BUSINESS REVIEW AND PROSPECTS

Business Review

To differentiate itself from other players in the textile industry, Addchance proactively developed itself as a one-stop service provider by vertically expanding its current business segments from spinning to knitting. It propelled the vertical integration over the year under review as follows:

River Rich Textile Limited

13th December, 2005	RMB50 million investment in Wuzhou (Guangxi Province) for the construction of a knitting mill for sweaters
30th December, 2005	US$10 million investment in Susong (Anhui Province) for the 50,000-spindle expansion project of the spinning mill in Anqing
7th July, 2006	US$6.19 million consideration for the acquisition of the entire registered share capital of River Rich, a Cambodia-based sweater manufacturing company, resulting in a US$1.31 million (HK$10.2 million) discount on acquisition on consolidated results.
23rd October, 2006	US$5.05 million consideration for the acquisition of the entire registered share capital of Winner Knitting, another Cambodia-based sweater manufacturing company, resulting in a US$1.7 million (HK$13.2 million) discount on acquisition on consolidated results.

Note: The above-mentioned dates are the agreement dates of the respective investments.

Since the listing of the shares of the Company on the Main Board of the Stock Exchange, the Group has been actively seeking suitable locations in Guangxi and Anhui provinces in the PRC to establish its next manufacturing site. The knitting mill in Wuzhou commenced operation since December of 2006 and the spinning mill in Susong is expected to commence operation in the second or the third quarter of 2007. With the new investment made in Wuzhou and Susong, the overall production capacity of our knitting and spinning business is expected to significantly increase in the next financial year.

With the acquisition of River Rich and Winner Knitting, the Group is exempted from quota restrictions on textile exports and the associated risks and uncertainties. On top of this, the Group can enjoy the competitive advantage of the 13 per cent import tax waiver when products are delivered directly from Cambodia to European countries.

The resolution regarding trade agreements on textile products between the PRC and each of the United States and Europe provided a relatively steady environment for the export of Chinese textile products. The knitting segment continued to demonstrate satisfactory performance during the year under review by achieving a 26.3% growth in revenue to approximately HK$450.5 million, accounting for 48.7% of the consolidated revenue. The segment contributed to a substantial increase in the sales of knitted sweaters to approximately 13.3 million pieces, compared with approximately 7.7 million pieces in last year, up 72.7% in terms of output quantities.

Looking forward, 2007 promises to be a fruitful year following the Group's strategic expansion. We are confident that the investments made in 2006 will successfully create steady earnings growth in the coming years.

Financial Review

Turnover

The turnover of the Group is primarily generated from the production and sale of dyed yarns and knitted sweaters. For the year under review, total turnover increased by approximately 2.8% as compared with last year, owing to the growth in the production and sale of knitted sweaters and cotton yarn after netting off with the effect of the Group's downsized trading business of cotton and yarns.

Turnover by operation

(Amount in HK$'000)

	2006	2005	Changes +/-%	2004	2003
Production and sale of dyed yarns	354,340	393,663	-10.0%	421,107	396,954
Production and sale of knitted sweaters	450,538	356,627	26.3%	190,278	84,974
Production and sale of cotton yarn	65,442	49,716	31.6%	36,528	25,099
Provision of dyeing and knitting services	36,105	31,392	15.0%	20,818	20,949
Trading of cotton and yarns	19,464	69,084	-71.8%	103,471	81,320
	925,889	900,482	2.8%	772,202	609,296
Exclude trading of cotton and yarns segement	906,425	831,398	9.0%		

Turnover by operation

(in % of total)

	2006	2005	2004	2003
Production and sale of dyed yarns	38.3%	43.7%	54.6%	65.2%
Production and sale of knitted sweaters	48.7%	39.6%	24.6%	13.9%
Production and sale of cotton yarn	7.1%	5.5%	4.7%	4.1%
Provision of dyeing and knitting services	3.9%	3.5%	2.7%	3.4%
Trading of cotton and yarns	2.0%	7.7%	13.4%	13.4%
	100%	100%	100%	100%

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

Through the dedicated effort of the marketing teams, the knitted sweater segment continued to demonstrate satisfactory performance during 2006 by achieving a 26.3% growth in revenue to approximately HK$450.5 million, accounting for 48.7% of the consolidated revenue. In terms of output quantities of knitted sweaters, revenue increased by approximately 72.7% whereas revenue in terms of monetary value saw only a 26.3% increase due to differentiation in the product mix. Our sweaters products were still exported mainly to Europe during the year under review. Sales made to international retail chain stores, such as H&M and Zara, accounted for approximately HK$384.8 million, which represented approximately 85.4% of the Group's sales of knitted sweaters for the year 2006. In the coming year, revenue from the knitted sweaters segment is expected to achieve substantial growth momentum as we explore new customers and markets and diversify product ranges.

Dyed yarn remains a core product segment for Addchance. Annual turnover from the production and sale of dyed yarns for the year 2006 was approximately HK$354.3 million, a slight decrease of 10.0% as compared with last year, and accounting for about 38.3% of the Group's total turnover. Revenue generated from the provision of dyeing services increased from approximately HK$31.4 million last year to about HK$36.1 million in the year of 2006, up 15.0% from last year. Most of the Group's dyed yarn was sold in the PRC and to Hong Kong manufacturers with production sites based in Guangdong, Jiangsu and Zhejiang which accounted for approximately 98% of the Group's sales of dyed yarn.

Turnover of the yarn-spinning business surged to approximaely HK$65.4 million for the year 2006 from approximately HK$49.7 million last year, representing an increase of 31.6%. Vertical expansion through investment in the Susong Spinning Mill, the yarn production arm of the Group, has enhanced its competitiveness since the production of cotton yarn can cater to the demand for the production and sale of dyed yarn. During the year under review, about 53.3% of yarn produced by the Group was used in its dyeing function.

Despite the apparent growth in the knitted sweater segment and yarn-spinning business, the results of the Group for the year under review increased slightly only due to contraction of the low-profit-margin segment of cotton and yarn trading. To fully utilize the resources and maximize profitability, the Group in 2006 implemented downsizing measures in the trading of cotton and yarns. Consequently, the revenue generated from the trading segment decreased from approximately HK$69.1 million last year to approximately HK$19.5 million in the year under review, resulting in a 71.8% drop in the turnover of the trading segment. Excluding the income generated from the trading of cotton and yarns, the turnover of the Group increased further to approximately 9.0%.

Cost of Sales

(Amount in HK$'000)

	2006	2005	Changes +/-%	2004	2003
Raw materials	400,217	423,679	-5.5	420,117	327,779
Fuel, coal and water treatment materials	19,969	27,367	-27.0	31,090	17,842
Direct Labour	57,174	33,846	68.9	33,333	23,448
Subcontracting - dyeing	665	2,857	-76.7	231	21,343
Subcontracting - knitting	134,567	98,139	37.1	51,997	23,848
Factory Overheads	91,465	73,227	24.9	53,270	48,743
Others	7,314	8,348	-12.4	5,908	9,829
	711,371	667,463	6.6	595,946	472,832

Despite the increase in turnover of the Group by approximately 9.0% (excluding the revenue in trading of cotton and yarns), the Group's cost of sales increased slightly by 6.6% as a result of the continuous implementation of stringent cost control measures, enhancement in overall operational efficiency as well as high level of flexibility achieved from strong diversified production bases.

With the changes in the sales mix, the Group's cost of sales increased further by 6.6%. In line with the substantial increase in the sales revenue of the knitted sweaters segment generated by higher output quantities of approximately 5.6 million pieces or 72.7%, the corresponding subcontracting charges for knitting, direct labour and factory overheads increased by approximately 37.1%, 68.9% and 24.9% accordingly. Raw materials continued to be the major cost component of sales, which accounted for approximately 56.3% of the Group's overall cost of sales for the year 2006.

Gross profit and gross profit margin

The Group recorded a gross profit of approximately HK$214.5 million for the year under review, representing a slight decrease of approximately 7.9% from HK$233.0 million last year. Due to the differentiation in the sweaters product mix, the average selling price for sweaters decreased by approximately 26.7%. Cost increases in the PRC, including the appreciation of Renminbi against the US dollar and the increase in minimum wage, have exerted pressure on the Group's profit margins. Strategic expansion and vertical integration have enhanced the competitive advantage of Addchance by facilitating the Group with a stable supply of raw materials, optimising factory utilization rates and lowering production costs, which will contribute to margin growth in the coming years.

Net profit margin

For the year ended 31st December, 2006, the net profit margin of the Group decreased from 8.4% last year to 7.1% this year. The differentiation in the product mix of sweater goods and the cost increase associated with expansion drove net profit margins downwards slightly. However, with the consequential startup of new investment in the coming year 2007, the Group is well-positioned to capitalise on the core strength of multi-location production capabilities with flexible and effective production planning. The competitive advantage of vertical integration can contribute to driving net margin growth in the next financial year.

Discount on acquisition of subsidiaries

The discount on acquisition arises on completion of the acquisition of 100% interest in River Rich and Winner Knitting in August and November 2006 respectively. Since the cost of acquisition represents approximately 10% and 30% discount of the net fair value of the identifiable assets and liabilities of River Rich and Winner Knitting respectively, these two acquisitions will accordingly increase the net assets value of the Group. In accordance with the International Financial Reporting Standards 3 “Business Combination” issued by the International Accounting Standard Board, these discounts are recognised immediately in the consolidated income statement of the Group upon completion.

Other income

Other income of approximately HK$11.5 million mainly comprised the tax refund received in 2006 from the PRC tax Bureau regarding the investment in Su Song, interest income and rental income from investment properties of the Group located in Hong Kong and the PRC. They are all industrial properties located in Hong Kong and an office unit located in the PRC.

Selling and distribution costs

Selling and distribution costs mainly comprised of transportation costs, and accessories and packaging expenses. For the year ended 31st December, 2006, the Group’s distribution costs amounted to approximately HK$65.5 million, representing an increase of 26.4% compared with the previous year. Selling and istribution costs increased in line with the expansion in the market and business volume of sweaters throughout the year.

Administrative expenses

Administrative expenses of approximately HK$92.0 million mainly represented staff costs including salary expenses and staff welfare expenses, directors’ remuneration, legal and professional fee, audit fee and depreciation charges. During the year under review, the administrative expenses increased by 11.9% from approximately HK$82.2 million for the previous year to approximately HK$92.0 million, representing 9.9% of the Group’s turnover. The increment was mainly due to the increase of the staff costs, directors’ remuneration and the legal and professional fees associated with listing compliance matters.

Finance costs

Finance costs comprised mainly of interest on bank borrowings and obligations under finance leases. Figures decreased by 18.1% from approximately HK$23.1 million for the previous year to approximately HK$18.9 million for the year under review owing to the inclusion of the imputed interest expense of HK$3.1 million made in the previous year.

Borrowings

As at 31st December, 2006, the Group had outstanding borrowings of approximately HK$302.9 million, comprising bank borrowings of approximately HK$298.4 million and obligations under finance leases of approximately HK$4.5 million. Of the total amount, approximately HK$231.9 million was due within one year and the remaining amount of approximately HK$71.0 million was due within 2 to 5 years.

The gearing ratio – total bank borrowings divided by total assets – was 30.2% last year as compared to 30.4% as at 31st December, 2006. With the strategic expansion of in 2006, the Group can still maintain a gearing ratio of the similar and healthy level.

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

As at 31st December, 2006, total assets of the Group amounted to approximately HK$982.9 million, representing an increase of approximately HK$142.2 million compared to HK$840.7 million last year. The financial position of the Group remained strong. The cash and cash equivalents amounted to approximately HK$56.7 million as at 31st December, 2006. The Group met its funding requirements in its usual course of operation by cash flows from operations, as well as long-term and short-term borrowings.

Net cash inflow in the amount of approximately HK$49.2 million was generated from operating activities, primarily reflecting growth in the Group's core business. Also, the increase in trade payables and bills payables of an aggregate amount of approximately HK$27.1 million increased further the net cash inflow generated from operating activities.

For the year under review, the net cash used in investing activities amounted to approximately HK$98.3 million, increased substantially by approximately HK$101.6 million compared with last year. The increase was mainly due to the purchase of property, plant and equipment and the acquisition of the land use rights upon the investment made in Su Song spinning mill and Wuzhou knitting mill.

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

The sales of the Group were evenly denominated in Hong Kong dollars, US dollars, Renminbi and EURO respectively while the purchases of Group were mainly made in Hong Kong dollars, US dollars and Renminbi. Most of the effect of the appreciation of the Renminbi against US dollars were naturally hedged through our PRC operations. Therefore, the exchange risk exposed arising from the Renminbi appreciation against US dollars was minimal to our Group. However, the fluctuations in the US dollars and Renminbi still always being concern of the Group and the Group will enter into appropriate hedging arrangements to mitigate the foreign currency risk should the need arises.

Stock turnover days

The stock turnover days of the Group for the year ended 31st December, 2006 was approximately 111 days as compared to 101 days last year. With the early start of the peak season in the coming year 2007, more raw material stock was piled up in the last quarter in 2006, resulting in slightly lengthened stock turnover days.

Sure Win International Textiles Limited

Debtors' turnover days

The debtors' turnover days was slightly improved by 2 days from last year's 70 days to this year's 68 days with the continuous tightened credit control on various customers. 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.

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 Board has recommended the payment of a final dividend of HK3.3 cents per share for the year ended 31st December, 2006 payable to shareholders whose name appear on the register of members on 8th May, 2007. Subject to the approval of the shareholders at the forthcoming annual general meeting, the total dividend for the year 2006 will be HK3.3 cents per share, which represented 20% payout of the profit for the year.

MAJOR CUSTOMERS AND SUPPLIERS

The Group's top five customers accounted for approximately 36.5% of the total sales in this year. The top five suppliers accounted for approximately 36.7% of the total purchases for the year under review. In addition, the Group's largest customer accounted for approximately 15.6% of the total sales and the Group's largest supplier accounted for approximately 12.9% of the total purchases for the year under review.

Save as disclosed in Note 39 to the consolidated financial statements, at no time during the year under review 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.