

## Management Discussion and Analysis

### FINANCIAL REVIEW

Turnover increased by approximately 20.3% or HK\$51.7 million to approximately HK\$306.3 million for the year ended 31 December 2002 reflecting continued growth in product sales and service income as a result of increased number of new distribution outlets in the Greater China region.

In the PRC, turnover increased by approximately 23.5% or HK\$36.4 million to approximately HK\$191.7 million. The increase is primarily due to the increase in the number of distribution outlets to 1,590 as at 31 December 2002, representing an increase of 501 distribution outlets.

In Taiwan, turnover increased by approximately 12.2% or HK\$12.2 million to approximately HK\$111.5 million. The growth in Taiwan was a result of increased marketing efforts and the increased in sales through selling to agencies of television direct sales. In addition, the launch of new product lines in Taiwan also contributed to the overall growth.



The Company has opened its first beauty centre in Hong Kong in 2002 and as at 31 December 2002, the Company has a total of three beauty centres in Hong Kong of which two are Class-A Natural Beauty SPA and one is Class-B Natural Beauty Salon SPA. In Hong Kong, the Company reported a turnover of approximately HK\$3.1 million for the year.

### Turnover by geographical region

	2002		2001	
	HK\$'000	%	HK\$'000	%
The PRC	191,697	62.6%	155,256	61.0%
Taiwan	111,465	36.4%	99,310	39.0%
Hong Kong	3,116	1.0%	—	—
	<b>306,278</b>	<b>100.0%</b>	<b>254,566</b>	<b>100.0%</b>

## Management Discussion and Analysis

### FINANCIAL REVIEW (continued)

**Products:** The Group manufactures and sells three main types of products, namely skin care products, beauty products and aromatherapeutic products under the NB<sup>®</sup> and Bio-up brand names. Sales of products are primarily made through beauty centres and dedicated counters and are the Group's key revenue contributor, accounting for approximately 83.2% of the Group's turnover for the year ended 31 December 2002 (2001: 90.4%). Gross profit margin of products increased to 85.3% (2001: 82.1%). The increase in both turnover generated from sale of products and gross profit margin was mainly attributable to the increase in distribution outlets, improved production logistics, enhanced inventory control system, quality research and development of the products and effective marketing efforts. During the year, the Group has launched three new product lines namely Bio-up, Oriental Beauty and N&B. Turnover of product sales per franchised store decreased by approximately 10.4% to approximately HK\$112,000 per store for the year ended 31 December 2002 compared to approximately HK\$125,000 in 2001 whilst turnover of product sales per owned stores decreased



by approximately 13.1% to approximately HK\$113,000 for the year ended 31 December 2002 compared to approximately HK\$130,000 in 2001. The decrease was due to the introduction of new mass market product lines which has a lower average selling price and the increase in the number of distribution outlets which lead to higher competition among distribution outlets located within the same cities.

**Services:** The Group provides skin treatments, beauty and spa services through its self-owned and operated Class-A beauty centres, namely Natural Beauty SPA. Service income are generated from owned beauty centres only as the Group does not share any service income generated in the franchised beauty centres with franchisees under the current franchise programme. Income from these services increased by approximately 109.7% to approximately HK\$51.5 million. The Group expects demand for skin treatment, beauty and spa services in the PRC to continue to grow as the economy of the PRC continues to prosper. On a per store basis, turnover increased by approximately 77.2% to approximately HK\$668,000 for the year ended 31 December 2002 compared to approximately HK\$377,000 in 2001. The increase was due to significant expansion in the number of distribution outlets and higher consumer awareness of the newly opened beauty centres and spa.

### Turnover by activities

	2002 HK\$'000	%	2001 HK\$'000	%
Products	254,810	83.2%	230,021	90.4%
Services	51,468	16.8%	24,545	9.6%
	<u>306,278</u>	<u>100.0%</u>	<u>254,566</u>	<u>100.0%</u>

## Management Discussion and Analysis

### FINANCIAL REVIEW (continued)

For the purpose of further enhancing the operations (especially financial management) of the 25 non-wholly owned subsidiaries of the Group (the "PRC Subsidiaries") that served as the regional vehicles of the Group to manage our self-owned and franchised beauty centres in the PRC, the Group seized the golden opportunity to acquire the minority interests in these PRC Subsidiaries in 2002, details of which are set out in the circulars of the Company dated 23 October 2002 and 18 November 2002. In addition, in order to continue to leverage on the experience of the respective local management in the operation and management of certain of the PRC Subsidiaries, the Group has, in 2002, entered into a total of six assets entrustment agreements with relevant local management (the "Entrustees") to entrust the management and operation of certain assets of the PRC Subsidiaries for a period of five years. Pursuant to the assets entrustment agreements, such Entrustees would bear the risks and rewards from the operation of these entrusted assets and will pay an annual entrustment fee to the Group. The Group will continue to negotiate with interested potential parties with a view to entering into assets entrustment agreements of a similar nature when opportunity arises as the Company believes it will be beneficial for the Company to have the opportunity to rely on the experience and expertise of these trustees over the management of the entrusted assets.

During the year ended 31 December 2002, the Group opened a total of 22 new self-owned beauty centres and 26 new self-owned dedicated counters thereby incurring capital expenditures of approximately HK\$20.7 million. The Group's distribution costs as a percentage of turnover increased from approximately 29.7% in 2001 to approximately 32.7% in 2002. The Group's administrative expenses as a percentage of turnover has also increased from approximately 16.1% in 2001 to approximately 19.3% in 2002. The increase in the distribution costs and administrative expenses as a percentage of turnover was due to higher staff costs and corporate office expenses as a result of the Company's listing on the main board of the Stock Exchange as well as the acquisitions of the 25 PRC Subsidiaries.

Tax expenses net of financial refunds for the year amounted to approximately HK\$21.9 million (2001: HK\$12.5 million), representing an increase of approximately 75.6% over 2001. The increase in net tax expenses was mainly attributable to the decrease in financial refunds received by the Company. For 2002, the relevant finance bureau has informed the Group that certain subsidiaries are entitled to certain preferential treatments in 2002, however, since such refund is only recorded as a deduction of income tax expense when it has been received or received subsequent to the balance sheet date. Up to the date of this report, only approximately HK\$7.1 million of financial refunds have been recorded. Financial refunds received from the local finance bureau in respect of financial year 2001 was approximately HK\$23.2 million.



## Management Discussion and Analysis

### FINANCIAL REVIEW (continued)

As a result of the increase in distribution costs and administrative expenses due to the expansion of the number of distribution outlets and the establishment of corporate office in Hong Kong, and the reduction of financial refunds from the local finance bureau of the PRC, the net profit of the Group decreased slightly by approximately 6.4% or HK\$4.6 million to approximately HK\$66.5 million for the year ended 31 December 2002. Geographically, both the PRC and Taiwan operations achieved strong growth in 2002 and have met our internal target. Compare to 2001, operating profit for the PRC and Taiwan operations have increased by approximately 32.2% and 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.

### Financial ratios review

	Formula used	2002	2001
Gross profit margin	Gross profit/Turnover	71.7%	74.9%
EBITDA margin	EBITDA/Turnover	35.1%	37.2%
Current ratio	Current assets/Current liabilities	4.6x	1.6x
Gearing	Net debt/Shareholders' equity	Cash positive	Cash positive
Return on shareholders' equity	Profit attributable to shareholders/ Shareholders' equity	9.1%	15.6%
Stock turnover days	Ending inventories/Cost of sales x 365 days	222 days	301 days
Debtors turnover days	Year end trade debtors/Turnover x 365 days	59 days	40 days
Dividend payout ratio	Total dividends/Profit attributable to shareholders	82.7%	32.3%

Gross profit margin ratio and EBITDA margin ratio for the year decreased slightly to approximately 71.7% and approximately 35.1% mainly due to a reduction in the margin for service income as a result of increased promotional activities offered by the newly established self-owned beauty centres during the year.

The Company raised net proceeds of approximately HK\$250 million from its initial public offerings in March 2002 of which approximately HK\$180 million was not yet utilised as at 31 December 2002. This has caused the current ratio of the Company to increase from 1.6 times to 4.6 times. During the year, the Company has continued its prudent financial management policy. As at 31 December 2002, the Group has a positive net cash balance of approximately HK\$216.8 million.

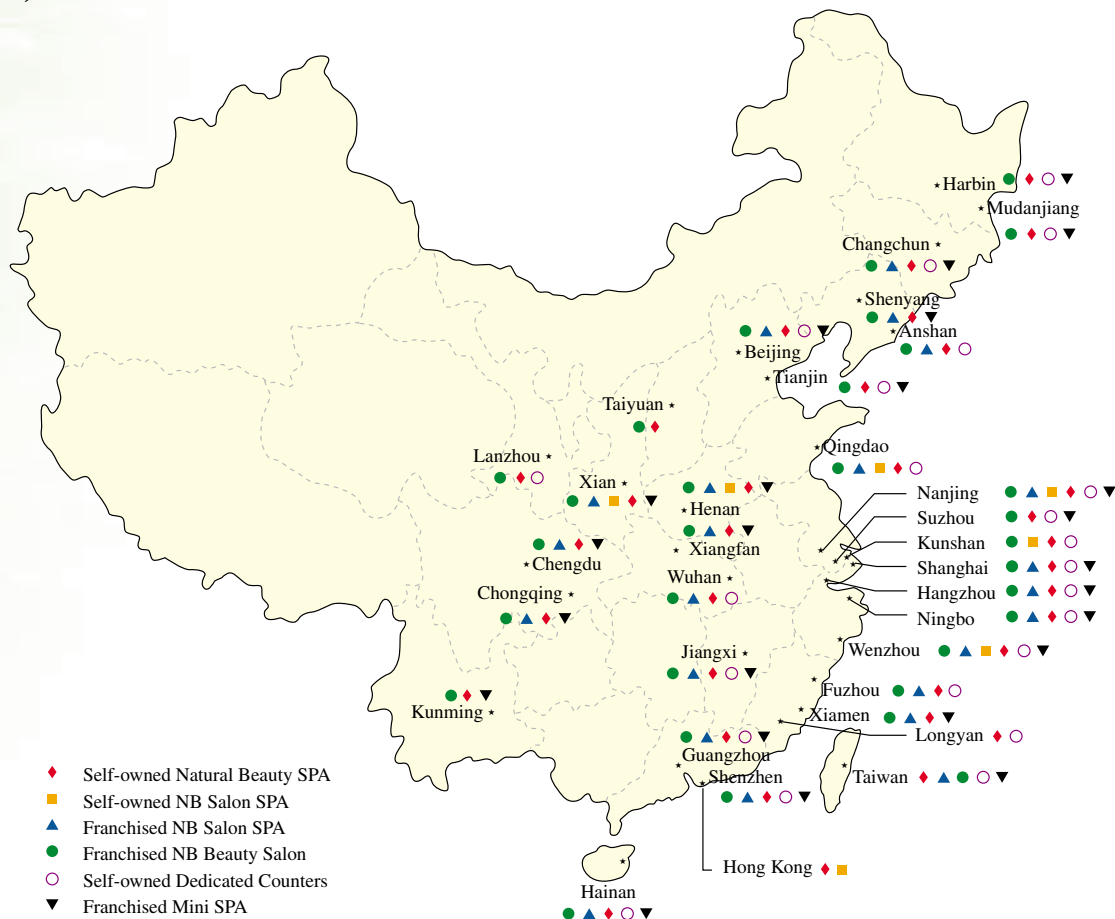
Stock turnover days has reduced substantially from 301 days in 2001 to 222 days in 2002. This improvement was mainly the result of a reduction in distribution lead time after the acquisition of the 25 PRC Subsidiaries, which acted as the distributors of the Company in different parts of the PRC in the past. Thus lower stock balance is required to be kept in our warehouses throughout the PRC. Debtors turnover days increased from 40 days in 2001 to 59 days in 2002. The increase was mainly due to an increase in trade receivables arising from television direct sales and year end credit sales. If such amounts were excluded, the debtors turnover days of the Group would be approximately 34 days, slightly lower than 2001.

## Management Discussion and Analysis

### SALES AND DISTRIBUTION CHANNELS

In 2002, the Group launched franchise programme for Mini SPAs. Mini SPA is a retail counter occupying around 30 m<sup>2</sup> to 100 m<sup>2</sup> of floor area that sells lower-end NB<sup>®</sup> products and offers certain body and facial treatment services to customers. Mini SPAs are designed to target second and third tier cities in the PRC and to cater for the mass market. As at the end of 2002, the Group has four types of beauty centres, namely Natural Beauty SPA, NB Salon SPA, NB Beauty Salon and Mini SPA, each offering a specific range of products and services under unique ambience targeting at different customer groups. During the year, the Group has worked with franchisees to transform Class-C NB Beauty Salon into Class-B NB Salon SPA with a view to increasing retail space for sale of Natural Beauty products. During 2002, 234 Class-C NB Beauty Salons were successfully transformed into Class-B NB Salon SPA. A substantial portion of the transformation costs were borne by the franchisees. The Group will offer franchisees of Class-C NB Beauty Salons to transform its store to either Class-B NB Salon SPA or Mini SPA format at their own choice and such transformation is expected to be completed by 2006.

As at 31 December 2002, the number of distribution outlets of Natural Beauty was 2,266 (2001<sup>(1)</sup>: 1,761).



Note:

(1) As at 31 October 2001.

## Management Discussion and Analysis

## SALES AND DISTRIBUTION CHANNELS (continued)

		2002	2001 <sup>(1)</sup>	2000	1999	1998
Natural Beauty SPA	– Owned	63	44	6	–	–
NB Salon SPA	– Owned	14	11	–	–	–
	– Franchised	654	123	–	–	–
		<u>668</u>	<u>134</u>	<u>–</u>	<u>–</u>	<u>–</u>
NB Beauty Salon	– Owned	–	–	–	1	1
	– Franchised	1,217	1,451	1,333	1,167	1,177
		<u>1,217</u>	<u>1,451</u>	<u>1,333</u>	<u>1,168</u>	<u>1,178</u>
Mini SPA	– Franchised	160	–	–	–	–
Dedicated counters	– Owned	158	132	93	93	91
Total	– Owned	235	187	99	94	92
	– Franchised	2,031	1,574	1,333	1,167	1,177
		<u>2,266</u>	<u>1,761</u>	<u>1,432</u>	<u>1,261</u>	<u>1,269</u>
Geographically located in:						
The PRC	– Owned	216	177	94	94	92
	– Franchised	1,374	912	588	406	263
		<u>1,590</u>	<u>1,089</u>	<u>682</u>	<u>500</u>	<u>355</u>
Taiwan	– Owned	16	10	5	–	–
	– Franchised	657	662	745	761	914
		<u>673</u>	<u>672</u>	<u>750</u>	<u>761</u>	<u>914</u>
Hong Kong	– Owned	3	–	–	–	–

Note (1): As at 31 October 2001

## PRODUCTS AND SERVICES

We pride ourselves that all our products are made of natural ingredients extracted from plants imported from various countries including France, Italy, Germany and the United States of America. These products are specially formulated for delicate skins and are particularly suitable for oriental complexion. Currently we have a number of product lines tailored for different segments of the market. In addition, through our research and development efforts, we were able to launch new products continuously. In 2002, we have launched three new product line with over 150 new products.

## PRODUCTION AND QUALITY CONTROL

To ensure the quality of our products meet the highest standard, all of our products are produced in-house by our two ISO9002 accredited production facilities located in Shanghai and Taipei. Our facilities produced over 1,000 different kind of skin care products under the NB<sup>®</sup> and Bio-up brand names. Current utilisation rate of both the Shanghai and Taipei production facilities are 77.1% (2001: 63.2%) and 70.8% (2001: 70.0%) respectively.

## RESEARCH AND DEVELOPMENT

With regards to research and development, our continued efforts have bear fruit. We have broadened our product range by successfully launching three new product lines in 2002 namely the Bio-Up skin care series, the Oriental Beauty skin care series, and N&B skin care series.

## Management Discussion and Analysis

### LIQUIDITY AND FINANCIAL MANAGEMENT

During the year, the Company issued and sold 500 million new Shares at the time of its listing, raising net proceeds of approximately HK\$250 million for the Company. Cashflow from operating activities for 2002 was approximately HK\$66.6 million (2001: HK\$134.8 million). The drop was primarily due to substantial increase in trade receivables as a result of trade receivables arising from sales through agencies of television direct sales and year end credit sales. As at 31 December 2002, the Group had bank balances and cash of approximately HK\$216.8 million and trading securities (which are mainly capital guaranteed bond funds) of approximately HK\$88.1 million with no external bank borrowing or any charge on assets.

In terms of gearing, as at each of 31 December 2001 and 2002, the Group had a negative gearing level (defined as net debt divided by shareholders' equity) as the Group has a net cash balance as at both year end dates. Current ratio of the Group (defined as the current assets divided by the current liabilities) as at 31 December 2002 was approximately 4.6 times (2001: approximately 1.6 times).

As at 31 December 2002, the Group had no material contingent liabilities, outstanding contracted capital commitments was approximately HK\$8.8 million in respect of the acquisitions of additional interests in some of its subsidiaries. With the cash and short term securities in hand, the Group's liquidity position remains strong and the Group has sufficient financial resources to satisfy its commitments and working capital requirements.

### USE OF PROCEEDS

From 28 March 2002 to 31 December 2002, the Group has invested approximately HK\$69.9 million mainly in the establishment of spas, marketing and promotion campaign, research and development, expansion of production facilities and the enhancement of computer system which were in accordance with the plans as set out in the Company's prospectus dated 19 March 2002. The Company will continue to use the unutilised proceeds in accordance with its plans as set out in the Company's prospectus dated 19 March 2002.

### TREASURY POLICIES AND EXPOSURE TO FLUCTUATIONS IN EXCHANGE RATES

The Group derives most of its revenue from the PRC and Taiwan (denominated in Renminbi and New Taiwan Dollar) as its operations are mainly concentrated in these two areas. As at 31 December 2002, approximately 69.3% of the Group's bank balances and cash was denominated in Renminbi, while approximately 29.5% was denominated in United States Dollars and Hong Kong Dollars.

The Group maintains a conservative approach on foreign exchange exposure management. Periodic review of the Group's exposure to foreign exchange risk will be conducted and derivative financial instruments may be used to hedge against such risks when necessary.



## Management Discussion and Analysis

### EMPLOYMENT, TRAINING AND DEVELOPMENT

As at 31 December 2002, the Group had a total of 1,518 employees of which 1,287 were based in the PRC, 185 in Taiwan and 46 in Hong Kong. Total remuneration for the year ended 31 December 2002 was approximately HK\$48.6 million, including retirement benefits cost of HK\$5.3 million. Remuneration packages of the Group are maintained at a competitive level to attract, retain and motivate high performing staff and are reviewed on a periodical basis.

The Group always maintains good working relations with its employees and is committed to employee training and development. Professional training courses to the beauticians employed by the Group and its franchisees are held on a regular basis to promote and maintain the quality and consistency of the services provided.

In addition, the Group has adopted a share options scheme on 11 March 2002, for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. The Directors may, at their discretion, invite any employee or directors of the Group and any qualified persons as set out on the scheme, to subscribe for Shares. Up to the date of this report, no share option had been granted under the share option scheme.

### FUTURE PLANS AND PROSPECTS

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 as our core focus. Year 2003 is expected to be a challenging year – competition is expected to further intensify following China and Taiwan's accession into the World Trade Organisation and consumer and tourism spending is expected to be negatively affected by the recent war in Iraq and more importantly, the outbreak of SARS in the region.

However, with the leadership from our management team and the highly experienced board of directors, we are confident that we have the ability to navigate through the current situation and progress to our goals. In 2003, we will continue to work diligently to maintain growth in this extremely competitive operating environment and have formulated plans to strengthen our leading position and to set the foundation for future growth.

In particular, we will continue with our multi-brand and multi-region development strategy with particular emphasis on the PRC market where most of the growth is expected in the near future. We have set a medium term target to increase our presence in the Greater China region by opening more beauty centres and dedicated counters in the next few years. By the end of 2006, we expect the total number of our distribution outlets in the Great China region to exceed 5,000. In addition, we will continue to leverage on our research and development capability to diversify and increase our product range to better serve different segments of the market.



## Management Discussion and Analysis

### **FUTURE PLANS AND PROSPECTS** (continued)

Going forward, the Group will, as and when opportunity arises, enter into negotiation with interested potential parties on the entrustment of the operation and management of certain assets to these parties. The management of the Company believes it will be beneficial for the Company to have the opportunity to rely on the experience and expertise of these potential parties (which need to possess both financial capability and expertise in management spas operations) over the management of the entrusted assets. This arrangement will enable the Group to receive a stable entrustment fee income (which will be determined based on an agreed rate of return on the value of the entrusted assets) and to continue to earn income from products sales whilst at the same time transfer the risks and rewards from the operation of these entrusted assets to the potential trustees. The Group expects the assets entrustment arrangements to be similar to the six assets entrustment agreements that the Group has entered into in 2002 which results has proven to be encouraging.

Besides organic growth, we will also explore co-operation or alliance opportunities with international players with a view to further strengthen our position in the region on the one hand and expand internationally on the other.

Through the relentless pursuit of excellence and supports from our member of staffs, franchisees as well as our customers, we are determined to become the leading researcher, manufacturer and distributor of quality skin care, beauty and aromatherapeutic products internationally.