

# BUSINESS

## INTRODUCTION

The Group is principally engaged in the manufacture and sale of yarn and grey fabrics. The Group is one of the largest cotton textile products manufacturers in the PRC. The Group's strategy is to remain competitive and create profits through the manufacture and sale of contemporary high value-added textile products. During the Track Record Period, the Group's main focus was on the promotion and sale of its spandex stretch yarn and spandex stretch grey fabrics. Sales of spandex stretch yarn and spandex stretch grey fabrics in aggregate represented approximately 31.1%, 65.7%, 74.7% and 74.6% of the Group's turnover during the Track Record Period. The Group also produces other types of yarn and fabrics. During the Track Record Period, the Group manufactured over 380 types of yarn products and over 2,900 types of fabric products. The Directors believe that the Group is regarded by its customers as a reputable manufacturer of high quality textile products.

Set out below is a summary of the Group's key financial results during the Track Record Period:

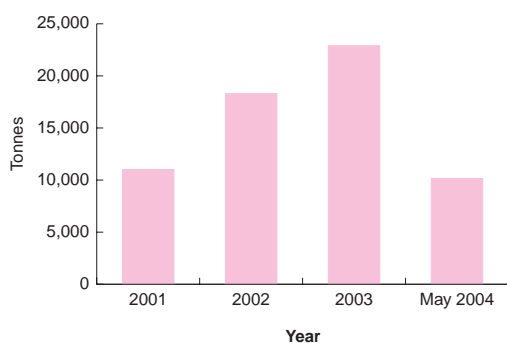
	<b>Year ended 31 December</b>			<b>Five months ended 31 May 2004</b>
	<b>2001</b>	<b>2002</b>	<b>2003</b>	
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Turnover	343,833	730,152	1,034,340	497,516
Gross profit	62,505	139,702	155,896	71,856
Profit for the year/period	49,935	106,803	84,838	47,572

The Group has facilitated its rapid expansion and growth through low cost acquisition and upgrading of production facilities of state-owned enterprises put into liquidation. Since commencement of its business, the Group has expanded its production capabilities by successfully acquiring fixed assets and factory premises of four state-owned enterprises, namely Taizhou No. 2 Weaving Factory, Suining Cotton, Rudong Textile and Feng County Textile, which were put into liquidation. Details of these acquisitions are disclosed in the subsection headed "History and development" under the section headed "Business" of this prospectus. Acquisitions of these assets also enabled the Group to absorb skilled labour on a selective basis from these enterprises who had been made redundant, thus saving the Group tremendous training time. In addition, the Directors consider expansion by means of acquisition is more economical as (1) lower capital is required so the rate of return is higher; and (2) shorter time and less management efforts are required to achieve desirable production capacity and accordingly, the management can focus on product and market development. In addition to acquiring assets from enterprises which were put into liquidation, new production facilities and equipment were also added. By a series of acquisitions, the Group has increased its production capacity as well as enhanced the breadth of its products, to cope with the increasing demand for the Group's products and products development plans.

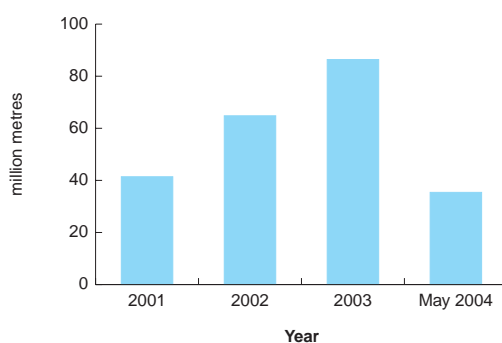
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The Group currently has a textile manufacturing base comprising eight production plants, with a total floor area of about 218,000 sq.m. in Xuzhou, Taizhou and Nantong in Jiangsu Province and Jinhua in Zhejiang Province. As at 31 May 2004, the Group had installed over 179,000 spindles, over 600 air-jet looms and over 650 shutters in its factories. Set out below is the Group's actual production volume during the Track Record Period:

**Yarn Production Volume**



**Fabrics Production Volume**



The Group's sales and marketing function is centralised and carried out by the sales and marketing team. The sales and marketing team focuses its effort on the agglomeration of textile enterprises in Zhejiang, Jiangsu, Guangdong and Shandong Provinces which, according to the China Textile Industry Development Report 2003/2004, together accounted for approximately 70.2% of the total PRC textile product sales in 2003. As at the Latest Practicable Date, the Group had over 1,100 PRC customers and over 100 overseas customers.

The Directors believe that continuous and innovative product development is important for the Group to maintain its competitiveness in the textile industry in the PRC. The Group constantly engages in market research to keep abreast of the latest clothing and textile trend. The Group and its customers frequently work together to jointly develop new yarn and fabrics. The Group also regularly consults its suppliers on the latest fiber, spandex, and other raw materials development and their applications. Furthermore, the Group jointly develops new materials with renowned material suppliers to build up its product inventory. The Directors believe its strategic relationships with its customers and suppliers can provide valuable insights into the textile and clothing industry and the Group gains knowledge of new production techniques through the product development process. Accordingly, the Group is well positioned to identify the upcoming trend in yarn and fabrics and react properly to changes in market demand for textile products.

The Directors believe that the Group has established a market position as a manufacturer of high quality textile products, especially in stretch textile products. It is believed that the PRC economy will continue to grow in the next decade, which will in turn create a strong domestic demand for contemporary and high quality garment products. Furthermore, the Directors believe the PRC's entry into the WTO and the cancellation of the quota system on 1 January 2005 provide significant growth opportunities for the Group, in particular in the export market even though the PRC's export of textile products will continue to be subject to certain restrictions. The Directors believe that the Group, as a textile material supplier, is likely to benefit from these developments.

## STRENGTHS OF THE GROUP

The Directors consider the principal strengths of the Group are as follows:

### **Specialising in contemporary and high value-added products and its new product development capacity**

The Directors believe that the Group has established a market position as one of the leading manufacturers of high quality textile products, in particular spandex stretch yarn and spandex stretch fabrics, which enjoy higher profit margins than traditional cotton yarn and fabric. The Directors believe, by focusing on product development, manufacturing and sales of new, high quality and high value-added yarn and grey fabrics, the Group will continue to enjoy a rapid business growth and generate a higher financial return than other textile manufacturers supplying traditional textile products.

### **Capital cost competitive advantage**

The Group's management has established a track record of building production facilities with relatively low capital investments through: (i) acquisitions of the fixed assets and factory premises of existing textile factories and upgrading of the production facilities by installing new machineries in the acquired factories; (ii) reallocation of selected employees of the Group to manage the new production facilities; and (iii) improving production efficiency and quality of the employees in the acquired factory, improving the production capacity through staff training. The Directors believe that, by adoption of such buy-and-build approach in expanding the Group's production capacity, the Group is able to expand its production capacity rapidly with low capital investments.

### **Adaptability and operating efficiency**

The Directors believe that the Group's production team and sales and marketing team can react efficiently to changing market conditions and customer demand. Accordingly, the Directors believe the Group could effectively adapt product and technical adjustments according to the changes in market and the customers' needs. The Group is able to produce sample yarn products in two days and sample fabric products in seven days.

Textile manufacturing is a capital intensive industry. The Directors believe that high utilisation rate of the production facilities is essential to reduce the unit cost of the products and allows the Group to remain competitive. The production facilities of the Group operate 24 hours a day with three shifts and on average, the Group is able to operate its production facilities at a utilisation rate of over 89% for both yarn and fabric products for the five months ended 31 May 2004.

The Group purchases its raw materials through its centralised purchasing team, which in turn distributes the raw materials to different plants. The Directors believe that such arrangement could effectively reduce the unit cost of raw materials and the administration cost of the Group.

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### **Consistent high quality products and stringent quality control**

The Group has adopted stringent quality control measures in each of its production processes. The Group has obtained several accreditations and quality certificates for its quality control system, details of these certificates are set out in the subsection headed "Quality control" under the section headed "Business" of this prospectus. During the Track Record Period, the Group's yarn products were produced at an Uster Statistics of 25-5% and the Group's fabrics products were produced under the Four Points System of the United States.

### **Broad customer base**

The Group has developed a broad customer base of over 1,200 customers. The Group has been able to establish and maintain good business relationships with its customers. The Directors believe that the Group will be able to leverage on its broad customer base in launching new products.

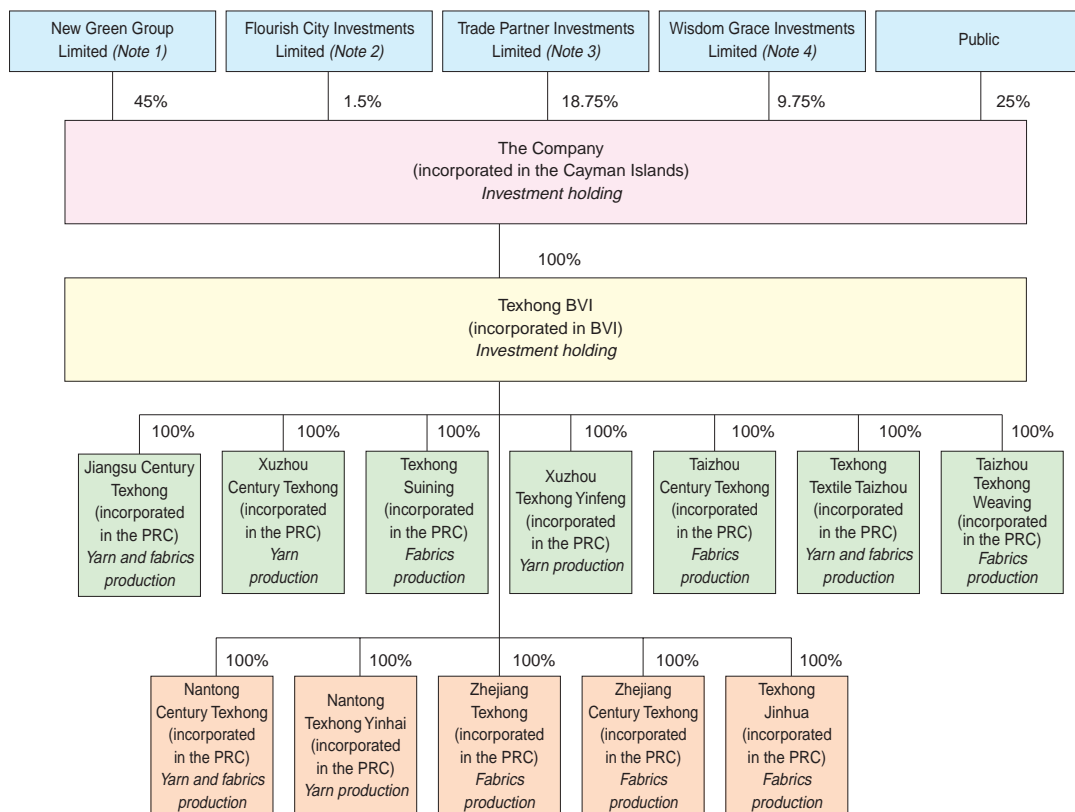
### **Experienced management team and lean and flexible management structure**

The Group adopts a lean management structure to ensure that management information can be passed on effectively and in a timely manner and management decisions can be implemented efficiently. The Group's management team has extensive experience in manufacturing and sales of textile products. They have also demonstrated the ability to open up markets of highly profitable products, improve the quality of the Group's products and expand the sales networks of the Group. The senior management of the Group also has extensive experience in acquiring suitable assets from state-owned enterprises which were put into liquidation. The Directors believe that, with the support of its experienced management team, the Group will be able to further enhance its leading position in the contemporary textile material market through scalable expansion of its business operations.

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## CORPORATE STRUCTURE

Set out below are the members of the Group and their respective principal businesses, and the shareholding structure of the Group immediately after the completion of the Share Offer and the Capitalisation Issue (assuming that the Over-allotment Option is not exercised and without taking into account the exercise of options granted or which may be granted under the Pre-IPO Share Option Scheme and the Share Option Scheme):



### Notes:

1. New Green Group Limited is a company incorporated in the BVI, the entire issued share capital of which is owned by Hong Kong Tin Hong. The entire issued share capital of Hong Kong Tin Hong is in turn beneficially owned by Mr. Hong.
2. Flourish City Investments Limited is a company incorporated in the BVI, the entire issued share capital of which is equally owned by Mr. Hong Xinbei and Mr. Hong Zhiliang, both are brothers of Mr. Hong.
3. Trade Partner Investments Limited is a company incorporated in the BVI, the entire issued share capital of which is owned as to 50.64% by Mr. Hong, as to 41.36% by Mr. Zhu Yongxiang 2.24% by Mr. Sha Tao, 1.68% by each of Messrs. Tang Daoping, Gong Zhao and Hu Zhiping and 0.36% by each of Messrs. Yin Jianhua and Zhang Chuanmin.
4. Wisdom Grace Investments Limited is a company incorporated in the BVI, the entire issued share capital of which is owned by Mr. Zhu Yongxiang.

## HISTORY AND DEVELOPMENT

The Group commenced its business when Mr. Hong established Hong Kong Tin Hong in Hong Kong in August 1997.

On 20 October 1997, the Group established Texhong Textile Taizhou. At that time, the Group rented part of the premises and machineries of Taizhou No. 2 Weaving Factory, a state-owned enterprise established in 1956 and an Independent Third Party, to engage in the sales and manufacturing of non-stretch grey fabrics. To the knowledge of the Directors, Taizhou No. 2 Weaving Factory had been scaling down its operations before it entered into the lease arrangement with the Group. Accordingly, the Directors believed that the lease arrangement enabled Taizhou No. 2 Weaving Factory to generate income from idle assets and provide employment to staff who would otherwise become redundant. Starting from 1999, Texhong Textile Taizhou also produced spandex stretch grey fabrics.

On 4 January 1998, the Group established Texhong Jinhua. The Group rented part of the premises and machineries of 浙江省浦江紡織總廠 (Zhejiang Province Pujiang Textile Head Factory) to engage in the sales and manufacturing of non-stretch grey fabric in Zhejiang Province. In 1999, Texhong Jinhua commenced production of spandex stretch grey fabric.

On 26 June 1998, to further expand its business, the Group established Texhong Suining. The Group rented part of the production facilities of Suining Cotton, a state-owned enterprise established in 1958 and an Independent Third Party, to produce non-stretch grey fabrics. To the knowledge of the Directors, similar to the lease arrangement with Taizhou No. 2 Weaving Factory, Suining Cotton had been scaling down its operations before it entered into the lease arrangement with the Group. Accordingly, the Directors believed that the lease arrangement enabled Suining Cotton to generate income from idle assets and provide employment to staff that would otherwise become redundant. In 1999, Texhong Suining started to produce spandex stretch grey fabrics.

Prior to April 1999, the Group's grey fabrics are sold in the domestic market. The Group began to export grey fabrics in April 1999.

In April 1999, the Group began the sale of garment fabrics in the PRC market and subsequently in May 2000, it began to export garment fabrics to overseas customers.

On 18 May 2000, the Group established a sino-foreign joint venture, Zhejiang Texhong, with Pujiang Xintian. Pujiang Xintian is a limited liability company established in the PRC and is owned as to 96.7% by Mr. Hong Xinbei, brother of Mr. Hong, and 3.3% by Mr. Hong Jingang, brother-in-law of Mr. Hong. Zhejiang Texhong was then owned as to 53.73% by Pujiang Xintian and 46.27% by the Group. On 17 May 2000, Zhejiang Texhong purchased a piece of land with a site area of approximately 41,065 sq.m. to construct its production facilities. Pursuant to an equity transfer agreement dated 28 February 2002, the Group acquired the 53.73% equity interest in Zhejiang Texhong held by Pujiang Xintian at a consideration of RMB5 million, which was determined by reference to the investment amount contributed by Pujiang Xintian less the dividends paid to it by Zhejiang Texhong and Zhejiang Texhong has since become a wholly-owned foreign enterprise. Zhejiang Texhong is principally engaged in the manufacture of stretch and non-stretch grey fabrics.

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In September 1999, to the knowledge of the Directors, as a result of losses incurred, Suining Cotton was declared bankrupt. As the Group has rented part of the production facilities of Suining Cotton since June 1998, the Group decided to take this opportunity to implement its low-cost expansion strategy by acquiring the fixed assets at workable conditions and land use rights from Suining Cotton. The Group established a wholly-owned foreign enterprise, Jiangsu Century Texhong (formally known as 江蘇新天紡織有限公司), on 6 June 2000 to pursue this acquisition. After its establishment, Jiangsu Century Texhong acquired the existing production facilities, including yarn spinning mill and fabric weaving mill which were equipped with 52,344 spindles and 408 shuttles, and a piece of land with a total site area of approximately 85,739.7 sq.m. from Suining Cotton at an aggregate consideration of RMB51 million, which was determined by reference to the then valuation of the acquired assets. As part of the acquisition and pursuant to the terms of the acquisition agreement, the Group employed 2,022 of the then employees of Suining Cotton, and to make up the Group in connection therewith, the Group was only required to pay RMB34,824,000. Subsequent to the acquisition, Jiangsu Century Texhong leased part of the production facilities to Texhong Suining for the continuance of its weaving operation and Jiangsu Century Texhong used the remaining part of the production facilities to start its spinning operation.

On 22 June 2000, to the knowledge of the Directors, as a result of losses incurred, Taizhou No. 2 Weaving Factory, the enterprise which leased part of its production facilities to the Group since October 1997, was declared bankrupt. The Group decided to acquire the fixed assets at workable conditions and land use rights from Taizhou No. 2 Weaving Factory. The Group established a wholly-owned foreign enterprise Taizhou Texhong Weaving on 15 November 2000 to pursue this acquisition. Taizhou Texhong Weaving purchased production plant, machineries which mainly included 72 air-jet looms and 592 shuttles and the land use rights of a piece of land with a total site area of 23,005.2 sq.m. of Taizhou No. 2 Weaving Factory at an aggregate consideration of RMB19.5 million, which was determined by reference to the then valuation of the acquired assets. As part of the acquisition and pursuant to the terms of the acquisition agreement, the Group employed 791 of the then employees of Taizhou No. 2 Weaving Factory, and to make up the Group in connection therewith, the Group was only required to pay RMB11,748,200. Of the production facilities acquired, 500 weaving machines were rented to Texhong Textile Taizhou so that Texhong Textile Taizhou can continue its weaving operation.

In April 2002, the Group established a wholly-owned foreign enterprise Taizhou Century Texhong in Jiangsu Province, which, in July 2002, purchased a site with a total area of 151,599.4 sq.m. in 江蘇省泰州市經濟開發區高新技術園 (High-tech Economic Development Zone, Taizhou, Jiangsu Province) at a consideration of approximately RMB26.3 million from 泰州國土資源局 (The Bureau of State Land Resources, Taizhou) to build a new production facility with an aggregate gross floor area of 24,889.3 sq.m. Taizhou Century Texhong also imported 162 air-jet looms from Japan and purchased 126 air-jet looms from Taizhou Texhong Weaving used for the production of spandex stretch grey fabrics.

On 10 May 2002, the Group established a wholly-owned foreign enterprise Zhejiang Century Texhong. Zhejiang Century Texhong is responsible for processing grey fabrics produced by Zhejiang Texhong.

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On 27 June 2002, the Group established a wholly-owned foreign enterprise Nantong Century Texhong to purchase the assets, including machineries, production plant and the land use rights of a site of 59,233.28 sq.m. of Rudong Textile, an Independent Third Party which went into bankruptcy, at a consideration of RMB30 million, which was determined by reference to the then valuation of the acquired assets. Rudong Textile was a state-owned enterprise and to the knowledge of the Directors, was declared bankrupt in year 2002 due to losses incurred.

On 13 January 2003, the Group established a wholly-owned foreign enterprise Xuzhou Century Texhong which rented a factory with a total floor area of approximately 11,100 sq.m. and purchased 16,800 spindles from Jiangsu Century Texhong for its production of spandex stretch yarn.

On 30 April 2004, the Group established a wholly-owned foreign enterprise Xuzhou Texhong Yinfeng which acquired the assets, including machineries, production plant and the land use rights of a piece of land with a total site area 59,308.9 sq.m. of Feng County Textile, an Independent Third Party which went into bankruptcy in year 2000, at an aggregate consideration of approximately RMB28 million, which was determined by reference to the then valuation of the acquired assets. Xuzhou Texhong Yinfeng is principally engaged in the manufacture of spandex stretch yarn.

During year 2000 to 2004, as stated above, the Group had expanded its manufacturing facilities principally through acquisition of fixed assets and factory premises from the four state-owned enterprises which were put into liquidation, namely Suining Cotton, Taizhou No. 2 Weaving Factory, Rudong Textile and Feng County Textile. For each acquisition, the Group acquired the assets from the relevant bankrupt state-owned enterprise at a cost lower than the then market value (being the value of the assets revalued by professional bodies at the time of the sale or acquisitions). The Group only acquired the assets and retained part of the labour from the bankrupt state-owned enterprises without acquiring their relevant current assets or liabilities, any products know-how, customer and supplier relationships associated with those state-owned enterprises. After each acquisition, the Group sent its experienced management team to take control of the daily operation, introduced new management policy to improve the production efficiency and product quality, to train the retained management and staff and to decide the new market positioning. These acquisitions were part of the Group's expansion strategy and sales orders from the Group's then existing facilities had been directed to these acquired production facilities shortly after acquisitions. As a result, the Group was able to turnaround the operations of these bankrupt state-owned enterprises and achieve profit for these production facilities after the relevant acquisition.

On 20 May 2004, the Group established a wholly-owned foreign enterprise Nantong Texhong Yin Hai which acquired the business of Nantong Shuanghong at a consideration of approximately RMB6.76 million, which was determined by reference to the net book value of the fixed assets and inventories acquired. The acquisition was funded by the Group's internally generated resources. Nantong Shuanghong was established in April 2002 and was engaged in double framing of yarn which is an integral part of yarn manufacturing. Nantong Shuanghong was owned as to 50% by Mr. Hong Weihe, father of



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Mr. Hong, 20% by Mr. Zhu Yongxiang, 20% by Mr. Sha Yunlong and 10% by Mr. Hu Jianhua. Prior to the acquisition, Nantong Shuanghong was a subcontractor of the Group. The Directors believed that the acquisition of Nantong Shuanghong would allow the Group a greater control of its production process and hence an assurance for product quality. Please refer to Appendix II to this prospectus for details about the financial position of Nantong Shuanghong as at 31 May 2004 and its operating results for the year ended 31 December 2003.

On 12 July 2004, the Company was incorporated in the Cayman Islands with limited liability and became the holding company of Texhong BVI as a result of the Reorganisation. Details of the Reorganisation are set out in the sub-paragraph headed “Group reorganisation” under the section headed “Further information about the Company and its subsidiaries” in Appendix VII to this prospectus.

As advised by Junhe Law Office, the PRC legal advisers to the Company and confirmed by the Directors, the Group has obtained all licenses, certificates and permits that are necessary under the relevant rules and regulations for carrying on its business in the PRC.

### PRODUCTS

The Group’s products can be broadly categorised into yarn, grey and garment fabrics and other textile products. Set out below is a breakdown of the Group’s turnover by principal products during the Track Record Period:

#### (i) Sales amounts by product

	Year ended 31 December						Five months ended 31 May	
	2001		2002		2003		2004	
	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000	%
<b>Yarn</b>								
Spandex stretch yarn	9,307	2.7	116,863	16.0	273,870	26.5	122,446	24.6
Other yarn	111,314	32.4	119,073	16.3	87,804	8.5	40,623	8.2
	<u>120,621</u>	<u>35.1</u>	<u>235,936</u>	<u>32.3</u>	<u>361,674</u>	<u>35.0</u>	<u>163,069</u>	<u>32.8</u>
<b>Grey fabrics</b>								
Spandex stretch grey fabrics	97,758	28.4	362,600	49.7	498,134	48.2	248,671	50.0
Other grey fabrics	86,078	25.0	62,077	8.5	92,058	8.9	32,278	6.5
	<u>183,836</u>	<u>53.4</u>	<u>424,677</u>	<u>58.2</u>	<u>590,192</u>	<u>57.1</u>	<u>280,949</u>	<u>56.5</u>
<b>Garment fabrics</b>	33,896	9.9	66,369	9.1	79,806	7.7	45,323	9.1
<b>Other textile products</b>	5,480	1.6	3,170	0.4	2,668	0.2	8,175	1.6
<b>Total</b>	<u><u>343,833</u></u>	<u><u>100.0</u></u>	<u><u>730,152</u></u>	<u><u>100.0</u></u>	<u><u>1,034,340</u></u>	<u><u>100.0</u></u>	<u><u>497,516</u></u>	<u><u>100.0</u></u>

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### (ii) Sales volume by product

	Year ended 31 December			Five months ended
	2001	2002	2003	31 May 2004
<b>Yarn (in tonnes)</b>				
Spandex stretch yarn	307	5,569	12,492	5,075
Other yarn	7,676	8,358	6,077	2,172
	<u>7,983</u>	<u>13,927</u>	<u>18,569</u>	<u>7,247</u>
<b>Fabrics (in million metres)</b>				
Spandex stretch grey fabrics	12.2	41.7	55.2	25.3
Other grey fabrics	26.0	21.8	22.9	7.0
Garment fabrics	2.8	4.4	5.9	3.1
	<u>41.0</u>	<u>67.9</u>	<u>84.0</u>	<u>35.4</u>

### Yarn

#### *Spandex stretch yarn*

Spandex stretch yarn is a yarn made by twisting textiles fibers around a continuous strand of spandex and concealing the core. The spandex in the core provides the yarn with elasticity. Spandex stretch yarn has the ability to stretch to a significant degree when tension is applied and restored to its original shape when the tension is released. During the Track Record Period, the Group had produced approximately over 210 types of spandex stretch yarn. The Group's main spandex stretch yarn products include polyester and rayon blended stretch yarn, rayon stretch yarn, combed cotton yarn and carded cotton yarn.

During the Track Record Period, sale volume of spandex stretch yarn was approximately 307 tonnes, 5,569 tonnes, 12,492 tonnes and 5,075 tonnes respectively. The Group's spandex stretch yarn were sold to fabric weaving mills, denim manufacturers and trading agents in the Jiangsu, Zhejiang, Guangdong and Shandong Provinces.

#### *Other yarn*

Yarn is a continuous strand of textile fibre, filament or material in a form suitable for knitting, weaving or otherwise intertwining to form a textile fabric. During the Track Record Period, except for spandex stretch yarn, the Group had also produced over 170 types of yarn. The Group's other yarn products mainly include polyester and rayon blended yarn, spun rayon yarn and cotton slubby yarn.

During the Track Record Period, sales volume of other yarn was approximately 7,676 tonnes, 8,358 tonnes, 6,077 tonnes and 2,172 tonnes respectively. The Group's other yarns were sold to fabric weaving mills and trading companies in the PRC.

For each of the three years ended 31 December 2003 and the five months ended 31 May 2004, in terms of tonnage, approximately 28%, 22%, 20% and 30% of yarn produced by the Group were used internally to produce grey fabrics products. The remaining portion of yarn was sold to independent customers.

### **Fabrics**

#### *Spandex stretch grey fabrics*

Spandex stretch grey fabrics are spandex stretch fabrics in the condition in which they leave the loom or knitting machine, before any bleaching, dyeing or finishing treatment has been given to them. Spandex stretch grey fabrics can be divided into three main types: two-way stretch, stretch in warp and stretch in weft. Two-way stretch is a woven or knit fabric with elastic properties in both directions, this is produced by weaving spandex yarn together. Stretch in warp is a woven fabric with elastic properties in the warp direction, this is produced by weaving spandex yarn in the warp together with non-stretch fabrics in the weft. Stretch in weft refers to a woven fabric with elastic properties in the weft direction, which is produced by using spandex yarn in the weft and other non-stretch fabrics. During the Track Record Period, the Group had produced over 1,900 types of spandex stretch grey fabrics. The measurement of the elasticity of the fabric depends on the percentage and specification of spandex fiber and the way it is knitted or woven into fabric. The Group's spandex stretch grey fabrics mainly include stretch grey fabrics with spandex and polyester and rayon blended stretch grey fabrics with spandex.

During the Track Record Period, sales volume of spandex stretch grey fabrics was approximately 12.2 million metres, 41.7 million metres, 55.2 million metres and 25.3 million metres respectively. The Group's spandex stretch grey fabrics were sold to printing and dyeing factories and trading agents in the Jiangsu, Zhejiang, Guangdong Provinces and other overseas countries.

#### *Other grey fabrics*

Other grey fabrics include fabrics without spandex, in the form before any bleaching, dyeing or finishing has been applied to it. During the Track Record Period, apart from spandex stretch grey fabrics, the Group had also produced over 530 types of other grey fabrics. The Group's other grey fabrics include cotton kahaki grey fabrics, cotton poplin grey fabrics, satin grey fabrics, dobby grey fabrics and interweaved grey fabrics.

During the Track Record Period, sales volume of other grey fabrics was approximately 26.0 million metres, 21.8 million metres, 22.9 million metres and 7.0 million metres respectively. The Group's other grey fabrics were sold to printing and dyeing factories and trading agents in the PRC.

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### *Garment fabrics*

Garment fabrics are fabrics that have been bleached, dyed and finished and can be used directly for the production of garment. During the Track Record Period, the Group had produced approximately 520 types of garment fabrics.

The Group's garment fabrics were mainly sold to overseas garment manufacturers and trading agents. During the Track Record Period, the Group mainly outsourced the printing and dyeing process on its grey fabrics to printing and dyeing companies. Grey fabrics which had been processed by these printing and dyeing companies i.e. garment fabrics would then be sold to the Group's customers. The Group did not incur outsourcing fee for the year ended 31 December 2001. Total outsourcing fees incurred by the Group for printing and dyeing processes to independent printing and dyeing companies for each of the two years ended 31 December 2003 and the five months ended 31 May 2004 amounted to approximately RMB31.6 million, RMB30.7 million and RMB13.1 million respectively.

### **Other textile products**

Other textile products sold by the Group mainly include extra raw materials and side products produced during the production process.

### **SALES AND MARKETING**

The Group's sales and marketing functions are centralised and carried out by the centralised sales and marketing team. This centralised sales and marketing team is further divided into three groups specialising in sales and marketing for different types of products, namely (i) yarn, (ii) grey fabrics and (iii) garment fabrics. The centralised sales and marketing team is responsible for formulating marketing and pricing strategy and overall sales planning for the Group. The senior management team is responsible for developing the Group's overall strategy, coordinating the sales and marketing and production planning functions as well as product development. The Group's technical production staff and quality control staff are to assist the sales and marketing teams to serve and liaise with the Group's customers. Upon receiving a sales order, the central sales and marketing team will negotiate with the customers directly and determine whether the sales order should be accepted and if so, the contract terms including price and delivery time based on the Group's production schedule, overall sales conditions and market conditions. Each production facility will enter into sales agreements with its customers according to the terms determined by the central sales and marketing team.

The Group's sales and marketing teams are responsible for marketing the Group's products to existing and potential customers and obtaining feedback from customers in respect of the quality of the products and services provided by the Group. The Group's market development and product development are two major components of its overall expansion strategy. The Directors believe it is important to enhance the Group's product development capability and to produce high quality distinctive textile products to maintain and develop its customer base. The Directors believe by maintaining a strong customer base, the Group can stay competitive in the industry.

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In order to promote its products and to keep abreast of any development in the textile and garment industry, the Group has participated in a number of textile, cotton and clothing conferences and exhibitions in the PRC and overseas such as the Chinese Export Commodities Fair, Autumn 2003, Interstoff Asia Autumn 2003 in Hong Kong and Inter-Textile Shanghai Apparel Fabrics Expo in Shanghai in 2003.

The Group has also placed advertisements in various publications of a textile industry magazine and websites to promote the products of the Group and to improve its corporate status in the textile industry.

Apart from the centralised sales and marketing team, the Group also has a branch in Shanghai. The Group has sales and marketing personnels stationed in Guangzhou (Guangdong Province), Shaoxing (Zhejiang Province) and Binzhou (Shandong Province). These sales personnels are responsible for providing after-sales and follow-up services and co-ordinating and managing the Group's sales network in the Guangdong, Zhejiang and Shandong Provinces respectively. The sales network of the Group currently covers 16 provinces and municipalities in the PRC.

As at the Latest Practicable Date, the Group had 9 sales and marketing personnel working in the yarn team, 11 personnel working in the grey fabric sales and marketing team and 27 sales personnel working in the garment fabric sales and marketing team.

During the Track Record Period, the Group did not appoint nor had any arrangements with external sales representatives, trading agents and distributors for the distribution of the Group's products.

Most of the Group's products were sold domestically in the PRC, mainly in the Jiangsu, Zhejiang, Guangdong and Shandong Provinces, during the Track Record Period. The Group's customers included fabric traders, fabric mills, printing and dyeing factories and garment manufacturers located in about 16 provinces and municipalities in the PRC. For the three years ended 31 December 2003 and the five months ended 31 May 2004, domestic sales accounted for approximately 95.9%, 95.1%, 93.0% and 90.4% of the Group's total sales while the remaining represented exports to overseas countries such as European countries, North America, Hong Kong and South Korea. Garment fabrics accounted for approximately 36%, 64%, 73% and 73% of the Group's export sales for each of the three years ended 31 December 2003 and the five months ended 31 May 2004 respectively, and grey fabrics accounted for substantially all of the balance of export sales. Since all of the subsidiaries of the Company are wholly-owned foreign enterprises, they are entitled to export their products without the requirement of obtaining export rights or certificates. All export sales recorded by the Group during the Track Record Period were direct sales to overseas customers. Sales to import and export companies in the PRC during the Track Record Period were recorded as domestic sales.

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Set out below is a breakdown of the Group's sales by geographical locations during the Track Record Period:

	Year ended 31 December						Five months ended 31 May	
	2001		2002		2003		2004	
	<i>RMB'000</i>	%	<i>RMB'000</i>	%	<i>RMB'000</i>	%	<i>RMB'000</i>	%
Jiangsu	272,325	79.2%	333,822	45.7%	362,672	35.1%	183,304	36.8%
Zhejiang	21,258	6.2%	265,949	36.5%	367,567	35.5%	154,616	31.1%
Guangdong	11,926	3.5%	25,562	3.5%	89,629	8.7%	45,236	9.1%
Shandong	7,920	2.3%	22,603	3.1%	39,895	3.9%	20,208	4.1%
Shanghai	6,385	1.9%	10,319	1.4%	41,476	4.0%	21,186	4.3%
Other provinces	9,785	2.8%	35,934	4.9%	60,325	5.8%	24,973	5.0%
Domestic subtotal	329,599	95.9%	694,189	95.1%	961,564	93.0%	449,523	90.4%
Export	14,234	4.1%	35,963	4.9%	72,776	7.0%	47,993	9.6%
<b>Total</b>	<b>343,833</b>	<b>100.0%</b>	<b>730,152</b>	<b>100.0%</b>	<b>1,034,340</b>	<b>100.0%</b>	<b>497,516</b>	<b>100.0%</b>

### Customers

The Group's customers include yarn or fabric traders, fabric weaving mills, printing and dyeing factories and garment manufacturers. As at the Latest Practicable Date, the Group had over 1,200 customers, of which over 1,100 were PRC customers and 100 were overseas customers. The Group's strategy is to focus on renowned medium to large-sized customers as the Directors believe these customers are willing and have the ability to pay premium prices for the Group's high quality products. Also, this type of customers usually have better credit profile.

For each of the three years ended 31 December 2003 and the five months ended 31 May 2004, sales to the five largest customers accounted for approximately 22.6%, 29.3%, 16.2% and 17.8% of the Group's turnover respectively. During the same period, sales to the largest customer accounted for approximately 5.7%, 12.5%, 3.7% and 4.2% respectively of the Group's turnover. As at the Latest Practicable Date, the five largest customers had established a stable business relationship with the Group. The Directors consider that the Group has established a good relationship with its customers. The Directors believe that such relationships will continue in the future.

The Directors confirm that as at the Latest Practicable Date, none of the Directors, their respective associates or, so far as the Directors are aware, any Shareholders who own 5% or more of the issued Shares of the Company immediately following the completion of the Share Offer and the Capitalisation Issue (taking no account of any Shares which may be taken up under the Share Offer or upon exercise of the Over-allotment Option)

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had any interests in any of the five largest customers of the Group during the Track Record Period.

### Credit policy

The Group offers credit terms for domestic customers from cash on delivery to 90 days while export sales are settled primarily by letters of credit or telegraphic transfer. According to the Directors, although certain customers have credit term of “cash on delivery”, at times, they did not settle the payment upon delivery. If the customers are recurring customers with good creditability, the Group normally grants a grace period of one month for these customers to settle the balance. The Group’s accounting department reviews the Group’s receivable aging monthly and they would inform the responsible sales personnel to follow up with the overdue trade receivable balances. Sales personnel would then contact the customers directly to chase for settlements. Unless payments were received or payment schedules were agreed with customers, no further credit sales would be made to the customers. The average debtors turnover days as at the end of each of the three years ended 31 December 2003 and as at 31 May 2004 were approximately 25 days, 41 days, 37 days and 32 days respectively. The Group’s bad debt provision policy is to provide specific provision for specially identified bad debt and full provision for all accounts receivable aged over one year. The Group had not experienced significant bad debt problems during the Track Record Period.

During the Track Record Period, the Group’s domestic sales were settled in Renminbi and export sales were settled in US dollars.

### Seasonality

The Group’s sales are subject to seasonality, sales are generally higher in the fourth quarter while lower during the first quarter. An analysis of the Groups sales by quarterly period for the three years ended 31 December 2003 is as follows:

	<b>Year ended 31 December</b>					
	<b>2001</b>		<b>2002</b>		<b>2003</b>	
	<i>RMB'000</i>	%	<i>RMB'000</i>	%	<i>RMB'000</i>	%
January-March	58,053	16.9%	125,128	17.1%	225,620	21.8%
April-June	80,143	23.3%	177,823	24.4%	245,390	23.7%
July-September	94,048	27.3%	200,705	27.5%	254,250	24.6%
October-December	111,589	32.5%	226,496	31.0%	309,080	29.9%
	<u>343,833</u>	<u>100.0%</u>	<u>730,152</u>	<u>100.0%</u>	<u>1,034,340</u>	<u>100.0%</u>

### RAW MATERIALS

The principal raw materials used in the production of the Group’s yarn is cotton, spandex, rayon and polyester and the principal raw material used in the production of fabrics is yarn.

## **Cotton**

The Group mainly uses domestic cotton and American cotton. Different types of cotton vary in colour and texture, thus providing each type of cotton with different characteristics. The Group aims to blend such mixture of domestic and American cotton to optimise the product quality while minimising purchase costs.

For each of the three years ended 31 December 2003 and the five months ended 31 May 2004, cost of cotton represented approximately 32.0%, 25.7%, 27.8% and 32.0% of the Group's total cost of raw materials.

In order to maintain a continued production cycle, the Group has a policy of maintaining approximately 30 days to 60 days cotton inventory. The level of the Group's cotton inventory will depend on orders on hand, the price of cotton in the PRC and the United States and the perceived future trend in cotton price. In selecting cotton suppliers, the Group usually takes into consideration the price and quality of the cotton.

For each of the three years ended 31 December 2003 and the five months ended 31 May 2004, the average consumption cost per tonne of cotton was approximately RMB9,888, RMB8,404, RMB11,723 and RMB14,971 respectively. The Directors believe it is not necessary for the Group to enter into any long term supply contracts with its suppliers to ensure stable material price as there are various sources of cotton and the Group has not experienced any difficulty in securing a steady source of high quality cotton.

Cotton purchased in the PRC, including imported cotton purchased from cotton traders in the PRC was paid on a cash-on-delivery basis while cotton imported from overseas was paid by letter of credit with average payment terms of 60 to 180 days.

## **Other raw materials**

Apart from cotton, yarn, spandex, rayon and polyester are other major raw materials used by the Group:

### *Yarn*

Yarn used by the Group in its fabric weaving mills is either sourced from the Group's yarn spinning mills or from independent yarn suppliers. For each of the three years ended 31 December 2003 and the five months ended 31 May 2004, cost of yarn represented approximately 45.2%, 57.9%, 53.6% and 52.2% of the Group's total cost of raw materials.

### *Spandex*

Spandex is used in the production of spandex core-spun yarn and is used to provide elasticity to the yarn. Spandex is a manufactured elastomeric fiber and is lightweight and flexible, it resists deterioration from perspiration, detergent and body oils and is characterised by its strength and durability. Spandex used by the Group is mainly purchased from PRC suppliers.



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### *Rayon*

Rayon is a man-made regenerated fiber. Rayon is used to produce rayon yarn and certain stretch yarn.

### *Polyester*

Polyester is a type of synthetic fiber.

During the Track Record Period, the Group had not experienced any shortage of raw materials supply nor had the Group encountered any difficulty in the sourcing of raw materials. The Directors consider raw materials used by the production of the Group's products are commonly available and alternative suppliers can easily be found to replace the current suppliers and there will not be any shortage in the supply of any of the raw materials in the foreseeable future.

### **Consumption of electricity and steam**

Continuous and steady supply of electricity are important for the Group's production. The Group also needs supply of steam to maintain the appropriate temperature and humidity level for its production process.

During the Track Record Period, the Group did not experience any significant shortage of electricity and steam except for minor suspension of electricity in the Zhejiang Century Texhong Plant in 2003. The Group has installed two electric generators in the Zhejiang Century Texhong Plant in April 2004 as back-up in case there is any suspension in electricity supply. According to current national and local laws and regulations of the PRC, the establishment and operation of a back-up electric generator owned by an enterprise shall satisfy some specific requirements if the electricity generated by the back-up electric generator is linked to the electricity power grid of the region. On the other hand, there is no national law or regulation that governs the use of non-network generators. Zhejiang Province has some specific provisions relating to the setting up and operation of non-network back-up electric generator. Under these provisions, Zhejiang Texhong is required to apply for approval from, and sign an agreement with, the local electricity supply bureau. Zhejiang Texhong has submitted an application to, obtained the approval from and signed the above-mentioned agreement with the local electricity supply bureau. Apart from the back-up electric generators installed in the Zhejiang Century Texhong Plant, the Jiangsu Century Texhong Plant and the Taizhou Century Texhong Plant have obtained written guarantees from the Suining Power Supply Company and 泰州市海陵區經貿局 (Taizhou Hailing District Economic and Trade Bureau) respectively for continuous electricity supply despite electricity shortage in the area.

Steam is produced by the Group by burning coal purchased from Independent Third Parties. During the Track Record Period, the Group did not experience any difficulty in securing steam supply.

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### **Suppliers**

The five largest suppliers of the Group in aggregate accounted for approximately 39.5%, 27.1%, 21.0% and 39.8% of the Group's total purchases for each of the three years ended 31 December 2003 and the five months ended 31 May 2004, respectively. The largest supplier accounted for approximately 16.5%, 6.8%, 6.0% and 25.4% of the Group's total purchases for each of the three years ended 31 December 2003 and the five months ended 31 May 2004 respectively. The Group has established a stable business relationship with each of the five largest suppliers. The Directors believe that the Group will continue these business relationships with these major suppliers in the future.

The Directors confirm that as at the Latest Practicable Date, none of the Directors, their respective associates or, so far as the Directors are aware, any Shareholders, who own 5% or more of the issued Shares of the Company immediately following the completion of the Share offer and the Capitalisation Issue (taking no account of any Shares which may be taken up under the Share Offer or upon the exercise of the Over-allotment Option) had any interests in any of the five largest suppliers of the Group during the Track Record Period.

### **PRODUCTION FACILITIES AND PRODUCTION PROCESS**

To maintain the Group's growth of business, the Group expanded its manufacturing facilities principally through acquisitions and upgrading the acquired production facilities. Since commencement of its business, the Group has successfully expanded its production capabilities by acquiring fixed assets and factory premises of four state-owned enterprises which were put into liquidation. New production facilities were also added to cope with the increasing demand for the Group's products and products development plans. By a series of acquisitions, the Group has achieved an increase in production capacity and the breadth of its products.

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During the Track Record Period, the Group's production capacity, standard production volume, actual production volume and utilisation rate were approximately as follows:

Name	Year ended 31 December			For the five months ended 31 May 2004
	2001	2002	2003	
<b>Annual production capacity</b>				
– Yarn (tonnes)	19,312	25,129	32,815	14,181
– Fabrics (million metres)	46.3	77.6	98.8	41.1
<b>Standard production volume</b>				
– Yarn (tonnes)	14,009	21,981	28,648	12,661
– Fabrics (million metres)	40.7	68.0	89.3	37.2
<b>Actual production volume</b>				
– Yarn (tonnes)	11,018	18,295	22,900	10,141
– Fabrics (million metres)	41.4	64.8	86.4	35.4
<b>Utilisation rate</b>				
– Yarn	72.5%	87.5%	87.3%	89.3%
– Fabrics	87.9%	87.6%	90.4%	90.5%

The annual production capacity is determined based on certain assumptions including, among others, (i) the specific types of machineries used in the production process, (ii) the ability of the Group's production facilities to sustain operation of 24 hours a day for 355 days in a year (in the case of the five month period ended 31 May 2004, 142 days), (iii) the operating efficiency of all yarn spinning machineries and fabric weaving machines being no less than 95% and 90% respectively, and (iv) the operating staff are well trained and familiar with the operating process. In determining the utilisation rates, standard production volume is used to compare with the production capacity. Standard production volume is derived from actual production volume, adjusted for certain assumptions used in determining the production capacity such as the type of products produced.

For the year ended 31 December 2003 and the five months ended 31 May 2004, the Group leased its doubling frames to Nantong Shuanghong and rental income received by the Group amounted to RMB375,000 and RMB250,000 respectively. These doubling frames were acquired in connection with all other machineries acquired by the Group from Suining Cotton in September 1999, however, these doubling frames were not used in the Group's production due to the lack of economies of scale.

## Production facilities

A summary of the Group's production facilities as at 31 May 2004 was as follows:

Name of factory	Name of company	Address	Main products/process	Total floor area of the factory (sq.m.)	Production facilities			
					Spindles	Air-jet looms	Shuttles	Others
Taizhou Texhong Plant	Texhong Textile Taizhou	No.22 Baisui Lane, Taizhou City, Jiangsu Province	Yarn and grey fabrics	25,435.26	10,816	-	400	-
	Taizhou Texhong Weaving		Fabric front-end weaving process		-	-	-	3 warping machines and 3 sizing machines
Taizhou Century Texhong Plant	Taizhou Century Texhong	No. 33 Tianhong Road, High-tech Economic Development Zone, Taizhou City, Jiangsu Province	Grey fabrics	28,434.15	-	288	-	-
Zhejiang Century Texhong Plant	Texhong Jinhua	Renming East Road, Puyan Town, Puyang County, Jinhua City Zhejiang Province	Fabric front-end weaving process	14,086.60	-	-	-	1 warping machine and 1 sizing machine
	Zhejiang Texhong		Grey fabrics		-	160	-	-
	Zhejiang Century Texhong		Grey fabrics processing		-	32	-	-
Jiangsu Century Texhong Plant	Texhong Suining	No.33 Fujian West Street, Suining County, Xuzhou City Jiangsu Province	Grey fabrics processing	61,953.19	-	-	120	-
	Jiangsu Century Texhong		Yarn and grey fabrics		71,304	90	-	6 open-end spinning machines
Nantong Century Texhong Plant	Nantong Century Texhong	No. 2 Jianghai West Road, Shuangdian Town, Nantong City Jiangsu Province	Yarn and grey fabrics	31,403.45	40,896	48	-	4 open-end spinning machines
Xuzhou Texhong Yinfeng Plant	Xuzhou Texhong Yinfeng	No. 105 Middle Liberation Road, Feng County, Xuzhou City, Jiangsu Province	Yarn and grey fabrics	36,099.34	39,188	20	144	3 open-end spinning machines
Nantong Texhong Yinhai Plant	Nantong Texhong Yinhai	No. 18 Chengzha Road, Nantong City, Jiangsu Province	Yarn drawing	10,000.00	-*	-	-	-
Xuzhou Century Texhong Plant	Xuzhou Century Texhong	Industrial complex at 104 National Highway (North), Taoyuan Town, Suining Town, Xuzhou County, Jiangsu Province	Yarn	11,100.00	16,800	-	-	-

\* Subsequent to 31 May 2004, Nantong Texhong Yinhai acquired Nantong Shuanghong which has 24,000 spindles.

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Three of the Group's plants are shared among different Group members: (i) the Taizhou Texhong Plant is shared by Texhong Textile Taizhou and Taizhou Texhong Weaving; (ii) the Zhejiang Century Texhong Plant is shared by Texhong Jinhua, Zhejiang Texhong and Zhejiang Century Texhong; and (iii) the Jiangsu Century Texhong Plant is shared by Texhong Suining and Jiangsu Century Texhong. Such arrangement was adopted by the Group in order to distinguish different production focuses (in terms of product/production process) of such Group members at each of the above three locations.

Production of yarn and production of fabrics require different types of machineries and equipment. In general, subject to the introduction of newer models and technology, machineries and equipment used for yarn and fabrics production can be used for approximately 15 years to 20 years.

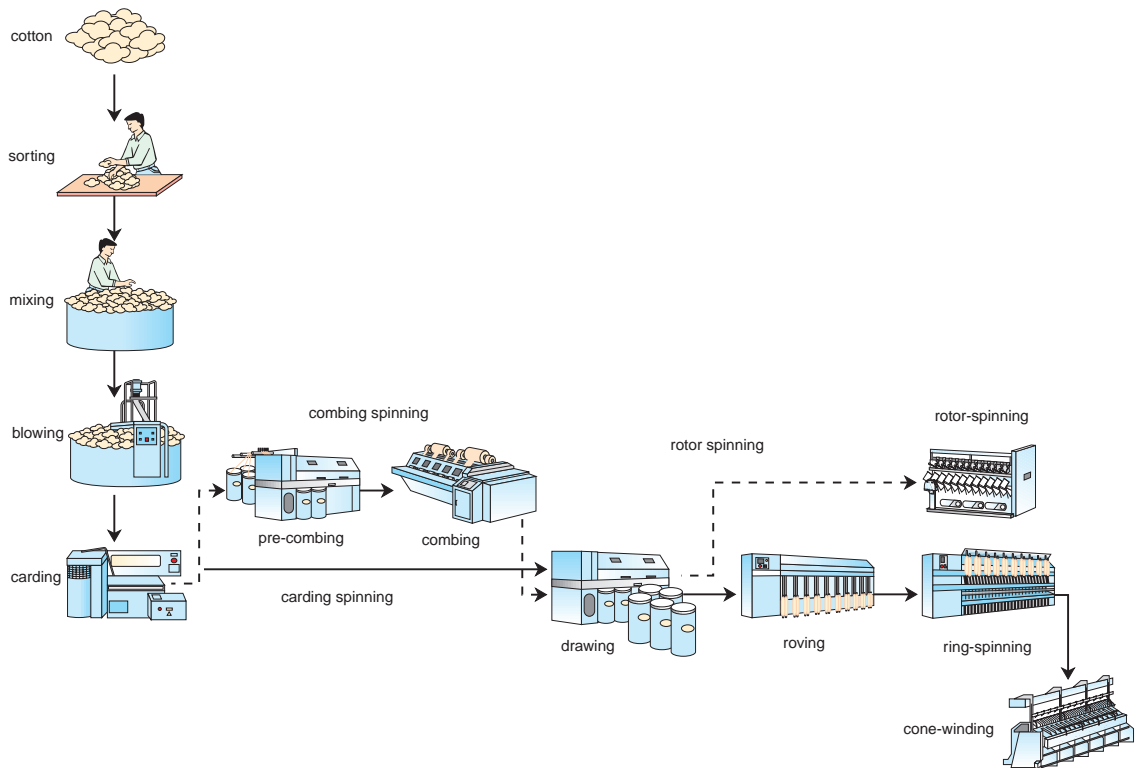
The Group's sales team is responsible for determining the optimal yarn and fabric products allocation. The Group's production department focuses on the improvement of cost structure and product quality to enhance the Group's profitability. When fabric weaving mills of the Group receive sales orders, the production department will determine whether the fabric weaving mill should use the yarn produced in house or yarn produced by independent yarn spinning mill based on the price and quality of the yarn required. At times, when specific yarn is required for producing special fabric requested by customers, the Group can utilise its product development capability to develop the specific yarn and hence the special fabric requested. The Directors believe that the Group's yarn production capability enables it to produce a wide variety of fabrics.

During the Track Record Period, the Group did not experience any interruptions in its production which had a significant effect on the Group's financial position.

## Production process

### Manufacturing process of yarn

The following shows the main spinning procedures adopted in the Group's production facilities:



### Sorting

Through this process, dirt and foreign matters are separated from cotton fibers.

### Mixing

Cottons from different bales are mixed in order to achieve uniformity of colour, length and other characters.

### Blowing/opening

This process is to loosen, clean and blend the fibers. Loosened clean fibers are fed to carding machine in sheet form.

## *Carding*

Carding separates the tufts into individual fibers, removes trash particles and short fibers, orients the fibers lengthwise and evenly distributes them on the surface of the cylinder before reassembling the fibers in a netlike and sliver form.

## *Pre-combing*

This is a process where slivers are drawn together to form a roll ("lap roll"). The purpose of this process is to produce uniform and stable lap rolls by repeatedly doubling of slivers.

## *Combing*

Combing is to parallel fibers and to remove any short fibers and impurity from the long staple so that the combed fibers will be more uniform in length.

## *Drawing*

Drawing increases the parallelism of the fibers and combines several carded (combed) slivers in one drawn sliver. This is a blending operation that contributes to greater yarn uniformity.

## *Roving*

Roving reduces the size of the drawn sliver, increases the parallelism of the fiber together with a small amount of twist.

## *Ring spinning*

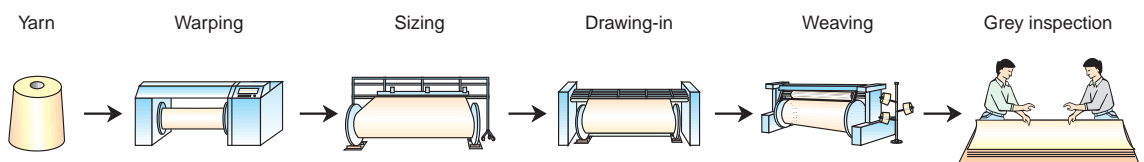
Spinning draws and adds the twist that makes the yarn into a single yarn.

## *Cone-winding*

The yarns are subjected to winding in order to increase the length of the yarn on the package, to control its quality, and to eliminate the impurities and defects.

## *Manufacturing of woven fabrics*

The following shows the main weaving procedures adopted in the Group's production facilities:



### *Warping*

During warping, hundred of yarns are simultaneously unwound from a group of bobbins placed in special creels and then wound again on a cylindrical roller (beam) with application of certain tension.

### *Sizing*

At sizing, yarns from several rollers are joined into one package, which can be used directly on the loom, and the yarns are treated with a special adhesive composition called “size”.

### *Drawing-in*

Drawing-in is to draw the yarn through heddles and drop wires of the warp stop motion, with the aim to form shed.

### *Weaving*

Woven fabrics are made with two or more sets of yarns interlaced at right angles to each other and done by a machine called a loom.

Weaving consists of the following steps:

1. Shedding: the raising of one or more harnesses to separate the warp yarns and form a shed.
2. Picking: passing through the shed to insert the filling.
3. Beat-up: the reed pushing the filling yarn back in the cloth.
4. Take-up: the finished cloth is wound on the cloth beam.

### *Inspection of grey fabrics*

Grey fabrics unloaded from looms are inspected for length and quality based on type of the production process and product. The grey fabrics are then cut and mended.

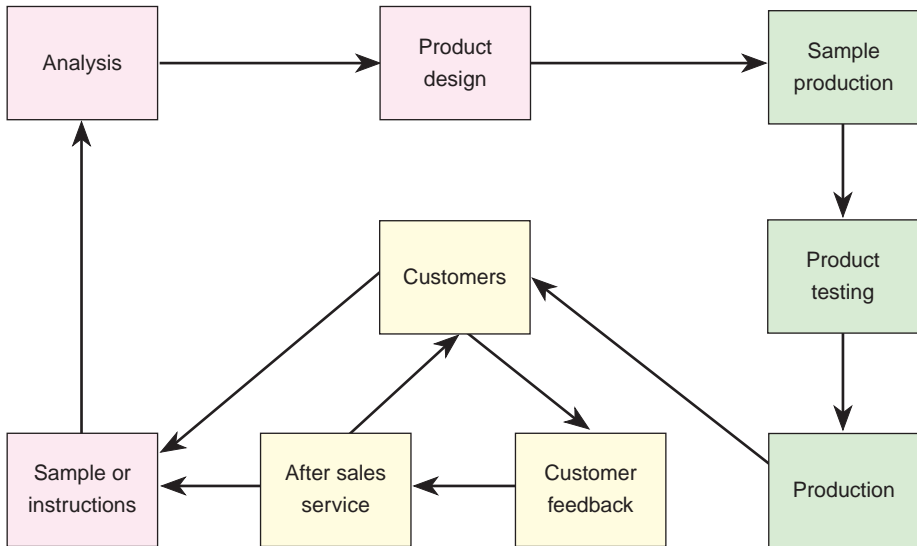
## **PRODUCT DEVELOPMENT**

The Group places strong emphasis on product development. As at the Latest Practicable Date, the product development department had 23 staff. The product development department usually initiates its product development process through discussion with the Group’s suppliers and customers. By working closely with its suppliers, the Group can keep abreast of the latest development of raw materials, their usage and functionality. The Group’s customers frequently provide samples or ideas to the Group to see whether manufacturing of certain types of fabric is feasible. Upon receiving ideas or



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samples from the suppliers and customers, the product development department will determine the feasibility of transforming the ideas into actual production and formulate products configuration and design. Samples of such products will be produced for further testings until the customers' requirements have been met. The production department will then commence mass production of such products according to the standards specified by the customers.



The product development department is also responsible for conducting feasibility studies on new materials and new technology which can be used in the production of spandex stretch yarn and spandex stretch fabrics. Once the new material has received market acceptance, the Group can immediately produce the products ahead of other competitors in the same industry. The Directors believe that these new materials can generate higher profit margins to the Group until competitive pressures lead to a price reduction when other competitors enter the market. Apart from the development of new materials, the product development department also undertakes studies to improve existing production technologies and operational efficiency, in order to keep abreast with the progress and advancement in the industry and to improve the quality and variety of the Group's products.

The Group has also attended industry exhibitions and conferences and reviewed industry journals to keep abreast with the trends and the new technologies available in the industry.

## QUALITY CONTROL

The Group regards quality control as an important part of its operation and has implemented a quality control system in its production facilities. Apart from random checking of raw materials and finished products, quality control measures are also in place throughout the production process. The Group's quality control department is responsible for quality control and quality assurance of the production. As at the Latest Practicable Date, the total number of staff in the quality control department was 112. The quality

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control department is responsible for setting up quality control measures and implementing the quality control procedures to meet the requirements of the Group's customers.

The Group has obtained several accreditations for its quality control system: Taizhou Texhong Weaving was accredited with the GB/T19001-2000 – ISO9001:2000 Standard in November 2001, Jiangsu Century Texhong was accredited with the GB/T19001-2000 – ISO9001:2000 Standard in July 2002 and Taizhou Century Texhong was accredited with GB/T19001-2000 – ISO9001:2000 Standard in January 2004. The Group's products also received various quality certificates. Details of the Group's awards and certificates are discussed in the sub-section headed "Awards and recognition" below.

### **Control of raw materials**

The quality control department carries out random checks of the quality of the cotton, yarn and spandex to ensure that the raw materials meet the Group's specifications. Raw materials are randomly checked to see if they meet the prescribed quality standards before they are accepted and stored in warehouse. Sub-standard raw materials will be returned to the suppliers.

### **Production control**

The Group employs a quality control system throughout the production process. Each staff is responsible for a specific quality control procedure. Salary of production staff is based on the quality and the quantity of the products they actually produce. All substandard products are not counted as the staff's output and penalty will be imposed on the staff who produces substandard products. The Directors believe the Group's quality control system will ensure that the quality of the products is maintained.

### **Finished products**

The quality control department conducts examinations on the finished products. All of the fabric products and samples of the yarn products will be tested by the quality control department. The quality control staff will ensure that the standards of the Group have been maintained. Products with inferior quality will be reprocessed.

## **COMPETITION**

The PRC textile manufacturing industry is fragmented with intense competition and no dominant player. Nevertheless, due to higher capital investment requirement, the textile sector producing high-end products is less competitive. The PRC textile industry has been going through consolidation in the last decade, textile manufacturers have tried to achieve large scale production through series of merger and acquisitions. Stretch textile products were commercialised in the PRC market in the 1990s. As the Group was one of the first movers in the spandex textile market, it has successfully built up its reputation among its customers as one of the top producers in this market segment in the PRC. However, as spandex textile products become more popular in the PRC, the Directors believe competition in this market segment will increase in the foreseeable future.

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In terms of competition faced by the Group for its principal products, the Directors believe that competition for its spandex stretch yarn mainly comes from manufacturers in the Jiangsu Province, in particular enterprises located in Zhang Jia Gang. Although these enterprises in general have a much smaller production scale than the Group, they are able to offer their products at lower prices. On the other hand, competition for the Group's spandex stretch grey fabrics mainly comes from manufacturers in the Zhejiang and Jiangsu Provinces who likewise are selling products at cheaper prices than the Group. Although, to the knowledge of the Directors, there are no specific industry statistics available to determine the current market share of these competitors, the Directors foresee that these local enterprises will try to expand and enlarge their share in this market.

Nevertheless, the Directors believe the Group is able to compete effectively against its competitors due to the following strengths of the Group:

- specialisation in contemporary and high value-added products and its product development capability;
- capital cost competitive advantage;
- high adaptability and operating efficiency;
- stringent high quality control and consistent high quality products;
- solid customer base; and
- experienced management team and simple, flexible management structure.


## ENVIRONMENTAL PROTECTION

All of the Group's plants had fully complied with the relevant PRC environmental protection laws and regulations during the Track Record Period and had obtained the requisite approvals from the relevant Environmental Protection Bureau.

Taizhou Century Texhong Plant was accredited with the ISO14001: 1996 certificate in January 2004.

The Directors confirmed that, up to the Latest Practicable Date, the Group had not received any notification from the relevant authorities regarding any breach of the applicable environmental protection laws and regulations.

## INTELLECTUAL PROPERTY RIGHTS

As at the Latest Practicable Date, the Group had 12 registered trademarks. The Company has applied to the Trade Marks Registry in Hong Kong and the Trade Marks Office of China for registration of the Company's logo  in Hong Kong and in the PRC.

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For further details of the intellectual property rights of the Group, please see the paragraph headed “Intellectual property rights of the Group” in Appendix VII to this prospectus.

### INSURANCE

The Group has maintained insurance policies in some of its subsidiaries. Zhejiang Texhong has an insurance policy on damage of raw materials and products during delivery and a comprehensive insurance against damage incurred in its fixed assets and non-fixed assets (inventory). These insurance policies protect the Group’s interests in the case where the Group’s assets and machinery are damaged and where Group’s raw materials and goods are damaged during transportation.

### AWARDS AND RECOGNITION

In the past few years, the Group had obtained various awards and recognition for the high quality products produced by the Group:

Year of awards	Company/product	Certificate/award	Authority
2001	Taizhou Texhong Weaving	ISO9001:2000 (Quality system certification)	Shenzhen Quality Certification Centre
2002	Jiangsu Century Texhong	ISO9001:2000 (Quality management system certification)	Beijing New Century Certification Co., Ltd.
2004	Taizhou Century Texhong	ISO9001:2000 (Quality management system certificate)	Universal Certification Service Co., Ltd. (Shenzhen Quality Certification Centre)
2004	Taizhou Century Texhong	ISO14001:1996 (Environmental management system certificate)	Universal Certification Service Co., Ltd. (Shenzhen Quality Certification Centre)

### RELATIONSHIP WITH HONG KONG TIN HONG

Hong Kong Tin Hong was incorporated in Hong Kong with limited liability on 27 August 1997. It is a private company wholly-owned by Mr. Hong and is engaged in investment holding. The assets which comprise the Group were businesses and operations of Hong Kong Tin Hong prior to the Reorganisation. Apart from its interest in the Group, Hong Kong Tin Hong has interests in certain textile related businesses which do not form

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part of the Group (the “Excluded Businesses”) and are either complementary to or likely to compete, directly or indirectly, with the Group’s businesses in the PRC. Details of the Excluded Businesses are as follows:

### **1. Tianhong Printing and Dyeing**

Tianhong Printing and Dyeing was originally a sino-foreign joint venture established by Independent Third Parties in October 1994 in the PRC. In January 2000, Hong Kong Tin Hong acquired a 51% shareholding interest of Tianhong Printing and Dyeing. In July 2002, Hong Kong Tin Hong acquired the remaining 49% of the shareholding interest. Tianhong Printing and Dyeing has since become a wholly-owned foreign enterprise of Hong Kong Tin Hong. Tianhong Printing and Dyeing is principally engaged in the provision of printing and dyeing services and sale of garment fabrics to garment manufacturers and trading agents. Tianhong Printing and Dyeing sells its products mainly in Jiangsu Province and Shanghai Municipality of the PRC. For each of the three years ended 31 December 2003, based on the audited accounts prepared in accordance with the relevant accounting principles applicable to enterprises in the PRC, turnover from subcontracting services and sale of garment fabrics of Tianhong Printing and Dyeing amounted to approximately RMB28.4 million, RMB33.8 million and RMB53.4 million respectively. During the same periods, it incurred net loss of approximately RMB10.7 million, RMB2.9 million and RMB2.8 million respectively. During the Track Record Period, the Group sold grey fabrics and bought garment fabrics from, and paid subcontracting fee to Tianhong Printing and Dyeing. Please refer to the subsection headed “Continuing connected transactions” under the section headed “Business” in this prospectus for details of these transactions.

The Directors are of the view that Tianhong Printing and Dyeing does not pose any competition to the Group as the businesses of Tianhong Printing and Dyeing and the Group are principally different.

### **2. Nantong Textile**

Nantong Textile is owned as to 39% by Hong Kong Tin Hong, the second largest shareholder while the remaining shareholding interests are owned by three Independent Third Parties. Nantong Textile was established in September 2002 but its operation did not start until September 2003. Nantong Textile is principally engaged in printing, dyeing of fabrics and selling of garment fabrics. Garment fabrics produced by Nantong Textile mainly include dyed and printed cotton fabrics, linen cotton blended fabrics and polyester cotton blended fabrics. During the Track Record Period, the Group sold grey fabrics to Nantong Textile. Please refer to the subsection headed “Continuing connected transactions” under the section headed “Business” in this prospectus for details of these transactions. Since the businesses of Nantong Textile and the Group are principally different, the Directors are of the view that Nantong Textile does not pose any direct competition to the Group. For the year ended 31 December 2003, turnover and net loss of Nantong Textile amounted to approximately RMB77.5 million and RMB0.8 million respectively. As Nantong Textile

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is at a start-up stage and had incurred loss in 2003, and since Hong Kong Tin Hong has no shareholding or management control over Nantong Textile, the Directors are of the view that it would not be in the interest of the Shareholders to include Nantong Textile in the Group at this stage.

The Group is engaged in the manufacture and sale of yarn and fabrics. It is not engaged in printing and dyeing work and does not maintain any printing and dyeing facilities. The relationship between the Group and each of Tianhong Printing and Dyeing and Nantong Textile is customer and supplier. The Group has to subcontract the printing and dyeing work to produce garment fabrics. The Group has over 20 other printing and dyeing service providers. The Directors believe the Group does not have to rely on Tianhong Printing and Dyeing and Nantong Textile to carry on its businesses given that:

- (i) sales to Tianhong Printing and Dyeing and to Nantong Textile as a percentage of the Group's total turnover for each of the three years ended 31 December 2003 and the five months ended 31 May 2004 were about 0.4%, 0.2%, 0.8% and 1.5% and about nil, nil, 0.1% and 0.3% respectively;
- (ii) the Group did not make any purchase from Nantong Textile during the Track Record Period while purchases from Tianhong Printing and Dyeing as a percentage of the Group's total sales of garment fabrics for each of the three years ended 31 December 2003 and the five months ended 31 May 2004 were about 0.1%, 0.8%, 6.4% and 18.5% respectively; and
- (iii) sale of garment fabrics of the Group represented only about 9.9%, 9.1%, 7.7% and 9.1%, respectively of the Group's total sales for each of the three years ended 31 December 2003 and the five months ended 31 May 2004.

In addition, transactions with these connected parties were conducted on arm's length basis and on normal commercial terms which were comparable to that with Independent Third Parties.

Regarding potential competition between the Group and Tianhong Printing and Dyeing and Nantong Textile, the Group's principal business of production and sale of yarn and grey fabrics does not compete with that of Tianhong Printing and Dyeing and Nantong Textile, which do not engage in the production and sale of the same type of products. However, the Group's business of the sale of garment fabric may compete with that of Tianhong Printing and Dyeing and Nantong Textile though the Directors are of the opinion that such potential competition does not impact on the financial position and operations of the Group as:

- (i) garment fabric is not a principal product of the Group, the sale of which as a percentage of the Group's total turnover for each of the three

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years ended 31 December 2003 and the five months ended 31 May 2004 were about 9.9%, 9.1%, 7.7% and 9.1% respectively;

- (ii) a majority of the Group's garment fabric products are sold to overseas customers while Tianhong Printing and Dyeing and Nantong Textile mainly sell to PRC customers; and
- (iii) the management team of the Group is basically independent from the management team of Tianhong Printing and Dyeing and Nantong Textile.

Nevertheless, in order to further delineate the respective businesses between the Group and each of Tianhong Printing and Dyeing and Nantong Textile and protect the Group from any possible direct and indirect competition from Tianhong Printing and Dyeing and Nantong Textile in respect of the Group's core business of manufacture and sale of yarn and grey fabrics and the export sale of garment fabrics, Mr. Hong has given an irrevocable non-compete undertaking in favour of the Company on 21 November 2004. Pursuant to the non-compete undertaking, Mr. Hong has, among other matters, irrevocably and unconditionally undertaken with the Company that he will not, and will procure, to the extent within his voting powers in the relevant associate, his associates not:

- (i) to engage in the business of the manufacture and sale of yarn and grey fabrics and the business of export sales of garment fabrics;
- (ii) to solicit any existing employees of the Group for employment by him or his associates (excluding the Group); and
- (iii) to make use of any information pertaining to the business of the Group which may have come to the knowledge in his capacity as the controlling shareholder of the Group or, as the case may be, as a Director for the purpose of competing with the business of the Group.

The non-compete undertaking will take effect upon the Listing and shall expire on the earlier of (i) the date on which Mr. Hong and his associate(s) cease to hold, in aggregate, 30% or more of the issued share capital of the Company; or (ii) the date on which the Shares cease to be listed on the Stock Exchange.

Hong Kong Tin Hong does not have any plan to inject Tianhong Printing and Dyeing and Nantong Textile into the Group in the next 12 months. The Directors consider that it will be beneficial for the Company to acquire these companies in future, the acquisition of which will be made subject to compliance with the applicable Listing Rules.

## **CONTINUING CONNECTED TRANSACTIONS**

Prior to the Listing, the Group has entered into various transactions with certain parties which will be connected persons (as defined under the Listing Rules) of the Company upon the Listing. All of these transactions will continue after the Listing and therefore will constitute continuing connected transactions (as defined under the Listing Rules) of the Company.

Set out below is the relationship between the Group and each of the connected persons and the details of the continuing connected transactions.

### **Relationship between the Group and each of the connected persons**

Tianhong Printing and Dyeing is a wholly-owned foreign enterprise established in the PRC and the entire equity interest of which is owned by Hong Kong Tin Hong. Hong Kong Tin Hong is in turn 100% beneficially owned by Mr. Hong, an executive Director and the indirect controlling shareholder of the Company.

Nantong Textile is a sino-foreign joint venture established in the PRC, 39% of the equity interest of which is owned by Hong Kong Tin Hong and the remaining aggregate 61% is owned by three Independent Third Parties.

Accordingly, both Tianhong Printing and Dyeing and Nantong Textile are connected persons of the Company.

Under the Listing Rules, for so long as each of Tianhong Printing and Dyeing and Nantong Textile remains a connected person of the Company, the transactions described below will constitute connected transactions upon the Listing.

### **Continuing connected transactions subject to the reporting, announcement and/or shareholders' approval requirements under Rules 14A.45 to 14A.48 of the Listing Rules**

#### *1. Sales of the Group's grey fabrics to Tianhong Printing and Dyeing*

During each of the three years ended 31 December 2003 and the five months ended 31 May 2004, the Group had sold from time to time its grey fabrics to Tianhong Printing and Dyeing and the aggregate sales of the Group's grey fabrics to Tianhong Printing and Dyeing amounted to approximately RMB1.4 million, RMB1.8 million, RMB8.3 million and RMB7.3 million respectively. The Group's grey fabrics have been sold to it on normal commercial terms and were no more favourable than those available to independent third party purchasers.

Pursuant to an agreement (the "Tianhong Sale Agreement") dated 21 November 2004 and entered into between the Group as vendor and Tianhong Printing and Dyeing as purchaser, Tianhong Printing and Dyeing agreed to purchase grey fabrics from the Group at market prices and on such terms of sales based principally on the standard



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terms of sale of the Group from time to time and such other terms as are no more favourable as those applicable to the sale of comparable grey fabrics to Independent Third Parties. The Tianhong Sale Agreement will have a term expiring on 31 December 2006 unless terminated earlier by three months' written notice by either party.

It is expected that the sales by the Group to Tianhong Printing and Dyeing under the Tianhong Sale Agreement for each of the three years ending 31 December 2006 may exceed 2.5% of each of the percentage ratios (as defined under Rule 14.04(9) of the Listing Rules) other than the profit ratio and will not exceed the annual monetary caps (the "Tianhong Sale Caps") of RMB19.5 million, RMB24.4 million and RMB30.5 million respectively.

The Tianhong Sale Caps are ascertained by reference to the sales made to Tianhong Printing and Dyeing for each of the three years ended 31 December 2003 and the five months ended 31 May 2004, the projected rate of growth in the Group's turnover and the increase in the production capacity of the Group. Grey fabrics sold by the Group to Tianhong Printing and Dyeing increased by approximately 369.1% from 2002 to 2003. Comparing the annualised sale to Tianhong Printing and Dyeing for the five months ended 31 May 2004 to the sales in 2003, the amount was increased by approximately 111.6%. The Group's production capacity is expected to increase in 2005 as the Group has plans to expand its garment fabric business. Accordingly, the Directors expect more grey fabrics will be sold to Tianhong Printing and Dyeing in the future for printing and dyeing process. The Tianhong Sale Caps assume the remaining seven months in year 2004 will generate more sales than the first five months, which is consistent with the Group's seasonal sale pattern. For the next two years, the Directors expect sale to Tianhong Printing and Dyeing will increase at an annual growth rate of 25%, which is much less than the historical growth rates during the Track Record Period.

The Tianhong Sale Agreement and the continuing connected transactions contemplated thereunder will be on normal commercial terms and conducted in the ordinary course of business. Such continuing connected transactions are normally subject to the reporting, announcement and the shareholders' approval requirements as set out under Rules 14A.45 to 14A.48 of the Listing Rules.

### *2. Purchase of garment fabrics by the Group from Tianhong Printing and Dyeing*

During each of the three years ended 31 December 2003 and the five months ended 31 May 2004, the Group had purchased garment fabrics from Tianhong Printing and Dyeing from time to time and the aggregate purchase of garment fabrics by the Group from Tianhong Printing and Dyeing amounted to approximately RMB48,000, RMB0.5 million, RMB5.1 million and RMB8.4 million respectively. The Group has purchased the garment fabrics from Tianhong Printing and Dyeing on normal commercial terms and were no less favourable than those available to independent third party purchasers.

Pursuant to an agreement (the "Tianhong Purchase Agreement") dated 21 November 2004 and entered into between the Group as purchaser and Tianhong Printing and Dyeing as vendor, Tianhong Printing and Dyeing agreed to sell garment fabrics to the Group at

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market prices and on such terms of sales based principally on its standard terms of sales from time to time and such other terms as are no less favourable to the Group as those applicable to the sales of comparable garment fabrics to Independent Third Parties. The Tianhong Purchase Agreement will have a term expiring on 31 December 2006 unless terminated earlier by three months' written notice by either party.

It is expected that the aggregate purchase of garment fabrics by the Group from Tianhong Printing and Dyeing under the Tianhong Purchase Agreement for each of the three years ending 31 December 2006 may exceed 2.5% of each of the percentage ratios (as defined under Rule 14.04(9) of the Listing Rules) other than the profit ratio and will not exceed the annual monetary caps (the "Tianhong Purchase Caps") of RMB20.0 million, RMB25.0 million and RMB31.3 million respectively.

The Tianhong Purchase Agreement and the continuing connected transactions contemplated thereunder will be on normal commercial terms and conducted in the ordinary course of business. Such continuing connected transactions are normally subject to the reporting, announcement and the shareholders' approval requirements as set out under Rules 14A.45 to 14A.48 of the Listing Rules.

The Tianhong Purchase Caps are ascertained by reference to the purchase made from Tianhong Printing and Dyeing for each of the three years ended 31 December 2003 and the five months ended 31 May 2004, the projected rate of growth in the Group's turnover and the increase in the production capacity of the Group. Garment fabrics purchased by the Group from Tianhong Printing and Dyeing increased by approximately 941.7% from 2001 to 2002 and 924.2% from 2002 to 2003. Comparing the annualised purchase from Tianhong Printing and Dyeing for the five months ended 31 May 2004 to that in 2003, the amount increased by approximately 293.3%. The Group's production capacity is expected to increase in 2005 and the Group has plans to expand its garment fabric business. Accordingly, the Directors expect more garment fabrics will be purchased from Tianhong Printing and Dyeing in the future. The Tianhong Purchase Caps assume that purchase in the remaining seven months in 2004 will be proportionately higher than the purchase in the first five months to fulfill the expected increase in sale demand for garment fabrics, which is consistent with the Group's seasonal sale pattern. For the next two years, the Directors expect purchase from Tianhong Printing and Dyeing will increase at an annual growth rate of 25%, which is much less than the historical growth rates during the Track Record Period.

### *3. Sales of the Group's grey fabrics to Nantong Textile*

During the year ended 31 December 2003 and the five months ended 31 May 2004, the Group had sold from time to time its grey fabrics to Nantong Textile and the aggregate sales of the Group's grey fabrics to Nantong Textile amounted to approximately RMB1.5 million and RMB1.3 million respectively. The Group's grey fabrics have been sold to each of them on normal commercial terms and were no more favourable than those available to independent third party purchasers.

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Pursuant to an agreement (the "Nantong Sale Agreement") dated 21 November 2004 and entered into between the Group as vendor and Nantong Textile as purchaser, Nantong Textile agreed to purchase grey fabrics from the Group at market prices and on such terms of sales based principally on the standard terms of sale of the Group from time to time and such other terms as are no more favourable as those applicable to the sale of comparable grey fabrics to independent third parties. The Nantong Sale Agreement will have a term expiring on 31 December 2006 unless terminated earlier by three months' written notice by either party.

It is expected that the aggregate sales by the Group to Nantong Textile under the Nantong Sale Agreement for each of the three years ending 31 December 2006 will not exceed 2.5% of each of the percentage ratios (as defined under Rule 14.04(9) of the Listing Rules) other than the profit ratio and will not exceed the annual monetary caps (the "Nantong Sale Caps") of RMB3.5 million, RMB4.4 million and RMB5.5 million respectively.

The Nantong Sale Caps are ascertained by reference to the sales made to Nantong Textile for the year ended 31 December 2003 and the five months ended 31 May 2004, the projected rate of growth in the Group's turnover and the increase in the production capacity of the Group. Comparing the annualised sale to Nantong Textile for the five months ended 31 May 2004 to the sales in 2003, the amount increased by approximately 102.4%. As mentioned before, the Group's production capacity is expected to increase in 2005 and the Group has plans to expand its garment fabric business. As the Group does not have printing and dyeing facilities, in order to expand sale of its garment business, the Group needs to sell its grey fabric to printing and dyeing factory, such as Nantong Textile, for printing and dyeing process and then buys the finished products, namely garment fabrics, from printing and dyeing factories. Accordingly, the Directors expect more grey fabrics will be sold to Nantong Textile in the future for printing and dyeing process. The Nantong Textile Caps assume the remaining seven months in 2004 will generate more sales than the first five months, which is consistent with the Group's seasonal sale pattern. For the next two years, the Directors expect sale to Nantong Textile will increase at an annual growth rate of 25%, which is much less than the historical growth rates.

The Nantong Sale Agreement and the continuing connected transactions contemplated thereunder will be on normal commercial terms and conducted in the ordinary course of business. Such continuing connected transactions are normally subject to the reporting and announcement requirements as set out under Rules 14A.45 to 14A.47 of the Listing Rules.

#### *4. Purchase of garment fabrics by the Group from Nantong Textile*

The Group did not purchase garment fabrics from Nantong Textile during the Track Record Period. However, as the Group's production capacity is expected to increase in 2005, the Directors expect the Group will purchase garment fabrics from Nantong Textile in the future.

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Pursuant to an agreement (the “Nantong Purchase Agreement”) dated 21 November 2004 and entered into between the Group as purchaser and Nantong Textile as vendor, Nantong Textile agreed to sell garment fabrics to the Group at market prices and on such terms of sales based principally on its standard terms of sales from time to time and such other terms as are no less favourable to the Group as those applicable to the sales of comparable garment fabrics to independent third parties. The Nantong Purchase Agreement will have a term expiring on 31 December 2006 unless terminated earlier by three months’ written notice by either party.

It is expected that the aggregate purchase of garment fabrics by the Group from Nantong Textile under the Nantong Purchase Agreement for each of the three years ending 31 December 2006 will not exceed 2.5% of each of the percentage ratios (as defined under Rule 14.04(9) of the Listing Rules) other than the profit ratio and will not exceed the annual monetary caps (the “Nantong Purchase Caps”) of RMB1.0 million, RMB1.3 million and RMB1.6 million respectively.

The Nantong Purchase Caps are ascertained by reference to the expected increase in sale of garment fabrics and hence the additional garment fabric required to be purchased by the Group to fulfill its sales orders in the foreseeable future. The top end of the Nantong Purchase Caps of RMB1.6 million, namely the cap for purchase from Nantong Textile in 2006, only represented about 2.0% of the Group’s total sales of garment fabrics in 2003. Given the garment fabric requirements of the Group in the past, the Directors believe it is highly likely for the Group to broaden its garment fabric supplier base and increase its garment fabric purchase in the next three years. Therefore, even though the Group did not purchase from Nantong Textile during the Track Record Period, the Directors believe the application for the waiver for purchase from Nantong Textile and the related Nantong Purchase Caps are fair and reasonable so far as the shareholders of the Company are concerned.

The Directors, including the independent non-executive Directors, consider that (i) each of the Tianhong Sale Agreement, the Tianhong Purchase Agreement, the Nantong Sale Agreement and the Nantong Purchase Agreement and the transactions contemplated thereunder (the “Continuing Connected Transactions”) are and will be entered into in the ordinary and usual course of business of the Group; and (ii) each of the Tianhong Sale Caps, the Tianhong Purchase Caps, the Nantong Sale Caps and Nantong Purchase Caps so determined are fair and reasonable so far as the Independent Shareholders are concerned. The terms of the relevant agreements governing the Continuing Connected Transactions are and will be negotiated on arm’s length basis, on normal commercial terms and are fair and reasonable so far as the shareholders of the Company are concerned and are in the interests of the Company and the Shareholders as a whole.

The Sponsor has reviewed relevant documentation, information and historical figures provided by the Company relating to the Continuing Connection Transactions and has also conducted additional due diligence by interviewing and discussing with the Company and certain of the Company’s advisers, and has obtained the necessary representations and confirmation from the Directors, to satisfy itself of the accuracy and completeness of the information provided. Based on its due diligence, the Sponsor is of the view that the

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Continuing Connected Transactions for which a waiver is sought are in the ordinary and usual course of business of the Group, on normal commercial terms, are fair and reasonable and in the interests of the Shareholders as a whole. In addition, the Sponsor is of the view that the Tianhong Sale Caps, the Tianhong Purchase Caps, the Nantong Sale Caps and the Nantong Purchase Caps are fair and reasonable and in the interests of the Shareholders as a whole.

### **Application for waiver**

Given that the Continuing Connected Transactions as set out above will continue after the Listing on a recurring basis and that the transactions under the Tianhong Sale Agreement, the Tianhong Purchase Agreement, the Nantong Sale Agreement and the Nantong Purchase Agreement will be entered into in the ordinary and usual course of business of the Group and will be made on an arm's length basis, on normal commercial terms and are fair and reasonable so far as the Shareholders as a whole is concerned, the Directors, including the independent non-executive Directors, consider that strict compliance with the announcement and/or independent shareholders' approval requirements (where applicable) under the Listing Rules would be unduly burdensome and impracticable on each occasion when any such individual transaction is entered into.

Accordingly, the Company has applied to and the Stock Exchange has granted a waiver from the strict compliance with the relevant announcement and independent shareholders' approval requirements in respect of the Continuing Connected Transactions as described above.

The Company will ensure compliance with the applicable rules set out in Chapter 14A of the Listing Rules in relation to all of the ongoing connected transactions between the Group and each of Tianhong Printing and Dyeing and Nantong Textile.

### **Continuing connected transactions exempt from reporting, announcement and independent shareholders' approval requirements**

During the Track Record Period, the Group has subcontracted Tianhong Printing and Dyeing from time to time to provide printing and dyeing of the grey fabrics manufactured by the Group. The processing fees paid by the Group to Tianhong Printing and Dyeing amounted to approximately nil, nil, RMB230,000 and nil respectively during each of the three years ended 31 December 2003 and the five months ended 31 May 2004. The Group has subcontracted Tianhong Printing and Dyeing to provide the aforesaid services on normal commercial terms, which were no more favourable than those available to Independent Third Parties.

It is expected that the Group will continue to subcontract Tianhong Printing and Dyeing to provide its printing and dyeing services on normal commercial terms from time to time after Listing and the annual processing fees payable by the Group for to Tianhong Printing and Dyeing will not exceed RMB1,000,000.

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The Directors, including the independent non-executive Directors, consider that the above transactions are and will be entered into the ordinary and usual course of business. The terms of such transactions are and will be negotiated on arm's length basis, on normal commercial terms and are fair and reasonable so far as the independent Shareholders are concerned and are in the interests of the Company and its shareholders as a whole.

The above transactions will constitute continuing connected transactions under Rule 14A.33 of the Listing Rules and are exempt from the reporting, announcement and independent Shareholders' approval requirements so long as they are entered into on normal commercial terms and each of the percentage ratios (as defined under Rule 14.04(9) of the Listing Rules) (other than the profits ratio) is, on annual basis, less than 0.1%; or is equal to or more than 0.1% but less than 2.5% and the total consideration is less than HK\$1,000,000.