

Chairman's Statement



*Dr. Tsai Yen Yu,
Chairman*

Dear fellow shareholders,

RESULTS

Natural Beauty achieved a turnover of approximately HK\$306.3 million (2001: HK\$254.6 million) and an operating profit of approximately HK\$85.1 million (2001: HK\$79.9 million) for the year ended 31 December 2002 which represented an increase of approximately 20.3% and approximately 6.5% over the past year respectively. Both the PRC and Taiwan operations achieved strong growth in 2002 and have met our internal target. When compared to 2001, the operating profit for the PRC and Taiwan operations have increased by approximately 32.2% and approximately 24.5% respectively. Our business in Hong Kong, being its first year of operation in a new market, recorded an operating loss of approximately HK\$9.5 million in 2002. However, our Class-A Natural Beauty SPAs in Hong Kong have started to achieve cashflow breakeven on a monthly basis during the fourth quarter of 2002.

DIVIDENDS

In appreciation of the continual support of our shareholders, the board of Directors (the "Board") has, in addition to recommending a final dividend of HK\$0.015 per Share, recommended a special dividend of HK\$0.005 per Share in respect of the year ended 31 December 2002, subject to the approval by shareholders at the forthcoming annual general meeting.

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A CHALLENGING YEAR

Shares of the Company were listed on the Main Board of the Stock Exchange on 28 March 2002, a year when most of the world's economies were going through a difficult time. Against this testing condition, Natural Beauty achieved encouraging results in 2002. Our performance reflected the resilience of our Greater China businesses and our ability to generate healthy returns. In spite of the global economic downturn the strength of Natural Beauty enabled us to grow our operating income and to take opportunities to lay the foundations for our future expansion.

HISTORY AND BACKGROUND

Started from a humble beginning with a single beautician chair in Taipei some 30 years ago, today we have over 2,200 outlets located throughout the PRC, Taiwan and Hong Kong and are now one of the leading skin care product and service providers in this region.

A GROWING BUSINESS

As at 31 December 2002, the Company together with its subsidiaries (the "Group") operates 77 self-owned spas (Class-A and Class-B), 2,031 franchised spas (Class-B) and beauty salons (Class-C) and 158 dedicated counters in the Greater China region.

In China (including Hong Kong), we have increased the number of our distribution outlets from 1,089 at the end of 2001 to 1,593 at the end of 2002 and we have extended our reach to Shenyang City, Liaoning Province and Hong Kong. Of these 1,593 distribution outlets, 62 are self-owned spas in the form of Class-A and Class-B formats, 1,374 are franchised spas and salons in the form of Class-B and Class-C format and 157 are in the form of dedicated counters within department stores and shopping complexes. We were one of the first to introduce the facial treatment concept into the PRC market some 10 years ago and in 2000, we introduced the spa concept to the PRC market. We have since maintained our leading position in providing quality skin care services in China. In view of the improving standards of living and consumer awareness for quality products in the PRC, we opened our first premium Class-A Natural Beauty SPA in 2000 in Shanghai in order to cater for the growing high-income segment of the population.

In Taiwan, we have maintained the number of our distribution outlets at around the same level. Of these 673 distribution outlets, 15 are self-owned spas in the form of Class-A format, 657 are franchised spas and salons in the form of Class-B and Class-C formats and one in the form of dedicated counters. Whilst the number of distribution outlets in Taiwan has only increased by one store, turnover from the Taiwan segment has increased by approximately 12.2% to approximately HK\$111.5 million. This is a result of effective marketing efforts of the Group and the launch of new product lines in the second half of 2002.

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A GROWING BUSINESS (continued)

Year 2002 was an important year for our operations in Hong Kong as it was the first time we set foot in the Hong Kong spa sector by opening our first Class-A Natural Beauty SPA and the total number of our outlets in Hong Kong quickly expanded to three before the end of last year. Despite only its first year of operation, our Class-A Natural Beauty SPAs have started to achieve cashflow breakeven on a monthly basis during the fourth quarter of 2002. Our spas in Hong Kong have recently been rated as the "Number 1 SPA" in Hong Kong, out of a total of 16 spa operators being rated, by 星島出版 (Sing Tao Publishing), a leading publication group in Hong Kong.

In 2002, we have also extended our services to male customers in the Class-A Natural Beauty SPA located within the Four Seasons Hotel in Shanghai (previously, it was only offered in Taiwan), and subsequently in 2003 to a Class-B NB Salon in Hong Kong. We are currently planning to extend such services to more locations in the region.

In addition, we have made several major decisions during the year, providing a strong foundation for our future growth:

1. We have acquired the minority interests of 25 non-wholly owned subsidiaries of the Group (the "PRC Subsidiaries") in order to further enhance the operations (especially financial management) of the 25 PRC Subsidiaries that served as the regional vehicles of the Group to manage our self-owned and franchised beauty centers in the PRC. Through this arrangement, the Group was able to restructure the costing structure of its distribution and therefore, improving the product sales margin of the Group.
2. In 2002, we have established over 500 new distribution outlets, and the total number of distribution outlets reached 2,266 at year end. We will continue to expand our distribution network in the Greater China region and expect the total number of our distribution outlets to exceed 5,000 by the end of 2006.
3. With a view to increasing product sales of the Group, the Group has started to set up sales counters in the existing distribution outlets i.e. "Shop-within-Shop". In addition, the Group has diversified the distribution network by introducing a new distribution concept called "Mini SPA" that cater for the mass market. Furthermore, the Group has worked with franchisees to transform Class-C NB Beauty Salon into Class-B NB Salon SPA in order to alleviate corporate image and enhance product sales. We believe that such conversion can increase the product sales capability of the franchised outlets thus resulting in higher product sales by the Group. At the end of 2002, the Group has a total of 891 Class-A Natural Beauty SPA, Class-B NB Salon SPA and Mini SPA. Going forward, the Group will continue to convert the remaining 1,217 Class-C NB Beauty Salon into either to Class-B NB Salon SPA or Mini SPA.

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A GROWING BUSINESS (continued)

4. We are committed to enhance profitability through active expansion of distribution network and implementation of effective cost control measures. The Group has already formulated various measures to streamline the cost, including entering into assets entrustment agreements to entrust the management and operation of certain assets to trustees. This will not only reduce our capital risk, but also provide a stable income to the Group.

OUR PRODUCTS

At Natural Beauty, we are very proud of our traditions of developing our own products with only the finest and natural materials extracted from plants. Our relentless pursuit of developing the highest quality products specially formulated for delicate skins and are particularly suitable for oriental complexion resulted in our continuous improvement in our existing products and the introduction of new products.

We have diversified our product range to cater for the needs of different customers. Through our three main product groups (namely, skin care products, beauty products and aromatherapeutic products) which, altogether has over 1,000 different products, our products are able to reach different types of consumers effectively.

During the year, the Group has continued to focus on research and development of new products thus allowing the Group to launch three new product lines to target younger generations and are suitable for sales in retail outlets, including the Bio-Up skin care series products which are made of natural plant-extracted ingredients imported from Australia; the Oriental Beauty skin care series products which are made of natural aromatic essential oils ingredients imported from France; and the N&B skin care series which are made from Natural Beauty's France natural plant-extracted ingredients, totalling over 150 new products. With an enriched product mix, the Group has successfully increased its presence in the mass market and younger customer segments. The Group aims to introduce over 100 new products to the market in 2003.

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CORPORATE GOVERNANCE

Already a leading provider of skin care products and services in the Greater China region, we further strengthened our leading position in this sector by transforming a 20-year old privately-held company into a publicly listed company in Hong Kong on 28 March 2002. It was a steep learning curve for all of us at Natural Beauty but we have managed it well. In order to further strengthen our corporate governance and transform Natural Beauty into a truly international corporation, we have established two management committees in February 2003 responsible for our PRC and Taiwan operations respectively. The committees are responsible for the formulation of business plans and strategies, subject to the Board's approval. Each management committees is made up of 10 senior management staff from various departments including directors of the Company. The PRC management committee is headed by myself and Mr. Lee Ming Ta and our Taiwan management committee is headed by Mr. Su Chien Cheng. In order to incentivise the members of the management committee, a portion of their monthly salary, ranging from 15% to 50% depending on the position held and contributions made, are directly linked to the sales performance of the Company. Members of the management committees are scheduled to meet regularly on a monthly basis. With the establishment of the management team, I will be able to focus more on research & development as well as training of our staff as well as the public, which I firmly believe is the two key elements of our success.

CONTRIBUTION TO THE COMMUNITY

During the year, we have sponsored a television programme called 激情創業 produced by CCTV in conjunction with the Ministry of Labour and Social Security. The programme provided business start-up opportunities and platform to unemployed workers. The programme attracted much community attention and received high acclaims from government officials. Other PRC enterprises were encouraged to learn from Natural Beauty and to work with the government to resolve social problems through the utilisation of social resources. The programme has also generated interests from potential franchisees to join our Company.

OUTLOOK

In 2003, we will continue to develop new products and to expand our market reach and brand name recognition in the Greater China region with the PRC market remain as a core focus.

To cope with the growing demand of our products, we have, subsequent to the year end date, acquired approximately 200 acres of land in Shanghai for the purpose of building our third production facility. We expect production in this new factory to begin in 2004.

In order to diversify our distribution network further and to provide additional channel of distribution other than through our spa and salon network, dedicated counters will also be part of our focus for bringing our products to the consumers in the near future and we intend to open approximately 70 new counters in 2003.

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OUTLOOK (continued)

The Group intends to penetrate into the international market in the future and will continue to actively explore alliance opportunities with international players from Europe, the United States of America and Japan, for the purposes of strengthening development capability, exchange of sales network and to jointly develop new products to enrich sales products, and to improve the Group's of overall profitability.

Year 2003 is expected to be a challenging year for Asia, especially when consumer and tourism spending has been negatively affected by the recent outbreak of the Severe Acute Respiratory Syndrome ("SARS") in the region. Competition is expected to intensify following China and Taiwan's accession into the World Trade Organisation. However, with high recognitions for our brands, extensive distribution networks through our self-owned and franchised spas and dedicated counters, customer loyalty which built up through the years and our franchisees whom most of them were experienced beauticians trained by Natural Beauty, we are very confident of our leading position in this region but, rest assure, we will not get complacency, we will be alert of any change to our operating environment and continue to work diligently to maintain growth in this extremely competitive operating environment.

APPRECIATION

I thank all my staff for their support and contributions which made the year under review a success. My appreciation also goes to our shareholders and the Group's customers, business partners and franchisees for their support during the year.

Dr. Tsai Yen Yu
Chairman