

INDUSTRY OVERVIEW

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INTRODUCTION

The consumer retail industry is affected by the economic health of the consumer market and the purchasing power of consumers. As an economy grows, wage levels and therefore individual disposable incomes tend to increase, leaving consumers with more money to spend on consumer retail products. In addition, changes or expected changes in the economic environment can affect individual expenditures on consumer retail products.

HONG KONG

The Hong Kong economy

Hong Kong is a relatively mature economy. In 2003, Hong Kong's annual per capita nominal gross domestic product ("GDP") was HK\$179,333 (approximately US\$23,080), second only to Japan in Asia and higher than some Western countries.

The table below shows the year-on-year growth in real GDP, per capita nominal GDP in HK dollars and US dollars and population in Hong Kong for the years indicated:

	2001	2002	2003
Real GDP (YoY, %)	0.5	1.9	3.2
Per capita nominal GDP (HK\$)	188,835	183,790	179,333
Per capita nominal GDP (US\$)	24,303	23,654	23,080
Population (millions)	6.76	6.79	6.85

Source: Hong Kong Census and Statistics Department website, updated August 2004

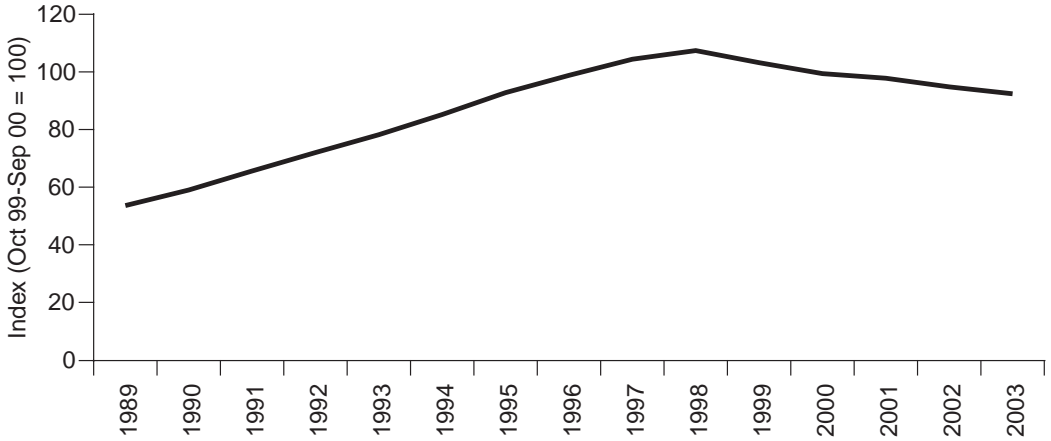
Consumers and consumer spending in Hong Kong

A number of factors have affected consumer spending in Hong Kong over the Track Record Period. Firstly, the Hong Kong economy has gone through a period of mild deflation, wage stagnation and economic contraction. Additionally, regional crises, including the outbreaks of SARS in 2003, had large adverse effects on consumer spending during those periods as people were less willing to venture into public places.

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Deflation is evidenced by Hong Kong's consumer price index ("CPI"), which measures the changes over time in the prices paid by consumers for a representative basket of goods and services. Hong Kong's CPI decreased steadily over the Track Record Period. The graph below indicates historical changes in Hong Kong's CPI.

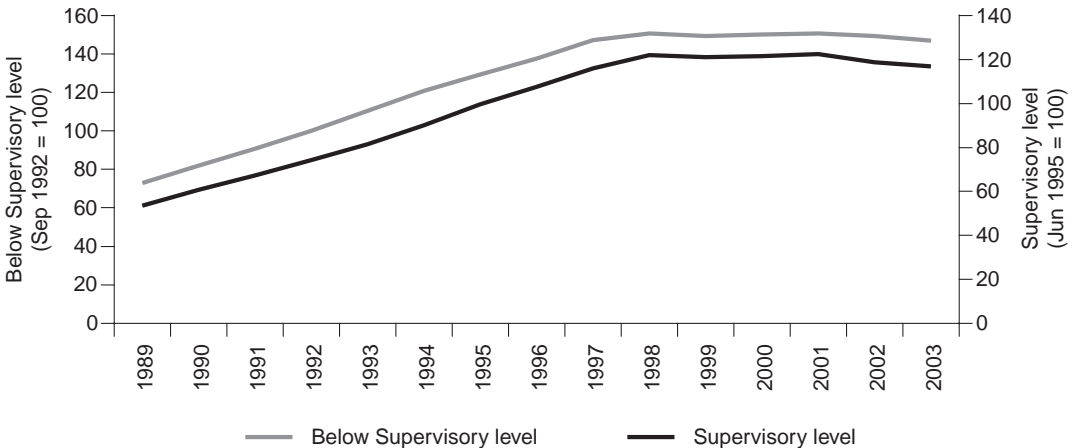
Hong Kong Consumer Price Index (1989–2003)



Source: Hong Kong Census and Statistics Department website, updated October 2004

Hong Kong experienced wage stagnation over much of the Track Record Period, which is illustrated by the nominal wage indices shown below.

Hong Kong Nominal Wage Indices (1989–2003)



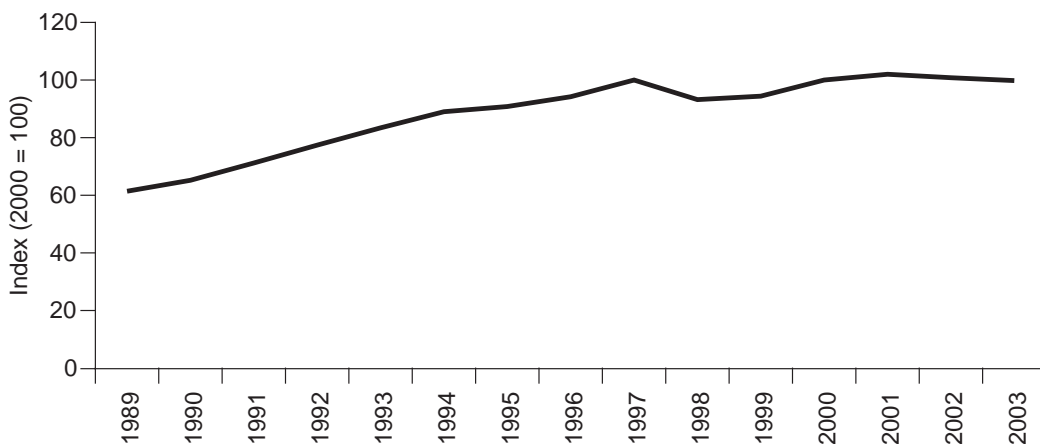
Source: Hong Kong Census and Statistics Department website, updated June 2004 (for below supervisory level) and updated November 2003 (for supervisory level)

Note: Below supervisory level wages for 1989–1998 as at September; all other years for both indices are as at December

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Throughout much of the Track Record Period, Hong Kong's private consumption expenditure index remained stable. The graph below illustrates historic changes in Hong Kong's private consumption expenditure index.

Hong Kong Private Consumption Expenditure Index (1989–2003)



Source: Hong Kong Census and Statistics Department website, updated August 2004

As detailed above, Hong Kong's economic indicators followed a declining or stagnant trajectory over the Track Record Period. However, more recent data obtained from the Hong Kong government indicate a recovery in Hong Kong's economy. Hong Kong's real GDP between the first half of 2003 and the first half of 2004 has increased significantly by 9.5% according to the Hong Kong Census and Statistics Department. The recovery in the economic situation in Hong Kong has also been reflected in Hong Kong's private consumption index, which has increased by 10.9% during the same period. Following these upward trends, Hong Kong's CPI began to show year-on-year increases from July to October of 2004.

The retail industry in Hong Kong

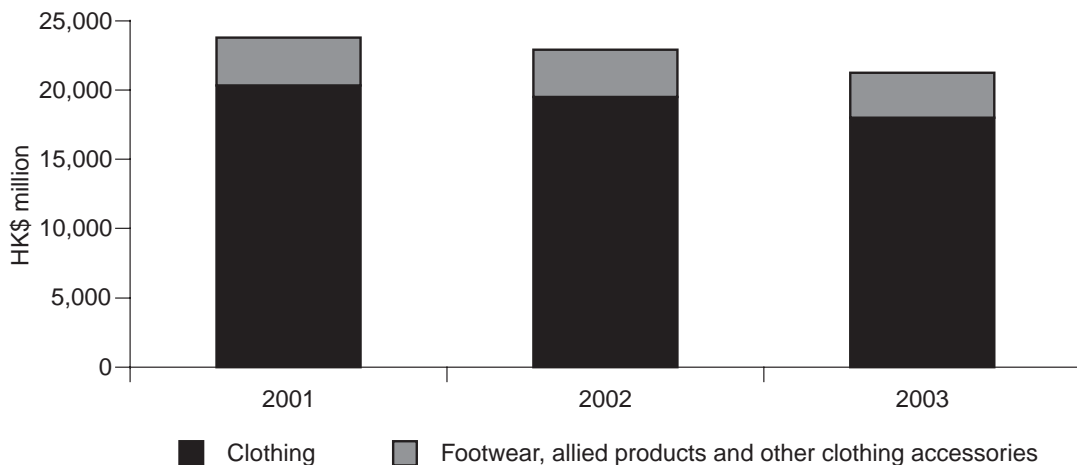
The retail apparel industry in Hong Kong is characterised by a large number of well-established market participants marketing products under an extensive number of both international and local brand names.

According to the Hong Kong government, retail sales of clothing, footwear, allied products and other clothing accessories in Hong Kong decreased from approximately HK\$23.8 billion (approximately US\$3.1 billion) in 2001 to HK\$21.3 billion (approximately US\$2.7 billion) in 2003, representing a 10.6% decrease. This decrease coincided with recessions experienced in parts of Asia, including Hong Kong, as well as regional crises such as the SARS outbreak in the first half of 2003.

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The chart below shows sales in clothing, footwear, allied products and other clothing accessories in Hong Kong since 2001:

Sales of Clothing and Footwear in Hong Kong (2001–2003)



Source: HKSAR Government Press Releases on Statistics of Retail Sales, updated August 2004

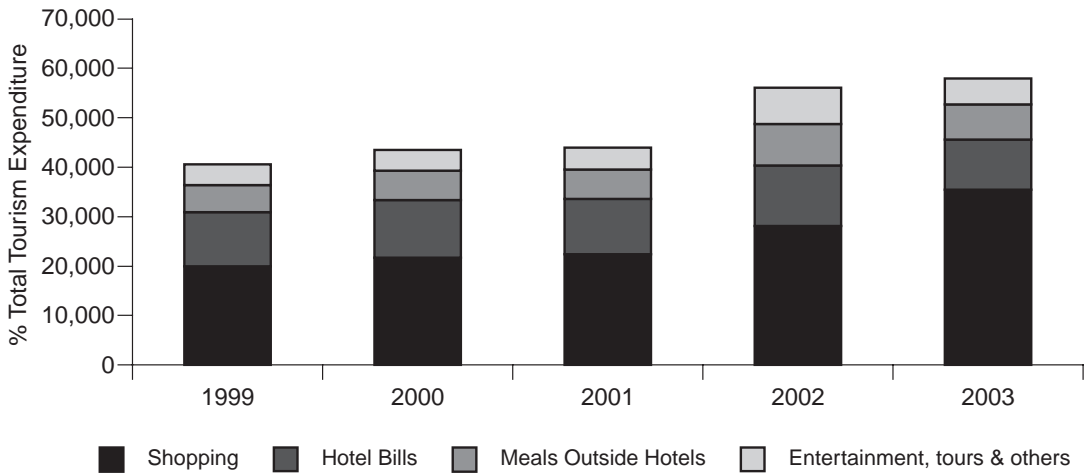
However, in line with the recent economic recovery in Hong Kong, retail sales in Hong Kong show signs of a recovery. According to the Hong Kong government in the first half of 2004, sales of clothing, footwear, allied products and other clothing accessories in Hong Kong increased by 21.3% over the same period in 2003, from HK\$10 billion (approximately US\$1.3 billion) to HK\$12.1 billion (approximately US\$1.6 billion).

The increase in Hong Kong's inbound tourism may positively affect the retail apparel industry in Hong Kong. According to statistics published by the Hong Kong government, in 2003, 15.5 million tourists visited Hong Kong spending HK\$46 billion (approximately US\$5.9 billion) on shopping. Shopping expenditures include purchases of ready-made apparel, food, cosmetics, shoes, handbags, wallets, belts, jewellery and a host of other products. As at the end of September 2004, the number of visitors to Hong Kong had already reached over 15.7 million, representing an average of 1.75 million visitors per month, an increase of 35% over the monthly average of 1.3 million visitors in 2003.

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The chart below details the increasing trend in tourism expenditures for the last five years.

Breakdown of Tourism Expenditure (1999–2003)



Source: Hong Kong Tourism Board, June 2004

Competition in Hong Kong

Competition in Hong Kong's retail apparel industry is fragmented but intense. Industry participants include multi-brand and single brand companies, both foreign and domestic, that compete for customers in different demographics. Participants competing for upper-middle class customers in their late twenties to thirties include luxury department stores and multi-brand stores such as *I.T.*, *Joyce*, *Lane Crawford*, *Seibu*, *Sogo* and *The Swank Shop*, and single-brand retailers such as *Prada*, *Gucci* and *Giorgio Armani*. The market segments served by such stores include consumers with a range of preferences, including high fashion. Competitors seeking to appeal to customers in their twenties and thirties who are more conscious of trends and high street fashion brands include international brands such as *Polo Jeans Company* and *CK Jeans* and local operators such as *Sistyr Moon*. Competitors seeking to appeal to a younger market in their teens and early twenties who are interested in "street fashion" include multi-brand retailers such as *double-park* and *X-Game* and single brand stores such as *Puma*.

Many local and international brands open up their own retail stores in Hong Kong to sell apparel directly to consumers. However, some brands rely on third party retailers to sell their apparel. Accordingly, Hong Kong's retail apparel industry participants also compete to secure licensing, franchise and distribution rights from such local and international brands. The competition consists of department stores, such as *Sogo*, *Lane Crawford* and *Seibu* and multi-brand and stand-alone retail outlets, such as *I.T.*, *Joyce*, *The Swank Shop*, *Sistyr Moon* and *X-Game*.

Further, with a limited amount of suitable retail space in Hong Kong, industry participants must also compete to secure prime retail locations.

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The barriers to entry into Hong Kong's retail apparel market are low for companies merely seeking to open one retail outlet to sell apparel, but are significant for companies that wish to open a chain of stores and establish brand recognition. Opening a chain of retail apparel stores requires significant capital expenditure to pay for expenses such as leases, leasehold improvements and inventory. In addition, companies wishing to start a chain of stores in Hong Kong face a limited supply of available quality retail space.

THE PRC

The PRC economy

The PRC's economy has experienced remarkable growth over the past ten years. Recently, the PRC economy has continued to grow at a rapid speed, recording a CAGR of 8.5% of its real GDP between 2001 and 2003 (official statistics).

The table below shows the year-on-year growth in real GDP, per capita nominal GDP in Renminbi and US dollars and population in the PRC for the years indicated:

	2001	2002	2003
Real GDP (YoY, %)	7.5	8.0	9.1
Per capita nominal GDP (RMB)	7,651	8,214	9,101
Per capita nominal GDP (USD)	921	988	1,095
Population (millions)	1,276	1,285	1,292

Source: Real GDP (YoY, %) data is from the China Economic Information Center, updated October 2004 (official statistics). All other data (including data in USD) from the Chinese Statistical Yearbook 2004 (official statistics)

Strong domestic demand and robust exports have been the major impetus for the PRC's recent accelerated economic growth. According to the Chinese Statistical Yearbook (official statistics), the country's retail sales of consumer goods increased from RMB 3.8 trillion (approximately US\$457 billion) in 2001 to RMB 4.5 trillion (approximately US\$541 billion) in 2003, representing a CAGR of 10.4%. The PRC has also been able to achieve strong export growth. In 2003, the PRC exported a total of RMB 3.6 trillion (approximately US\$433 billion) of goods and services worldwide. From 2001 through 2003, the PRC's exports grew at a CAGR of 28.4% according to the China Statistical Yearbook (official statistics).

Consumers and consumer spending in the PRC

The PRC has witnessed a significant increase in wages over the past few years. The table below illustrates the growth of the average annual salary of workers in the four municipalities and provinces of special economic zones ("SEZs"):

Average Annual Salary of Workers in the Four Municipalities and Provinces of SEZs in the PRC (1999–2003)

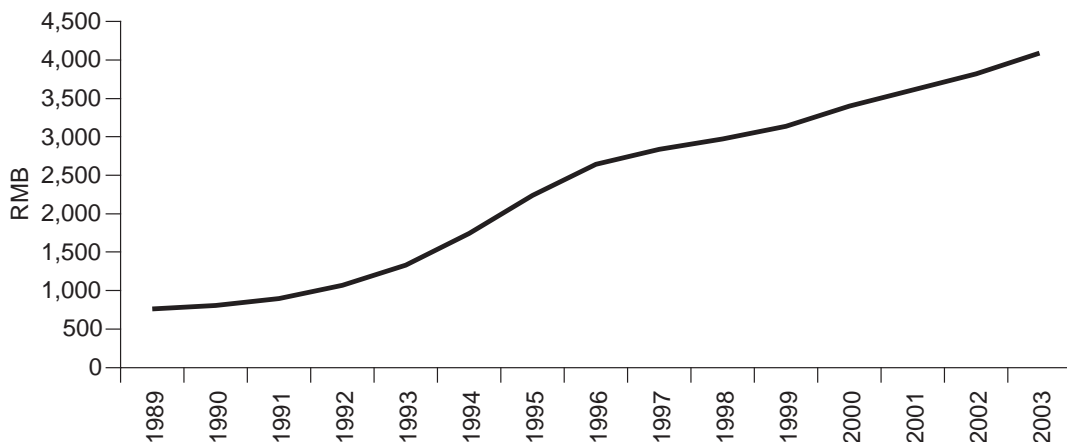
Year	Shanghai	Guangdong	Beijing	Tianjin	Zhejiang	Chongqing	Fujian	Average	% change
(all amounts in RMB)									
1999	16,641	12,245	14,054	11,056	11,201	7,182	9,490	11,696	14.1
2000	18,531	13,823	16,350	12,480	13,076	8,020	10,584	13,266	13.4
2001	21,781	15,682	19,155	14,308	16,385	9,523	12,013	15,550	17.2
2002	23,959	17,814	21,852	16,258	18,785	10,960	13,306	17,562	12.9
2003	27,304	19,986	25,312	18,648	21,367	12,425	14,310	19,907	13.4

Source: Chinese Statistical Yearbook 2000, 2001, 2002, 2003 and 2004 (official statistics)

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The increase in wages in the PRC has led to corresponding increases in consumer spending. Compared with the 1980s and 1990s, where wages were mainly spent on daily necessities, people in the PRC have begun to spend increasing amounts of money on luxury goods and services, including entertainment, holidays, clothing, wireless communications and cars. For example, in 2000, 50 out of 10,000 urban households in the PRC owned cars (official statistics). By 2003, 136 out of 10,000 urban households owned cars, representing a CAGR of approximately 39.6% over four years (official statistics). As at the end of August 2004 the total number of PRC mobile telephone users had grown to over 315 million, making the PRC the largest market for mobile telephones in the world (official statistics). The graph below illustrates the growth in PRC household consumption:

PRC Household Consumption (1989–2003)



Source: *Chinese Statistical Yearbook 2003 and 2004 (official statistics)*

The retail industry in the PRC

With a large population and rapid economic growth, the PRC represents a growing sales and marketing opportunity for retailers of consumer goods. The increase in personal wealth and purchasing power for many people in the PRC has therefore led to an increase in expenditures on clothing. The average annual per capita expenditure of urban households on clothing grew at a rate of approximately 10.7% and 7.9% in 2002 and 2003 respectively, in nominal terms (official statistics). The following chart shows the average annual per capita expenditure of urban households on clothing in the PRC from 2001 to 2003:

	Average annual per capita expenditure of urban households on clothing				
	1999	2000	2001	2002	2003
Clothing (RMB)	482.37	500.46	533.66	590.88	637.73
YoY growth (%)	0.3	3.8	6.6	10.7	7.9

Source: *China Statistical Year 2001, 2002, 2003 and 2004 (official statistics)*

PRC Regulations

Prior to the PRC's entry into WTO, foreign investments were severely restricted from providing retail services in the PRC for both their own proprietary operations and for third parties.

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On 25 June 1999, the PRC's State Economic Trade Commission and the Ministry of Foreign Trade and Economic Cooperation jointly issued the Measures. The Measures expanded the scope of potential foreign participation in the PRC retail sector to all provincial capitals and cities directly under the state planning. To gain access to the PRC market, non-PRC retailers must apply for permission from the PRC government in accordance with the Measures, which have high market entry thresholds for foreign investment enterprises.

However, to fulfill the PRC's WTO commitment to the opening up of its distribution services sector, the Ministry of Commerce issued the New Measures on 16 April 2004, which regulate foreign investments in distribution services such as wholesale, retail, commission agency and franchising. When the New Measures took effect from 1 June 2004, the Measures were abolished.

There are a number of major changes in the New Measures, including permitting foreign investors to engage in the operation of distribution services on a wholly owned basis from 11 December 2004. The New Measures also enlarge gradually the geographical coverage of foreign-invested commercial enterprises and lower the market entry threshold. In terms of requirements for foreign-invested commercial enterprises to set up stores, it is stipulated in the New Measures that foreign investors can apply to set up both commercial enterprises and stores at the same time in accordance with simplified procedures and clear guidelines.

According to the New Measures, the foreign invested commercial enterprise must meet the following conditions: (i) its minimum registered capital must comply with the requirements of PRC company law (RMB500,000 (approximately HK\$467,290) for wholesalers and RMB300,000 (approximately HK\$280,374) for retailers); (ii) it must comply with the normal total investment and registered capital requirements for foreign invested enterprises; and (iii) in general, its term of operations may not exceed 30 years, or 40 years in the western region of the PRC. Moreover, the foreign invested commercial enterprise must meet the following conditions to open retail stores: (i) if applying to open a store at the same time as applying to establish the enterprise, the proposed store must conform to the urban development plan and the commercial development plan of the city where it is located; and (ii) if applying to open a store after the establishment of the enterprise, then in addition to meeting the above requirement, the enterprise must also (a) have undergone annual inspection on time and passed, and (b) have received all of its registered capital from its investors.

The procedures for establishing a foreign invested commercial enterprise are first to submit an application (including a project description, feasibility study and other relevant documents required) to the relevant provincial level Commerce Bureau for preliminary approval. If that preliminary approval is granted, the application is submitted to the Ministry of Commerce for approval. Additionally, any retail stores to be opened by an established foreign invested commercial enterprise must be approved according to the same process. The approval process together generally does not exceed four months given the satisfactory submission of application documents. The approved foreign invested commercial enterprise shall be registered with competent Administration of Industry and Commerce within one month after the approval issued by the Ministry of Commerce or the authorised provincial branch.

Given the above and as further advised by the Group's PRC legal counsel, the subsidiaries of the Group's joint venture in the PRC should not have any material obstacle in obtaining approval for conversion into foreign invested commercial enterprises.