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## INDUSTRY OVERVIEW

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### CHINA TEXTILE AND APPAREL MANUFACTURING INDUSTRY

Since the initiation of economic reforms and open policies in the late 1970s, China's economy has been among the fastest growing economies in the world. The manufacturing of apparel has also started to shift from developed countries to developing or less developed countries since the cost of production is the critical competitive factor in the industry. Since then, the apparel manufacturing industry has become a pillar industry in the PRC and played a significant role in China's economy.

To take advantage of the abundance of low-cost labour and raw materials across the border, apparel factories were set up in Guangdong province of the PRC by lots of Hong Kong apparel companies in the early 1980s. As a result of the "Open Door Policy" endorsed by the PRC government in the late 1970s, the establishment of special economic zones in four Chinese southern cities, namely Shenzhen, Zhuhai, Shantou and Xiamen, also attracted foreign investments from Taiwan, Japan, South Korea, etc to set up apparel factories in China.

China's apparel industry has long been concentrated in its coastal areas, including Beijing, Fujian, Guangdong, Guangxi, Hainan, Hebei, Jiangsu, Liaoning, Shandong, Shanghai, Tianjin and Zhejiang. Coastal concentration continued after the introduction of market reforms due to the region's experience in managing apparel production, including convenient transportation and communication, good infrastructure, and "external economies of scale" such as easy access to financial institutions, trading companies, and export agents. However, the rising labour costs and the instability of raw materials supply along the coast have driven the apparel industry from coastal areas to inland locations, forming a more geographically dispersed industry. Coastal manufacturers have been compelled to move inland to achieve lower labour costs as manufacturers in other Asian countries (as well as inland Chinese manufacturers) become more competitive in the apparel industry. Furthermore, the coastal areas have been among the earliest regions in China to implement economic reforms, resulting in increased competition from Chinese private investors and foreign investors in the apparel industry in that area. Privately-owned enterprises, with their modern equipment and greater flexibility in product types, distribution channels, and types of incentive systems, are particularly fierce competitors.

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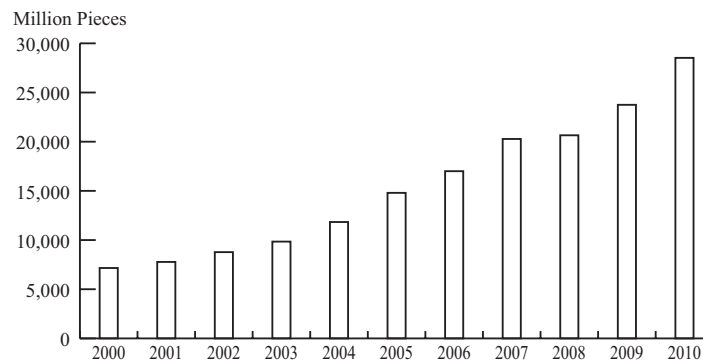
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Since then, China became the largest apparel manufacturer and exporter in the world. At that time, the majority of China's apparel exports were designed by foreign customers and made from imported fabrics. Most of these apparel products were intended for mass markets and charged at moderate or low prices.

Over the past 10 years, the production of apparel in China increased from approximately 7,159 million pieces in 2000 to approximately 28,523 million pieces in 2010, representing a CAGR of approximately 14.82%.

### China's production of Apparel from 2000 to 2010



*Source: Wind Info (a financial data and software service provider in the PRC)*

In 1992, China initiated efforts to establish a market economy. Reforms were expanded further to areas that were not covered previously, e.g. foreign retailers were allowed entry into China for the first time, major changes were introduced in the structure and role of financial institutions, and government policies that disallowed forward and backward integration in the fibre-fabric-apparel-retail channel were removed.

These reforms improved the flexibility and responsiveness of the Chinese apparel industry. Since the 21st century, the integrated production chain from fibre processing and dyeing at the upstream, down to fabrics and apparel production at the downstream has been formed in the PRC.

Nowadays, the China textile and apparel industry possesses an advantage in the international apparel markets in terms of low manufacturing cost and product design. Currently, most of the apparel manufacturers in the PRC still focus on the production of low to medium end products on OEM basis to take advantages of the low labour costs and scale of production or work with brand owners or retailers to design the fabric and apparel, while some of the manufacturers are moving forward and start shifting their focus from undertaking OEM to the building of their own brands and own domestic market for the domestic-made fabrics and apparel. The PRC government has also adopted policies to foster the building of own Chinese brands, to raise the proportion of export to international markets under domestic brand names as well as to boost the domestic consumption of domestic-made apparel.

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According to 《紡織工業“十二五”科技進步綱要》(Summary of Technological Improvements of the Textile Industry in the 12th Five-Years\*) (“**Summary**”) issued in November 2010 by the China National Textile and Apparel Council (中國紡織工業協會), the technology used in developing functional and differentiated fabrics has been improved during the 11th five-years. In particular, the improvements in the weaving and dyeing processes enhanced the quality and stability of the fabrics and hence added value thereon. The fabrics have also been developed from uni-functional (such as anti-bacteria or anti-wrinkles) to multi-functional for enhancing the added-value of apparel. As set out in the Summary, the self-sufficiency rate of fabrics within the PRC achieved 95% and the export amounts of fabrics grew at a CAGR of over 10% as compared to year 2000.

As the consumption demand for the functional knitwear has been increasing in recent years, functional knitwear such as waterproof, anti-bacteria, moisture-absorbing etc, has been marketed to the consumers continually. In light of this, the PRC textile industry in the coming few years, pursuant to the Summary, will continue to focus on the research and development of the textile products in order to popularise the application of the differentiated and functional fibres as well as to enhance the quality, class and added-value of the fabrics through diversification and individualisation.

The economic growth over the recent years in the PRC has also fueled the growth in China’s textile and apparel industry. However, the global financial crisis in 2008 slowed down the consumer demand globally, which in turn deteriorated the development of the China textile and apparel industry. To safeguard the healthy development of the industry in light of the global financial crisis, the PRC government has included the textile and apparel industry as one of the top ten-industry in its revitalisation plan and implemented favourable policies to support the textile and apparel manufacturers, including the tax rebate for export of apparel products since 1 August 2008, which has encouraged the textile and apparel enterprises and lifted profits of the whole industry. With the gradual recovery of the global and the PRC economy since 2009, both the exports and the domestic sales in the textile and apparel industry have revitalized. Yet, the potential increase in the cost of raw materials (in particular of cotton) and labour and the appreciation of RMB have become a challenge to the textile and apparel industry in the future.

### CHINA TEXTILE AND APPAREL EXPORT MARKET

Textile products serve as essential foreign trading goods. Prior to China’s joining of the WTO, the EU and the US normally imposed quota restrictions on China-made apparel products to protect their domestic textile and apparel manufacturing industries. Since China has joined the WTO in November 2001 and reached the ATC with members of the WTO, such quota restrictions previously imposed on China-made apparels were gradually removed and finally abolished on 1 January 2005.

According to the ATC, trade in apparel came under the rules of the GATT on 1 January 2005. Under the GATT, members of WTO are generally prohibited from using quotas to regulate trade, but they are permitted to use the tariffs in a non-discriminatory way. Accordingly, since 2005, after the abolition of the quota restrictions on 1 January 2005, the only restrictions left on China-made apparel products were the two transitional China-specific safeguard clauses

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(detailed below) restraining China imports from disrupting the WTO members' markets until 31 December 2008 and 2013 respectively and the anti-dumping protection from China-made goods for 15 years from the date of WTO accession of China, in November 2001.

In order to avoid a sudden influx of China-made textile and apparel, there were two transitional China-specific safeguard clauses under the current WTO rules allowing members of the WTO to restrict the imports of China-made textile and apparel. The first one is the Textile-Specific Safeguard Clause (“TSSC”), which was effective until 31 December 2008 and could be invoked by any member of the WTO who is able to show “market disruption” by Chinese textile imports serious enough to “impede the orderly development” of their own textile trade and request consultations with China, and China has to limit its shipments of the products cited to the level of the first twelve of the fourteen months prior to the complaint, plus 7.5% (6% for wool products) until agreement between the two parties is reached. If this is not effectively done, such member of the WTO can impose quantitative restrictions on imports of those products at the abovementioned levels. Such measures may be in place for only one year, although they can be reapplied after the expiry of that period.

Although, the TSSC has expired as of 31 December 2008, China is still subject to the second transitional China-specific safeguard clause, namely Product-Specific Safeguard Clause (“PSSC”), which will only expire on 10 December 2013 and apply to all products, including all textile and apparel products. When products of China are being imported into any member of the WTO in such increased quantities or under such conditions as to cause or threaten to cause market disruption to the domestic producers of like or directly competitive products, the affected member may request consultations with China and pursue application of a measure. If these bilateral consultations lead to an agreement that imports of Chinese origin are a cause of market disruption, where necessary, China may be required to take action to prevent or remedy the market disruption. If consultations do not lead to any agreement between China and the affected member within 60 days of the receipt of a request for consultations, the affected member has the right, in respect of such products, to withdraw concessions or otherwise limit imports, but only to the extent necessary to prevent or remedy such market disruption.

In addition to the PSSC, China is also subject to the anti-dumping protection for 15 years from the date of WTO accession until 2016. If a company exports a product at a price lower than the price it normally charges in its own home market, it is regarded as “dumping” the product. Under the GATT, it allows importing countries to take action against dumping, including charging extra import duty on a particular product from the particular exporting country in order to bring its price closer to the “normal price”. All anti-dumping measures must expire five years after the date of imposition, unless investigation shows that ending the measure would lead to injury to the domestic market of the importing country.

Notwithstanding the abovementioned trading restrictions left on China-made products, China continues to be the largest apparel exporter in the world.

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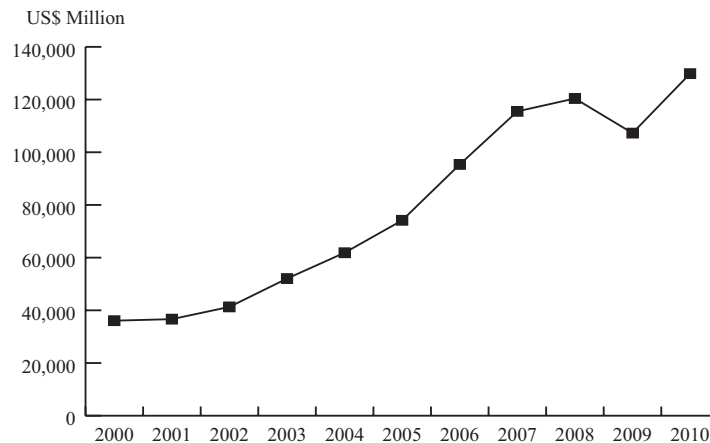
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### Exports from China

Being one of the world's largest export countries, the exports of textile and clothing from China have demonstrated an increasing trend over the last 10 years. Particularly since 2002 (the year after China joined the WTO), apparel exports from China showed a significant growth upon the removal of key tariffs and quotas. According to the PRC government, about 30% of the products from the textile industry have been exported to the international markets and the market share of China's export has ranked first in the last 10 years.

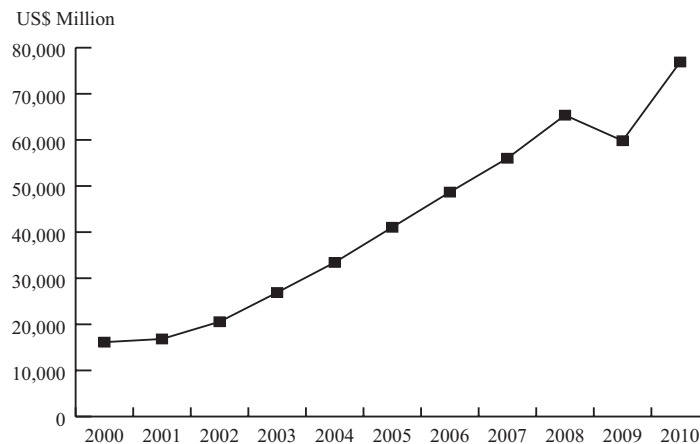
As illustrated in the charts below, China's exports of clothing to the world increased from approximately US\$36,071 million in 2000 to approximately US\$129,838 million in 2010, represented a CAGR of approximately 13.66%, its exports of textile to the world also increased from approximately US\$16,135 million in 2000 to approximately US\$76,900 million in 2010, represented a CAGR of approximately 16.90%.

#### China's Exports of Clothing to the World from 2000 to 2010



Source: WTO

#### China's Exports of Textile to the World from 2000 to 2010



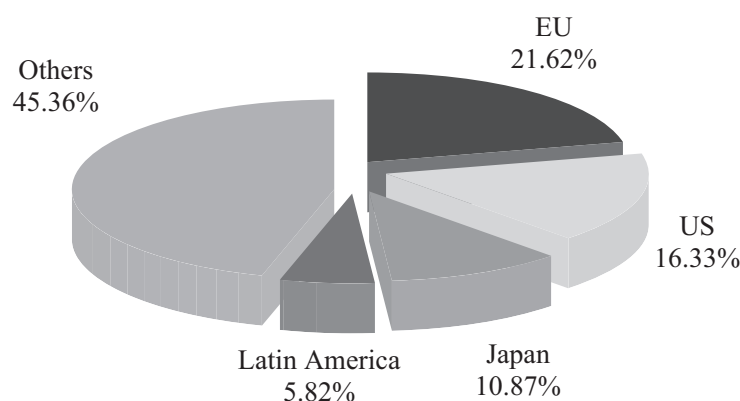
Source: WTO

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### Exports by Countries

In 2010, the EU was the largest importer of China's textile and apparel, which accounted for approximately 21.62% of the total export of China of approximately US\$206.53 billion. The US and Japan ranked the second and third largest importers respectively, and accounted for approximately 16.33% and 10.87% of the total export of China respectively. Latin America ranked fourth of the largest importers and accounted for approximately 5.82% of the total export of China. Imports of these top four importers represented approximately 54.64% of China's total exports of textile and apparel products in 2010.

**China's Exports of Textile and Apparel by Countries in 2010**



*Source: China Customs Statistics of China*

### EU Market

China has been the leading exporter of textile to the EU over the past years. In 2009, China ranked first in both the exports of apparel and apparel accessories; as well as textile yarn, fabrics and related products, followed by Turkey. China's market share of exports to EU is far ahead of other countries'.

**Top 5 Exporters of Textile and Apparel to EU in 2009**

| Rank | Apparel and Apparel Accessories |                             |                   | Textile Yarn, Fabrics and Related Products |                             |                   |
|------|---------------------------------|-----------------------------|-------------------|--|-----------------------------|-------------------|
|      | Country                         | Export value<br>(€ million) | % of share<br>(%) | Country                                    | Export value<br>(€ million) | % of share<br>(%) |
| 1    | China                           | 27,296                      | 44.8              | China                                      | 5,034                       | 31.0              |
| 2    | Turkey                          | 7,147                       | 11.7              | Turkey                                     | 2,840                       | 17.5              |
| 3    | Bangladesh                      | 5,126                       | 8.4               | India                                      | 1,780                       | 11.0              |
| 4    | India                           | 4,530                       | 7.4               | Pakistan                                   | 1,338                       | 8.2               |
| 5    | Tunisia                         | 2,283                       | 3.7               | Switzerland                                | 709                         | 4.4               |

*Source: Statistical yearbook, European Commission*

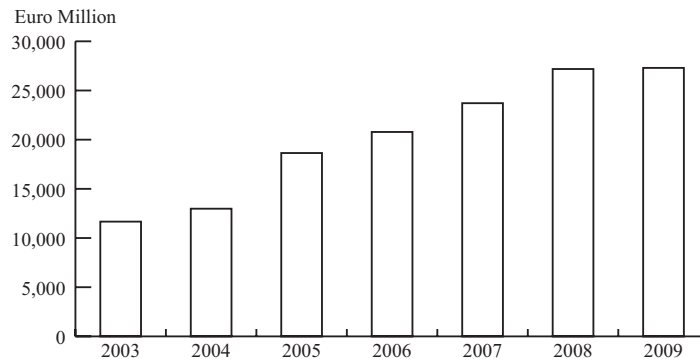
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According to the statistics yearbook of European Commission, the import of apparel and apparel accessories by the EU from China showed a CAGR of approximately 15.22% from 2003 to 2009. In 2009, the total import value of apparel and apparel accessories from China amounted to approximately €27,296 million, accounting for approximately 44.8% of the EU's total imports.

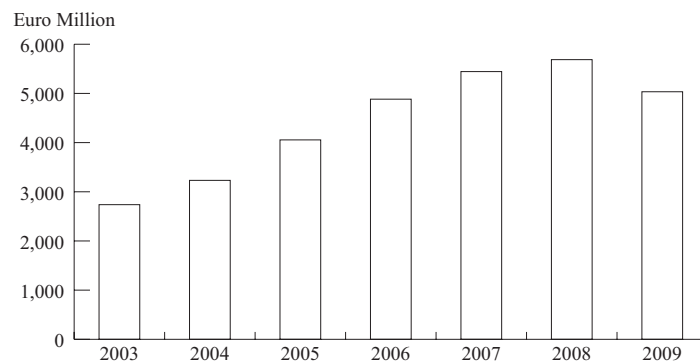
### EU's Imports of Apparel and Apparel Accessories from China from 2003 to 2009



Source: Statistical yearbook, European Commission

The textile yarn, fabrics and related products imported by the EU from China, according to the statistics yearbook of European Commission, increased from approximately €2,738 million in 2003 to approximately €5,034 million in 2009, representing a CAGR of approximately 10.68%. The market share of China's export increased from approximately 16.8% in 2003 to approximately 31% in 2009.

### EU's Imports of Textile Yarn, Fabrics and Related Products from China from 2003 to 2009



Source: Statistical yearbook, European Commission

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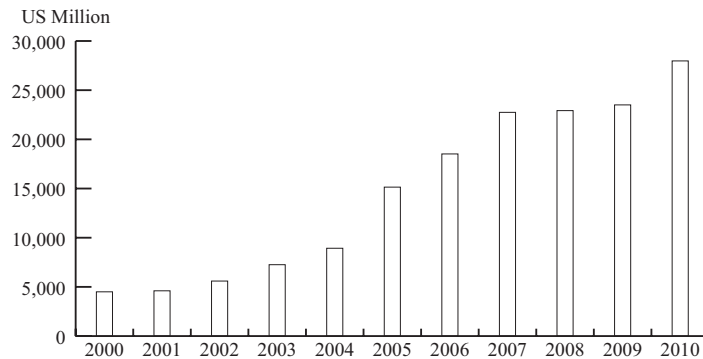
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### US Market

China is also the largest exporter of apparel to the US. In 2010, the imports of apparel from China accounted for about 39.18% of total apparel imports of the US in 2010. According to the US Office of Textiles and Apparel, the apparel imported by the US from China grew from approximately US\$4,498.97 million in 2000 to approximately US\$27,975.01 million in 2010, representing a CAGR of approximately 20.05%.

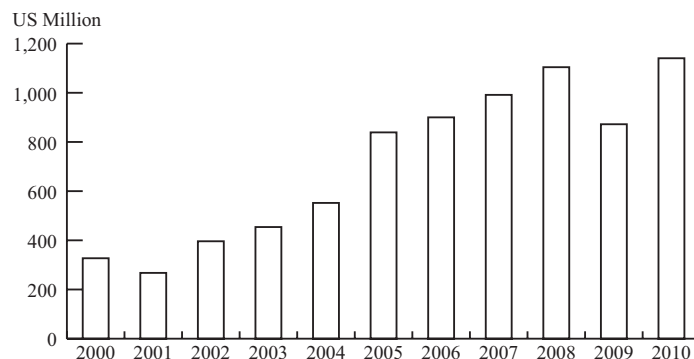
#### US's Imports of Apparel from China from 2000 to 2010



Source: US Office of Textiles and Apparel

Apart from importing apparel, the US has also imported fabrics from China over the last ten years. In accordance with the US Office of Textiles and Apparel, China has been the major exporter of fabrics to the US and the fabrics imported from China by the US accounted for approximately 23.91% of the total fabrics imported in 2010. The fabrics imported by the US from China increased from approximately US\$327.10 million in 2000 to approximately US\$1,140.48 million in 2010, representing a CAGR of approximately 13.30%. Despite there was a decrease in import of fabrics from China in 2009, the import has bounced back and increased by approximately 30.78% in 2010.

#### US's Imports of Fabrics from China from 2000 to 2010



Source: US Office of Textiles and Apparel



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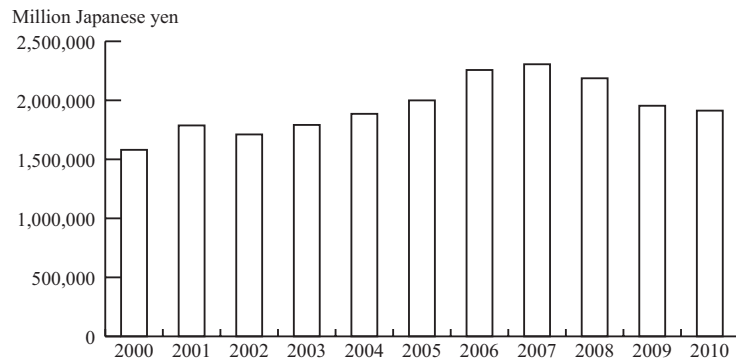
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### Japan Market

According to the Ministry of Finance, Japan, imports of apparel and accessories from China to Japan were relatively stable during the period from 2000 to 2010. In 2010, Japan imported approximately 1,912,729 million Japanese yen of apparel and accessories from China.

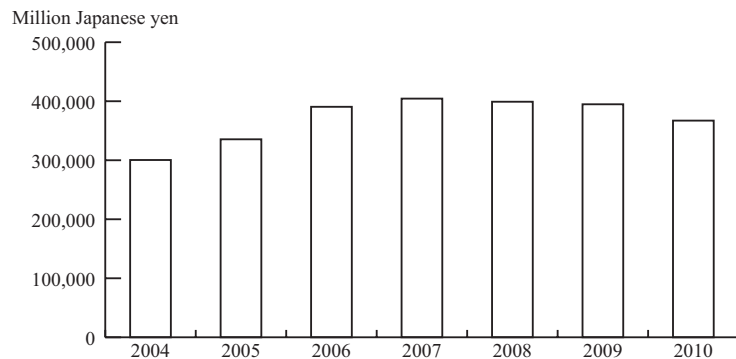
#### Japan's Imports of Apparel and Accessories from China from 2000 to 2010



Source: Ministry of Finance, Japan

In addition to apparel and accessories, Japan also imported textile yarn and fabrics from China. In 2010, textile yarn and fabrics amounting to approximately 367,159 million Japanese yen were imported to Japan from China.

#### Japan's Imports of Textile Yarn and Fabrics from China from 2004 to 2010



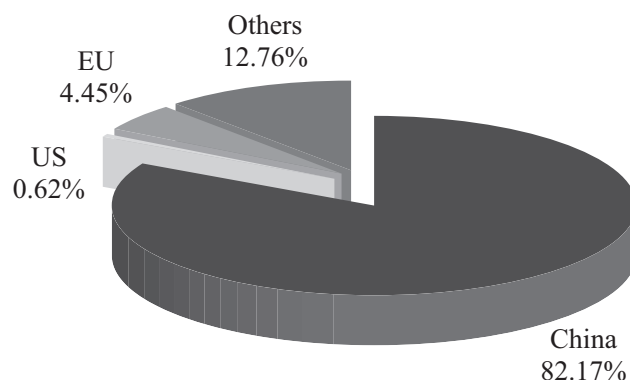
Source: Ministry of Finance, Japan

Although total volume of imports dropped slightly by approximately 2.12% from approximately 1,954,083 million Japanese yen in 2009 to approximately 1,912,729 million Japanese yen in 2010 for apparel and accessories and approximately 7.01% from approximately 394,844 million Japanese yen in 2009 to approximately 367,159 million Japanese yen in 2010 for textile yarn and fabrics, China remained as the single largest import market of Japan

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and accounted for market shares of approximately 82.17% of its total imports of apparel and accessories and approximately 58.91% of its total imports of textile yarn and fabrics respectively, as illustrated in the chart and table below.

### Japan's Imports of Clothing and Accessories by Countries in 2010



*Source: Ministry of Finance, Japan*

### Japan's Import of Textile Yarn and Fabrics by Countries in 2010

| Countries    | Value<br>(Million<br>Japanese<br>yen) | Market<br>Share<br>(%) |
|--------------|---------------------------------------|------------------------|
| <b>China</b> | <b>367,159</b>                        | <b>58.91</b>           |
| EU           | 46,302                                | 7.43                   |
| US           | 18,043                                | 2.89                   |
| Others       | 191,799                               | 30.77                  |
| <b>Total</b> | <b>623,303</b>                        | <b>100.00</b>          |

*Source: Ministry of Finance, Japan*

## TEXTILE AND APPAREL INDUSTRY IN SHANDONG PROVINCE, THE PRC

Nowadays, about 80% of the textile factories in the PRC are located in the major coastal provinces. Equipping with well-established infrastructure, highly efficient logistics and transport as well as well-developed industry auxiliaries, the coastal areas in the PRC are the production bases for apparel worldwide. The top five provinces, namely Zhejiang, Guangdong, Jiangsu, Shanghai and Shandong, accounted for approximately 75.63% of the total apparel exports of China in 2010 with an export value amounted to approximately US\$156.20 billion.

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Shandong is one of the traditional apparel exporting provinces and ranked among the top five in the PRC, which recorded an export value of approximately US\$17.32 billion for the year 2010. Besides, Shandong is also one of the major consumption provinces in the PRC with its population of about 96 million at the end of 2010. As a result, demands for both overseas and domestic textile and apparel products are expected to be immense and provide an advantageous potential for the development of textile and apparel industry in Shandong. The 2009 Exhibition of Fabrics, Yarns and Accessories held in Shandong, the PRC, which was organised by various apparel associations, such as 山東省紡織工業協會 (Shandong Textile and Apparel Association\*) and 山東省服裝行業協會 (Shandong Provincial Garment Association\*), expected that the demands for textile yarn and accessories for production of textile will increase on an annual rate of about 20% per year.

### Top Five Apparel Exporting Provinces in China

| Rank | Province       | 2009  |                   | 2010  |                   |
|------|----------------|---|-------------------|---|-------------------|
|      |                | Export Value<br>(US\$ billion)<br>(Approximate) | % to total export | Export Value<br>(US\$ billion)<br>(Approximate) | % to total export |
| 1    | Zhejiang       | 39.75   | 23.8              | 49.76   | 24.1              |
| 2    | Guangdong      | 30.99   | 18.6              | 37.69   | 18.3              |
| 3    | Jiangsu        | 26.71   | 16.0              | 33.58   | 16.3              |
| 4    | Shanghai       | 15.29   | 9.2               | 17.85   | 8.6               |
| 5    | Shandong       | 14.19   | 8.5               | 17.32   | 8.4               |
|      | Other province | 40.09   | 23.9              | 50.33   | 24.3              |
|      | Total          | <u>167.02</u>                                   | <u>100%</u>       | <u>206.53</u>                                   | <u>100%</u>       |

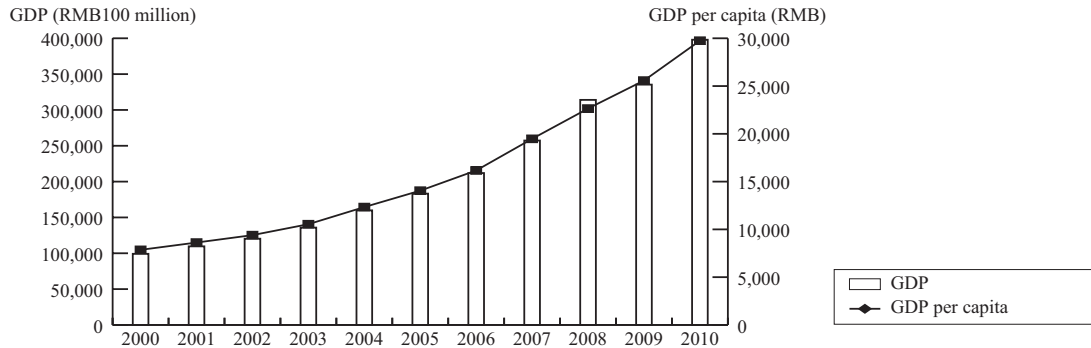
Source: China Customs Statistics

## CHINA DOMESTIC CONSUMER MARKET

With the rapid economic growth and large population, China has become an important consumer market. According to 中華人民共和國國家統計局 (National Bureau of Statistics of China), China has grown substantially over the last 10 years with GDP growing at a CAGR of approximately 14.90% from approximately RMB9,921.5 billion in 2000 to approximately RMB39,798.3 billion in 2010. The GDP per capita has also grown from approximately RMB7,858 in 2000 to approximately RMB29,748 in 2010, represented a CAGR of approximately 14.24%, implying that the domestic consumers have been fast gaining the financial ability to spend on consumption. The International Monetary Funds (“IMF”) also forecasts an optimistic outlook on the economic growth of China with an approximately 9.4% growth in GDP and approximately 8.9% growth in GDP per capita per annum for the years from 2011 to 2016.

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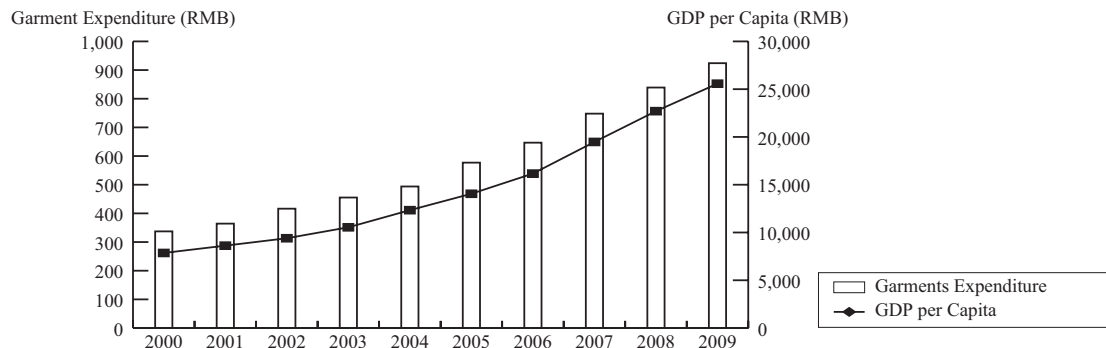
### China's GDP and GDP per Capita from 2000 to 2010



*Source: National Bureau of Statistics of China*

The improving economic conditions in China and the supporting policies from the PRC government enhance the importance of domestic consumer market of China, including domestic apparel market. The global financial crisis in 2008 has also led to the Chinese textile and apparel manufacturers to shift their focus from the overseas markets to the domestic markets. As illustrated in the chart below, over the past 10 years, the per capita annual garments expenditure in urban area has grown steadily, and aligned with the growth in GDP per capita.

### China's Per Urban Household Capita Annual Garments Expenditure from 2000 to 2009



*Source: National Bureau of Statistics of China*

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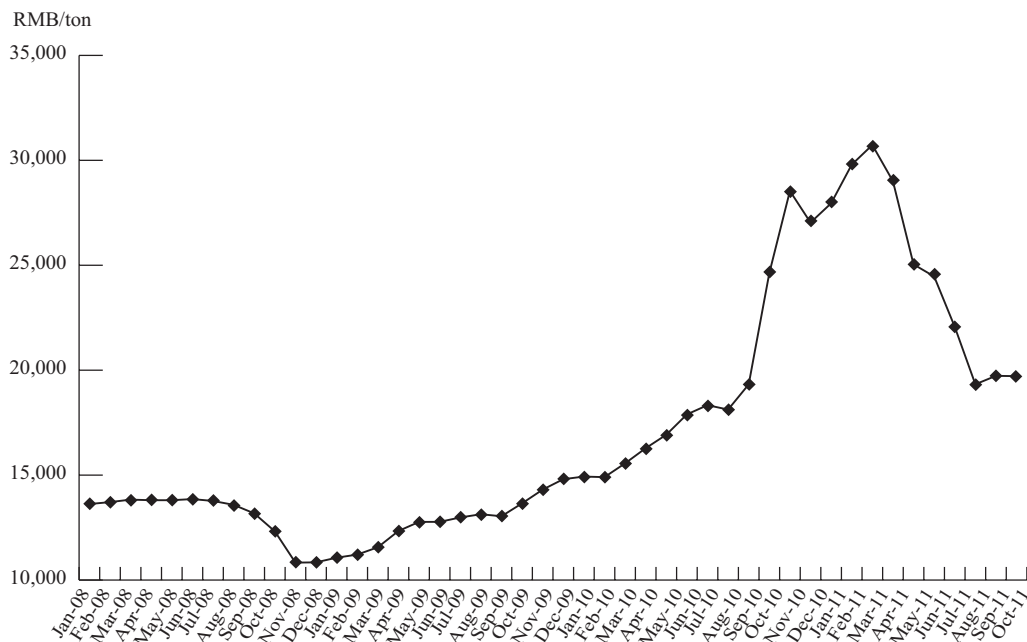
### KEY RAW MATERIALS CONSUMED BY OUR GROUP

Cotton yarns, synthetic yarns and greige fabrics are the major raw materials consumed for the manufacturing of our Group's general and functional innerwear and fabrics. The costs of both cotton yarns and synthetic yarns can be volatile depending on the cotton and crude oil prices which are largely determined by the supply and demand of cotton and crude oil price in the commodity markets. The price trends of cotton and crude oil from January 2008 to October 2011 are set out in the charts below.

#### Cotton yarns and cotton price trend in the PRC

Since cotton yarns and greige fabrics are among the major raw materials for our Group's manufacturing, the price fluctuation on cotton was one of the key factors which affected our Group's cost of production. The China Cotton Index, which is the price of cotton per ton in RMB delivered to mills for manufacturing cotton fabric, as quoted by the China Cotton Association can be used as a reference for the price of cotton fabric procured in the PRC. During the Track Record Period, the monthly average price of cotton decreased since July 2008 which was mainly due to the fact that demand for cotton significantly decreased as a result of the global financial crisis in 2008 and reached its bottom of RMB10,830 per ton in November 2008. However, since early 2009, the monthly average price of cotton increased substantially and reached its highest at RMB30,732 per ton in March 2011 during the Track Record Period. The average cotton prices during the Track Record Period were approximately RMB13,096, RMB12,804, RMB19,373 and RMB27,832 per ton respectively while our average cost of cotton yarns was approximately RMB21.3, RMB20.7, RMB28.1 and RMB33.7 per kg respectively.

**China Cotton Index**



*Source: China Cotton Association (The above China Cotton Index is for cotton of 328 grading)*

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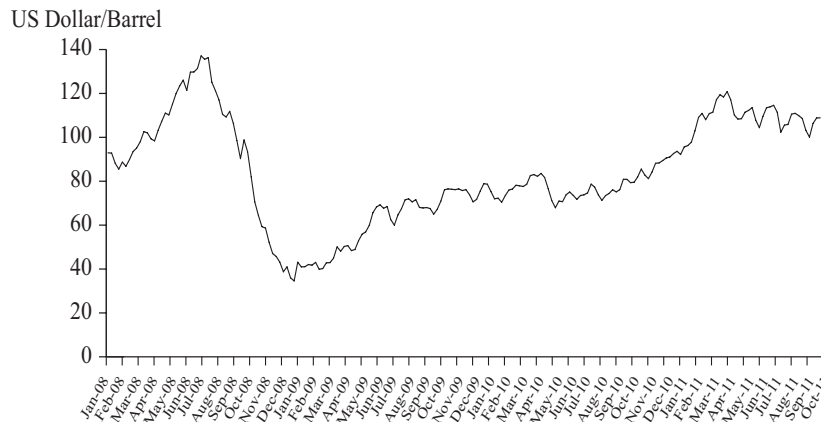
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### Synthetic yarns and crude oil price trend

Synthetic yarns are the major raw materials for our production of functional fabrics. We purchased over 500 kinds of synthetic yarns during the Track Record Period with an average cost of approximately RMB23.0, RMB28.2, RMB39.0 and RMB50.7 per kg respectively. There are numerous types of synthetic yarns available in the market and prices of these synthetic yarns vary based on their respective chemical compositions and functions. However, the price trend of synthetic yarns can be reflected from the cost of crude oil, which is the key component of many kinds of fibre for synthetic yarns that in turn affects our production costs. During the Track Record Period, the crude oil price reached its highest in July 2008 at approximately US\$137 per barrel according to the world crude oil price as illustrated in the figure below. The crude oil price then decreased substantially to its lowest in January 2009 and began to increase steadily since then. The average crude oil prices during the Track Record Period were approximately US\$95.62, US\$60.07, US\$77.68 and US\$107.09 per barrel, respectively.

### Crude Oil Price



Source: Energy Information Administration

### COMPETITION IN THE OEM APPAREL INDUSTRY IN THE PRC

The PRC is one of the world's key producers and exporters of apparels. Characterised by the low capital requirement and labour-intensive nature, the entry barrier of the OEM apparel industry is low. Most of the PRC apparel manufacturers mainly focus on low and medium end garment products and engage principally in export-oriented OEM segment of the industry. As a result, the OEM apparel industry is highly fragmented with intense competition due to the abundance of labour with low cost and skills. In view of this industry environment, our Group represents a mere fraction of the overall OEM apparel industry of the PRC with our total unit of innerwear production for the year ended 31 December 2010 of approximately 18.717 million pieces representing only approximately 0.066% of the total production of the apparel in the PRC amounted to 28,523 million pieces. Our Directors believe that there is no particular player in the market that is capable of dominating the industry given such a high fragmentation rate within the OEM apparel industry in the PRC.

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Despite we only represent a small market share within the whole apparel industry, our Directors believe that the established relationships with the customers and proven track record provide continuous support to our Group's growth with our aim to pursue differentiation in high-value added products and continuous quality improvement.