

Directors' Report

The directors of Natural Beauty (the "Directors") are pleased to present their report together with the audited financial statements of Natural Beauty and its subsidiaries (hereinafter collectively referred to as the "Group") for the year ended 31 December 2002.

PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding. The principal activities of the subsidiaries are (a) manufacture and sale of skin care, beauty and aromatherapeutic products and (b) provision of beauty treatments, spa services and skin care consulting and training. Other activities and particulars of the Group's subsidiaries are set out in Note 1 to the accounts.

SUBSIDIARIES

Particulars of the Group's subsidiaries as at 31 December 2002 are set out in Note 14 to the accounts.

RESULTS AND APPROPRIATIONS

The results of the Group for the year ended 31 December 2002 are set out in the consolidated profit and loss account on page 43.

SEGMENTAL INFORMATION

An analysis of the Group's turnover and results by geographical location of customers for the year ended 31 December 2002 is set out in Note 3 to the accounts.

DIVIDENDS

An interim dividend of HK\$0.0075 per Share was paid to shareholders on 31 October 2002 and the Board has resolved to recommend the payment of a final dividend of HK\$0.015 per Share and 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.

CLOSURE OF REGISTER OF MEMBERS

The register of members of the Company will be closed from 27 May 2003 to 28 May 2003, both dates inclusive, during which period no transfer of shares may be registered. In order to qualify for the final and special dividends, all completed transfer forms together with the relevant share certificates must be lodged with the Company's Hong Kong branch share registrar, Hong Kong Registrars Limited at Room 1901-5, 19th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong not later than 4:00 p.m. on 26 May 2003.

BANK BORROWINGS

As at 31 December 2002, the Group did not have any external bank borrowings.

Directors' Report

RESERVES

Details of the movements in the reserves of the Group during the year are set out in Note 25 to the accounts.

SHARE CAPITAL

Details of the movement in share capital of the Group are set out in Note 24 to the accounts.

PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES

The Company's Shares were listed on the Stock Exchange on 28 March 2002. Save as disclosed herein, neither the Company, nor any of its subsidiaries has purchased, redeemed or sold any of the Company's listed securities during the year and up to the date of this report.

PROPERTY, PLANT AND EQUIPMENT AND INVESTMENT PROPERTIES

NB Taiwan held the following office buildings as investment properties as of 31 December 2002:

- (a) 1st-10th Floors, Nos. 186 and 188, Section 2, Chun-Hsin Road, Hsin-Tien City, Taipei, Taiwan.
- (b) No. 1 of 3rd Floor, No. 2 of 3rd Floor, No. 3 of 3rd Floor and No. 5 of 3rd Floor, No. 128, Section 2, Chung-Der Road, Tai Chung, Taiwan.

Details of the movements in property, plant and equipment and investment properties are set out in Note 13 to the accounts.

PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's articles of association and there is no restriction against such rights under the laws in the Cayman Islands.

MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2002, the Group's largest customer accounted for approximately 2.7% of the Group's turnover, and the aggregate amount of turnover attributable to the Group's five largest customers represented approximately 7.7% of the Group's total turnover.

The largest supplier for the year ended 31 December 2002 accounted for approximately 3.7% of the Group's total purchases (excluding purchases of a capital nature), and the combined total of the five largest suppliers accounted for approximately 11.9% of the Group's total purchases for the year.

At no time during the year have the Directors, their associates or any shareholder of the Company who to the knowledge of the Directors owns more than 5% of the Company's issued share capital had any interests in these major customers and suppliers.

Directors' Report

DIRECTORS

The Directors who held office during the year and up to the date of this report were:

Executive Directors:

Dr. Tsai Yen Yu (alias Dr. Tsai Yen Pin)
Mr. Lee Ming Ta (alias Mr. Lee Ming Tah)
Mr. Su Chien Cheng

Non-executive Director:

Ms. Su Sh Hsyu

Independent non-executive Directors:

Mr. Yeh Liang Fei
Mrs. Chen Shieh Shu Chen

In accordance with the Company's articles of association, Dr. Tsai Yen Yu and Ms. Su Sh Hsyn will retire by rotation and, being eligible, will offer themselves for re-election at the forthcoming annual general meeting.

Each of the non-executive Director and the independent non-executive Directors is currently appointed for a term of three years commencing from 11 March 2002.

The biographical details of the Directors and the senior management of the Group are set out on pages 25 to 28.

DIRECTORS' SERVICE CONTRACTS

Each of Dr. Tsai Yen Yu ("Dr. Tsai"), Mr. Lee Ming Ta ("Mr. Lee"), Mr. Su Chien Cheng ("Mr. Su"), Ms. Su Sh Hsyu ("Ms. Su"), Mr. Yeh Liang Fei and Mrs. Chen Shieh Shu Chen, being all the executive and non-executive Directors, has entered into a Director's service contract dated 11 March 2002 with the Company under which they have been appointed to act as executive Directors (in the case of Dr. Tsai, Mr. Lee and Mr. Su) and non-executive directors (in the case of Ms. Su, Mr. Yeh Liang Fei and Mrs. Chen Shieh Shu Chen) for an initial term of three years commencing from 11 March 2002 and shall continue thereafter until terminated by either party giving to the other not less than three calendar months' notice in writing. The initial aggregate annual remuneration pursuant to such service contracts is HK\$2,840,000 (as to HK\$1,000,000 to Dr. Tsai, HK\$700,000 to Mr. Lee, HK\$600,000 to Mr. Su, HK\$500,000 to Ms. Su, HK\$20,000 to Mr. Yeh Liang Fei and HK\$20,000 to Mrs. Chen Shieh Shu Chen) subject to an annual increment at the discretion of the Directors of not more than 10% of the annual remuneration immediately prior to such increase.

Directors' Report

DIRECTORS' SERVICE CONTRACTS (continued)

Each of Dr. Tsai, Mr. Lee, Mr. Su and Ms. Su is also entitled to a management bonus. The aggregate amount of the bonuses payable to these executive Directors and the non-executive Director will not exceed 15% of the audited consolidated profit after taxation and minority interests but before extraordinary items of the Group in respect of that financial year of the Company.

Save as disclosed above, no Director has any unexpired service contract which is not determinable by the Group within one year without payment of compensation, other than normal statutory obligations.

DIRECTORS' INTERESTS IN SECURITIES

As at 31 December 2002, the interests of the Directors and the chief executive of the Company in the equity securities of the Company and its associated corporations (within the meaning of the then Securities (Disclosure of Interests) Ordinance (the "SDI Ordinance") (which has been replaced by the Securities and Futures Ordinance effective on 1 April 2003)) as recorded in the register required to be kept pursuant to Section 29 of the SDI Ordinance or as otherwise notified to the Company and the Stock Exchange pursuant to Section 28 of the SDI Ordinance and the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code") were as follows:

| Name of Director | Number of Shares | | | | Number of share options |
|------------------|--------------------|---------------------------|---------------------------|-----------------|-------------------------|
| | Personal interests | Family interests | Corporate interests | Other interests | |
| Dr. Tsai | – | – | 1,500,000,000 (Note 1) | – | – |
| Mr. Su | – | – | 225,000,000 (Note 2) | – | – |
| Ms. Su | – | – | 225,000,000 (Note 2) | – | – |
| Mr. Lee | – | 1,500,000,000 (Note 1) | – | – | – |

Notes:

- (1) The two references to 1,500,000,000 Shares relate to the same block of Shares. Such Shares are held by Efficient Market Investments Limited which is beneficially owned as to 70% by Dr. Tsai through Knightcote Enterprises Limited.
- (2) The two references to 225,000,000 Shares are included in the 1,500,000,000 Shares held by Efficient Market Investments Limited which Mr. Su and Ms. Su each have 15% beneficial interest through Knightcote Enterprises Limited.

Other than as disclosed above, none of the Directors, the chief executive or their associates had any personal, family, corporate or other interests in the securities of the Company or any of its associated corporations as defined in the SDI Ordinance as at 31 December 2002.

SHARE OPTION SCHEME/DIRECTORS' RIGHTS TO ACQUIRE SHARES IN THE COMPANY

Pursuant to the Company's share option scheme approved by a resolution of the shareholders of the Company dated 11 March 2002 (the "Share Option Scheme"), the Company may grant options to full-time employees (including executive or non-executive Directors) of the Company or its subsidiaries to subscribe for the shares at a consideration of HK\$1 for each lot of share options granted. The Share Option Scheme will remain valid for a period of 10 years commencing on 11 March 2002. Options granted may be exercised during such period as would be determined by the board of directors of the Company (the "Board") and notified to each grantee upon grant of the option, but in any event not later than 10 years from the date of grant of the option. The subscription price for Shares under the Share Option Scheme may be determined by the Board at its absolute discretion but in any event will not be less than the higher of: (a) the closing price of the Shares as stated in the Stock Exchange's daily quotations sheet on the date of grant of the option, which must be a business day; and (b) the average of the closing price of the Shares as stated in the Stock Exchange's daily quotations sheets for the five business days immediately preceding the date of grant of the relevant option.

The maximum number of Shares in respect of which options may be granted under the Share Option Scheme shall not, when aggregated with any shares subject to any other schemes, exceed 10% of the number of Shares in issue as at the date of approval of the scheme (the "Scheme Mandate Limit"). The Company may seek approval by its shareholders in general meeting for "refreshing" the 10% limit under the scheme. However, the total number of Shares which may be issued upon exercise of all options to be granted under all of the schemes of the Company (or its subsidiary) under the limit as "refreshed" must not exceed 10% of the Shares in issue as at the date of approval of the limit. Options previously granted under the scheme (including those outstanding, cancelled, lapsed in accordance with the scheme or exercised options) will not be counted for the purpose of calculating the limit as "refreshed".

The Company may grant share options to specified participants over and above the Scheme Mandate Limit or the refreshed Scheme Mandate Limit referred to above subject to shareholders' approval in general meetings and the issue of a circular.

The total number of Shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the Share Option Scheme and any other schemes of the Company (or the subsidiary) must not exceed 30% of the relevant class of securities of the Company (or the subsidiary) in issue from time to time. No options may be granted under any schemes of the Company (or the subsidiary) if this will result in the limit being exceeded.

Directors' Report

SHARE OPTION SCHEME/DIRECTORS' RIGHTS TO ACQUIRE SHARES IN THE COMPANY

(continued)

The total number of Shares issued and to be issued upon exercise of the options granted to a participant of the Share Option Scheme (including both exercised and outstanding options) in any 12-month period up to the date of grant to each participant shall not exceed 1% of the Shares in issue, and any further grant of options in excess of such limit shall be approved by shareholders in general meeting with such participant and his associates abstaining from voting. The Company must also send a circular to its shareholders.

No option had been granted by the Company under the Share Option Scheme since its adoption.

Save as disclosed above, at no time during the year was the Company or any of its subsidiaries a party to any arrangements to enable the Directors to acquire benefits by means of the acquisition of Shares in, or debentures of, the Company or any other body corporate and neither the Directors, supervisors nor the chief executive, nor any of their spouses or children under the age of 18, had any right to subscribe for the securities of the Company, or had exercised any such right.

SUBSTANTIAL SHAREHOLDERS

The register of substantial shareholders maintained under Section 16(1) of the SDI Ordinance showed that, other than the interests disclosed above in respect of certain directors, the following shareholders had a beneficial interest of 10% or more in the issued share capital of the Company as at 31 December 2002:

| Name | Note | Number of ordinary shares | Percentage of the Company's issued share capital |
|--|------|---------------------------|--|
| Efficient Market Investments Limited ("Efficient Market") | 1 | 1,500,000,000 | 75.00% |
| Knightcote Enterprises Limited ("Knightcote") | 2 | 1,500,000,000 | 75.00% |
| Dr. Tsai | 3 | 1,500,000,000 | 75.00% |
| Mr. Su | 4 | 225,000,000 | 11.25% |
| Ms. Su | 5 | 225,000,000 | 11.25% |

Notes:

- Efficient Market is beneficially owned by Knightcote.
- Knightcote is beneficially owned by Dr. Tsai as to 70%, Mr. Su as to 15% and Ms. Su as to 15%.
- These shares are attributable to Dr. Tsai in respect of her 70% interest in Knightcote.
- These shares are attributable to Mr. Su in respect of his 15% interest in Knightcote.
- These shares are attributable to Ms. Su in respect of her 15% interest in Knightcote.

Directors' Report

DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE

Save as disclosed in Notes 12 and 28 to the accounts, no Director had a significant beneficial interest, either direct or indirect, in any contracts of significance to the business of the Group to which the Company or any of its holding companies or subsidiaries was a party during the year.

DIRECTORS' INTERESTS IN COMPETING BUSINESS

During the year and up to the date of this report, no Directors is considered to have an interest in a business which competes or is likely to compete, either directly or indirectly, with the business of the Group, as defined by the Listing Rules, other than those businesses of which the directors of the Company have been appointed as directors to represent the interests of the Company and/or the Group.

MANAGEMENT CONTRACT

Save as disclosed in the section headed "Financial review" under Management Discussion and Analysis and "Connected Transactions" under Directors' Report of this annual report, no contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

CONNECTED TRANSACTIONS

Details of the connected transactions that are required to be disclosed for the year ended 31 December 2002 are set out in Notes 12, 14 and 28 to the accounts, their respective details were set out in the section headed "Connected Transactions" of the prospectus of the Company dated 19 March 2002. Save as disclosed therein, the following transactions would constitute connected transactions, as defined in the Listing Rules.

- (1) Shanghai Natural Beauty Sanlian Cosmetics Company Limited ("NB Sanlian"), a subsidiary of the Group, has entered into distribution agreements with each of its 25 non-wholly owned subsidiaries in the PRC (the "PRC Subsidiaries") on 31 March 2001 for the sales of the products manufactured by the Group to the PRC Subsidiaries. These transactions are entered into on normal commercial terms and in the ordinary and usual course of business, and are fair and reasonable and in the interests of the shareholders of the Group as a whole.

These transactions, upon listing of the Shares on the Stock Exchange, constitute continuing connected transactions under Chapter 14 of the Listing Rules and may require full disclosure by way of press announcements and, subject to the value of the transactions, prior approval by independent shareholders of the Company in general meeting. However, since the continuing connected transactions will be conducted in the normal course of business of the relevant members of the Group on a regular basis and on normal commercial terms, the Directors consider that strict compliance with the full disclosure requirement by way of press announcements would be impractical and unduly burdensome for the Company.

CONNECTED TRANSACTIONS (continued)

(1) (continued)

Accordingly, the Company has applied to the Stock Exchange for waivers from strict compliance with the said full disclosure requirements for these non-exempted continuing connected transactions for a period of three financial years ending 31 December 2004 subject to the conditions, among others, that the respective consideration of the continuing connected transactions for each of the 25 PRC Subsidiaries of NB Sanlian does not exceed their respective limits on any financial year as follows. The limits ("Caps") below are based on the historical sales records of NB Sanlian to each of the 25 PRC Subsidiaries, the details were set out in the section headed "Continuing Connected Transactions" on pages 104 and 105 of the prospectus of the Company dated 19 March 2002.

However, the Company respectively announced on 18 September, 8 and 28 October 2002 and issued the circulars on 23 October and 18 November 2002 that NB Sanlian entered into sale and purchase agreements with minority shareholders of each of the 25 PRC Subsidiaries to acquire the minority shareholders' interests of the 25 PRC Subsidiaries representing interests in the 25 PRC Subsidiaries ranging from 10% to 39% (the "Acquisitions"). According to the sale and purchase agreements, the vendors will not share the results of the 25 PRC Subsidiaries starting from 1 July 2002 and the details of corresponding accounting treatment are set out in Note 14 to the accounts. As a result, in the Directors' point of view, the transactions between NB Sanlian and the 25 PRC Subsidiaries entered into on 31 March 2001 are not subject to any disclosure or shareholders approval requirements as connected transactions in pursuant to Rule 14.24(4) of the Listing Rules with effect from 1 July 2002. In this respect, the actual sales records of NB Sanlian to each of the 25 PRC Subsidiaries for the relevant period from 1 January 2002 to 30 June 2002 are set out in the table below:

| Subsidiaries | Caps HK\$'000 | Actual sales records | |
|--|------------------|---|---|
| | | Actual sales records for the relevant period from 1 January 2002 to 30 June 2002 HK\$'000 | Actual sales records for the year ended 31 December 2002 (for reference purpose only) HK\$'000 |
| Wu Han Natural Beauty Cultural Development Co., Ltd. | 10,000 | 1,084 | 4,463 |
| Ning Bo Hai Shu Natural Beauty Cosmetics Co., Ltd. | 10,000 | 819 | 2,902 |
| Wen Zhou Natural Beauty Cosmetics Co., Ltd. | 8,178 | 1,168 | 4,406 |
| Hai Nan Natural Beauty Cosmetics Co., Ltd. | 5,778 | 634 | 1,880 |
| Jiangxi Natural Beauty Sanlian Cosmetics Co., Ltd. | 7,212 | 251 | 1,462 |

Directors' Report

CONNECTED TRANSACTIONS (continued)

(1) (continued)

| Subsidiaries | Caps HK\$'000 | Actual sales records | Actual sales records |
|---|------------------|---|---|
| | | for the relevant period from 1 January 2002 to 30 June 2002 HK\$'000 | for the year ended 31 December 2002 (for reference purpose only) HK\$'000 |
| Nanjing Natural Beauty Cosmetics Co., Ltd. | 7,101 | 751 | 2,325 |
| Kun Shan Natural Beauty Sanlian Cosmetics Co., Ltd. | 3,861 | 472 | 1,148 |
| Haerbin Sanlian Natural Beauty Cosmetics Co., Ltd. | 5,410 | 272 | 1,410 |
| Shenzhen Natural Beauty Cosmetics Co., Ltd. | 10,000 | 3,012 | 10,128 |
| Xi An Natural Beauty Mingyu Cosmetics Co., Ltd. | 10,000 | 1,139 | 3,763 |
| Cheng Du Natural Beauty Cosmetics Co., Ltd. | 10,000 | 960 | 3,893 |
| Beijing Natural Beauty Cosmetics Co., Ltd. | 10,000 | 6,428 | 14,194 |
| Qingdao Natural Beauty Ornaments Co., Ltd. | 6,794 | 874 | 2,515 |
| Henan Natural Beauty Cosmetics Co., Ltd. | 6,919 | 1,022 | 2,931 |
| Tianjin Natural Beauty Cosmetics Co., Ltd. | 6,672 | 505 | 1,549 |
| Su Zhou Natural Beauty Cosmetics Co., Ltd. | 5,228 | 1,146 | 2,983 |
| Lan Zhou Natural Beauty Cosmetic Co., Ltd. | 1,397 | 179 | 448 |
| Chang Chun Natural Beauty Cosmetics Co., Ltd. | 5,167 | 536 | 1,625 |
| Taiyuan Natural Beauty Cosmetics Co., Ltd. | 2,977 | 261 | 361 |
| Anshan Natural Beauty Cosmetics Co., Ltd. | 10,000 | 1,094 | 1,740 |
| Mudanjiang Natural Beauty Cosmetics Co., Ltd. | 2,312 | 305 | 1,110 |
| Fuzhou Natural Beauty Cosmetics Co., Ltd. | 4,506 | 468 | 1,205 |
| Long Yan Natural Beauty Cosmetics Co., Ltd. | 1,532 | 102 | 179 |
| Xiang Fan Natural Beauty Cosmetics Co., Ltd. | 4,874 | 616 | 2,226 |
| Kunming Natural Beauty Cosmetics Co., Ltd. | 1,411 | 230 | 891 |

The respective consideration of the continuing connected transactions for each of the 25 PRC Subsidiaries of NB Sanlian did not exceed their respective Caps during the relevant time in 2002.

Directors' Report

CONNECTED TRANSACTIONS (continued)

(1) (continued)

The Board (including the independent non-executive Directors) confirmed that the continuing connected transactions are on normal commercial terms in the ordinary and usual course of business of all of the companies concerned throughout the year ended 31 December 2002 and in accordance with the relevant distribution agreements governing them on terms that are fair and reasonable and in the best interests of the independent shareholders of the Company as a whole. Further, the respective aggregate consideration of the continuing connected transactions for each of the 25 PRC Subsidiaries does not exceed their respective Caps in the circumstances described above. The auditors of the Company has also provided a letter to the board of Directors (with a copy to the Stock Exchange) confirming that:

- (i) the continuing connected transactions have received the approval of the Board;
- (ii) the continuing connected transactions have been entered into in accordance with the relevant distribution agreements governing the transactions; and
- (iii) the respective aggregate consideration in respect of the continuing connected transactions for each of the 25 PRC Subsidiaries of NB Sanlian have not exceeded their respective Caps in the circumstances described above.

- (2) On 2 July 2002, Beijing Natural Beauty Cosmetics Company Limited ("NB Beijing"), a subsidiary of the Company, has entered into an assets entrustment agreement with Ms. Wang On Cheung (the "Operator"). Pursuant to the assets entrustment agreement, NB Beijing has agreed to appoint the Operator to manage and operate its entire assets and liabilities (the "Entrusted Assets"). The scope of operation includes the entire business of NB Beijing, which contain the provision of spa and beauty services, the sale of beauty and skin care products under the Natural Beauty brand, the provision of beauty training courses and assisting NB Beijing with the development of franchise networks. The appointment of the Operator is effective for a period of five years from 2 July 2002 to 1 July 2007 (the "Entrusted Period"). During the term of the appointment over the Entrusted Period, the Operator shall in each year pay to NB Beijing an annual asset entrustment fee (the "Annual Asset Entrustment Fee") equivalent to RMB4,204,000, it was determined with reference to the net asset value of NB Beijing as at 1 July 2002. The Operator shall be entitled to retain any profits generated by the Entrusted Assets under her management and operation during the Entrusted Period. On the other hand, the Operator shall be obligated to bear any losses, excluding the depreciation of operating assets, arising from the Entrusted Assets under her management and operation during the Entrusted Period. As security for the Operator's obligations under the assets entrustment agreement, the Operator shall deposit a security deposit (the "Security Deposit") with NB Beijing in an amount equivalent to the aggregate Annual Asset Entrustment Fee payable by the Operator during the Entrusted Period. The Operator was a director of NB Beijing on the date of signing the assets entrusted agreement, but she has resigned as director of NB Beijing on 15 September 2002. Therefore, the Operator is a connected person under the Listing Rules. Accordingly, the transaction constitutes a connected transaction for the Company under Chapter 14 of the Listing Rules and that is required to be disclosed herein. Details of the transaction are set out in Note 14 to the accounts.

Directors' Report

RETIREMENT SCHEMES

Particulars of the retirement schemes operated by the Group are set out in Note 23 to the accounts.

AUDITORS

Following the combination of the Mainland China and Hong Kong practices of Arthur Andersen and PricewaterhouseCoopers from 1 July 2002, Arthur Andersen resigned as auditors of the Company and was succeeded by PricewaterhouseCoopers.

PricewaterhouseCoopers, being eligible, offer themselves for re-appointment. A resolution for the re-appointment of PricewaterhouseCoopers as auditors of the Company is to be proposed at the forthcoming Annual General Meeting.

By order of the Board
Dr. Tsai Yen Yu
Chairman

Hong Kong
23 April 2003