a result of the decrease in our bank borrowings to RMB9,000,000; and (ii) interest income derived from return of investments of the Group's cash and other financial assets.

For the six months ended 30 June 2005, tax expenses amounted to RMB40,740,000 (2004: RMB32,139,000). The effective tax rate was 34.1% (2004: 36.9%).

### Profit attributable to equity holders

Our profit attributable to equity holders of the Company for the six months ended 30 June 2005 was approximately RMB78,313,000, an increase of 42.6% over RMB54,903,000 for the corresponding period last year. Net profit margin attributable to the equity holders of the Company for the period was 7.1%, which was slightly better in comparison to the corresponding period last year.

Our operating profit margin decreased from 11.3% to 10.2% primarily due to the adjustment of non-cash impact of IFRS 2. Excluding the additional employee costs as a result of the adoption of IFRS 2 "Share-based Payment" for the period and the corresponding period last year, the operating profit margin for both periods would have been 11.1% and 11.4%, respectively. Period-on-period growth of profit attributable to equity holders without the IFRS

2 effect would have been 55.7%. Our net profit margin attributable to the equity holders of the Company was also positively impacted by a lower effective tax rate of 34.1% compared to 36.9% for the corresponding period last year.

Basic earnings per share amounted to RMB7.65 cents (corresponding period last year: RMB7.28 cents). Excluding the impact of IFRS 2 adjustment, basic earnings per share amounted to RMB8.54 cents (corresponding period last year: RMB7.45 cents).

**Provision for inventories**

Inventories are stated at the lower of cost and net realizable value. In the event that net realizable value falls below cost, the difference is taken as a provision for inventories.

Our accumulated provision for inventories as at 30 June 2005 and 31 December 2004 amounted to approximately RMB18,720,000 and RMB10,228,000, respectively.

**Provision for doubtful debts**

Our policy in respect of provision for doubtful debts remained unchanged from the corresponding period last year.

Our accumulated provision for doubtful debts as at 30 June 2005 and 31 December 2004 amounted to approximately RMB12,583,000 and RMB10,020,000, respectively.

## BUSINESS REVIEW

The Group was established in 1989 and our business has been expanding rapidly since then. In June 2004, the Group successfully completed an initial public offering of the Company on the Main Board of The Stock Exchange of Hong Kong Limited (the "Hong Kong Stock Exchange"). Subsequent to our listing, the Company was honoured to be included as a constituent stock of the Hang Seng Composite Index Series and the Hang Seng Free Float Index Series in January 2005 and further as a constituent stock of the MSCI China Index in June 2005.

During the six months ended 30 June 2005, we continued to focus on our growth strategies to: (i) enhance brand awareness and customer loyalty to our products; (ii) upgrade our capabilities in product design and development; (iii) reinforce and expand our sales channels and distribution infrastructure; and (iv) improve our supply chain management for greater versatility and efficiency.

**Sponsorships and marketing/promotional activities**

During the six months ended 30 June 2005, the Group embarked on a number of marketing initiatives.

In January 2005, 北京李寧體育用品有限公司 (Beijing Li Ning Sporting Goods Co., Ltd.) ("Beijing Li Ning"), a subsidiary of the Company, entered into a marketing and advertising agreement with NBA Properties, Inc., the marketing and licensing arm of the National Basketball Association ("NBA"), a market leader in basketball and sports marketing with a global reputation. Under the agreement, the Group will utilize NBA's extensive marketing and media resources in the PRC market to promote the LI-NING brand. This partnership represents another milestone for the Company as a leader in China's sporting goods industry as it endeavors to broaden the scope of cooperation with international groups, as well as improve the marketing of the LI-NING brand.

In April 2005, the Group entered into a three-year deal with Netease, a leading Internet technology venture in the PRC, whereby the two parties agreed to work in close collaboration to launch the "Li-Ning Netease Sports Channel" (李寧網易體育頻道), an information exchange platform for the Internet population featuring professional and comprehensive coverage of sports news. Backed by a series of joint initiatives in promotional activities, marketing resources and corporate culture development, the channel will put together the power of sport in the Internet and accomplish the idea that "Anything is Possible". Meanwhile, NBA reports in greater depths were carried following the official strategic marketing alliance between "LI-NING" and NBA to enable greater exposure to the NBA section. Coverage of the medal-winning national sports teams will also be enhanced, with emphasis on in-depth reports on the diving team, the table tennis team, the gymnastics team and the shooting team.

Further in April 2005, the Group entered into a partnership with Swarovski, the world renowned maker of crystal jewellery and decorations, pursuant to which Swarovski crystal inlays would be featured on LI-NING ladies' tennis wear, gymnastic suits and gymnastic footwear, adding a richer flavour of fashion content to the products.

The Group has increased public awareness of its new products (including basketball, running, soccer, tennis and gymnastic fitness products) with effective advertising strategies. In the PRC, "Anything is Possible", a statement representing the philosophy strongly advocated by the Group to underpin its advertising efforts, has become a popular catchphrase in daily life. According to a recent Internet poll conducted by a PRC newspaper, the LI-NING brand was selected by Internet users as one of the top three favourite brands in the sports wear category. Moreover, LI-NING was the only sporting goods brand selected as one of "My Favourite PRC Brands 2005" in a campaign organized by CCTV.



**Product development**

During the period, through in-house research and development and extensive cooperation with international partners, the Group is developing an increasing range of products that will meet international standards both in terms of professional requirements and fashion trends.

In 2004, the Group started to launch different types of specialized footwear series (including soccer and basketball, tennis, running and fitness products), such as the professional "Tie" series soccer boots designed in honor of Chinese soccer star Li Tie. Our new basketball footwear series was also vastly popular in the market. In the recent Spring season, the Company launched in the PRC its RUN FREE ultra-light air-flow running shoes. Made with the ultra-light materials developed in-house, combined with imported leather material and the latest designs and craftsmanship, the new product has achieved an internationally advanced air-flow standard and received overwhelming response from the market.

The Group's design and research and development center in Hong Kong concentrates its effort on establishing the overall design features of the LI-NING brand products, formulating concepts and strategies in brand design, upgrading design technologies and concentrating on the design of high-end products with well-defined functions and identities. The center is also working with institutions and colleges in Hong Kong and overseas, including the Department of Sports Science & Physical Education of the Chinese University of Hong Kong, on various projects.

**Distribution and retail network**

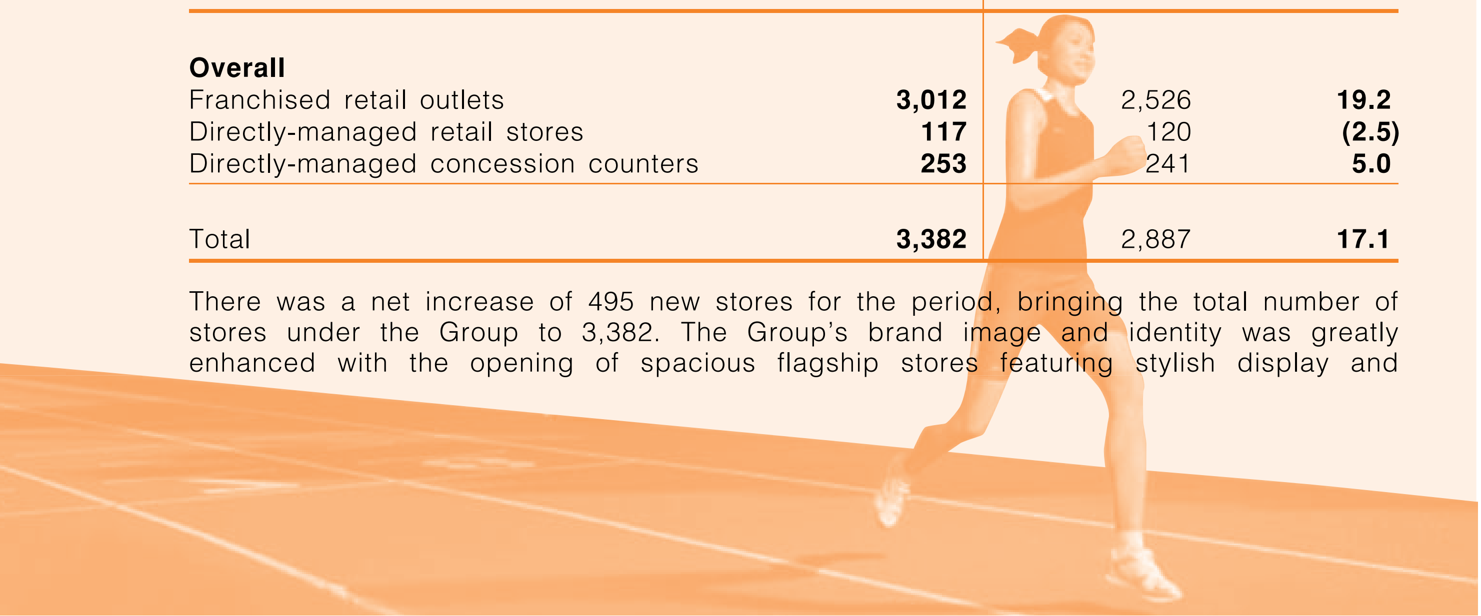
We have established an extensive network of distributors and retailers with sales outlets throughout China, underpinned by a diversified combination of franchised retail outlets, directly-managed retail stores and concession counters. The Group continued to expand its domestic sales channels during the period. As at 30 June 2005, its domestic distribution and retail network comprised:

- over 330 distributors operating 3,012 franchised retail outlets for the LI-NING and KAPPA brands across the country; and
- a total of 117 directly-managed retail outlets and 253 concession counters in Beijing, Shanghai and 11 provinces in the PRC.

*Number of franchised and directly-managed retail outlets*

| | **As at 30 June 2005** | As at 31 December 2004 | **Change (%)** |
|---|---|---|---|
| **LI-NING brand** | | | |
| Franchised retail outlets | **2,698** | 2,272 | **18.8** |
| Directly-managed retail stores | **115** | 117 | **(1.7)** |
| Directly-managed concession counters | **245** | 233 | **5.2** |
| Total | **3,058** | 2,622 | **16.6** |
| **KAPPA brand** | | | |
| Franchised retail outlets | **314** | 254 | **23.6** |
| Directly-managed retail stores | **2** | 3 | **(33.3)** |
| Directly-managed concession counters | **8** | 8 | **—** |
| Total | **324** | 265 | **22.3** |
| **Overall** | | | |
| Franchised retail outlets | **3,012** | 2,526 | **19.2** |
| Directly-managed retail stores | **117** | 120 | **(2.5)** |
| Directly-managed concession counters | **253** | 241 | **5.0** |
| Total | **3,382** | 2,887 | **17.1** |

There was a net increase of 495 new stores for the period, bringing the total number of stores under the Group to 3,382. The Group's brand image and identity was greatly enhanced with the opening of spacious flagship stores featuring stylish display and



decorations at prime locations in major PRC cities. During the period, the newly opened flagship stores include the 1,600 square metre store at Jie Fang Road in Wuhan, the 880 square metre store at Zhong Shan Road in Xiamen and the 436 square metre store at East Main Street in Xi'an.

### Supply chain management

An integrated supply chain management system is being implemented for all franchised and directly-managed retail outlets under the Group to provide centralized procurement, inventory and logistics services. As a result of effective supply chain management, the Group managed to respond to market changes in a more efficient and flexible manner during the period, as highlighted in the following:

- two large-scale sales fairs for distributors were organized during the period to shorten the turnover period for product development and order placements;
- the average inventory turnover was shortened to 97 days compared to 124 days for the corresponding period last year as a result of improved inventory management;
- the average accounts receivable turnover was maintained at a healthy level of 39 days, increased by 6 days compared to 33 days for the corresponding period last year; and
- the average trade payable turnover decreased by 6 days to 65 days from 71 days for the corresponding period last year.



## FINANCIAL CONDITIONS

### Net asset value

As at 30 June 2005, the Group's total net asset value was RMB1,068,215,000 (31 December 2004: RMB1,027,225,000). Net asset value per share was RMB104.42 cents (31 December 2004: RMB100.41 cents).

### Liquidity and capital resources

For the six months ended 30 June 2005, the Group's net cash outflow from operations amounted to RMB43,197,000, as compared to net cash inflow of RMB32,856,000 for the corresponding period last year. The decrease in cashflow was mainly attributable to slightly longer turnover for sales amounts as more flexible but managed credit limits were granted to distributors in tandem with increased sales, while we continued to make payments to suppliers according to schedules stipulated in relevant contracts.

Net cash (cash and cash equivalents less bank borrowings) as at 30 June 2005 amounted to RMB140,136,000, representing a decrease of RMB142,432,000 compared to the net cash amount recorded on 31 December 2004. Such decrease comprised net cash outflow from operations amounting to RMB43,197,000 as stated above, dividend payments of RMB46,932,000, total net capital expenditure of RMB14,212,000 for the purchase of office and production facilities and refurbishment of fixed assets, an increase in short-term investment of RMB41,419,000 in financial assets at fair value through profit or loss, interest expenses on bank borrowings amounting to RMB1,102,000, offset with interest income received amounting to RMB2,460,000 and net return on fixed deposits of RMB1,970,000.

As at 30 June 2005, the Group's cash and cash equivalents amounted to RMB149,136,000 (31 December 2004: RMB322,568,000). Total outstanding borrowings amounted to RMB9,000,000 (31 December 2004: RMB40,000,000). Equity holders' equity amounted to RMB1,050,536,000 (31 December 2004: RMB1,010,017,000). The Group was in a net cash position. The debt to equity holders' equity ratio, expressed as a percentage of total outstanding borrowings over equity holders' equity was 0.9% (31 December 2004: 4.0%).

As at 30 June 2005, the Group did not enter into any interest rate swaps to hedge against risks relating to interest rates.

### Pledge of assets

As at 30 June 2005, fixed deposits amounting to RMB99,318,000 were pledged by the Group to secure bank borrowings in favor of its subsidiaries. As at 30 June 2005, notes receivable of the Group amounting to RMB9,000,000 were pledged to the bank as security for bank borrowings of RMB9,000,000.

### Contingent liabilities

As at 30 June 2005, the Group had no material contingent liabilities.

### Foreign exchange risk

The Group mainly operated in the PRC with most transactions settled in Renminbi and did not have significant exposure to foreign exchange risk during the six months ended 30 June 2005.

## CORPORATE RESTRUCTURING

During the six months ended 30 June 2005, the Group conducted a corporate restructuring in respect of its wholly-owned subsidiary Beijing Li Ning, which is mainly engaged in the sales of the LI-NING branded products. Prior to the restructuring, Beijing Li Ning was a domestic funded company established in the PRC with limited liability, owned as to 80% by 上海悅奧體育用品有限公司 (Shanghai Yue Ao Sporting Goods Co., Ltd.) ("Shanghai Yue Ao") and 20% by 佛山李寧體操學校服務有限公司 (Foshan Li Ning Gymnastics School Services Company Limited). After the restructuring, Beijing Li Ning was converted into a sino-foreign equity joint venture held as to approximately 75% by 李寧體育(上海)有限公司 (Li Ning Sports (Shanghai) Company Limited) ("Shanghai Li Ning"), a wholly-owned subsidiary of the Company in the PRC and approximately 25% by Li Ning Sports (Hong Kong) Company Limited ("Hong Kong Li Ning"), a wholly-owned subsidiary of the Company in Hong Kong.

The purpose of the restructuring was to rationalize the shareholding structure of the Company to improve management and operational efficiency. The Group will continue to review and monitor the Group structure, and to implement further restructuring as and when appropriate.

## JOINT VENTURE WITH AIGLE

On 30 June 2005, Hong Kong Li Ning, an indirect wholly owned subsidiary of the Company, entered into an agreement with Aigle International S.A. ("AIGLE") to establish a 50/50 joint venture company in Hong Kong. Under the arrangement, the joint venture company will set up a wholly foreign-owned enterprise in the PRC, which will be granted the exclusive right by AIGLE to manufacture, market, distribute and sell garment and footwear products for outdoor leisure activities and extreme sports with the AIGLE trademarks in the PRC (excluding Hong Kong, Taiwan and Macau) for 50 years.

AIGLE is a world-renowned brand company that specializes in producing and distributing garment and footwear products for outdoor leisure activities. We believe the long-term strategic joint venture is conducive to the Group's objective of developing a multi-brand business, as well as enhancing our overall competitive strengths. By joining forces with AIGLE to develop the PRC market, the Company is set to benefit from the combination of AIGLE's worldwide reputation and extensive experience in designing garment and footwear products for outdoor leisure activities with the Group's vast sales and distribution network and leading position in the PRC sports market.

## DISPOSAL OF INTERESTS IN KAPPA BRAND BUSINESS

On 30 June 2005, Shanghai Yue Ao, a subsidiary of the Company, agreed to transfer its entire 80% equity interest in 北京動向體育發展有限公司 (Beijing Dong Xiang Sports Development Co., Ltd.) ("Beijing Dong Xiang", a subsidiary of the Company) to 上海泰坦體育用品有限公司 (Shanghai Tai Tan Sporting Goods Co., Ltd.) ("Shanghai Tai Tan") for a consideration of RMB8,614,000 (the "Disposal"). Shanghai Tai Tan is a company owned as to 93% by Mr. Chen Yi Hong (an executive director of the Company) and his spouse and is therefore a connected person of the Company under the Rules Governing the Listing of Securities on the Hong Kong Stock Exchange (the "Listing Rules").

Concurrent with the Disposal, Shanghai Li Ning, a subsidiary of the Company, agreed to assign all its rights in the outstanding debts in the sum of RMB36,200,000 owed to it by Beijing Dong Xiang to Shanghai Tai Tan for a consideration of RMB36,200,000.

Beijing Dong Xiang is primarily engaged in the development, manufacturing, sales and distribution of all products related to, named or associated with the KAPPA brand. The KAPPA brand originates in Italy and is currently owned by the BasicNet Group of Italy. Pursuant to the license and distribution agreements and know-how license agreement between the BasicNet Group and Beijing Dong Xiang (the "KAPPA License Agreements"), Beijing Dong Xiang has been granted the exclusive right to distribute KAPPA branded products in the PRC (including Macau but excluding Hong Kong and Taiwan) until 31 December 2007.

The Disposal was consistent with the Group's strategic repositioning to redirect its resources to focus primarily on the development of the Company's own brands or acquiring or establishing long term joint venture with international brands, such as the joint venture with AIGLE. As the KAPPA License Agreements represent only short term arrangements between the Group and the BasicNet Group that will expire on 31 December 2007, the Company will not be able to enjoy in the long run the benefits of growth in value of the KAPPA brand fostered by the Company and funded with its resources in developing KAPPA's business.

The directors of the Company believe that the Disposal is beneficial to the business development of the Group and in the interest of the Company and its shareholders as a whole. The transaction was approved by independent shareholders of the Company at the extraordinary general meeting held on 11 August 2005. Upon completion of the Disposal, Beijing Dong Xiang would cease to be a subsidiary of the Company.

## HUMAN RESOURCES

As at 30 June 2005, the Group had about 3,699 employees (31 December 2004: 4,402 employees).

In addition to basic remuneration packages and discretionary bonuses for employees, share options may also be granted to eligible employees based on the Group's results and the performance of individual employees.

## OUTLOOK AND DEVELOPMENT STRATEGIES

China's GDP grew 9.5% for the first six months of 2005. The retail sector continued to spearhead the nation's economic growth, with aggregate retail sales of consumer products consistently outgrowing GDP. The pattern of consumption is changing with increased disposable income and improved living standards, underpinned by higher expenditure on sports, healthcare and entertainment. Against this backdrop, the sporting goods industry of the PRC is well positioned for rapid growth.

Looking ahead, the 2008 Beijing Olympic Games are expected to generate a strong passion and motivation for sporting activities among the Chinese public, which the Group will endeavor to capitalize the opportunity of increasing demand for sporting goods. The Group believes that, as a premium sports brand in the PRC with solid business and financial infrastructure, it will benefit from these potential developments in the market.

The Group will continue to develop its core competitive strengths in product research and design and brand marketing. We will strive to make major progress in our core strengths to compete internationally by the end of 2008. For product development and design, plans have been established to increase our products' appeal to international market and enhance the professional standards of the LI-NING brand by improving its quality through innovative designs and technological improvements. The Group will also continue with its efforts to increase brand awareness by implementing comprehensive marketing strategies to enlarge customer loyalty and increasing preference for its products.

The Group will keep enhancing its core competencies to further expand its retail network of franchised retail outlets, directly-managed stores and concessions counters. Meanwhile, we will continue to improve our store image and display with a view to further elevating our brand profile and same store growth. We will also improve the management of our supply chain for better efficiency and effectiveness in our operation.

Apart from managing our own brands, the Group will also continue to seek opportunities for long-term cooperation with international brands, with a view to enhancing its competitive edge and intrinsic value.

By leveraging our competitive strengths, the Group's management is committed to launching premium sporting goods for customers, fostering job satisfaction for its employees and generating attractive returns for shareholders and investors.