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 yarn dyeing, knitting, 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.

Revenue

For the financial year ended 31 December 2005, the Group recorded a turnover of HK$1,499.4 million (2004: HK$1,315.7 million), representing an increase of 14% in comparison to the previous financial year. The increase in turnover was mainly attributable to the sale of dyed yarn from the newly established yarn dye production line which commenced operations in September 2004 as well as an increase in sales in the PRC market.

Gross Profit

The gross profit of the Group for the financial year ended 31 December 2005 was HK$338.3 million (2004: HK$313.9 million), representing an increase of 7.8% in comparison to the previous year. The gross profit margin slightly decreased from 23.9% in the previous year to 22.6% in the current year. The slight decrease in gross profit margin was mainly attributable to the increase in outsourcing cost due to the Group subcontracted some of the manufacturing processes to other fabric suppliers as result of water and electricity shortages in 2005. In addition, the depreciation charge increased by 59.5% from HK$31.1 million in 2004 to HK$49.6 million in 2005 due to the addition of production facilities including a power and steam generating plant, production machinery and the construction of new factory complexes and other production facilities.

Net Profit

The Group's net profit attributable to shareholders for the financial year ended 31 December 2005 was HK$79 million (2004 (restated): HK$104.8 million), representing a year-on-year decrease of 24.6%. Net profit margin for the year ended 31 December 2005 was 5.3% (2004: 8.0%). The decrease in net profit margin compared with the previous year was principally attributable to the allowance for doubtful debt of HK$13 million (2004: 1.7 million) mainly from a previous customer in Singapore, and coupled with an increase in labour cost of 26.9% due to the newly established yarn dye operation and an increase in marketing staff to further develop new market opportunities in Asia and the PRC.

Management Discussion and Analysis

Other Income and Expense

Other income of approximately HK$8.5 million was mainly comprised of HK$4.3 million in shipping and handling charges earned by Kam Hing International Shipping Limited and its subsidiary. The remaining balance was primarily the result of rental income. Selling and distribution costs of HK$93.9 million consisted of HK$86.4 million in shipping and delivery costs, that represented an increase of 14.3% in comparison to the previous year which is in line with the increase in revenue. Administrative expenses, which includes salaries, depreciation and other related expenses, increased 19.8% year-on-year to HK$123.2 million. The increase was due to additional administrative staff and depreciation charges for expansion of yarn dye operations. Additional professionals were employed to enhance production and marketing functions as well as overall management of the Group.

During the year under review, the Group recorded allowance for doubtful debts of HK$13 million (2004: HK$1.7 million), which was mainly attributable to an allowance made against the outstanding receivable of HK$11.6 million from a customer in Singapore. Finance costs, which mainly includes interest on long-term loans from banks, short-term trust receipt loans and finance lease interest, increased by 64.3% to HK$26.1 million (2004: HK$15.9 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 2005, the Group had net current assets of HK$247.7 million (2004 (restated): HK$148.4 million). The Group maintains a healthy financial position by financing its operations from internally generated resources and long-term bank loans. As at 31 December 2005, the Group had cash and bank deposits of HK$174.3 million (2004: HK$124.8 million). The current ratio of the Group was 1.4 times (2004: 1.3 times).

As at 15 July 2005, the Group had successfully obtained a 3-year syndicated loan facility amounting to HK$305 million from a syndicate of eight international and local banks at an interest rate of HIBOR plus 0.7% per annum for supplying additional working capital, repaying a current bank loan and financing future expansion of production capacity. The syndicated loan facility could reduce interest expenses and strengthen the Group's financial position by funding long-term investment by long term financing.

The total interest bearing bank and other borrowings of the Group as at 31 December 2005 were HK$719.1 million (2004: HK$358.8 million), netting off the cash on hand of HK$174.3 million (2004: 124.8 million), the Group's net debt gearing ratio was approximately 80.4% (2004: 38.7%). Increase in net debt gearing ratio was mainly due to the recognition of discounted bills with recourse not supported by letters of credit of approximately HK$104.9 million as financial assets and liabilities of the Group in compliance with the new Hong Kong Accounting Standard ("HKAS") HKAS39, whilst the discounted bills with recourse not supported by letters of credit of HK$77.8 million was reflected as contingent liabilities of the Group as at 31 December 2004. For the purpose of comparison on the same basis as last year, the net debt gearing ratio as at 31 December 2005 was approximately 65% by excluding the discounted bills with recourse not supported by letters of credit of HK$104.9 million.

Management Discussion and Analysis

Debtors' turnover period, inventory turnover period and creditors' turnover period for the year were 76.1 days (2004: 53.7 days), 92.8 days (2004: 84.6 days) and 69.5 days (2004: 62.6 days) respectively. For the purpose of comparison on the same basis as last year, the debtors' turnover period for the year was 50.6 days, by excluding the discounted bills with recourse not supported by letters of credit of HK$104.9 million, which decreased slightly from 53.7 days in the previous financial year due to early settlement of some customers as a result of better credit control. The increase in the inventory turnover period from 84.6 days to 92.8 days was attributable to the increase in inventory in anticipation of the increase in production demand for the yarn dyeing and fabric dyeing. The creditors' turnover period increased slightly from 62.6 days to 69.5 days due to longer credit days offered by some suppliers.

Financing

As at 31 December 2005, the total banking and loan facilities of the Group amounted to HK$1,433.5 million (2004: HK$755 million), of which HK$627.6 million (2004: HK$429 million) was utilized.

As at 31 December 2005, the Group's long-term loans were HK$360.8 million (2004: HK$95.5 million) comprised of term loans from banks of HK$311.9 million (2004: HK$53.5 million) and long-term finance lease payable of HK$48.9 million (2004: HK$42 million). The increase in long-term loan was mainly due to addition of the syndicated loan of HK$305 million during the year, whilst the increase in long-term finance lease payable was attributable to the acquisition of machinery and other property, plant and equipment, which were principally financed by way of finance leases. The Group's long-term bank loans were comprised of loans drawn down by Kam Hing Piece Works Limited, a subsidiary of the Group, 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 HK3.1 cents per share in respect of the year ended 31 December 2005 to shareholders of record as of 29 May 2006. 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.

Management Discussion and Analysis

Foreign Exchange Risk and Interest Rate Risk

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 financial effect of RMB appreciation by 2% against US$ on 21 July 2005 to the Group is not significant as most of the Group's raw materials are purchased in US$. Since the exchange rate of US dollars, Hong Kong 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.

All bank 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.

Charge on Group's Assets

As at 31 December 2005, certain plant and machinery and motor vehicles of the Group with an aggregate net book value of HK$191.1 million (2004: HK$148.6 million) were under finance leases.

Capital Expenditure

During the year, the Group invested HK$294.2 million (2004: HK$261.1 million) in property, plant and equipment, as well as prepaid land lease payments, of which 68.5% (2004: 77.8%) was used for the purchase of plant and machinery, 18.3% (2004: 11.5%) was used for the construction of new factory premises, 7% (2004: Nil) was used for the acquisition of a piece of land in Enping, Guangdong Province, PRC, and the remaining was used for the purchase of other fixed assets.

As at 31 December 2005, the Group had capital commitments of HK$32.3 million (2004: HK$96.7 million) in property, plant and equipment, which are to be funded by net proceeds from internal resources.

Staff Policy

The Group had 3,100 (2004: 2,064) employees in the PRC, and 107 (2004: 118) employees in Hong Kong, Macau and Singapore as at 31 December 2005. 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.

Management Discussion and Analysis

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 participants, which is further explained under the heading "share option scheme" in note 27 to the financial statements, for the purpose of providing an appropriate incentive package for the growth of the Group.

Contingent Liabilities

As at 31 December 2005, the Company had contingent liabilities in relation to guarantees given to banks to secure credit facilities granted to certain subsidiaries amounting to HK$678.4 million (2004: HK$429 million). The Group also had bills discounted with recourse of HK$30.6 million (2004: HK$106.4 million).

Major Customers and Suppliers

In the year ended 31 December 2005, sales to the five largest customers accounted for 53.5% (2004: 60.9%) of the total sales and sales to the largest customer included therein accounted for 21.6% (2004: 30.8%).

Purchases from the five largest suppliers accounted for 30.1% (2004: 39.3%) of the total purchases for the year and purchases from the largest supplier included therein accounted for 6.9% (2004: 10.9%).

None of the Directors, their respective associates (as defined in the Rules (the "Listing Rules") Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Stock Exchange")) 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 2005, sales to the four largest regions (Singapore, Taiwan, Hong Kong and the PRC (other than Hong Kong and Macau)) accounted for 85.0% (2004: 84.3%) of the total sales of the Group and sales to the largest region (Singapore) included therein accounted for 51.3% (2004: 54.8%) of the Group.

As at 31 December 2005, the Group's assets located in Hong Kong and the PRC (other than Hong Kong and Macau) accounted for 24.2% (2004: 25.9%) and 75.7% (2004: 74%) 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 2005 accounted for 97.9% (2004: 97.7%) of the total capital expenditure of the Group.