

K-Star

K-STAR SPORTS LIMITED

(Incorporated in Singapore under the Companies Act (Chapter 50) of Singapore)(Company Registration Number 200820976H)
(Registered as a foreign company in Malaysia under the Companies Act 1965 of Malaysia)
(Malaysian Branch Registration Number 995214-D)

A. NOTES TO THE UNAUDITED FINANCIAL REPORT FOR THE SECOND QUARTER ENDED 30 JUNE 2012

A1. Basis of accounting and changes in accounting policies

a) Basis of accounting

The consolidated interim financial statements of K-Star Sports Limited (the “Company” or “K-Star”) and its subsidiary company (“the Group”) for the quarter ended 30 June 2012 are unaudited and have been prepared in accordance with Singapore Financial Reporting Standards (“FRS”) and Appendix 9B of the Bursa Malaysia Securities Berhad (“Bursa Securities”) Main Market Listing Requirements.

The unaudited consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements of the Group for the financial year ended (“FYE”) 31 December 2011. These explanatory notes attached to the interim financial statements provide an explanation of events and transactions that are significant to an understanding of the changes in the financial position and performance of the Group since the FYE 31 December 2011.

On 1 January 2012, the Company adopted the new or amended FRS that are mandatory for application from that date. Changes to the Company’s accounting policies have been made as required, in accordance with the transitional provisions in the respective FRS:

No.	Title
Framework	The Conceptual Framework for Financial Reporting 2010 (Chapters 1 and 3)
FRS 12	Amendments to FRS 12 Deferred Tax: Recovery of Underlying Assets
FRS 101	Amendments to FRS 101 Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters
FRS 107	Amendments to FRS 107 Disclosure - Transfers of Financial Assets

The adoption of these new or revised FRS did not result in substantial changes to the Group’s and the Company’s accounting policies and had no material effect on the amounts reported for the current or prior financial years.

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At the date of authorisation of this report, the following FRS were issued but not yet effective:

No.	Title	Effective date - Annual periods commencing on or after
FRS 1	Amendments to FRS 1 - Presentation of Items of Other Comprehensive Income	1.7.2012
FRS 19	Employee Benefits	1.1.2013
FRS 27	Separate Financial Statements	1.1.2013
FRS 28	Investments in Associates and Joint Ventures	1.1.2013
FRS 32	Offsetting Financial Assets and Financial Liabilities	1.1.2014
FRS 110	Consolidated Financial Statements	1.1.2013
FRS 111	Joint Arrangements	1.1.2013
FRS 112	Disclosure of Interests in Other Entities	1.1.2013
FRS 113	Fair Value Measurements	1.1.2013

The Directors do not anticipate that the adoption of these FRS (including sequential amendments), where relevant to the Company, in future periods will have a material impact on the financial statements of the Company in the period of their initial adoption.

Changes in accounting policies

The accounting policies and presentation adopted by the Group for the interim financial statements are consistent with those adopted for the Group's audited consolidated financial statements for the FYE 31 December 2011.

b) Basis of consolidation

The consolidated financial statements of the Group have been prepared using the historical cost method similar to the "pooling-of-interest" as acquisition of subsidiary is accounted for as reconstructions of businesses. Under the historical cost method, the acquired assets and liabilities are recorded at their existing carrying amounts.

The consolidated financial statements include the results of operations, and the assets and liabilities of the pooled enterprises as part of the Group for the whole of the current period.

Other than accounting of subsidiary company using the historical cost method as disclosed above, the results of the subsidiary companies acquired during the financial year, if any, are included in the consolidated statement of comprehensive income from the effective date in which control is transferred to the Group.

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Subsequent acquisitions of subsidiary companies, if any, are accounted for using the purchase method. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest.

Where accounting policies of a subsidiary do not conform with those of the Company, adjustments are made on consolidation when the amounts involved are considered significant to the Group.

All inter-company balances and significant inter-company transactions and resulting unrealised profits or losses are eliminated on consolidation and the consolidated financial statements reflect external transactions and balances only. The results of subsidiary companies acquired or disposed of during the financial year are included or excluded from the consolidated statement of comprehensive income from the effective date in which control is transferred to the Group.

c) **Functional currency and translation to presentation currency**

(i) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The financial statements are presented in Renminbi, which is also the functional currency of the Group.

(ii) Transactions and balances

Foreign currency transactions are measured and recorded in the functional currency using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated at the closing rates ruling at the respective statement of financial position dates. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the profit or loss.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the date of transactions. Non-monetary items measured at fair values in foreign currencies are translated using the exchange rates when the fair values are determined.

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(iii) Group companies

The results and financial positions of all entities that have functional currencies different from the presentation currency are translated into the presentation currency as follows:

- (1) Assets and liabilities are translated at the closing exchange rate at the end of reporting period;
- (2) Income and expenses are translated at average exchange rates (unless the average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- (3) All resulting currency translation differences are recognised in the currency translation reserve in equity.

A2. Audit report of the Group's preceding annual financial statements

The Group's audited consolidated financial statements for the FYE 31 December 2011 were not subject to any audit qualification.

A3. Seasonal or cyclical factors

There are no seasonal or cyclical factors which materially affect the Group during the quarter under review.

A4. Unusual items

There were no unusual items affecting assets, liabilities, equity, net income or cash flows of the Group during the current financial quarter and financial year-to-date.

A5. Material changes in estimates

There were no changes in estimates of amounts reported in prior financial year that have a material effect on the results of the current quarter under review.

A6. Changes in share capital and debts

There were no issuance, cancellations, repurchase, resale and repayment of debt and equity securities, share buy backs, share cancellation, shares held as treasury shares and resale of treasury shares for the current financial period to date.

A7. Subsequent material events

There are no other material events as at the date of this announcement that will affect the results in the financial period under review.

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A8. Financial instruments with off-balance sheet risks

There were no financial instruments with off-balance sheet risks as at the date of this report.

A9. Segment information

a) Operating segments

The Group has only one operating segment, which is the design, manufacture and sale of sports footwear, sports apparel and accessories.

However, the breakdown of the Group revenue by product type is as follows:

	Six (6) months ended 30 June 2012	
	<u>RMB'000</u>	<u>RM'000</u>
Sale of sports footwear	214,610	107,284
Sale of sports apparel and accessories	32,563	16,278
	<hr/>	<hr/>
	247,173	123,562
	<hr/>	<hr/>
	Six (6) months ended 30 June 2011	
	<u>RMB'000</u>	<u>RM'000</u>
Sale of sports footwear	318,963	159,449
Sale of sports apparel and accessories	37,277	18,635
	<hr/>	<hr/>
	356,240	178,084
	<hr/>	<hr/>

b) Geographical segments

The Group operates predominantly in the People's Republic of China ("PRC"). Accordingly, no separate business and geographical segment information is presented.

A10. Property, plant and equipment

The valuations of property, plant and equipment have been brought forward without amendment from the Company's audited consolidated financial statements for the FYE 31 December 2011.

A11. Status of corporate exercise

Save for the announcement made by the Company on 16 December 2011 pertaining to the acquisition of the entire issued and paid-up share capital of Jinjiang Saifeite Shoes Plastics Co., Ltd by Fujian Jinjiang Dixing Shoes Plastics Co. Ltd. ("Dixing"), a wholly-owned subsidiary company of K-Star ("Acquisition"), there was no other corporate proposal announced but not completed as at 20 August 2012, being the latest practicable date which is not earlier than 7 days from the date of issue of this quarterly report. Barring any unforeseen circumstances, the Acquisition is expected to be completed within 4 months from the date of this report.

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A12. Contingent liabilities

There were no material changes in the contingent liabilities or contingent assets since the last annual statement of financial position ended 31 December 2011.

A13. Capital commitments

There is no capital commitment as at 30 June 2012.

A14. Changes in the composition of the Group

There were no other changes in the composition of the Group during the financial period under review.

A15. Reserves

a) Statutory reserve

In accordance with the relevant laws and regulations of the PRC, the subsidiary company of K-Star established in the PRC are required to transfer 10% of its profit after taxation prepared in accordance with the accounting regulation of the PRC to the statutory reserve until the reserve balance reaches 50% of the respective registered capital. Such reserve may be used to offset accumulated losses or increase the registered capital of this subsidiary, subject to the approval from the PRC authorities, and are not available for dividend distribution to the shareholders.

b) Merger reserve

The merger reserve arises from the difference between the cost of investment of subsidiary and the share capital of the subsidiary acquired under the pooling-of-interest method of accounting.

A16. Related party transactions

There were no related party transactions during the current quarter and the financial year to date.

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B. ADDITIONAL INFORMATION REQUIRED BY BURSA MALAYSIA SECURITIES BERHAD MAIN MARKET LISTING REQUIREMENTS

B1. Review of performance

The Group recorded revenue of RMB 139.06 million for the current quarter three (3) months ended 30 June 2012 (“2Q2012”), representing a decrease of approximately 32.06% as compared to the preceding year corresponding quarter three (3) months ended 30 June 2011 (“2Q2011”) as retail sales growth was decelerated by weaker end-market demand and the downtrend in the overall economy has continued to curb the Group’s earnings.

For the six (6) months financial period ended (“FPE”) 30 June 2012 (“1H2012”), the sales of original equipment manufacturer (“OEM”) products which accounted for approximately 14.55% of the total footwear revenue were lowered by 26.77% as compared to the FPE 30 June 2011 (“1H2011”). The result reflected that the labour-intensive industry where the Group operates is facing challenges from higher labour and raw material costs, leaving it vulnerable to other lower labour cost countries.

The sales of the Group’s footwear products under its proprietary brand “Dixing” which accounted for approximately 85.45% of the total footwear revenue for the 1H2012 has declined by 33.63% as compare to the 1H2011. In addition, the revenue growth for the sports apparel and accessories has also lost some momentum recording 12.65% lower as compared to the preceding year corresponding period. This was mainly due to delayed orders as retailers were experiencing inventory overstock.

Overall, the total Group’s revenue for the 1H2012 fell by 30.62% as compared to the preceding year corresponding period, amid concern on the economy slowdown, uncertainties on recovery of Europe’s fiscal crisis and intensified competition has continue to undermine the sportswear market as well as the Group’s businesses.

The gross profit margin for the 1H2012 was recorded approximately 2.62% lower as compared to the 1H2011. This was mainly attributable to the decrease in average footwear selling price of approximately 2.71% while certain production cost components such as wages and raw materials were remained high.

The sales and distribution expenses incurred in the 1H2012 was RMB 17.43 million, standing approximately 8.48% higher as compared to the preceding year corresponding period of RMB 16.07 million. In view of the retailers will continue to face keen competition and an increasingly complex market environment in the sportswear industry, the Group has continued to aid efforts in promotional and advertising activities in the 1H2012, which was approximately RMB 1.44 million higher as compared to the preceding year corresponding period.

The Group’s administrative expenses for the 1H2012 was higher by approximately 10.43% as compared the preceding year corresponding period. This was mainly due to higher depreciation costs arising from the construction and renovation of an exhibition hall and staff dormitory which were completed at the end of 4th quarter 2011.

Comparing to the 1H2011, the Group’s profit before taxation (“PBT”) and profit after taxation (“PAT”) were recorded lower by approximately 54.33% and 54.68% respectively, of which the profitability was depressed by lower sales, shrinking gross profit margin and the increases in expenses as mentioned above.

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The Group's PBT is arrived at after charging/(crediting) amongst others, the following:

	Individual quarter ended		Individual quarter ended	
	30 June 2012	30 June 2011	30 June 2011	30 June 2011
	RMB '000	RMB '000	RM '000	RM '000
Interest income	(287)	(224)	(143)	(112)
Other income including investment income	(2)	-	(1)	-
Interest expense	550	79	275	39
Depreciation	1,831	1,369	915	684
Amortisation	231	187	115	93
Provision for doubtful	*1	*1	*1	*1
Bad debts written off	*1	*1	*1	*1
Provision for slow moving inventory	*2	*2	*2	*2
Inventory written off	*2	*2	*2	*2
(Gain)/ Loss on disposal of quoted or unquoted investments or properties	N/A	N/A	N/A	N/A
Impairment of assets	*3	*3	*3	*3
(Gain)/Loss on foreign exchange	19	32	9	16
(Gain)/Loss on derivatives	N/A	N/A	N/A	N/A
Exceptional items	N/A	N/A	N/A	N/A

Notes:

*1 *The Directors took reasonable steps to ascertain that action had been taken in relation to the writing off of bad debts and the making of allowance for doubtful debts and satisfied themselves that there were no bad debts to be written off and no allowance for doubtful debts was required.*

*2 *The Directors are not aware of any circumstances which would render it necessary to write off any inventory or to make any allowance for slow moving inventory as at the date of this report.*

*3 *The Directors are not aware of any indication of impairment.*

N/A *Not applicable as the Group does not have any quoted or unquoted investments or properties, derivatives and exceptional items as at the date of this report.*

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	Current year to date ended		Preceding year to date ended	
	30 June 2012 RMB '000	30 June 2011 RMB '000	30 June 2011 RM '000	30 June 2011 RM '000
Interest income	(577)	(362)	(288)	(181)
Other income including investment income	(5)	-	(3)	-
Interest expense	1,167	295	583	148
Depreciation	3,674	2,616	1,837	1,308
Amortisation	420	375	210	187
Provision for doubtful debts	*1	*1	*1	*1
Bad debts written off	*1	*1	*1	*1
Provision for slow moving inventory	*2	*2	*2	*2
Inventory written off	*2	*2	*2	*2
(Gain)/ Loss on disposal of quoted or unquoted investments or properties	N/A	N/A	N/A	N/A
Impairment of assets	*3	*3	*3	*3
(Gain)/Loss on foreign exchange	21	96	10	48
(Gain)/Loss on derivatives	N/A	N/A	N/A	N/A
Exceptional items	N/A	N/A	N/A	N/A

Notes:

*1 *The Directors took reasonable steps to ascertain that action had been taken in relation to the writing off of bad debts and the making of allowance for doubtful debts and satisfied themselves that there were no bad debts to be written off and no allowance for doubtful debts was required.*

*2 *The Directors are not aware of any circumstances which would render it necessary to write off any inventory or to make any allowance for slow moving inventory as at the date of this report.*

*3 *The Directors are not aware of any indication of impairment.*

N/A *Not applicable as the Group does not have any quoted or unquoted investments or properties, derivatives and exceptional items as at the date of this report.*

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B2. Variation of results against immediate preceding quarter

	Current quarter ended 30 June 2012 RMB '000	Preceding quarter ended 31 March 2012 RMB '000
Revenue	139,063	108,110
Profit before taxation	17,555	14,122
Profit after taxation and total comprehensive income for the period	12,825	10,555

	Current quarter ended 30 June 2011 RM '000	Preceding quarter ended 31 March 2012 RM '000
Revenue	69,518	54,044
Profit before taxation	8,776	7,060
Profit after taxation and total comprehensive income for the period	6,411	5,276

In the 2Q2012, the Group reported higher revenue and PBT of RMB 139.06 million and RMB 17.56 million respectively as compared to the revenue of RMB 108.11 million and PBT of RMB 14.12 million in the preceding quarter three (3) months ended 31 March 2012 ("1Q2012").

Production output and sales of OEM footwear, Dixing brand footwear, apparel and accessories were recorded higher as compared to 1Q2012. A lower sale recorded in the 1Q2012 was mainly due to lower production output in conjunction with the Chinese New Year festive holiday in China.

In the 2Q2012, gross profit margin has decreased by approximately 3.06% as a result of reduced average footwear selling price of approximately 6.41%. Whilst total expenses remained fairly consistent, PBT rebounded by 24.31% on account of higher sales.

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B3. Prospects for the financial year ending 31 December 2012

The overall economic development in China was stable in the 1H2012 albeit faced with complicated and volatile economic environment in China and globally. China's gross domestic product rose 7.6% in the 2Q2012 from a year earlier, indicating that the Chinese government is aiding efforts to reverse an economic slowdown and to maintain sustainable economic development and are expected to continue to step up policy fine-tuning in the second half of 2012 to support growth.

Albeit the outlook in the near term is less favourable amid the slowdown of economy, the Group remains optimistic on the long term potential growth of the sports industry in China following the implementation of the China 12th Five Year Plan (2011-2015) and the National Fitness Plan (2011-2015) which continued to promote and provide momentum to the sports industry in China.

The Group remains cautious on the uncertainty of the global economic recovery and perceived that the competition within China's sporting goods industry will remain intense. The Group will undertake necessary measures by extending discounts or subsidies to the distributors as an incentive to support and maintain their business profitability amid the current market environment continues to be challenging.

In addition, the rising costs of labour and raw material will persist to further add pressure on the profit margin of the Group. Accordingly, the Group will continue its focused effort tending toward in enhancing operational efficiency and effectiveness. On the other hand, we will continue to focus on product branding, advertising, design and development, strengthening and expanding our sale and distribution network to maintain our competitive edge and to reinforce long term sustainability.

The Board of Directors of K-Star ("Board") believes that the Group's prospects for the financial year ending 31 December 2012 would remain positive. Barring any unforeseen circumstances, the Group expects to continue to record satisfactory performance for the financial year ending 31 December 2012.

B4. Profit forecast and profit guarantee

The Group has not provided any profit forecast or profit guarantee in any public document for the current financial quarter.

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B5. Taxation

Taxation comprises the following:

	Current Quarter RMB '000	Current year to date RMB '000
PRC income tax	4,730	8,297

	Current Quarter RM '000	Current year to date RM '000
PRC income tax	2,365	4,148

The effective tax rates of the Group for the current quarter and current year to date were 26.94% and 26.19% respectively as compared to the applicable tax rate of 25%. The difference of effective tax rate and the applicable tax rate was mainly due to losses of the Company not allowable for group relief.

B6. Group borrowings

The Group's borrowings as at 30 June 2012 were as follows:

	Total RMB'000	Total RM'000
Short-term bank borrowings:		
Secured	9,100	4,549
Unsecured	13,026	6,512
	<u>22,126</u>	<u>11,061</u>

B7. Changes in material litigation

As at the date of this report, there is no litigation or arbitration, which has a material effect on the financial position of the Group and the Board is not aware of any proceedings pending or threatened or of any fact likely to give rise to any proceedings.

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B8. Dividend

There were no dividends declared by the Company for the current quarter ended 30 June 2012.

B9. Earnings per share

a) Basic earnings per share

	Individual quarter ended		Individual quarter ended	
	30 June 2012	30 June 2011	30 June 2012	30 June 2011
Profit attributable to equity holders of the Company (RMB'000)	12,825	30,115	6,411	15,055
Weighted average number of ordinary shares in issue ('000)	266,400	266,400	266,400	266,400
Basic earnings per share (RMB cents/RM sen)	4.81	11.30	2.41	5.65

	Cumulative six (6) months ended		Cumulative six (6) months ended	
	30 June 2012	30 June 2011	30 June 2012	30 June 2011
Profit attributable to equity holders of the Company (RMB'000)	23,380	51,591	11,687	25,790
Weighted average number of ordinary shares in issue ('000)	266,400	266,400	266,400	266,400
Basic earnings per share (RMB cents/RM sen)	8.78	19.37	4.39	9.68

b) Diluted earnings per share

The diluted earnings per share is the same as the basic earnings per share as there were no potential dilutive ordinary shares as at the respective balance sheet dates.

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B10. Realised and unrealised profits/(losses)

	Cumulative quarter		Cumulative quarter	
	Six (6) months ended 30 June 2012 RMB '000	Six (6) months ended 30 June 2011 RMB '000	Six (6) months ended 30 June 2012 RM '000	Six (6) months ended 30 June 2011 RM '000
Realised	343,407	334,032	171,668	166,983
Unrealised	(21)	(96)	(10)	(48)
Total retained profits	343,386	333,936	171,658	166,935

	Preceding quarter ended 31 March 2012	
	RMB '000	RM '000
Realised	330,563	165,248
Unrealised	(2)	(1)
Total retained profits	330,561	165,247

By Order of the Board

Ding Jianping
Executive Chairman and
Chief Executive Officer
27 August 2012