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### OVERVIEW

We are a functional fabric and innerwear manufacturer established in the PRC, offering various types of functional fabrics and innerwear for infants, toddlers as well as adults. We manufacture functional and customised fabrics for major lingerie and apparel brands including *Triumph*, *Wacoal*, *Embry Form*, *Maniform* (曼妮芬), *Aimer* (愛慕), *Miiow* (貓人) (previously known as *Maoren*), *Sunlaura* (桑扶蘭) and *VANCL* (凡客誠品), and innerwear products on an OEM basis for major apparel brands including *Outdoor*, *Ito-Yokado* (伊藤洋華堂), *Pigeon*, *Lee*, *Puma*, *DKNY*, *Carter's* and *Orsay*. Our products are mainly sold to (i) the sourcing agents, who then resell to the renowned apparel brands; (ii) the wholesaler, who then resell to retail shops and department stores; and (iii) the brand owners directly. To the best of the knowledge of our Directors, we are not aware of any relationship (apart from normal business relationship) between the brand owners and their respective sourcing agents as well as between the wholesaler and its end customers.

We have established a business model integrated with fabric and innerwear manufacturing and sale. We are vertically integrated and highly mechanised, as featured by the following production processes: (i) fabric weaving and knitting; (ii) fabric dyeing and finishing; (iii) fabric printing; and (iv) innerwear cutting and sewing. Our vertically integrated operations allow us to factor in the specific requirements of our customers in each production process. We are therefore able to offer our customers greater flexibility in their order specifications in the textile supply chain.

Our fabrics feature a variety of colours and patterns, and by combining different fibre mixtures, cotton counts and knitting methods, they could satisfy the specifications and functional requirements set by our customers. We make use of functional and chemical fibres, i.e. yarns having special functions such as temperature regulation or moisture absorption, to produce fabrics with such functions. We have also been licensed by Outlast, a worldwide company involved in the research, development, design and marketing of phase-change materials, to manufacture and sell certain Outlast's fabrics which comprise microencapsulated phase-change materials coated fabrics or fibres in China. During the Track Record Period, sales of fabrics accounted for approximately 17.4%, 13.3%, 31.9% and 32.8% of our revenue respectively.

In addition, we use our own fabrics in the manufacture of innerwear products, with a growing focus on utilising our functional fabrics for innerwear. Sales of innerwear products contributed to approximately 82.6%, 86.7%, 68.1% and 67.2% of our revenue respectively during the Track Record Period.

Based on the confirmations given by the sourcing agents, our fabrics and innerwear products sold to them are used by relevant brand owners they represent. For our innerwear products, they are labelled or packed with the packaging materials bearing the names and/or logos of the relevant brand provided by the respective sourcing agents or brand owners.

Our production facilities are based in Zhucheng, Shandong, the PRC with an aggregate gross floor area of more than 52,000 sq.m. as at the Latest Practicable Date. Equipped with modern production facilities, our annual production capacity of innerwear was approximately

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18.6 million pieces and our annual production capacity of fabrics was approximately 4,000 tons as at the Latest Practicable Date. During the Track Record Period, our revenue grew from approximately RMB136.2 million in 2008 to approximately RMB378.3 million in 2010, representing a CAGR of approximately 66.7%.

The following table sets forth our selected financial information and operating data for the Track Record Period:

### Selected income statement data:

	For the year ended 31 December			For the six months ended 30 June	
	2008 (RMB'000) (audited)	2009 (RMB'000) (audited)	2010 (RMB'000) (audited)	2010 (RMB'000) (unaudited)	2011 (RMB'000) (audited)
Revenue	136,188	194,912	378,289	101,357	140,158
Gross Profit	33,669	67,416	105,645	28,573	46,642
Profit before tax	9,450	40,737	66,405	12,279	10,666
Total comprehensive income	8,046	31,446	53,666	9,585	4,187

### Selected operating data:

	For the year ended 31 December			For the six months ended 30 June	
	2008 (audited)	2009 (audited)	2010 (audited)	2010 (unaudited)	2011 (audited)
Gross profit margin	24.7%	34.6%	27.9%	28.2%	33.3%
Profit margin based on profit before tax	6.9%	20.9%	17.6%	12.1%	7.6%
Profit margin based on total comprehensive income	5.9%	16.1%	14.2%	9.5%	3.0%

	For the year ended 31 December			For the six months ended 30 June	
	2008	2009	2010	2010	2011
Sales volume					
— Fabrics (tons)	584	566	1,718	584	594
— Innerwear (thousand pieces)	12,028	14,697	19,794	6,333	6,799

We focus on overseas markets for our innerwear products. During the Track Record Period, export sales of our Group amounted to approximately RMB116.1 million, RMB162.6 million, RMB229.4 million and RMB95.0 million respectively, representing a CAGR of approximately 40.6% and contributed to approximately 85.3%, 83.4%, 60.6% and 67.8% respectively of our revenue during the Track Record Period.

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We plan to expand and upgrade our production facilities and capacities in order to enhance our strength in developing and manufacturing functional fabrics, which, our Directors believe, offer higher profit margin. It is our strategy to maintain our continuing focus on the Japanese market and expand further in the PRC and overseas markets. We will also build up our ODM capability so as to strengthen our research and development ability for developing products to be marketed under our own brand “UTEX”. In this way, our Group strives to grow into one of the leading Chinese functional fabric and innerwear manufacturers for major international apparel brands.

Our Directors believe that our close proximity to the ports in Qingdao, Shandong, the PRC, allows us to benefit from the efficient logistics infrastructure available in Qingdao, which was ranked the ninth largest port in the world in terms of container traffic by the American Association of Port Authorities in 2009.

### EARTHQUAKE IN JAPAN

We sell both fabrics and innerwear products to our Japanese customers. During the Track Record Period, our revenue generated from sales to the Japanese market contributed to approximately 84.4%, 82.4%, 51.9% and 56.0% of the total revenue of our Group respectively. As at 30 June 2011, trade receivables due from our Japanese customers amounted to approximately RMB4.7 million, representing approximately 14.8% of our total trade receivables and all of which have been settled as at the Latest Practicable Date.

In March 2011, Japan was hit by the Higashi Nihon Daishinsai (東日本大震災), which was caused by a 9.0-magnitude earthquake occurred in the Tohoku district, northeast of Japan. The earthquake triggered destructive tsunami which struck the northeastern coast of Japan, and led to an explosion at the nuclear power plant in Fukushima, Japan, leading to a public concern on possible nuclear meltdown and radiation leakage. The catastrophe has caused extensive damage and more than 10,000 deaths, and the estimated economic loss is up to approximately US\$300 billion. Our Group has inquired with our Japanese customers as to the impact of the catastrophe on them. Based on the latest information obtained by our Directors, our Japanese customers, being either brand owners, their respective sourcing agents, or the wholesaler (or its end customers which are retail shops and department stores), have not suffered significant loss or damage. Since the occurrence of the catastrophe, we have not received any cancellation of orders from our Japanese customers and have not experienced any material fluctuation in the aggregate volume of orders from them. We also have not received any request from our Japanese customers for deferral of payment to us or any indication as to their inability to pay any amount due to us. In addition, we made enquiries with our major Japanese customers shortly after the earthquake, none of these customers claimed that they suffered from serious damage from the earthquake as their major operations are not in the northeastern part of Japan. Based on the above, our Directors are of the view that our sales to the Japanese customers and the recoverability of the trade receivables from them will not be significantly adversely affected in the near future. Our sales to Japanese customers for the six months ended 30 June 2011 amounted to approximately RMB78.4 million, increased by approximately 37.9% from RMB56.9 million for the corresponding period in 2010.

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### *Situation of, and orders from, our major Japanese customers since the earthquake*

#### **Toray Trading (Shanghai) Co. Ltd. (“Toray Shanghai”)**

Toray Shanghai, a subsidiary of Toray Group, our largest customer for 2009, 2010 and the six months ended 30 June 2011, is the sourcing agent of Ito-Yokado Group, an established retail group in Japan. Based on the inquiry with Toray Shanghai, our Directors understand that only 3 (out of 174) outlets of Ito-Yokado Group have been damaged during the Higashi Nihon Daishinsai and the earthquake has not caused any material adverse impact on Toray Group. Toray Shanghai has indicated that the Higashi Nihon Daishinsai has not significantly adversely affected its customers’ demands. In early April 2011, our Group obtained request from Toray Shanghai to reserve adequate innerwear production capacity to satisfy potential orders from it in the remaining months of 2011. The total confirmed sales orders thus far received by our Group from Toray Shanghai for the year 2011 have been increased by approximately 30% over the preliminary sales orders received for the year 2010. Our sales to Toray Group increased by approximately 104.3% from approximately RMB18.7 million for the six months ended 30 June 2010 to approximately RMB38.1 million for the same period in 2011.

#### **Itochu Textile (China) Co. Ltd. (“Itochu Textile”)**

Itochu Textile, not our top five customers during the Track Record Period, whose major business includes, among others, manufacturing and exporting textile products to Japan, mainly purchases functional fabrics for innerwear from our Group. Based on the inquiry with Itochu Textile, our Directors understand that Itochu Textile’s parent company is based in Osaka and has no branch in northeast Japan, and as such its operations remain normal after the Higashi Nihon Daishinsai. During the first half 2011, our sales to Itochu Textile amounted to approximately RMB222,000 represented a decrease of approximately 74.4% from approximately RMB867,000 for the corresponding period in 2010. Despite the decrease in sales in the first half 2011, our Group has continued to receive orders from Itochu Textile. In view of the above, our Directors are of the view that the Higashi Nihon Daishinsai has no significant adverse effects on the sales to this customer.

#### **Growly Co. Ltd. (“Growly Co.”)**

Growly Co., which is one of our top five customers in 2008 and 2009 and the sourcing agent of various brands. eg., *Lee*, mainly purchases functional innerwear from our Group. Based on the inquiry with Growly Co., we understand that the Higashi Nihon Daishinsai has caused limited impact on it as its operations are mainly located in central Japan, which is far away from the main disaster areas. Growly Co. further indicated that the earthquake has not caused any material adverse impact on its customers, who are located all around Japan. Given the disruption of electricity supply in northeast Japan caused by the Higashi Nihon Daishinsai, Growly Co. expects the demand for functional innerwear in northeast Japan to increase in the coming winter. As such, it is expected by our Directors that Growly Co.’s purchase order with our Group for the winter series will be at least maintained at similar level in 2010. During the six months ended 30 June 2011, our sales to Growly Co. amounted to approximately RMB5.8 million, representing an increase of approximately 4.4% as compared to that of approximately RMB5.5 million sales in the first half of 2010.

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### **Qingdao Jyunsei International Trade Co. Ltd. (“Qingdao Jyunsei”)**

Qingdao Jyunsei, one of our top five customers in 2008 and 2009, is the sourcing agent of *Outdoor*. Based on the inquiry with Qingdao Jyunsei, our Directors understand that it is based in Osaka and has no operations in northeast Japan. In addition, most of its customers are located in south of Tokyo, which are not directly affected by the Higashi Nihon Daishinsai. Separately, Qingdao Jyunsei has also indicated its intention to extend the orders with our Group to brands other than *Outdoor*. In view of the above, our Directors are of the view that sales to this customer will not be significantly adversely affected in the near future. During the six months ended 30 June 2011, our sales to Qingdao Jyunsei amounted to approximately RMB2.5 million, which have decreased by approximately 69.2% from approximately RMB8.2 million for the corresponding period in 2010. Our Directors confirmed that the decrease in sales to Qingdao Jyunsei was not related to the Higashi Nihon Daishinsai, but our Group’s strategy to focus on functional products. As Qingdao Jyunsei’s orders were mainly general innerwear, our sales to it decreased in line with the decrease in our total sales of general innerwear in the first half 2011 as compared to that of 2010.

### **Nishimatsuya Chain Co. Ltd. (“Nishimatsuya Chain”)**

Based on the inquiry with the sourcing agent of Nishimatsuya Chain, one of our top five customers in 2008 and 2009 and a large scale retailer of children’s clothing, our Directors understand that the Higashi Nihon Daishinsai has not caused material impact on the operations of Nishimatsuya Chain although Nishimatsuya Chain has branches in northeast Japan. The sourcing agent of Nishimatsuya Chain has also indicated that it has no plan to reduce the amount of planned orders to our Group. Our sales to Nishimatsuya Chain in the first half of 2011 amounted to approximately RMB7.6 million, represented an increase of approximately 141.2% as compared to approximately RMB3.1 million in the same period of 2010.

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### **Shinei Corporation**

Based on the inquiry with Shinei Corporation, one of our top five customers in 2008 and 2009 and a wholesaler of garments products, our Directors understand that Shinei Corporation has no branch in northeast Japan, and the Higashi Nihon Daishinsai has not significantly affected its production and operations. Shinei Corporation has also confirmed that it does not expect any notable changes in its customers' demand and its orders with our Group in the near future notwithstanding the Higashi Nihon Daishinsai as it indicated that the earthquake has not caused any material adverse impact on its customers, which are retail shops and department stores around Japan. Our sales to Shinei Corporation for the six months ended 30 June 2011 amounted to approximately RMB3.9 million, represented a decrease of approximately 32.8% as compared to approximately RMB5.7 million in the corresponding period of 2010. Our Directors confirmed that the decrease in sales to Shinei Corporation was not related to the Higashi Nihon Daishinsai but our Group's strategy to focus on functional products. As Shinei Corporation's orders were mainly general innerwear, our sales to it for the first half of 2011 decreased in line with the decrease in our total sales of general innerwear in the same period as compared to that of 2010.

### **Chaoriwu Group**

During the six month ended 30 June 2011, our sales to Chaoriwu Group (including 湖南朝日五內衣有限公司 and 青島朝日五內衣有限公司 (Hunan Chaoriwu Innerwear Co., Ltd.\* and Qingdao Chaoriwu Innerwear Co. Ltd.\*)), one of the five largest customers of our Group for the year of 2010 which manufactures and sells garments mainly to Japanese customers, decreased from approximately RMB10.3 million in the first half 2010 to approximately RMB5.0 million, represented a decrease of approximately 50.9%. Despite the decrease in sales in the first half 2011, our Group has continued to receive orders from Chaoriwu Group. Chaoriwu Group indicated that the earthquake has not caused any material adverse impact as its operations are mainly located in Osaka and Tokyo of Japan, which are far away from the main disaster areas.

Our Directors expect that the economy of Japan will remain uncertain until the nuclear crisis is settled and the redevelopment plan of the affected area is drawn up. The pace of such recovery is also unclear. Our Directors consider that as the products we sell to our Japanese customers comprise mainly innerwear, which is basic household goods, the demand for our products may increase or decrease at the recovery stage. If the recovery of the Japanese economy is slow which leads to substantially fewer orders from our Japanese customers, our business and financial performance could be materially adversely affected.

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Although we have not experienced any significant decreased orders (as compared with those in 2010) or any deferred payment from our major Japanese customers due to the Higashi Nihon Daishinsai, we can give no assurance that we will be able to maintain our sales volume to our Japanese customers at the same level as we had during the Track Record Period, or that we will be able to recover all the trade receivables from them, which can be affected by other factors such as our product mix and the financial condition of our Japanese customers.

We also cannot assure that there will not be any aftershocks, further natural disasters or catastrophes, or any government actions in Japan which are all beyond our control. These may result in material impact on our Japanese customers, which may adversely affect the volume of their orders, and consequently our revenue and profits. Any other detrimental change in the economic, political and social conditions, legal and regulatory requirements or decrease of demand in this market may adversely affect our financial results.

### COMPETITIVE STRENGTHS

We believe the following competitive strengths allow us to achieve sustainable growth of our business:

#### **Vertically integrated operations**

Our Group provides one-stop services from fabrics development to manufacture of innerwear products. Our services principally include (i) fabric weaving and knitting; (ii) fabric dyeing and finishing; (iii) fabric printing; and (iv) innerwear cutting and sewing. Our Directors believe that such vertically integrated operations enable our Group to effectively reduce lead time and logistics costs as well as to provide our customers with a more flexible textile supply chain solution which optimises our profitability. Our Directors believe that this vertically-integrated operation model is one of the core competitive strengths of our Group among domestic and overseas competitors.

### **Advanced and environmental-friendly production facilities**

Our production is equipped with technically advanced machinery. In particular, our weaving machines, dyeing machines, pre-shrinking machines, stentering machines and flat screen and rotary screen printing machines, were procured from machinery manufacturers in Japan, Germany, Italy, Hong Kong and Taiwan. In January 2010, we purchased eight sets of high-temperature airflow dyeing machines, which enable us to reduce up to two-third of water consumption in the dyeing process. In the same year, we also introduced two sets of clothing hanging pipeline systems to enhance our innerwear serving process which enabled us to improve the logistics in serving pipelines. We also imported three sets of automatic cutting beds in 2010 and first half of 2011 to improve the precision and efficiency of our cutting process. We maintain our own sewage treatment facilities and closely monitor the level of hazardous chemicals in our sewage so as to comply with relevant environmental protection regulations. With the growing public concern in environmental protection, we believe our attention to the environmental impact in our production process would provide us a positive image as a responsible corporate and lead us to more sustainable growth in the future.

### **Established relationships with key customers**

We believe that, as a result of our efforts devoted in quality control and on-time delivery, our Group has established long term and stable business relationships with our customers, in particular the sourcing agents of a broad range of apparel brands, including *Outdoor*, *Pigeon* and *Lee*, and has been able to secure new customers over the years, including *Triumph*, *Wacoal*, *Embry Form*, *Maniform* (曼妮芬), *Miiow* (猫人) (previously known as *Maoren*) and *Sunlaura* (桑扶蘭). Our business relationships with our major customers range from one to ten years, within which our business relationships with our top five customers for the year ended 31 December 2010 have lasted for approximately two years. We exported a substantial portion of our products during the Track Record Period to apparel retailers or their sourcing agents in Japan who we believe have traditionally set relatively strict product quality standards on apparel manufacturers. We have worked closely with such customers and adopted stringent quality control measures in each of the production processes to ensure that our products match their needs and specifications.

Our Directors believe that our reliable and high-quality products and dedicated customer services are essential for our future expansions, and we can capitalise on our experience in serving Japanese customers to further expand into the European and US markets, in which the product quality standards are equally stringent. In 2010, we were appointed as an authorised manufacturer of *Puma* and believe that our production process has complied with its prescribed requirements on safety, quality and environmental protection, etc. In the same year, our Group has been engaged by sourcing agents of certain US and European apparel brands to manufacture apparel on their behalf including *DKNY*, *Carter's* and *Orsay*. Our Directors believe that this reflects the quality of our Group's products is able to meet the standards expected in these mature markets.



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Our Directors believe that our relationship with our customers has been close, which has enabled us, and will continue to enable us, to understand the market trend and introduce new products to cater such demand in a timely manner.

### **Experienced management team and advanced management system**

Our Group is led by our management team consisting of Mr. Wong, Madam Hung Kin, Mr. S.H. Wang and Mr. Wei, each of whom has extensive experience in the fabrics and innerwear manufacture and/or the relating trading industry. In particular, Mr. S.H. Wang, our executive Director and general manager of Zhucheng Eternal Knitting, has more than 20 years of experience in the knitwear industry. Mr. Wei, our executive Director and general manager of Zhucheng Yumin Knitting, has been engaged in the manufacturing and sale of fabrics since 1999.

We have adopted an ERP system to manage our production process since 2005. Every production process, starting from acceptance of orders from customers to the sale of products, is under the control of the ERP system. Our Directors believe that the ERP system enables our management team to monitor the whole production process so as to effectively shorten the turn-around time and maintain inventory of raw materials and finished goods at a reasonable level.

### **In-house fabrics development and testing department**

Our Group has a dedicated team of fabrics development and testing staff to develop and test our new functional fabrics in order to cater the needs of our customers. Our Directors believe that with our in-house product development capability and focus on manufacturing of functional fabrics and innerwear, we were able to achieve growing average selling prices during the Track Record Period as the average selling prices of our functional fabrics and innerwear produced with such fabrics were generally higher than those of our general fabrics and innerwear produced with general fabrics. We will continue our focus on manufacturing and developing different kinds of functional fabrics and innerwear, so as to sustain the business growth that we enjoyed during the Track Record Period and maintain our competitive strength.

### **Strategic location in Shandong, the PRC**

Our principal production facilities are located in Zhucheng, Shandong, a city west of Qingdao, Shandong, and one of the major textile manufacturing bases in the PRC. Our Directors believe that, given its proximity to Japan and the historical background, Shandong has become a popular location in the PRC where many Japanese firms and enterprises set up their representatives and liaison offices. Taking advantage of this strategic location, we have successfully established business with some Japanese apparel brands or their sourcing agents through their offices in the area. We have also established a liaison office in Qingdao for better on-going communication with our Japanese customers. Our Directors believe that our close proximity to the ports in Qingdao also allows us to benefit from the efficient logistics infrastructure available in Qingdao, which was ranked the ninth largest port in the world in terms of container traffic by the American Association of Port Authorities in 2009.

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### BUSINESS STRATEGIES

Our principal business strategies are:

**Focus on producing high profit margin products and developing innovative products with high added value**

Given our experience and capability, we intend to focus on producing products that we consider to have higher profit margin in the coming years. We believe that in order to achieve continuous growth, it is essential for our Group to distinguish ourselves from our competitors by focusing on developing innovative products with high added-value and higher profit margin.

Over the past few years, we have introduced various kinds of functional fabrics. For instance, we introduced our temperature-regulating fabrics in 2010 by using Outlast's patented temperature-regulating fibres. Our Directors believe that such fabrics have great market potential and will sustain further sales growth in the future.

**Upgrade and expand our production facilities and ERP system, and improve our production processes to reinforce our one-stop solutions**

Our Group vertically integrates the production processes from fabric development to innerwear OEM production, which we believe would enable us to achieve a higher profit margin and contribute to the establishment of a stable business relationship with our customers. We plan to reinforce our one-stop solution services by forming a centralised administrative headquarters to strengthen our control over different processes. We will continue to upgrade and expand our production machinery and facilities to enhance our production efficiency, reduce energy and water consumption costs and increase production capacity for higher margin products. For details of our expansion plan, please refer to the paragraph headed "Production – Production facilities and capacity – Expansion" in this section.

In line with the public attention to global warming and environmental protection, we intend to devote resources on pursuing a more environmental-friendly manufacturing process in the near future. Currently, textile product productions in the PRC are not subject to any carbon emission standard as China has yet to formulate such standard. However, at the United Nations Climate Change Conference 2009 in Copenhagen, China announced that it targets to reduce carbon emissions per unit of GDP in 2020 by 40% to 45% with respect to 2005 level. We consider that this shows China's intention to regulate its carbon emission and eventually will lead to the establishment of relevant carbon emission standards. Such standards will in turn affect manufacturing industries, guiding them towards low-carbon production. As to fabric and innerwear production, our Directors believe that low-carbon production can be implemented throughout the design stage to the production stage. We intend to achieve this by using energy or resources saving equipment during the manufacturing process, as well as taking into account the level of carbon emission when selecting raw materials and fabrics. We believe that by being "green", we can lower our production cost especially in terms of energy and water consumption. Besides, we believe that we can also market our products with the "green" concept at a higher price to markets which are environmentally aware. Our aim is to achieve a higher sales volume and realise a higher return by developing environmental-friendly products.

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As our dedication to enhance our information technology infrastructure, we intend to upgrade our ERP system by adopting a new set of tracking procedure, so that our customers would be able to track the progress of their orders through our system. Our Directors believe that these upgrades and expansions will lead to greater economies of scale for the operation of our Group and therefore improve our competitiveness and profitability as well as fulfill our commitment to reinforce our one-stop solutions.

### **Enhance our new high-tech fabrics development capability**

Our Directors believe that the future growth of our Group depends on our ability to develop advanced and high quality fabric products according to changing market demand. Moreover, we have conducted fabric development using fibre and yarn provided by Daiichibo Co., Ltd. (第一紡織株式會社) and Toyobo Co., Ltd. (東洋紡織株式會社) since 2010 on a standalone basis. The resulting products, in the form of developed fabrics or garment manufactured therefrom, were sold to our own customers, or back to Daiichibo Co., Ltd. and Toyobo Co., Ltd. In view of growing customers' demand and in order to strengthen our competitiveness in the market, we intend to devote more resources on the development of new functional fabrics and innerwear products with higher profit margin. We intend to expand the capability of our product development team by purchasing new testing equipment, recruiting industry experts and providing technical trainings to our technicians.

### **Extend our spring/summer collections of fabrics and innerwear products**

The demand for fabrics and innerwear products can be broadly divided into two fashion seasons: spring/summer and autumn/winter. According to our experiences, higher sales are normally recorded during the second half of each year. Our Directors consider that apart from focusing on the autumn/winter products, we shall extend our spring/summer products in the future, which will enable our Group to mitigate the effects of seasonality on our sales, strengthen our income base and solicit more customers. In view of this, we took an initiative role to hold an exhibition in Zhucheng, Shandong in April 2011 together with our customers and suppliers to promote our spring/summer collections of fabrics and innerwear products. We also participated in exhibitions in Shenzhen in May and in Shanghai in August this year. We intend to organise and participate in different trade exhibitions regularly in the future. Our Directors believe that by doing so and leveraging on our existing capability of fabrics development, we are able to manufacture fabrics and innerwear products with functions specialised for the spring/summer collections that meet our customers' expectation and requirement.

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### **Develop our ODM capacity and commence production of high-end fabrics using our brand name “UTEX”**

We will devote resources in developing our ODM capacity by cooperating with other leading brands in China, with the aim to market our products under our own brands eventually. During this process, we will continue to reinforce our efforts of providing personalised and professional service to our customers and promote our corporate profile in the market.

We registered our “UTEX” trademark in 2010 but had not commenced producing or marketing our products under this brand name up to the Latest Practicable Date. To solidify our vertically integrated operations, we intend to produce and market our self-designed fabric products under our own brand name “UTEX” in the future. Our vision is to position the “UTEX” brand for relatively high-end fabrics that are produced with distinctive or special functions to be developed by our Group, and with stringent quality control and standard, with a view to obtaining a comparatively higher margin than our other products. To achieve this, we will make use of our experience in the incubating ODM production for domestic and international brand owners to develop and strengthen our research capability, with which we will then develop new types of fabrics which are distinguishable from those of our competitors and could meet market demand. We intend to launch our “UTEX” branded fabrics only after our research capability enables us to operate our branded products in a sustainable manner. Our Directors believe that our “UTEX” branded fabrics will in the long run gradually become one of the major components of our product mix.

### **Market expansion into the PRC and overseas markets**

During the Track Record Period, our sales were made primarily to the Japanese market, which accounted for approximately 84.4%, 82.4%, 51.9% and 56.0% of our revenue respectively. We have been selling our products in the PRC since our establishment, and have also commenced selling primarily infants’ innerwear to the US since 2010 to diversify our customer base. Our strategy is to further increase our sales effort to the PRC and overseas markets, and we intend to achieve this by organising and participating in different product exhibitions in the PRC. We took an initiative role to hold an exhibition in Zhucheng, Shandong in April this year to promote our fabrics and also participated in exhibitions in Shenzhen in May and in Shanghai in August this year. For overseas market, we will solidify our existing relationship with our customers and attempt to obtain business referrals from them. We have been successful in obtaining innerwear orders from a Korean brand owner in the first half of 2011, whom we understand was referred to us by an existing customer. Our Directors believe that such strategy would enable our Group to expand beyond the Japanese market which is beneficial to the organic growth of our Group.

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### **Enhance collaboration with suppliers**

We have entered into an exclusive cooperation agreement with one of our fibre and yarn suppliers for the development of new fabrics, details of which is set out in the paragraph headed “Suppliers” in this section. We realise the ability to keep abreast of the latest development in technology is essential for our business growth. We intend to reinforce our collaboration with our suppliers in the future. Our Directors believe that collaboration with the upstream companies will allow us to have better control over our raw material costs and enhance our Group’s product development capability. Our Group also intends to extend our cooperation with universities in the PRC.

### **PRODUCTS**

We are a vertically integrated manufacturer of functional fabrics and innerwear products. Our products are mainly supplied to various renowned apparel brands in the world, their respective sourcing agents or the wholesaler.

Based on the confirmations given by the sourcing agents, our fabrics and innerwear products sold to them are used by the relevant brand owners they represent. For our innerwear products, they were labelled or packed with the packaging materials bearing the names and/or logos of the relevant brand owners provided by the respective sourcing agents or brand owners.

Our Group manufactures two types of products: (i) fabric products, and (ii) innerwear products. We manufacture an assortment of functional fabrics, and work with our customers to produce fabrics that meet their specific order requirements. In essence, we make use of new fibres available in the market to develop fabrics that we consider would meet the market demand, and market such fabrics to the apparel brand owners. Our customers will then revert with the compositions, designs and specifications they require, with which we will customise the fabrics to meet such requirements. Our customers who are garment manufacturers in turn use our fabrics to produce finished garments for sale to apparel brand owners.

We also manufacture innerwear on an OEM basis, using fabrics either produced by ourselves or third party suppliers. Our customers provide samples and drawings based on their requirements, and we will produce the innerwear based on the same. Throughout this process, we may also assist our customers on the design of the innerwear and advise them on the use of different types of fabrics.

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The following table sets out the breakdown of the revenue of our Group sold to our customers by product during the Track Record Period:

	For the year ended 31 December						For the six months ended 30 June			
	2008		2009		2010		2010		2011	
	(RMB'000)	(%)	(RMB'000)	(%)	(RMB'000)	(%)	(RMB'000)	(%)	(RMB'000)	(%)
<b>Fabric products</b>										
— General fabrics	23,640	17.4	13,773	7.1	19,911	5.3	8,084	8.0	13,141	9.4
— Functional fabrics	—	—	12,065	6.2	100,692	26.6	27,585	27.2	32,804	23.4
<b>Subtotal</b>	<b>23,640</b>	<b>17.4</b>	<b>25,838</b>	<b>13.3</b>	<b>120,603</b>	<b>31.9</b>	<b>35,669</b>	<b>35.2</b>	<b>45,945</b>	<b>32.8</b>
<b>Innerwear products</b>										
— General innerwear	112,548	82.6	95,218	48.8	121,005	32.0	41,518	41.0	38,181	27.2
— Functional innerwear	—	—	73,856	37.9	136,681	36.1	24,170	23.8	56,032	40.0
<b>Subtotal</b>	<b>112,548</b>	<b>82.6</b>	<b>169,074</b>	<b>86.7</b>	<b>257,686</b>	<b>68.1</b>	<b>65,688</b>	<b>64.8</b>	<b>94,213</b>	<b>67.2</b>
<b>Grand Total</b>	<b>136,188</b>	<b>100.0</b>	<b>194,912</b>	<b>100.0</b>	<b>378,289</b>	<b>100.0</b>	<b>101,357</b>	<b>100.0</b>	<b>140,158</b>	<b>100.0</b>

### Fabric segment

Our Group manufactures a wide range of general and functional fabrics for sale to garment manufacturers and also for the production of our innerwear products. We are capable of producing customised fabrics that meet specific requirements of our customers. We understand the garment manufacturers will in turn process our fabrics into finished garments for sale.

Our Group specialises in producing weft knitted fabrics, meaning that the warp is perpendicularly attached to the loom, and that the weft runs in rows back and forth through the warp to make the fabric. This makes the fabric stretchy and comfortable.

### Major fabrics categories

Our Group produces a wide range of fabrics which are classified according to their knitting structure, type of finish and usage. Our products can be classified into two broad categories, namely general fabrics and functional fabrics. General fabrics are primarily made with cotton yarns, while functional fabrics are mainly made with synthetic yarns. By combining different fibre mixtures, cotton counts and using specific knitting methods, functional fabrics carry features such as smart thermal insulation, water resistance, moisture control, anti-microbial and/or anti-odour. We make use of the functional and chemical fibres, i.e. yarns having special functions such as temperature regulation or moisture absorption available in the market, to produce fabrics with different functions. For example, we make use of certain patented temperature-regulating fibres produced by Outlast, a worldwide company involved in

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the research, development, design and marketing of phase-change materials, and produce our temperature-regulating fabrics. Our functional fabrics mainly offer various functions, namely smart thermal insulation, water resistance, moisture control, anti-microbial and/or anti-odour etc. During the Track Record Period, we developed approximately 100 varieties of functional fabrics with different compositions, designs and specifications.

We are also an authorised manufacturer of Outlast products. We have been granted a non-exclusive licence by Outlast to manufacture and sell certain Outlast's fabrics which comprise microencapsulated phase change materials coated fabrics or fibres in China to third parties who are themselves trademark licensees of Outlast. Outlast has also granted us a non-exclusive licence to use its Outlast trademark in connection with the manufacture, promotion, distribution and sale of such products. We are not required to pay any license fee to Outlast. In order to ensure the quality of our products meets Outlast's standard, our Group may only obtain the microencapsulated phase change materials from Outlast or its certified suppliers, and is required to submit sample of Outlast's fabrics to Outlast for certification prior to sale. According to the licensing agreement between Outlast and our Group, there are no prescribed terms for the purchase or sales of Outlast's fabrics to be obtained or sold by our Group. Instead, the terms of such sale or purchase, including price and volume, are to be negotiated on an individual basis. The licences from Outlast were effective from 5 April 2010 and are valid until 30 September 2013. For the year ended 31 December 2010, being the year in which the relevant licences were granted, we obtained materials from Outlast or its certified suppliers for an amount of approximately RMB2.3 million, representing 0.8% of our total costs of sales, and sold more than 40,000 kg of Outlast's fabrics for an amount of approximately RMB3.9 million, representing approximately 1.0% of our total revenue in the same year. For the six months ended 30 June 2011, our purchases from Outlast amounted to approximately RMB1.9 million, representing approximately 2.0% of our total costs of sales, and we have sold more than 45,000 kg Outlast's fabrics for approximately RMB3.9 million, representing approximately 2.8% of our total revenue for the period.

In addition to providing plain fabrics, we are capable of dyeing fabrics into different colours and printing patterns onto the fabrics according to our customers' requirements. The dyed fabrics may have pre-designed patterns added by pressing and calendaring under high temperature. Our design studio will use the pre-designed patterns from our customers and produce print screens accordingly. Patterns are separated by colours such that one pattern usually requires multiple screens. These screens are either rotary or flat depending on the design specifications. Fabric is laid under the screens and sent through the printing machine for printing.

### **Innerwear segment**

We offer a wide range of innerwear for men, women, toddlers and infants, including t-shirts, vests, long-sleeves pullover, men's briefs and boxer briefs, women's panties, long johns, toddlers' and infants' body suits and bibs with different designs, colour and materials. Our Group manufactures innerwear on an OEM basis for major apparel brands such as *Outdoor*, *Ito-Yokado* (伊藤洋華堂), *Pigeon*, *Lee*, *Puma*, *DKNY*, *Carter's* and *Orsay* through engagement by their respective sourcing agents. According to our management, these innerwear products can be

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further classified into two categories, namely general innerwear comprising mainly innerwear made with cotton fabrics, and functional innerwear, comprising mainly innerwear made with functional fabrics that incorporate features such as smart thermal insulation, water resistance, moisture control, anti-microbial and/or anti-odour, respectively. Our innerwear products are mainly exported to Japan.

### PRODUCT DEVELOPMENT

The apparel industry is constantly subject to change in terms of fashion trends and demand for new fabrics and innerwear. We have our own product development team to develop new products to cope with the changing market demand. As at the Latest Practicable Date, our product development team consisted of 23 members.

For fabrics, our product development team is responsible for improving existing fabrics as well as developing new functional fabrics with other specific properties and style to meet the demand of the market or the requirements of our customers as well as improving product quality and production efficiency. We have equipment in our in-house laboratory dedicated to sample manufacturing where we test the attributes of the fabrics, such as insulation, weight, strength, colours, pattern and textures. We also collaborate with our suppliers in developing new functional fabrics. During the Track Record Period, our Group has developed approximately 100 varieties of fabrics. Moreover, we have conducted fabric development using fibre and yarn provided by Daiichibo Co., Ltd. (第一紡織株式會社) and Toyobo Co., Ltd. (東洋紡織株式會社) since 2010. The resulting products, in the form of developed fabrics or garment manufactured therefrom, were sold to our own customers, or back to Daiichibo Co., Ltd. and Toyobo Co., Ltd.

For innerwear, we focus on improving our innerwear quality by attending exhibitions in and out of China, exchanging ideas with our customers and suppliers and conducting market research in the major cities in China to collect first-hand information on the market trends.

During the Track Record Period, we provided financial aid to six students. We target to continue providing financial aid to three students per year in the future, for attending textile and apparel engineering and design courses in 河北科技大學紡織服裝學院 (Institute of Textiles and Apparel of Hebei University of Technology\*) in return for the commitment of these students, upon their graduation, to join and work in our Group for a minimum term of six years. Through this financial aid programme, we believe that we could secure a stable supply of skilled workers and engineers to contribute to our operations and business.

In addition to developing new products, we have been making effort to improve our processing technology. Our Directors expect that such efforts will eventually lead to higher customer satisfaction on our product quality, improve production efficiency and techniques, and lower the rate of raw materials consumption, waste discharge and production costs.



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### SALES AND MARKETING

#### Sales and marketing strategy

We emphasise on our “customer-oriented” principle in our operations and our sales staff are required to act proactively in satisfying customers’ needs in order to maintain a stable relationship with our customers.

Our Group has sales and marketing teams in the PRC and Hong Kong, responsible for conducting marketing activities and soliciting new customers. Our sales efforts primarily target at established brands in domestic and international markets. We visit our customers’ offices and retail outlets in order to gain a better understanding of the markets in which our customers operate. On the other hand, our customers also visit our production facilities. We believe that our customers could have a better understanding of our product development capability, production process, quality control mechanisms, and employee care standards through such visits. We establish close contacts with our customers so that we can assist them in responding to change in market demands. We also have a liaison office in Qingdao where representatives of most of our Japanese customers are located. Our Directors believe that by locating sales representatives near our Group’s customers, our Group is able to respond to customers’ inquiries promptly.

In addition, we have entered into a master cooperation agreement with 武漢貓人製衣有限公司 (Wuhan Maoren Garment Co. Ltd.\*) (“**Wuhan Maoren**”) as part of our strategy to maintain customer loyalty and secure its order quantity. Pursuant to the agreement, Wuhan Maoren has the right to request us to grant an exclusive right to use any fabrics custom-designed for it within an agreed period, during which we will not offer such fabrics to other customers, and Wuhan Maoren shall place order for at least 50 tons for each type of such fabrics. Wuhan Maoren also agreed to engage our Group for innerwear production in the event such fabrics are designed for innerwear. The cooperation agreement had a term of one year until 25 June 2011 and had been then automatically renewed for another year until 25 June 2012. The price and terms of each sales order under the cooperation agreement are to be determined by various factors, such as composition of the fabrics demanded by Wuhan Maoren, production process and costs of raw materials. As advised by our PRC legal advisers, the master cooperation agreement with Wuhan Maoren is legally binding. During the Track Record Period, sales to Wuhan Maoren contributed to approximately nil, 0.6%, 5.0% and 1.3% of our total revenue respectively. We are also in discussion with another customer on entering into framework sales and purchase agreement. We will continue to look for further cooperation opportunities with our customers and we expect that they will help boost our sales performance in the future.

Furthermore, we carry out our marketing activities through other means, including promoting the latest information on our Group and our products through our website, to enhance our profile. We also carry out marketing activities together with our customers and suppliers through participating in trade exhibitions with them. We believe that this allows us to leverage on the scale and reputation of our suppliers and customers in marketing our products. We held an exhibition in Zhucheng, Shandong in April 2011 to promote our spring/summer collections of fabrics and innerwear to our customers, and participated in large scale exhibitions within the

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PRC such as the fabrics exhibitions in Shenzhen in May and in Shanghai in August this year. In addition to the abovementioned sales and marketing channels, we secure new customers through referrals from our existing customers. Our Directors believe that such referrals reflected our customers' positive views on our product quality, efficient services and competitive pricing.

### Sales team

As at the Latest Practicable Date, our Group had a sales team consisting of 33 personnel. One of the focuses of the sales team is to gain an early understanding of the proposed new designs and ideas of our customers before each new season. Meetings with major customers are held prior to the commencement of each season in order to formulate the production and sales plan for the coming season. With this information, the sales team can then suggest the customer about the selection of fabrics, trimming, washing or printing techniques or designs to fit that customer's specific design and fabric requirements as well as production budget. Our Directors believe that these personalised services are important for us in obtaining and securing orders from our customers as well as maintaining long term relationships with them.

### Customers

Our customers are mainly (i) sourcing agents; (ii) wholesaler; or (iii) brand owners. As at the Latest Practicable Date, we had over 10 customers who are sourcing agents representing more than 15 brands. Our business relationships with our major customers range from one to ten years, within which our business relationships with our top five customers for the year ended 31 December 2010 have lasted for approximately two years. The table below sets out some of our key customers:

	Name of customer	Brand	Length of relationship
<b>Fabrics</b>	Chaoiwu Group <sup>#</sup> (including 湖南朝日五內衣有限公司 and 青島朝日五內衣有限公司 (Hunan Chaoiwu Innerwear Co., Ltd.* and Qingdao Chaoiwu Innerwear Co. Ltd.*))	N/A (Note)	Since 2009
	上海廣裕紡織品有限公司 <sup>#</sup> (Shanghai Guangyu Textile Co. Ltd.*)	<i>Triumph, Wacoal Embry Form, Sunlaura (桑扶蘭)</i>	Since 2009
	武漢貓人製衣有限公司 <sup>#</sup> (Wuhan Maoren Garment Co. Ltd.*)	<i>Miiow (貓人)</i>	Since 2009
	青島紡聯集團進出口有限公司 (Qingdao Textile Union Group Import-Export Co. Ltd.*)	N/A (Note)	Since 2010
	撫順小寶寶夢衣有限公司 (Fushun Dreamy Baby Wear Co. Ltd.*)	N/A (Note)	Since 2008
伊藤忠纖維貿易(中國)有限公司 (Itochu Textile (China) Co. Ltd.*)	<i>Maniform (曼妮芬), Wacoal</i>	Since 2009	

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	Name of customer	Brand	Length of relationship
<b>Innerwear</b>	Toray Group <sup>#</sup>	<i>Ito-Yokado</i>	Since 2009
	CFI Hong Kong Limited <sup>#</sup>	<i>Carter's</i>	Since 2010
	Growly Co., Ltd.	<i>Lee</i>	Since 2005
	青島純青國際貿易有限公司 (Qingdao Jyunsei International Trade Co. Ltd.*)	<i>Outdoor</i>	Since 2007
	Nishimatsuya Chain Co., Ltd.	N/A (Note)	Since 2006
	Shinei Corporation	N/A (Note)	Since 2001

*Note: Our Group is not responsible for the labeling and packing of the products for these customers and hence no information is available for the relevant branding of the products.*

<sup>#</sup> Top five customers of our Group for the year ended 31 December 2010.

\* For identification purpose only.

Our Directors believe that it is common for brand owners to conduct the fabric procurement and innerwear manufacturing process through sourcing agents and such sourcing agents generally play a key role in selecting fabrics suppliers and garment manufacturers, and thus our long-term and stable business relationships with the sourcing agents of the apparel brands is a critical factor to succeed in our industry and help drive our sales. Apart from our sales to sourcing agents, we also sell some of our innerwear products directly to brand owners, or to the wholesaler, whose end customers are retail shops and department stores.

Set out below is the breakdown of the revenue of our Group sold to brand owners and sourcing agents/wholesaler respectively during the Track Record Period:

	For the year ended 31 December						For the six months ended 30 June			
	2008	2009		2010		2010		2011		
	<i>(RMB'000)</i>	(%)	<i>(RMB'000)</i>	(%)	<i>(RMB'000)</i>	(%)	<i>(RMB'000)</i>	(%)	<i>(RMB'000)</i>	(%)
Sourcing agents/wholesaler	136,188	100.0	193,740	99.4	355,612	94.0	101,143	99.8	134,102	95.7
Brand owners	—	—	1,172	0.6	22,677	6.0	214	0.2	6,056	4.3
<b>Total</b>	<b>136,188</b>	<b>100.0</b>	<b>194,912</b>	<b>100.0</b>	<b>378,289</b>	<b>100.0</b>	<b>101,357</b>	<b>100.0</b>	<b>140,158</b>	<b>100.0</b>

Although in general we do not enter into long-term agreement with most of our customers, we discuss with our customers the estimated production volume that they expect to order at the beginning of each season. We utilise such information for our production planning and procurement purposes. Upon receiving purchase orders from our customers, our sales team together with our production department will assess our production capacity before accepting the orders. We generally enter into written contracts with our customers, which are mostly on a standalone basis without any prescribed minimum purchase commitment. Once the order is confirmed, it could only be cancelled by mutual consent. Our production of fabrics will only

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commence after written contracts have been entered into. Depending on the type and size of products ordered, the finished products are ready for delivery to our customers within 60 days in average after the purchase orders are confirmed.

During the Track Record Period, sales to our top five customers accounted for approximately 69.5%, 63.5%, 59.8% and 54.4% respectively of our total revenue. Sales to our largest customer for each of the three years ended 31 December 2010 and the six months ended 30 June 2011 accounted for approximately 16.6%, 31.6%, 33.8% and 27.2% respectively of our total revenue in such year/period. Mr. Wei, our executive Director, was interested in 75% equity interest in 上海廣裕紡織品有限公司 (Shanghai Guangyu Textile Co. Ltd.\*) (“**Shanghai Guangyu**”), one of our top five customers for the year ended 31 December 2010 and for the six months 30 June 2011 and contributed to approximately nil, 1.9%, 5.7% and 11.0% of our revenue during the Track Record Period respectively. As confirmed by Mr. Wei, he disposed of all his interest in Shanghai Guangyu in March 2011 to Mr. Xu Nai Feng (許乃峰), an independent third party, at the consideration of RMB750,000, being the initial contribution amount of such equity interests and represented a discount of approximately 1.3% to the then net asset value of such interests. The disposal by Mr. Wei is to avoid any potential conflict of interests between his interests in our Group and Shanghai Guangyu subsequent to our Listing. After the disposal, Mr. Wei ceased to have any equity interest in Shanghai Guangyu. Our Directors understand that Shanghai Guangyu is owned as to 75% by Mr. Xu Nai Feng and as to the remaining 25% by another independent third party after the disposal by Mr. Wei. According to the articles of association and the business licence of Shanghai Guangyu, it is engaged in, among other things, the sale of knitted wear, fabrics, clothes and household goods. As Shanghai Guangyu is the fabrics sourcing agent for brands such as *Triumph*, *Wacoal* and *Embry Form*, Shanghai Guangyu remained as our customer as at the Latest Practicable Date and our Directors intend to continue such relationship after the Listing. Given there is no non-competition agreement between Shanghai Guangyu and our Group or Mr. Wei, our Directors intend to leverage on the experience of Mr. Wei to develop direct customer relationships with the aforementioned brand owners in longer run. Save as aforesaid, none of our Directors, chief executive, their respective associates or, any Shareholder who, so far as our Directors are aware owns more than 5% of our issued Shares or any of our subsidiaries, or their respective associates had any interest in any of the five largest customers of our Group during the Track Record Period.

Our Group has focused on export sales historically. We entered into the Japanese innerwear market in 2001 and have since 2010 commenced selling our products into the US market. With the increase in GDP and the increasingly strong sentiment towards the overall economic conditions in the PRC, we plan to increase our sales and marketing efforts in the PRC market.

As detailed in the section headed “Financial Information — Factors affecting our results of operations — Product mix” of this prospectus, our management has begun shifting our business focus from general fabrics to functional fabrics, and from general innerwear to functional innerwear. Our Directors believe that such positioning has great potential and differentiates us from our major competitors.

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The following table shows the breakdown of our revenue by markets during the Track Record Period:

Countries	For the year ended 31 December						For the six months ended 30 June			
	2008		2009		2010		2010		2011	
	(RMB'000)	(%)	(RMB'000)	(%)	(RMB'000)	(%)	(RMB'000)	(%)	(RMB'000)	(%)
	(audited)		(audited)	(audited)		(unaudited)		(audited)		
Japan	114,974	84.4	160,595	82.4	196,443	51.9	56,869	56.1	78,428	56.0
The PRC (including Hong Kong)	20,040	14.7	32,289	16.6	148,896	39.4	44,488	43.9	45,159	32.2
The US	—	—	—	—	30,249	8.0	—	—	14,552	10.4
Others <sup>(Note)</sup>	1,174	0.9	2,028	1.0	2,701	0.7	—	—	2,019	1.4
Total	<u>136,188</u>	<u>100.0</u>	<u>194,912</u>	<u>100.0</u>	<u>378,289</u>	<u>100.0</u>	<u>101,357</u>	<u>100.0</u>	<u>140,158</u>	<u>100.0</u>

Note: Others include sales made to Canada, Spain, Israel and Korea.

### Pricing and credit control

The prices of our Group's products are determined by our senior management after taking into account, among others, the complexity, technology and features of the products, the size of the order, the timing of the delivery, the prevailing market conditions including competition, our cost of sales and expected profit margin. For innerwear products, selling prices of items with complex embroidery or sewing or made with functional fabrics are generally higher than items made with general fabrics or items which require less cutting and sewing steps and techniques. Average selling prices of fabrics are affected by the function of, and complexity in producing, such fabrics. The profit margins of our functional fabrics and innerwear produced with such fabrics are generally higher than those of general fabrics and innerwear produced with general fabrics respectively.

We do not price each order on a standalone basis. All of the services required by a customer are factored in by the planning and merchandising staff when pricing apparel for that customer. Prices for orders are negotiated on an individual basis for each customer. Generally, any increase in the price of raw materials and any appreciation in Renminbi are factored into the pricing consideration for the orders.

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The following table sets out the total units sold and average selling prices of our innerwear products and fabrics during the Track Record Period:

	For the year ended 31 December						For the six months ended 30 June			
	2008		2009		2010		2010		2011	
	Total	Average	Total	Average	Total	Average	Total	Average	Total	Average
	units	selling	units	selling	units	selling	units	selling	units	selling
	sold	prices	sold	prices	sold	prices	sold	prices	sold	prices
	(tons)	(RMB)	(tons)	(RMB)	(tons)	(RMB)	(tons)	(RMB)	(tons)	(RMB)
General fabrics	584	40,480	340	40,520	401	49,710	174	46,540	195	67,290
Functional fabrics	—	—	226	53,280	1,317	76,430	410	67,240	399	82,170
Total	<u>584</u>		<u>566</u>		<u>1,718</u>		<u>584</u>		<u>594</u>	
	(pieces)		(pieces)		(pieces)		(pieces)		(pieces)	
General innerwear	12,028,000	9.36	10,788,000	8.83	12,699,000	9.53	4,506,000	9.21	3,369,000	11.33
Functional innerwear	—	—	3,909,000	18.89	7,095,000	19.26	1,827,000	13.23	3,430,000	16.33
Total	<u>12,028,000</u>		<u>14,697,000</u>		<u>19,794,000</u>		<u>6,333,000</u>		<u>6,799,000</u>	

Our Group's sales are mainly settled in US dollars and Renminbi. Set out below are the respective percentages of the settlement currencies of our Group's sales during the Track Record Period:

	For the year ended 31 December			For the six months ended 30 June	
	2008	2009	2010	2010	2011
	%	%	%	%	%
US dollars	85.9	85.3	64.0	64.0	67.8
Renminbi	<u>14.1</u>	<u>14.7</u>	<u>36.0</u>	<u>36.0</u>	<u>32.2</u>

Most of our customers settle their payment by way of letters of credit, while a small portion of them pay us through telegraphic transfer or by cash upon delivery. We generally provide our customers with trade credit period of 30 to 60 days, depending on our Group's assessment of the creditworthiness of the individual customer. For new customers, we usually collect a deposit of 20% to 30% prior to our production.

As at 31 December 2008, 2009 and 2010 and 30 June 2011, the average trade receivables turnover days of our Group were 22 days, 20 days, 33 days and 56 days respectively. We monitor the amount due from customers on a daily basis. Our provision policy for doubtful accounts receivables is based on the length of time a particular sum has become overdue. During the Track Record Period, the provisions for doubtful accounts receivables amounted to approximately RMB28,000, nil, nil and nil respectively.

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### **Logistics**

Depending on the terms of the purchase orders, we deliver our products to our overseas customers either to their warehouses in the PRC or the port of shipment in the PRC or ship them to the country where the customer locates. In most cases, we deliver our products to our overseas customers by way of cargo shipment, mainly shipped via the Qingdao Port, Shandong.

As regard to domestic sales, our Group's products are delivered by trucks to our customers across the PRC. To facilitate such deliveries, our Group maintains our own trucks and also engages the services of third party delivery companies.

During the Track Record Period, we had not experienced any material disruption in the logistics services provided by third party logistics operators for the delivery of our products.

### **After-sale services**

We provide our dedicated and proactive support to our customers based on our “customer-oriented” principle. Our sales team primarily focuses on confirming orders and product specifications with our customers, and is also responsible for the provision of after-sale services to our customers as well as handling claims or complaints from our customers. Our sales team also coordinates with the production team for any necessary reprocessing of orders. We also invite our customers to visit our manufacturing plants from time to time.

During the Track Record Period and up to the Latest Practicable Date, our Group had not received any material complaints and claims from our customers in relation to quality of products, nor had we experienced any material products recall.

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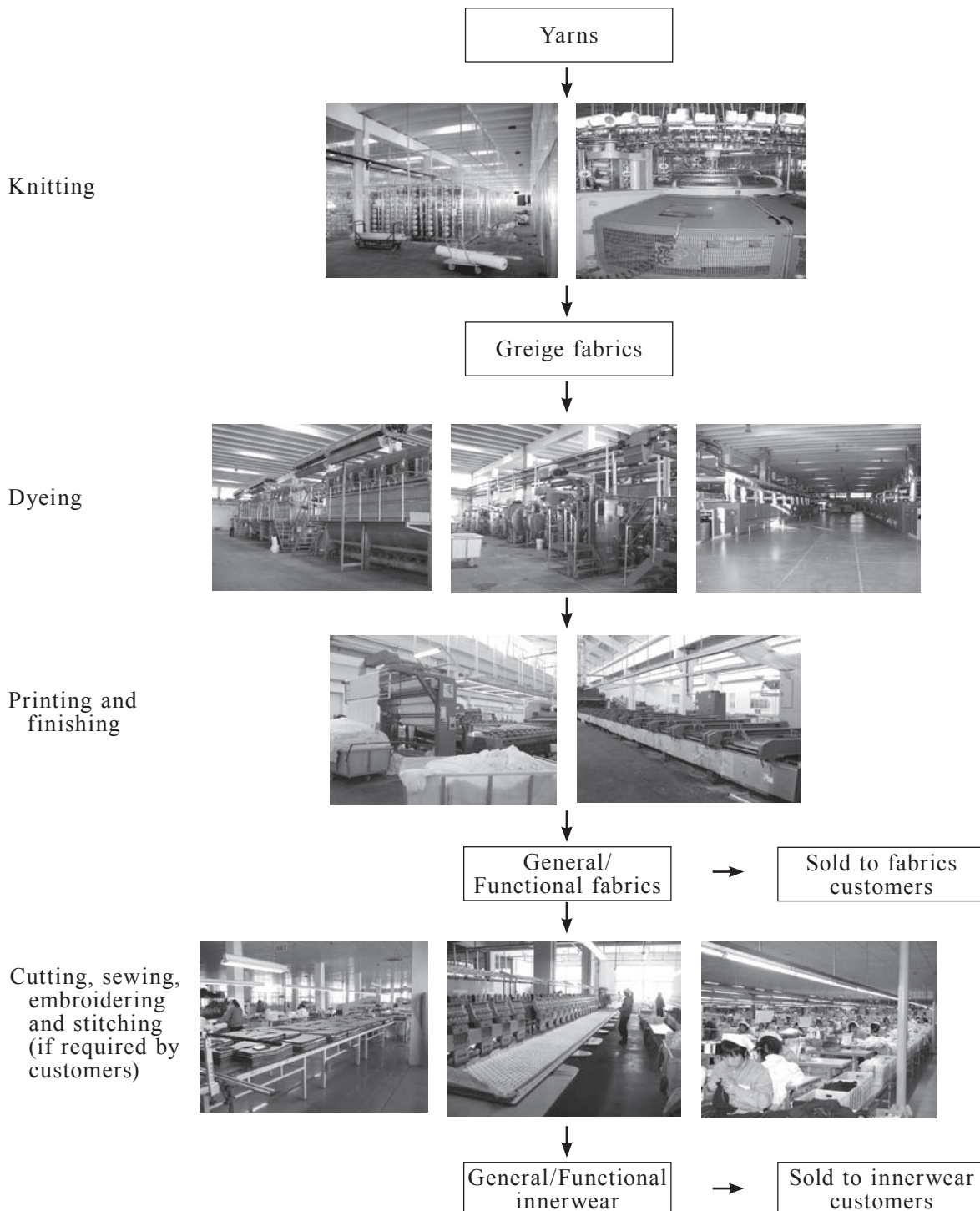
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## PRODUCTION

### Production process

Our production process is vertically integrated and highly mechanised, which can generally be divided into four processes: knitting, dyeing, printing and finishing of fabrics, and cutting and sewing of knitted innerwear, which are illustrated in the following diagrams:





### ***Knitting***

Raw materials, including yarns, are first being sample-checked by our quality control staff to ensure their quality standards before production. General and functional fabrics are produced using various kinds of yarns, i.e. general fabrics are made with cotton yarns, while functional fabrics are made with synthetic yarns. Before the yarns are being knitted, they are required to go through the pre-processing stage during which they will be treated by different chemicals. For instance, cotton yarns used for production of general fabrics will be bleached by hydrogen peroxide and sodium hydroxide to reduce the level of alkali, and synthetic yarns used for production of functional fabrics will be treated by chemicals mixed with specific formula which match their properties. Cones of yarn, after winding, are then arranged in the cylindrical knitting machine for knitting. The knitted greige fabrics are inspected by the quality control staff before they are transported to the dyeing process.

### ***Dyeing***

In preparation for the dyeing process, fabrics are first treated in a scouring process to remove dirt and impurities. Chemicals and dyes are then added onto the scoured fabric for the dyeing or bleaching process.

We employ both airflow and waterflow dyeing methods. Fabrics are dyed and dehydrated in the centrifugal spinning process and dried according to the requirements of specific fabrics. Dried fabrics are then inspected by our quality control staff. Fabrics that do not require printing will then be processed through the finishing step.

### ***Printing and finishing***

We make use of the patterns provided by our customers to make print screens for use in the printing process. Patterns are separated by colours such that one pattern usually requires multiple screens. These screens are either rotary or flat depending on the design specifications. Fabrics are laid under the screens and sent through the printing machine.

The fabrics are then finished by treatment at high temperature to meet customers' requirements on the width, weight and shrinkage allowance of each order. The fabrics are then inspected and shipped to our fabric customers or are transferred to our innerwear factories for cutting and sewing.

### ***Cutting and sewing (for innerwear)***

We use both self-manufactured fabrics and external-sourced fabrics. When the fabrics are delivered to the cutting and sewing department for processing, they are first inspected by the quality control staff who will inspect the textures and colour of the fabrics for defect identification. After inspection and testing by the quality control staff, raw materials qualified for processing are then prepared for cutting and sewing. Computer-aided design equipment is used to prepare customised markers. Markers are used to guide workers in cutting the fabric into separate pieces which are subsequently sewn together to produce an innerwear. To preserve

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the shape and appearance of the finished products, ironing might be necessary. In order to ensure high product quality, finished innerwear are inspected for sewing and overall quality before they are packaged and delivered to our customers.

### Production facilities and capacity

Our production base is located in Zhucheng, Shandong, with an aggregate gross floor area of more than 52,000 sq.m. as at the Latest Practicable Date. Our Group's production machinery are mainly imported from Japan, Germany and Italy, Hong Kong and Taiwan. As at the Latest Practicable Date, we had 31 sets of dyeing machines (including 8 sets of high-temperature airflow dyeing machines), 34 sets of knitting machines, 3 sets of stentering machines, 2 sets of printing machines, 7 sets of embroidering machines and 26 sets of cutting machines.

Actual production volume is dependent upon a number of factors, including fabric specifications and types, complexity of design and quality requirements.

The table below sets out our processing capacity, processing output and utilisation rates of our production lines during the Track Record Period:

Process	For the year ended 31 December									For the six months ended 30 June		
	2008			2009			2010			2011		
	Designed capacity (Note 1)	Actual processed	Utilisation rate (Note 2) (%)	Designed capacity (Note 1)	Actual processed	Utilisation rate (Note 2) (%)	Designed capacity (Note 1)	Actual processed	Utilisation rate (Note 2) (%)	Designed capacity (Note 1)	Actual processed	Utilisation rate (Note 2) (%)
Weaving and knitting (in tons) (Note 3)	200	138	69.0	500	533	106.6	1,200	1,278	106.5	600	558	93.0
Dyeing and finishing (in tons)	1,500	996	66.4	2,400	2,055	85.6	3,600	3,280	91.1	2,000	1,233	61.7
Printing (in tons)	650	594	91.4	650	421	64.8	650	474	72.9	325	178	54.8
Cutting and sewing (in thousand pieces of apparel) (Note 4)	13,000	12,756	98.1	15,000	14,584	97.2	18,000	18,717	104.0	9,300	8,030	86.3

*Note:*

- The designed capacity of each production line was derived on the assumption that the production line is being operated on a continuous basis (16 working hours a day for weaving and knitting and dyeing and finishing, and 8 hours a day for printing and cutting and sewing) throughout the year/period except for maintenance purposes and on certain public holidays and using the production capacity available at the end of the respective year/period. Therefore, the utilisation rate for certain process in a year/period may be affected if additional machineries for such process have been installed in later part of that year/period. Moreover, the designed capacity set out above is also calculated based on the product mix of our Group. Given that product of same weight but with more complicated knitting, cutting and/or dyeing requirements would occupy more of our production time than products with less complicated processing requirements, the designed capacity of our production lines would vary if we focus more on producing complex or simple products in the future.
- Utilisation rate of each production line was derived by dividing the actual processed volume/quantity of a particular process during the relevant year/period by the designed capacity during the relevant year/period.
- Utilisation rates of weaving and knitting in 2009 and 2010 exceeded 100% for the respective years as over-time work was noted during the peak seasons.
- Utilisation rate of cutting and sewing in 2010 exceeded 100% as our Group's actual production capacity was more than the designed capacity.

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### *Expansion*

In view of the high utilisation rates of our production lines during the Track Record Period, our Group has invested in upgrading our equipment to enhance our production efficiency and competitiveness. For example, in 2010, we purchased eight sets of high-temperature airflow dyeing machines, which enable us to reduce up to two-third of water consumption for dyeing process. In 2010 and first half of 2011, we purchased three sets of automatic cutting beds which enhance the efficiency of our cutting process by approximately 30% (in terms of production volume per person). We also introduced two sets of clothing hanging pipeline systems to enhance our innerwear sewing process. The use of such hanging pipeline systems increased our production efficiency by over 10% (in terms of number of innerwear processed).

In the near future, we intend to expand our knitting and dyeing capacity according to the following schedule:

	As at the Latest Practicable Date	2011 Q4	Q1	2012		
<b>Machines</b>				Q2	Q3	Q4
<i><b>Knitting machines</b></i>						
Current number of sets/Number of sets to be acquired	34	2	6	7	7	7
Current capacity/expected increase in capacity (tons)	1,750	100	300	350	350	350
Total capacity (tons)	1,750	1,850	2,150	2,500	2,850	3,200
<i><b>Dyeing machines</b></i>						
Current number of sets/Number of sets to be acquired	31	2	—	—	6	—
Current capacity/expected increase in capacity (tons)	4,000	1,000	—	—	2,100	—
Total capacity (tons)	4,000	5,000	5,000	5,000	7,100	7,100

We also intend to expand our cutting and sewing capacity by purchasing more cutting and sewing machines. As cutting and sewing machines are relatively less costly, our Directors will monitor the utilisation rate of these machines and make appropriate purchases when required.

We estimate that the capital expenditures for the two years ending 31 December 2011 and 2012 will be approximately RMB18 million and RMB65 million respectively. Our planned future capital expenditures mainly include the purchase of additional production facilities and construction of factories. Our Group expects to fund these expansion plans with bank financing, cash flow from our operations and the net proceeds to be received by us from the Share Offer. Please also refer to the section headed “Future plans and use of proceeds” of this prospectus for more details.

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### **Third party outsourcing**

We occasionally outsource certain production processes, in particular, sewing and knitting processes, to third-party sub-contractors when demand exceeds our production capacity. We generally supply them with materials in the outsourced production.

The costs incurred by us in respect of third-party outsourcing arrangements during the Track Record Period were approximately RMB8.3 million, RMB11.9 million, RMB22.0 million and RMB8.1 million respectively, accounting for approximately 8.1%, 9.4%, 8.1% and 8.7% of our total cost of sales for the respective periods. We select third-party sub-contractors based on the quality and cost of their works. We do not enter into long-term agreements with any third-party sub-contractors so as to maintain flexibility. During the Track Record Period, we had not experienced any difficulty in identifying and engaging sub-contractors. Our Directors are of the view that there are no associated risks with outsourcing arrangements as there are a number of sub-contractors available in Zhucheng, Shandong. It is expected that such outsourcing arrangements will be continued to optimise our production capacities.

### **ENVIRONMENTAL PROTECTION**

Manufacturing enterprises in the PRC are subject to various PRC environmental protection laws and regulations. Under current PRC national and local environmental protection laws and regulations, any enterprise which discharges waste water is required to seek approval from the relevant environmental protection authorities as part of the approval process for setting up such an enterprise in China. The relevant PRC laws and regulations also require such enterprise to have waste water treatment facilities that meet the relevant environmental standards and to have the pollutants treated before discharge. In addition, current PRC national and local environmental protection laws and regulations impose fees for the discharge of polluted water and fines, and in certain events, order the suspension of operation by the relevant enterprise, for the discharge of pollutants which are insufficiently treated. Details in relation to environmental matters are set out in the section headed “Regulatory overview — Environmental protection” of this prospectus.

We are committed to operate in compliance with applicable environmental laws and regulations and have taken steps to ensure that any waste and by-products produced as a result of our operations are properly treated and discharged so as to minimise the adverse effects to the environment. We have an on-site sewage treatment plant in Zhucheng, Shandong that treats sewage generated from our production process, in particular, dyeing and printing processes, by chemical and biological treatments. Processed sewage is required to meet certain chemical standards prescribed by the environmental protection department before it is discharged to the municipal sewage treatment network. The environmental protection department has set up monitoring equipment at our sewage treatment plant to ensure the processed sewage meets the prescribed standard before discharged. Officers of the government’s environmental protection department also visit us on a regular basis to inspect our plant and equipment. Since the

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commencement of our operation and up to the Latest Practicable Date, we had not been subject to any penalty or fines imposed by the environmental protection authorities. Our cost of compliance with the relevant environmental protection laws and regulations during the Track Record Period has been minimal and we expect this will remain to be the case going forward.

As confirmed by our PRC legal advisers, prior to the commencement of our operations, we had complied with the relevant environmental protection laws and regulations in the PRC by submitting an environmental impact assessment to the local environmental protection bureau for approval and have passed inspections for our environmental protection facilities upon completion of construction. According to the written confirmation from the local authority, we have neither committed any non-compliance nor been charged for, or incurred any penalties or fines, as a result of having violated any relevant environmental protection laws and regulations. Our PRC legal advisers further advised that we had complied with all relevant PRC laws and regulations regarding environmental protection in all material respects in the locations at which our production plants operated during the Track Record Period.

We have been devoting resources to minimise the use of water in our production process. In particular, we introduced eight sets of high-temperature airflow dyeing machines from Germany in 2010 which enable us to substantially reduce the consumption of water and generation of sewage in the dyeing process. We also intend to devote resources on deploying more environmental-friendly manufacturing process in the future, thereby making ourselves an environmental-friendly fabrics and innerwear manufacturer.

### INFORMATION SYSTEM

Our existing information management system incorporates an ERP system, a software application that is co-developed by us and a software company, which integrates various information in relation to, among other things, our procurement, production and sales under one system. The centralisation of such data enables us to thoroughly manage our manufacturing process, supply chain, logistics, information flow, fund flows and inventory control through real time input, payroll and status checks of our purchases and orders, raw materials and inventory level, accounts receivables and accounts payables, as well as to monitor our production schedule, logistics support and warehousing needs.

With effect from August 2009, manufacturers of any consumer product for export to the US which are primarily intended for children aged twelve or below must provide on such product a tracking label or other distinguishing permanent mark which contains certain basic information, including the source, date of manufacture, and more detailed information on the manufacturing process such as the batch or run number of the product. Our ERP system records information of every piece of our products, including its manufacturing date and time, the raw materials used in its production, and details of the purchaser of the product. In such a way, we can then easily identify the relevant piece of products in the event of any product recall by us, our supplier or customer, and thus reducing our quality control costs. In January 2011, Shandong Grand Concord, our subsidiary mainly engaging in the export of our products to the US and Europe, passed the factory audit of Bureau Veritas, an international company specialising in conformity assessment and certification in relation to regulatory or voluntary standards, in the

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areas of product identification and traceability, document control, product analysis and testing. Our other PRC operating subsidiaries, i.e. Zhucheng Eternal Knitting and Zhucheng Yumin Knitting, currently are not required to undergo such factory audit by Bureau Veritas as they are not involved in the export of children wear to the US. Depending on our business needs, these two subsidiaries may also apply for similar factory audits from third party assessors in the future. Our Directors believe that our Group, through Shandong Grand Concord, is ready for the implementation of the new regulatory requirements in the US.

### SAFETY ISSUES

Pursuant to 《中華人民共和國勞動法》 (Labour Law of the PRC\*) (“**PRC Labour Law**”) promulgated on 5 July 1994, employers are required to establish and improve their labour safety and health care system, to strictly implement the labour safety and health care regulations, to carry out labour safety and health care education among their workers and to prevent accidents during work and reduce occupational hazards. We have complied with the PRC Labour Law and other relevant applicable laws and regulations in relation to labour management. Pursuant to 《中華人民共和國安全生產法》 (Work Safety Law of the PRC\*) promulgated on 29 June 2002, which became effective on 1 November 2002, enterprises operating production activities within the PRC are required to observe laws and regulations concerning production safety, strengthen their administration of, establish and improve a system of responsibility for, and improve, facility conditions to ensure production safety. During the Track Record Period and up to the Latest Practicable Date, save for the regular inspections by local authorities, we were not involved in any production safety matter which had to be approved and examined by the government.

We are required to comply with 《企業職工勞動安全衛生教育管理規定》 (Regulation Governing the Corporate Labour, Safety and Hygiene Educational Management\*) formulated pursuant to the PRC Labour Law. In this connection, a production safety committee has been established by us for the administration of production safety. In addition, we provide safety education to our employees and have established safety standards in connection with matters such as the usage of fire protection equipment, the operation of vehicles and the mechanism of reporting industrial accidents with a view to enhancing occupational safety and minimising the possibility of work-related accidents and injuries as well as occupational illness.

Our Group regularly receives safety inspection from our customers, such as *Carter’s*, *Puma*, etc. The scope of such safety inspection depends on the request of our customers, which usually includes safety production procedures, the safety equipment maintained by our Group, other welfare of our employees and fire control. It is a pre-condition for us to pass the safety inspection in order to cooperate with these customers. During the Track Record Period, we did not receive any adverse comments from these customers during the course of factory safety inspection and have continued to receive orders from them.

We had not committed any material non-compliance in relation to health and safety matters during the Track Record Period. As advised by our PRC legal advisers, we had been in compliance with the relevant laws, rules and regulations in relation to health and safety matters in the PRC during the Track Record Period.

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### PROCUREMENT OF RAW MATERIALS AND SUPPLIERS

Our ERP system has enabled us to plan ahead for raw material procurement to ensure a steady and timely supply of principal raw materials. By monitoring the data in the ERP system, our procurement team forms a procurement plan according to each manufacturing order and submits the procurement plan to our internal audit team for approval. Our internal audit team is responsible for finalising the procurement plan and selecting suitable suppliers. Our internal audit team is also responsible for coordinating with our quality control team in relation to the quality of raw materials.

#### Raw materials

Raw materials used in our Group's production process consist principally of yarns, greige fabrics, dyes and apparel sewing-related materials such as thread, trimmings, buttons and zippers. Raw materials costs comprise the largest portion of our cost of sales. During the Track Record Period, raw materials costs accounted for approximately 51.7%, 57.7%, 68.9% and 60.2% respectively of our total cost of sales. Subject to price and quality requirements, we purchase yarns and greige fabrics from local suppliers mainly in Zhucheng, Shandong, the PRC. During the Track Record Period, we did not experience any shortage of supply of raw materials.

Our demand for raw materials is subject to various market factors. To the best knowledge and belief of our Directors, the prices of cotton yarns, synthetic yarns and greige fabrics are generally affected by the commodity prices of cotton and crude oil, and the prices of yarns and greige fabrics have increased steadily and moderately during the Track Record Period. During the Track Record Period, our purchases of cotton yarns accounted for approximately 25.6%, 14.7%, 8.0% and 10.7% of our cost of sales respectively while our purchases of synthetic yarns accounted for approximately 10.3%, 23.5%, 38.8% and 28.5% of our cost of sales respectively. Our purchases of greige fabrics accounted for approximately 0.3%, 4.4%, 15.0% and 8.7% respectively of our cost of sales during the same periods. For details of the price trend of cotton and crude oil during the Track Record Period, please refer to the section headed "Industry Overview — Key raw materials consumed by our Group" of this prospectus.

Although the prices of yarns and greige fabrics have increased steadily and moderately during the Track Record Period, such increment was partially shifted to our customers. In line with our business strategy, we aim to produce more functional and specialised products which are generally of a higher profit margin, such that we can achieve a better control in our pricing and raw material costs.

#### Electricity and steam

Continuous and steady supply of electricity is important for our Group's operations. Our Group also needs continuous and steady supply of steam during the dyeing process to maintain optimal and consistent product colour and quality because humidity and temperature could affect the physical conditions, such as strength, extension, conductivity and softness, of the fibres.

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During the Track Record Period, our Group secured electricity supply from the public power supply network and steam supply from independent third parties. Our Group intends to continue obtaining supply of electricity and steam from these sources after the Listing.

During the Track Record Period, our Group had not experienced any material interruption of operation as a result of electricity or steam suspension. During the Track Record Period, our costs for electricity and steam accounted for about approximately 8.7%, 7.3%, 4.9% and 6.1% of our cost of sales respectively.

### Suppliers

Our Group considers that it is commercially beneficial to build up a stable and close business relationship with our suppliers. It is also our strategy to concentrate our purchases from a few reliable suppliers such that we will be able to increase our bargaining power with these suppliers by ordering sufficient or bulk quantities. Therefore, we procured a substantial portion of the raw materials from a couple of major suppliers during the Track Record Period. However, we also secure a list of readily available alternative suppliers by diversifying our sources of supply and maintaining at least a small proportion of raw material supplies from suppliers other than the major suppliers for each type of raw materials, in particular, yarns. We believe that we have a supplier base which is sufficiently large for mitigating any risk of over-reliance on our major suppliers.

Our major suppliers are located in the PRC. We order raw materials from our suppliers through purchase agreements, which are mostly on a standalone basis without any prescribed minimum purchase commitment. Once the order is confirmed, it is only cancellable by mutual consent. We generally purchase raw materials when we receive orders from our customers in order to control our inventory risk. In addition, we also purchase basic types of cotton and synthetic yarns and common materials regularly based on our forecast of orders. Some of our suppliers offer us credit terms ranging from 30 to 120 days. Our purchases are mainly made in RMB and we normally settle our invoices with our suppliers twice a month by telegraphic transfer.

When selecting suppliers, members of our procurement team will evaluate the quality and cost of raw materials, the payment terms and the delivery lead-time. Our procurement team also conducts periodic assessment of the on-time delivery performance of our suppliers, the quality of the materials they supply, and their overall cooperation with our Group.

We also enter into cooperation or long term supply agreements with certain suppliers to ensure a stable supply of our raw materials. For instance, we have entered into a tri-partite cooperation agreement with a fibre supplier and a textile company in 2010. Pursuant to the agreement, the fibre supplier shall provide the two agreed types of fibres to the textile company exclusively, and the textile company shall provide yarns produced using those fibres for our Group's exclusive use. The fibre supplier has the right to request the textile company and us to consume at least 50 tons, 100 tons and 150 tons respectively fibres for each of the three years commencing from the date of the agreement. The cooperation agreement has a term of three years and will expire on 15 September 2013 and shall be renewed upon agreement by



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the parties. There are no prescribed terms of pricing for each transaction to be made under this cooperation agreement. Such terms will be separately negotiated by the parties. As this agreement was entered into in second half of 2010, we have not made purchases under this cooperation agreement up to the end of the Track Record Period. Our Directors believe that such arrangements would secure our source of raw materials in the future, and enhance our cooperation with our suppliers, such that they will be able to respond swiftly and supply and develop raw materials of various specifications and style for our use according to changing market demands.

During the Track Record Period, purchases from our five largest suppliers accounted for approximately 33.1%, 41.6%, 33.4% and 54.5% of our total cost of sales respectively, and purchases from our largest supplier for each of the three years ended 31 December 2010 and the six months ended 30 June 2011 accounted for approximately 17.3%, 15.4%, 10.4% and 13.1% of our total cost of sales in such year/period respectively. None of our Directors, chief executive, their respective associates or any Shareholder who, to the knowledge of our Directors, owns more than 5% of our issued Shares or any of our subsidiaries or their respective associates had any interest in any of our five largest suppliers during the Track Record Period.

Our Directors consider that we have established good relationship with our suppliers. Although we do not normally enter into long term supply contracts with our suppliers, we had not experienced any major difficulties in procuring raw materials to meet our production requirements during the Track Record Period.

### INVENTORY CONTROL

Our Group manufactures innerwear products and fabrics largely on individual purchase order basis. Therefore, our effective management of inventory of raw materials plays a substantial role in our inventory control. We monitor and control the levels and ages of our raw materials by implementing an inventory management policy through our ERP system in order to enhance the smooth running of our operations and to minimise wastage.

It is our practice to purchase raw materials based on our production schedule and the manufacturing order monitored by our ERP system. The general lead time for raw materials ordered to be delivered ranges from 1 to 30 days. We may also increase our stocks of raw materials at times when our management, with reference to the market information gathered by our procurement team, anticipates that the price of the raw materials will increase. If any circumstances arise which require us to change our usual stock level, such issue will be discussed amongst our Board and the head of each department. Our Board confirms that during the Track Record Period, our Group had not experienced any circumstances that required us to change our inventory level in usual practice.

During the Track Record Period, we were able to maintain a reasonable level of inventory because most of the fabrics used in our innerwear products are manufactured by us. We produced the fabrics upon receiving confirmed orders for innerwear products from our customers, which effectively reduced excess inventory of unused fabrics.

We also carry out stock-take semi-annually to ensure the quantity of our inventory and identify any obsolete stock.

## **QUALITY CONTROL**

### **Fabric manufacturing segment**

In order to ensure the provision of reliable and high-quality fabrics to our customers, we perform quality inspection and testing at different stages throughout our manufacturing process, from procurement of raw materials to packaging of finished products. Our quality control standards enable us to maintain the reprocessing ratio of our products at a low level.

#### *Procurement of raw materials*

It is our procurement policy that we obtain and test samples of raw materials before we confirm the purchase orders. Our warehouse staff check the quantity of raw materials delivered prior to confirming the receipt of raw materials. Raw materials are tested when they reach our warehouse. Yarns, greige fabrics and semi-finished fabrics are physically inspected and tested by our quality assurance team for eligibility. Chemicals such as dyes and dyeing auxiliaries must be chemically certified for eligibility through quality inspection by our chemical testing centre. Quality of packaging materials will be inspected through conventional viewing as defects can be identified easily through appearance inspection. Any raw materials which fail the inspection will not be accepted and will be returned to our suppliers for replacement.

#### *Production*

At each of our production steps, comprehensive inspections on the quality of the semi-finished and finished fabrics are conducted to ensure compliance with customers' order specifications. The semi-finished and finished fabrics need to go through three quality testing points. Preliminary inspection is carried out on greige fabrics before dyeing. Intermediate inspection is performed after the dyeing procedure to ensure the colours and quality of the dyed fabrics are in compliance with our customers' order specifications. During the final inspection, fabrics are put onto a stentering machine for, on the one hand, cleaning, wringing and drying and on the other hand, screening knitting patterns and colours of the fabrics, identifying flaws in thickness and for physical touch inspection. The fabrics will then go through physical, chemical and bacteria testing before a quality inspection report is issued by our quality assurance staff. Thereafter the fabrics will be transported to the warehouse.

### **Innerwear segment**

We start our quality control procedures at an early stage in our raw material procurement upon our receipt of raw materials. Our quality assurance staff inspects and tests the fabrics by putting them onto a stentering machine for checking their colours, knitting patterns, thickness and texture. Other raw materials are inspected through an appearance inspection to ensure that they comply with our quality standards. Our quality assurance staff also carries out appearance inspection on the semi-finished components at each stage of the manufacturing process. Only qualified semi-finished components are allowed for the next manufacturing stage. During the ironing stage, our quality assurance team conducts appearance inspection on the innerwear, sewing crafts and supplementary sewing materials of the semi-finished components. During

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the packaging stage, our quality assurance staff performs appearance inspection on the supplementary packaging materials such as price tags and care labels to ensure that they are appropriately attached to the right innerwear products, which are then packaged according to customers' requirements. If requested by our customers, we will send samples of the finished products to certified laboratories in Qingdao for quality compliance testing before the finished products are shipped to our customers.

### INSURANCE

We maintain insurance coverage for our factories, manufacturing facilities and inventories, covering losses owing to fire, flood, earthquake and hurricane. We also maintain insurance covering risks such as employee injury and loss and theft of, and damage to, our properties. In 2010, we expended an aggregate of approximately RMB834,000 on maintaining insurance policies. We do not maintain business interruption insurance. Significant damage to any of our manufacturing facilities or buildings, whether as a result of fire or other causes, would have a material adverse effect on our results of operations. Furthermore, we do not maintain insurance against product liability for products we sell, since our standard purchase contracts obligate the suppliers to bear this risk, and it is not compulsory to maintain product liability insurance under the PRC law.

For products we export, we maintain export credit insurance with China Export and Credit Insurance Corporation (中國出口信用保險公司), which insures us against non-payment by our customers after delivery of our goods.

We consider that our insurance coverage is adequate and in line with industry norm. During the Track Record Period and up to the Latest Practicable Date, we had not made any material insurance liability claims and we had not received any material claims from third parties in relation to the use of our products or third-party liability.

### INTELLECTUAL PROPERTY

We rely on a combination of trade secret laws, as well as enter into non-disclosure agreements, implement internal security systems and policies and employ other methods to protect our intellectual property. Our employees are required to sign an employment agreement which prohibits the disclosure of any of our proprietary intellectual property to any third parties.

As of the Latest Practicable Date, we were the owner of five registered trademarks in the PRC and two registered trademarks in Hong Kong. For more information, please see the paragraph headed "Intellectual property rights of our Group" in Appendix V to this prospectus.

We have also been licensed by Outlast to manufacture and sell certain Outlast's fabrics which comprise microencapsulated phase-change materials coated fabrics or fibres in China to third parties who are themselves trademark licensees of Outlast. In addition, Outlast has granted us a non-exclusive licence to use its Outlast trademark in connection with the manufacture, promotion, distribution and sale of such products.

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Our Group has not obtained and does not intend to obtain any patent in respect of the functional fabrics we developed. This is because our Directors believe that fabrics trend is always changing in line with fashion trend while application for patent can be a lengthy process and the results of such application are unpredictable. Further, our Directors understand that if our Group's functional fabrics are patented, we would be required to publicise the relevant formula in producing such fabrics. As the functional fabrics developed by our Group are distinguishable in respect of their ingredients and the way the yarns are composed, our Directors are concerned that our competitors could slightly deviate from the relevant formula to produce products with similar attributes and functions, in which case it would be difficult for our Group to prove any infringement of patent. As such, our Directors believe that instead of devoting resources in applying for patent rights, it is more cost-effective to better serve our customers and enhance our production capability at this stage of corporate development. Our Directors will review the need and feasibility for application for patent and will make application for future developed fabrics if and when appropriate and possible.

### AWARDS AND RECOGNITIONS

Since the establishment of our Group, we have been granted a number of significant awards and recognitions by the PRC government authorities and recognised organisations. These awards and recognitions, we believe, signify our position in the fabric and innerwear production industry in the PRC:

<b>Awards and recognitions</b>	<b>Year of grant</b>	<b>Award/grant/issuing organisation</b>
2003年度外貿出口先進單位 (Export Trade Advanced Entity in 2003*)	2004	中共濰坊市委 (Weifang Municipal Committee of the Chinese Communist Party*) 濰坊市人民政府 (Weifang Municipal People's Government*)
2004年度外貿出口先進單位 (Export Trade Advanced Entity in 2004*)	2005	中共諸城市委 (Zhucheng Municipal Committee of the Chinese Communist Party*) 諸城市人民政府 (Zhucheng Municipal People's Government*)
2005年度全市外貿工作先進單位 (Citywide Foreign Trade Work Advanced Entity in 2005*)	2006	中共濰坊市委 (Weifang Municipal Committee of the Chinese Communist Party*) 濰坊市人民政府 (Weifang Municipal People's Government*)

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Awards and recognitions	Year of grant	Award/grant/issuing organisation
2005年度外貿工作先進單位 (Foreign Trade Work Advanced Entity in 2005*)	2006	中共諸城市委 (Zhucheng Municipal Committee of the Chinese Communist Party*) 諸城市人民政府 (Zhucheng Municipal People's Government*)
濰坊市誠信民營企業 (Weifang Municipal Integrity Private Enterprise*)	2006	濰坊市誠信民營企業評審委員會 (Weifang Municipal Integrity Private Enterprise Evaluation Committee*)
2006年度外貿工作先進單位 (Foreign Trade Work Advanced Entity in 2006*)	2007	中共諸城市委 (Zhucheng Municipal Committee of the Chinese Communist Party*) 諸城市人民政府 (Zhucheng Municipal People's Government*)
2006年度招商引資先進單位 (Advanced Entity for Attracting Businesses and Foreign Capitals in 2006*)	2007	中共諸城市委 (Zhucheng Municipal Committee of the Chinese Communist Party*) 諸城市人民政府 (Zhucheng Municipal People's Government*)
2008年度森林青島流通中心第5屆 品質改善會議 — 品質管理優秀獎 (Honourable Mention for Quality Management — The Fifth Session of Quality Improvement Conference of Moririn's Qingdao Circulation Centre in 2008*)	2008	モリリン株式会社 (Moririn Co. Ltd.) — a Japanese global sourcing company
勞動保障誠信示範單位 (Model Credit Entity for Employee Protection)	2010	濰坊市人力資源和社會保障局 (Weifang City Human Resources and Social Security Bureau*)
2010年度企業財務會計信息工作先進單位 (Advanced Entity for Finance and Accounting Information in 2010)	2010	濰紡市財政局 (Weifang City Finance Bureau*)

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Awards and recognitions	Year of grant	Award/grant/issuing organisation
Best of the Best Award <i>(for achieving and maintaining a quality standard as top among vendors for 2010)</i>	2011	Carter's/OshKosh — a US leading provider of apparel and related products exclusively for babies and young children
5 Banner Award <i>(for maintaining an observed quality level of less than 0.5% for 2010)</i>	2011	Carter's/OshKosh

None of the above awards or certificates obtained by our Group was revoked or terminated as at the Latest Practicable Date.

### LEGAL PROCEEDINGS, CLAIMS AND COMPLIANCE

As at the Latest Practicable Date, we were not involved in any litigation, arbitration or claim of material importance, and no litigation, arbitration or claim was known to the Board to be pending or threatened by or against us, that would have a material adverse effect on our operation result of financial condition.

Our Board considers that during the course of our Group's daily operation as a fabrics and innerwear manufacturing company, our Group is in full compliance with the obligations as to environmental protection.

### NON-COMPLIANCES OF THE COMPANIES ORDINANCE

Mr. Wong and Madam Hung Kin, both being executive Directors of our Company, are the only directors of Grand Concord (HK), a subsidiary of our Company, since its incorporation. They had failed to lay audited accounts of Grand Concord (HK) before its annual general meetings for the periods from 30 November 1995 to 31 March 1996, and from 1 April 2004 to 31 December 2004; for the years ended 31 March 1997, 1998, 1999, 2000, 2001, 2002, as well as for the years ended 31 December 2005, 2006, 2007 and 2008. They had instead approved the relevant accounts of Grand Concord (HK) by way of written resolutions of shareholders on 18 August 2010. Further, Mr. Wong and Madam Hung Kin had laid the audited accounts of Grand Concord (HK) for the years ended 31 March 2003 and 2004 only at the general meeting held on 30 November 2005. The aforesaid constituted non-compliances of section 122 of the Companies Ordinance.

As advised by Mr. Wong and Madam Hung Kin, such non-compliances occurred as Grand Concord (HK) did not receive competent and timely professional advice on the ongoing compliance requirements under the Companies Ordinance, in particular, the requirements under section 122 of the Companies Ordinance, from the then auditor and secretarial firm engaged by Grand Concord (HK) for accounting and company secretarial matters.

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To rectify such non-compliances, Mr. Wong and Madam Hung Kin filed an application to the Court of First Instance of the High Court of Hong Kong on 15 October 2010 applying for an order of the court to substitute the aforesaid annual general meetings by written resolutions of shareholders and extend the time for approving the abovementioned accounts of Grand Concord (HK). The Court of First Instance heard the application on 5 November 2010 and granted an order in the terms of the application.

Given the Court of First Instance has already granted an order allowing the time for approving the abovementioned accounts of Grand Concord (HK) be extended, Grand Concord (HK) was advised that the non-compliances have been duly rectified.

In order to avoid any further or other non-compliance, Grand Concord (HK) has appointed a professional company secretarial firm to attend to the compliance matters under the Companies Ordinance. Our Company Secretary, Mr. Lee Yin Sing, who is a member of the Hong Kong Institute of Certified Public Accountants with over 8 years of auditing experience in finance control and accounting, together with the Board, will also oversee the compliance matters of our Company and our subsidiaries pursuant to the relevant laws. Professional accountants and legal advisers will be retained to advise our Group on compliance and accounting matters where required.

### APPROVALS AND PERMITS

We have been advised by our legal advisers as to Hong Kong laws and PRC laws that we have obtained all requisite permits, licences and approvals from relevant authorities to legitimately conduct our businesses and operations in accordance with all relevant laws and regulations in Hong Kong and the PRC. Set out below are the major approval, permits, licences and certificates required for our manufacturing operations:

No.	Name of document	Issuer	Registration/ approval/ document no.	Date of issue/ renewal	Validity
<i>Zhucheng Eternal Knitting</i>					
1.	企業法人營業執照 (Enterprise Legal Person Business License*)	濰坊市工商行政 管理局 (Weifang Municipal Administration for Industry and Commerce*)	370700400006495	29 June 2011	24 October 2000 to 23 October 2050
2.	中華人民共和國外商投資企業 批准證書 (Certificate of Approval for Establishment of Enterprises with Foreign Investment in the PRC*)	山東省人民政府 (Shandong Provincial People's Government*)	商外資魯府濰字[2000] 1233號 (Shang Wai Zi Lu Fu Wei Zi [2000] No. 1233*)	23 June 2011	Valid, subject to annual review

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No.	Name of document	Issuer	Registration/ approval/ document no.	Date of issue/ renewal	Validity
3.	城市排水許可證 (Municipal Sewage Disposal Permit*)	諸城市市政管理局 (Zhucheng Municipal Affairs Administration*)	2007字第0020號 (2007 Zi No. 0020)	15 November 2007	15 November 2007 to 14 November 2012
<i>Zhucheng Yumin Knitting</i>					
4.	企業法人營業執照 (Enterprise Legal Person Business Licence*)	濰坊市工商行政 管理局 (Weifang Municipal Administration for Industry and Commerce*)	370700400008419	1 December 2008	22 November 2004 to 21 November 2054
5.	中華人民共和國外商投資企業 批准證書 (Certificate of Approval for Establishment of Enterprises with Foreign Investment in the PRC*)	山東省人民政府 (Shandong Provincial People's Government*)	商外資魯府濰字[2004] 3140號 (Shang Wai Zi Lu Fu Wei Zi [2004] No. 3140*)	12 September 2006	Valid, subject to annual review
6.	中華人民共和國取水 許可證 (The PRC Water Drawing Permit*)	諸城市水利水產局 (Zhucheng Municipal Water Conservation and Water Product Bureau*)	取水魯諸字 [2007] 第016號 (Qu Shui Lu Zhu Zi [2007] No. 016*)	27 November 2007	27 November 2007 to 31 December 2011 ( <i>Note</i> )
7.	排放污染物許可證 (Pollutants Discharge Permit*)	諸城市環境保護局 (Zhucheng Municipal Environmental Protection Bureau*)	魯環許字臨 3707820022號 (Lu Huan Xu Zi Lin No. 3707820022)	1 November 2010	November 2010 to November 2011 ( <i>Note</i> )



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No.	Name of document	Issuer	Registration/ approval/ document no.	Date of issue/ renewal	Validity
<i>Shandong Grand Concord</i>					
8.	企業法人營業執照 (Enterprise Legal Person Business Licence*)	濰坊市工商行政 管理局 (Weifang Municipal Administration for Industry and Commerce*)	370700400007772	22 July 2010	9 July 2007 to 8 July 2057
9.	中華人民共和國外商投資企業 批准證書 (Certificate of Approval for Establishment of Enterprises with Foreign Investment in the PRC*)	山東省人民政府 (Shandong Provincial People's Government*)	商外資魯府濰字[2007] 0981號 (Shang Wai Zi Lu Fu Wei Zi [2007] No. 0981*)	20 July 2010	Valid, subject to annual review
10.	城市排水許可證 (Municipal Sewage Disposal Permit*)	諸城市市政管理局 (Zhucheng Municipal Affairs Administration*)	2009字第0008號 (2009 Zi No. 0008)	25 February 2009	25 February 2009 to 24 February 2014

*Note:* As advised by our PRC legal advisers, based upon the existing information and documents of our Group, there is no legal impediment to renew the permits.

## PROPERTIES

### Owned properties

As at the Latest Practicable Date, our Group owned three parcels of land with buildings erected thereon in the PRC. These three parcels of land have a total site area of approximately 106,180.53 sq. m. and the major buildings erected thereon with a total gross floor area of approximately 52,394.19 sq. m.. Our existing production lines and head office premises are currently housed in these buildings. In addition, our Group also owns the land use right of a parcel of land at Zhucheng, Shandong with a site area of approximately 30,798.00 sq. m. for our development. In addition to the above manufacturing sites, we own two residential apartments for senior staff dormitory purpose. Details of these owned properties are set out in the section headed “Group I — Properties held and occupied by our Group under various long-term title certificates in the PRC and valued on market value basis” in Appendix III to this prospectus.

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According to our PRC legal advisers, we have obtained all relevant approvals and title documents, including land use rights and building ownership certificates, of these parcels of land and buildings and own the full legal rights to use and assign these properties. The current usages of these properties are in compliance with the approved usages prescribed in the title documents. Our Board considers that these properties are crucial to our operations since all of our existing operational and production facilities are housed therein.

LCH (Asia-Pacific) Surveyors Limited, an independent Professional Surveyor, has reported and valued the property interests of our Group as at 31 August 2011. The texts of the letter, summary of values and the valuation certificate issued by LCH (Asia-Pacific) Surveyors Limited for this purpose are set out in Appendix III to this prospectus.

### **Leased properties**

We lease properties for use in our business operations.

As at the Latest Practicable Date, we rented four properties which were used as offices and workshop from independent third parties in the PRC with a total gross floor area of approximately 2,150.14 sq.m. and in Hong Kong with a total saleable area of approximately 264.03 sq.m.. LCH (Asia-Pacific) Surveyors Limited, an independent Professional Surveyor, has reported the property interests of our Group as at 31 August 2011. The texts of the letter, summary of values and the valuation certificates issued by LCH (Asia-Pacific) Surveyors Limited for this purpose are set out in Appendix III to this prospectus. Details of these leased properties are set out in the section headed “Group II — Properties occupied by the Group under an operating lease in Hong Kong” and “Group III — Properties occupied by the Group under various operating leases in the PRC” in Appendix III to this prospectus.

As to the three properties with a total gross area of approximately 2,150.14 sq.m. which we rented in the PRC, the landlords of such properties had not obtained building ownership certificates. Our Directors have decided not to renew such tenancy agreements upon their expiry, and our Directors also confirm that the lack of building ownership certificates will not have a material adverse impact on our results of operations given that these leased properties are not irreplaceable.

In addition, certain tenancy agreements in respect of the properties we rented in the PRC and used as factory, office and staff dormitory had not been registered with the relevant PRC authorities during the Track Record Period. As advised by our PRC legal adviser, the non-registration during the term of the tenancy would not affect the validity of the tenancy agreements. We will use our best endeavours to urge the landlords of other properties (details of which are set out in the section headed “Group III — Properties occupied by the Group under various operating leases in the PRC” in Appendix III to this prospectus) to attend to the required registration of the relevant tenancy agreements.

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### COMPETITION

The fabric and innerwear products manufacturing business is highly competitive. Our Group faces competition from a significant number of domestic and foreign companies offering similar products, which include many companies with larger operating scale and which have stronger financial strengths and resources than our Group. The principal competitive factors that influence our customers' purchasing decision include product quality, price, and the provision of additional apparel-related services such as design, printing and embroidery, and product development services. Please also refer to the section headed "Industry overview — Competition in the OEM apparel industry in the PRC" of this prospectus for more details.

In view of this highly competitive environment, our Directors believe that it is crucial for us to develop and maintain long-term business relationships with our key customers, in particular, the sourcing agents and brand owners. Further, by leveraging on our vertically integrated operation, good relationship with our suppliers and existing customers, the expertise of our management team, and our constant effort in developing different kinds of functional fabrics and innerwear, we believe that we will be able to sustain and grow in the highly fragmented and competitive fabrics and knitwear manufacturing industry in China. Please refer to our competitive strengths as set forth in the paragraph headed "Competitive strengths" in this section for more details.