# OPERATIONAL UPDATE - 3rd Quarter

In order to further enhance the transparency of the Group and to enable shareholders, investors and the general public to better appraise the operational performance of the Group the board of Directors of Top Form International Limited announces certain selected operational data for the third quarter of fiscal 2006

# The First Half

In our 2006 interim report we discussed the uncertainties and impact of the trade disputes between China, the E.U. and U.S. markets together with the implementation chaos which compelled us to reshuffle production loadings between China and our overseas plants in Thailand and the Philippines with consequential losses of efficiency and increase in operating costs. We also noted that, for calendar year 2006, the quota allocation mechanism appeared to have stabilized and that we were confident of acquiring sufficient quota for our needs in China. Our challenge during the second half of our fiscal year was rebuilding the efficiency of our plants to fully meet the needs of our existing and new customers.

### Quota

During the third quarter under review, the calendar year 2006 quota allocation and auction sales were completed. Through participation in the process and purchases from the market, we have secured sufficient quota in China to satisfy our needs. The spending in quota for the calendar year is \$22 million. In the meantime, quota usage by China in general has been low compared with the control level. As at May 8<sup>th</sup> 2006 the quota usage of brassiere categories by China was as follows:

Quota	2006	Control Level
E.U. #31	18.3%	35.1%
US 349/649	13.4%	35.1%

Note: Control Level is a straight line projection of perfect utilization from beginning to end of year.

While demand in both the E.U. and U.S.A markets has remained stable, the decline in utilization is believed to be driven by relocation of production - especially price-sensitive business - to elsewhere outside of China.

Should the utilization trend continue, we expect quota would cease to be an adverse factor to business operations for the remainder of calendar 2006.

# **Manufacturing**

Our efforts over the last few months in rebuilding our plant efficiencies and global capacity have seen encouraging results. In our quarter to March 31<sup>st</sup>, 2006 we produced 14.8 million units of bras. This is in line with our earlier expectations and the output level attained is equivalent to the same period a year ago. Efficiency levels in China have resumed a normal level. Efficiency in our Thailand plants is improving, albeit at a slower level. We are quite confident that by the end of the fourth quarter, we will be able to produce around 17 million units of bras, matching the record output attained in the same quarter of the previous year.

#### **Operating Profit**

While the average selling price and material costs of OEM sales remained stable for the third quarter, operating profit was adversely affected by the domino effect of the production delays resulting from the trade disputes and quota fiasco that took place in the second quarter. In our effort to mitigate the delivery problems for our customers, we recorded exceptionally high operating costs from overtime operations and air freight shipments.

## **Brands**

In our strategic plan we predicate the growth of this business unit on acquisitions. In the absence of an immediate M&A target we have started on a prudent basis to re-invest in the existing operations, primarily in the structure, to position ourselves for internal growth. There was a modest increase in sales turnover in the third quarter, and the operating loss recorded in the period was in line with the expected performance of the unit at its current level of sales turnover.

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## Capital Expenditure

Capital expenditure for the nine months to March 31<sup>st</sup> amounted to HK\$28 million and is not anticipated to exceed HK\$35 million by the end of our fiscal year. This compares with expenditure of HK\$68 million in fiscal 2005.

## Outlook for the Year and Beyond

Top Form will see a set back in performance for the current fiscal year when compared to last year, primarily due to the trade disputes and the quota fiasco that took place in the first half of the year. While we are encouraged that we are well on our way to complete recovery of our production capacity and sales volume in the second half, we expect the abnormal costs incurred in clearing the backlog carried over from the first half will mop up some of our operating profit for the year.

Going forward, we are optimistic with the seemingly healthy market, the prospects of new customers and an increasing demand from existing customers. We are however mindful of the downside that might be brought on by the trend of increasing interest rates which might affect consumer spending, and the weakening of the greenback against most Asian currencies which, together with rising labor costs in China, could have a negative impact on our cost performance. Our business plan for the next fiscal year therefore calls for a prudent approach and we will target our annual growth on basis of the capacity buildup which we will attain at the fourth quarter of the current fiscal year.

The Board wishes to remind investors that the above operational data for the third quarter of fiscal 2006 are based on the group's unaudited management account. Investors are cautioned not to unduly rely on such data.

In the meantime, investors are advised to exercise caution in dealing in the securities of the Company.

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