Management Discussion and Analysis

Operational and Financial Review

The Group is principally engaged in the manufacture and sale of knitted fabrics and dyed yarn. The Group purchases raw yarn and through a series of production processes including knitting, yarn dyeing, fabric dyeing and final processing to produce dyed yarn and fabric. To ensure stable production, the Group has established self-sufficient production facilities including a water supply plant, a sewage treatment plant and a power and steam generating plant to ensure 24-hour non-stop production at the manufacturing base in Panyu, the PRC. Most of the Group's products are supplied to garment manufacturers in various countries around the world for the production of branded casual wear which is ultimately supplied to major global retail chain stores.

During the year under review, the Group established a garment factory in Madagascar to diversify its business downstream. The factory mainly produces finished knitted garment to major global retail chain operators.

Revenue

For the financial year ended 31 December 2006, the Group recorded a revenue of HK$2,013.9 million (2005: HK$1,499.4 million), representing an increase of 34.3% in comparison to the previous financial year. The increase in revenue was mainly attributable to the increase in sales to the existing customers and new customers, together with the expansion of sale of dyed yarn.

Gross Profit

The gross profit of the Group for the year ended 31 December 2006 was HK$395.9 million (2005: HK$338.3 million), representing an increase of 17.0% in comparison to the previous year. The gross profit margin decreased from 22.6% in the previous year to 19.7% in the year under review. The decrease in gross profit margin was mainly due to the increase in outsourcing cost resulting from subcontracting part of the manufacturing processes to other fabric suppliers as a result of the strong orders received in 2006.

Net Profit

The Group's net profit attributable to shareholders for the financial year ended 31 December 2006 was HK$101.1 million (2005: HK$79.0 million), representing a year-on-year increase of 28.0%. Net profit margin for the year ended 31 December 2006 was 5.0% similar to last year (2005: 5.3%).

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Other Income and Expense

Other income of approximately HK$9.3 million was mainly comprised of HK$4.1 million in shipping and handling charges earned by Kam Hing International Shipping Limited and its subsidiaries. The remaining balance was primarily the result of rental income and the sale of scrap materials. Selling and distribution costs of HK$89.8 million consisted of HK$82.7 million in shipping and delivery costs, that represented a decrease of 4.3% in comparison to the previous year which is due to reduction of shipping charges and improvement in logistics flow. Administrative expenses, which includes salaries, depreciation and other related expenses, increased 16.5% year-on-year to HK$143.5 million. The increase was due to additional administrative staff and depreciation charges for the business expansion.

Finance costs, which mainly includes interest on long-term loans from banks, short-term trust receipt loans and finance lease interest, increased by 56.5% to HK$40.8 million (2005: HK$26.1 million) as compared with the previous year. This was primarily a result of the increase in working capital requirement due to the expansion of the Group's operations and the increase in debt financing for the investment in production equipment and production facilities.

Liquidity and Financial Resources

As at 31 December 2006, the Group had net current assets of HK$47.8 million (2005: HK$247.7 million). The reduction in net current assets was mainly attributable to the classification of the current portion of a term loan from banks due from 2007 to 2008. The Group will constantly review its financial position and maintains a healthy financial position by financing its operations from internally generated resources and long-term bank loans. As at 31 December 2006, the Group had cash and cash equivalents of HK$193.1 million (2005: HK$172.2 million). The current ratio of the Group was 1.0 times (2005: 1.4 times).

The total bank and other borrowings of the Group as at 31 December 2006 were HK$750 million (2005: HK$719.1 million), netting off the cash and cash equivalents of HK$193.1 million (2005: HK$172.2 million), the Group's net debt gearing ratio was approximately 69.7% (2005: 80.8%). Decrease in net debt gearing ratio was mainly due to the improvement of cash flow as a result of strengthened credit control.

Debtors' turnover period, inventory turnover period and creditors' turnover period for the year were 66.6 days (2005: 76.1 days), 87.6 days (2005: 92.8 days) and 86.8 days (2005: 69.5 days) respectively. The decrease in the debtors' turnover period was due to early settlement of some customers as a result of better credit control. The decrease in the inventory turnover period was attributable to the stringent inventory control during the year. The creditors' turnover period increased was due to longer credit days offered by some suppliers.

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Financing

As at 31 December 2006, the total banking and loan facilities of the Group amounted to HK$1,416.5 million (2005: HK$1,433.5 million), of which HK$672.7 million (2005: HK$678.4 million) was utilised.

As at 31 December 2006, the Group's long-term loans were HK$188.4 million (2005: HK$360.8 million) comprised of term loans from banks of HK$151.7 million (2005: HK$311.9 million) and long-term finance lease payable of HK$36.7 million (2005: HK$48.9 million). The decrease in long-term loan was mainly due to the shift of current portion of the term loans and finance lease to current liability as well as the repayment of the term loans and finance lease.

The Group's long-term bank loans comprised of loans drawn down by Kam Hing Piece Works Limited, 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 HK4.0 cents (2005: HK3.1 cents) per share in respect of the year ended 31 December 2006 to shareholders of record as of 28 May 2007. The decision is subject to approval by shareholders regarding the payment of the final dividend at the annual general meeting of the Company.

Capital Structure

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

76.3% (2005: 78.1%) 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 was denominated in US dollars, Hong Kong dollars and Renminbi. The Group has transactional currency exposures. Such exposure arise from substantial portion of sales or purchases by operating units in US dollars and RMB. The Group currently does not have a foreign currency hedging policy. However, the management monitors foreign exchange exposure and will consider hedging significant foreign currency exposure should the need arise.

All bank and other borrowings of the Group were denominated in US dollars and Hong Kong dollars on inter-bank borrowing interest rate and prime rate bases. The Board is of the opinion that the Group is not subject to any significant interest rate risk.

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Charge on Group's Assets

As at 31 December 2006, certain items of property, plant and equipment of the Group with an aggregate net book value of HK$194.6 million (2005: HK$191.1 million) were under finance leases.

Capital Expenditure

During the year under review, the Group invested HK$180.2 million (2005: HK$294.2 million) in property, plant and equipment, as well as prepaid land lease payments, of which 77.2% (2005: 68.5%) was used for the purchase of plant and machinery, 14.2% (2005: 18.3%) was used for the construction of new factory premises, 4.7% (2005: 7%) was used for the acquisition of pieces of land in preparation for future production capacity expansion and the remaining was used for the purchase of other property, plant and equipment.

As at 31 December 2006, the Group had capital commitments of HK$21.9 million (2005: HK$32.3 million) in property, plant and equipment, which are to be funded by net proceeds from internal resources.

Staff Policy

The Group had 4,050 (2005: 3,100) employees in the PRC, and 1,293 (2005: 107) employees in Hong Kong, Macau, Singapore and Madagascar as at 31 December 2006. 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 Mandatory Provident Fund Schemes 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 provide senior management an appropriate incentive package for the growth of the Group.

Management Discussion and Analysis

Contingent Liabilities

As at 31 December 2006, the Company had contingent liabilities in relation to guarantees given to banks to secure credit facilities granted to certain subsidiaries amounting to HK$672.7 million (2005: HK$678.4 million). The Group also had bills discounted with recourse of HK$103.3 million (2005: HK$30.6 million). The Group had a contingent liability in respect of possible future long service payments to employees with a maximum possible amount of HK$2.1 million (2005: HK$1.4 million).

Major Customers and Suppliers

In the year ended 31 December 2006, sales to the five largest customers accounted for 55.7% (2005: 53.5%) of the total sales and sales to the largest customer included therein accounted for 20.9% (2005: 21.6%).

Purchases from the five largest suppliers accounted for 37.2% (2005: 30.1%) of the total purchases for the year and purchases from the largest supplier included therein accounted for 9.5% (2005: 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 2006, sales to the four largest regions (Singapore, Taiwan, Hong Kong and the PRC (other than Hong Kong and Macau)) accounted for 89.4% (2005: 85%) of the total sales of the Group and sales to the largest region (Singapore) included therein accounted for 56.4% (2005: 51.3%) of the Group.

As at 31 December 2006, the Group's assets located in Hong Kong and the PRC (other than Hong Kong and Macau) accounted for 21.9% (2005: 24.2%) and 76.9% (2005: 75.7%) 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 2006 accounted for 92.1% (2005: 97.9%) of the total capital expenditure of the Group.