

MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS REVIEW AND PROSPECTS

Business Review

2005 was a successful year for Addchance. With the advantage on advanced dyeing facilities and production know-how associated with the strategically located production bases, persistent vertical integration and good market reputation, the Company was successfully listed on the Stock Exchange last October.



Zhangjiagang Addchance Dyeing & Finishing Co., Ltd
Zhangjiagang Addchance Spinnery Co., Ltd

The Group proactively developed itself as a one-stop service provider for garment customers with selection of production for yarn products at different stages: whether from a simply supply of cotton yarn, or a production of a well-knitted sweater; from the spinning of cotton into yarn, to the provision of yarn dyeing service.

The Group is principally engaged in the production and sale of dyed yarn, knitted sweaters and cotton yarn, the provision of dyeing services, knitting services and trading of cotton and yarns. Its major products include over 200 different types of dyed yarns made of cotton, cashmere, ramie, rayon, acrylic, polyester, silk, wool, nylon, linen and mixtures of the above and knitted sweaters including cardigans and pullovers.

Despite the uncertainties in the industry arising from the quota elimination, the Group has continued to grow. During the year under review, the Group focused on the production of knitted sweaters and the market demands for knitted sweater continued to expand, both contributed to the increases in the sale of knitted sweaters to 7.7 million pieces, compared with 4.4 million pieces last year. The results of the Group for the year under review was significantly better, with an increase in net profit of approximately 58% and an increase in net margin from 6.2% to 8.4% over last year. The Board has recommended a final dividend of HK\$4.7 cents per ordinary share for the year ended 31st December, 2005.

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Financial Review

Turnover

The turnover of the Group is primarily generated from production and sale of dyed yarns and knitted sweaters. With the continuous expansion in the production and sale of knitted sweaters, Addchance recorded a double-digit growth in turnover. For the year under review, total turnover increased by approximately 17% over last year, from approximately HK\$772.2 million to about HK\$900.5 million.

Turnover by operation

(Amount)

	2005 HK\$'000	2004 HK\$'000	Changes +/- %	2003 HK\$'000	2002 HK\$'000
Production and sale of dyed yarns	393,663	421,107	-7%	396,954	433,909
Production and sale of knitted sweaters	356,627	190,278	87%	84,974	130,318
Production and sale of cotton yarn	49,716	36,528	36%	25,099	3,502
Provision of dyeing and knitting services	31,392	20,818	51%	20,949	15,663
Trading of cotton and yarns	69,084	103,471	-33%	81,320	87,296
	<u>900,482</u>	<u>772,202</u>	<u>17%</u>	<u>609,296</u>	<u>670,688</u>

Turnover by operation

(in % of total)

	2005	2004	2003	2002
Production and sale of dyed yarns	43.7%	54.6%	65.2%	64.7%
Production and sale of knitted sweaters	39.6%	24.6%	13.9%	19.4%
Production and sale of cotton yarn	5.5%	4.7%	4.1%	0.5%
Provision of dyeing and knitting services	3.5%	2.7%	3.4%	2.3%
Trading of cotton and yarns	7.7%	13.4%	13.4%	13.1%
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

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Turnover of the sweater business grew by about 87%, from approximately HK\$190.2 million to about HK\$356.6 million. This represented approximately 40% of the Group's total turnover and made a significant contribution to the Group, surged from approximately 25% of the Group's total turnover last year to approximately 40% in 2005. Revenue growth was mainly driven by the higher average selling prices, sustainable economies of scale and improved operational efficiency. The textile quota disputes and the re-introduction of quota in 2005 had no adverse effect on the Group's business and order flow of the Group had been stable in the year of 2005.

Cenxi Addchance Textile Factory Limited



Our sweaters products were still mainly exported to the EU during the year under review. Sale of sweater products made to international retail chainstores accounted for approximately HK\$316.3 million, which represented approximately 88.7% of the Group's sales of knitted sweaters for the year of 2005.

Dyed yarn is still being the core product of Addchance. Annual turnover from the production and sale of dyed yarns was approximately HK\$393.7 million, a slight decrease of approximately 7% as compared with last year, and accounted for approximately 44% of the Group's total turnover for the year 2005. Revenue generated from the provision of dyeing services increased from approximately HK\$20.8 million last year to about HK\$31.4 million in the year of 2005, a 51% increase as compared with last year. Most of the Group's dyed yarn was sold in the PRC and Hong Kong and it accounted for approximately 81% of the Group's sales of dyed yarn while the remaining represented exports to overseas countries including Thailand, Taiwan, Cambodia and Indonesia.

Turnover of the yarn-spinning business surged to approximately HK\$49.7 million for the year of 2005 from approximately HK\$36.5 million last year, representing an increase of 36%. The Group has expanded vertically to enhance its competitiveness and the Susong Spinning Mill is the yarn production arm of the Group, the production of cotton yarn can cater the demand for the production and sale of dyed yarn. During the year under review, about 56% of yarn produced by the Group was used in its dyeing function.

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Cost of Sales

(Amount)

	2005 HK\$'000	2004 HK\$'000	Changes +/- %	2003 HK\$'000	2002 HK\$'000
Raw materials	423,679	420,117	0.8	327,779	348,742
Fuel, coal and water					
treatment materials	27,367	31,090	-12.0	17,842	29,218
Direct Labour	33,846	33,333	1.5	23,448	18,269
Subcontracting - dyeing	2,857	231	>100	21,343	50,744
Subcontracting - knitting	98,139	51,997	88.7	23,848	39,253
Factory Overheads	73,227	53,270	37.5	48,743	36,202
Others	8,348	5,908	41.3	9,829	3,875
	<u>667,463</u>	<u>595,946</u>	<u>12.0</u>	<u>472,832</u>	<u>526,303</u>

With the continuous implementation of stringent cost control measures and enhancement in overall operational efficiency, the Group's cost of sales increased by 12.0% from HK\$595.9 million last year to HK\$667.5 million for the year under review despite the 17% increase in turnover. Raw materials continued to be the major component in the cost of sales, which accounted for approximately 63.5% of the Group's overall cost of sales for the year 2005. In line with the sharp increase in the sales of knitted sweaters by approximately 88% in 2005, the subcontracting charges for knitting increased accordingly.

Gross profit and gross profit margin

The Group recorded a gross profit of approximately HK\$233.0 million for the year under review, representing an increase of approximately 32% as compared to approximately HK\$176.3 million last year. With the increase in the production and sale of knitted sweaters with higher gross profit margin, which led to the Group's gross profit margin increased from 22.8% for the previous year to 25.9% for the year of 2005. The strategic expansion and vertical integration enhanced the competitive advantage of Addchance and facilitate the Group with stable raw materials supply, optimized factory utilization rate and lower production cost, the gross profit margin therefore improved continuously with the effectiveness of the Group's sales and production planning and strengthened cost control.

Sweater business continued to be the most profit-generating segment of the Group. With the continuous expansion of customer base, almost the twofold increase in sales volume and the increasing economies of scale, the Group enjoyed a lower production cost. Allied with this, the 17.1% increase in the average selling price of knitted sweaters in 2005 drove the gross profit margin of sweater business increased from 28.2% for the previous year to 31.4% for the year of 2005.



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Net profit margin

The net profit margin of the Group increased from 6.2% last year to 8.4% this year. Despite the surge in gross profit margin, the Group continuously implemented cost control measures to improve the net profit margin. Save for the inclusion of the listing expenses of approximately HK\$14.2 million and the imputed interest expense on an amount due to Dr. Sung Chung Kwun (“Dr. Sung”) of approximately HK\$3.1 million with the adoption of the new and revised International Financial Reporting Standards, the net profit and the net margin of the Group would be increased further to approximately HK\$92.7 million and 10.3% respectively.

Other revenue

Other revenue of approximately HK\$7.4 million mainly comprised interest income and rental income from investment properties of the Group located in Hong Kong and the PRC. They are all industrial and commercial buildings located in Hong Kong and the PRC.

Distribution costs

Distribution costs mainly included the transportation costs, accessories and packing expenses. For the year ended 31st December, 2005, the Group's distribution costs amounted to approximately HK\$51.8 million representing an increase of 16.8% when compared with the previous year. In line with the expansion in the market and business volume, the distribution costs increased accordingly.

Administrative expenses

Administrative expenses of approximately HK\$82.2 million mainly represented the staff costs including the salary expenses and staff welfare expenses, listing expenses, bank charges, traveling expenses and depreciation. During the year under review, the administrative expenses increased by 28.7% from HK\$63.9 million for the previous year to HK\$82.2 million, accounting for 9.1% of the Group's turnover. The increment was mainly due to the listing expenses of approximately HK\$14.2 million arose upon the listing of the Company's shares on the Stock Exchange on 5th October, 2005.

Finance costs

Finance costs mainly comprised the interest on bank borrowings and obligations under finance leases. Amount increased by 33.2% from HK\$17.3 million for the previous year to HK\$23.1 million for the year under review. The increase was mainly due to the imputed interest expense on an amount due to Dr. Sung of approximately HK\$3.1 million.

Borrowings

As at 31st December, 2005, the Group had outstanding borrowings of approximately HK\$263.1million, comprising bank borrowings of approximately HK\$254.1 million and obligations under finance leases of approximately HK\$9.0 million. Of the total amount, an amount of approximately HK\$248.5 million was due within one year and the remaining amount of approximately HK\$14.6 million was due over one year.

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Upon completion of the reorganisation in preparation for the listing on the Stock Exchange, an amount due to Dr. Sung of approximately HK\$192.2 million was capitalized and therefore the borrowings level decreased by around 54.6% from HK\$579.5 million for the previous year to HK\$263.1 million this year. Gearing ratio, being the total bank borrowings divided by total assets, was 33.1% last year as compared to 30.2% as at 31st December, 2005.

The guarantees and assets pledged by Dr. Sung were all released since the listing of the Shares on the Stock Exchange. As at 31st December, 2005, certain land and buildings and machinery and equipment with an aggregated net book value of approximately HK\$37.6 million and bank balances of approximately HK\$21.3 million of the Group were utilized as security for the Group's borrowings.

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

The financial position of the Group remained strong. The cash and cash equivalents amounted to HK\$86.1 million as at 31st December, 2005. The Group met its funding requirements in its usual course of operation by cash flows from operations, long-term and short-term borrowings, as well as issuance of equity securities.

Net cash inflow in the amount of HK\$128.6 million was generated from operating activities, reflecting primarily growth in the Group's core business. Also, the settlement of the debt due from related companies of approximately HK\$48.1 million also increased the net cash inflow generated from operating activities.

For the year under review, the net cash used in financing activities amounted to HK\$58.2 million, increased by approximately HK\$54.7 million compared with last year. The increase was mainly due to the aggregate effect of the net repayment of bank loan of approximately HK\$17.3 million, the repayment of the amount due to Dr. Sung of approximately HK\$111.3 million during the year and the net proceeds of about HK\$101.0 million raised associated with the listing expenses of approximately HK\$22.0 million arisen from the issue of new shares of the Company in October 2005.

With ample financial resources and strong financial position, the Group has confidence in taking advantage of any favourable opportunities in the coming years.

Stock turnover days

The stock turnover days of the Group for the year ended 31st December, 2005 was approximately 101 days as compared to 116 days last year. With the tightened procurement policy and the clearance of the piled up raw material stock, the stock turnover days was continuously reduced to a more healthy level by 15 days for the year under review.

Debtors' turnover days

The debtors' turnover days was slightly lengthened by 6 days from 64 days last year to 70 days this year with the increase in the sales volume in the last quarter this year compared with that of last year. The Group offered credit terms to its trade customers of 30 days to 120 days subject to the trading history and the individual creditability of the customers.

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Dividend Policy

The declaration of dividends is subject to the discretion of the Directors, which is expected to take into account factors such as the Group's financial results, shareholders' interests, general business conditions and strategies, the Group's capital requirements, contractual restrictions on the payment of dividends by the Company to the shareholders or by the Group's subsidiaries to the Company, taxation considerations, possible effects on the Group's creditworthiness, statutory and regulatory restrictions and any other factors as the Directors may deem relevant. The Directors expect that the interim and final dividends will be declared and/or paid from time to time in an aggregate amount of not less than 25% of profits attributable to equity holders of the Company.



Sure Win International Textiles Limited

The Board has recommended the payment of a final dividend of HK\$4.7 cents per share for the year ended 31st December, 2005 payable to shareholders whose name appear on the register of members on 29th May, 2006. Subject to the approval of the shareholders at the forthcoming annual general meeting, the total dividend for the year will be HK\$4.7 cents per share, which represented 25% payout of the profit for the year.

MAJOR CUSTOMERS AND SUPPLIERS

The Group's top five customers accounted for approximately 36.6% of the total sales. The top five suppliers accounted for approximately 28.3% of the total purchases for the year under review. In addition, the Group's largest customer accounted for approximately 23.8% of the total sales and the Group's largest supplier accounted for approximately 8.0% of the total purchases for the year.

Save as disclosed in Note 42 to the consolidated financial statements, at no time during the year have the Directors, their associates or any shareholders of the Company (which to the knowledge of the Directors own more than 5% of the Company's share capital) had any interest in these major customers and suppliers.