

Management Discussion and Analysis of the Operations

RESTAURANT OPERATION

The results of the restaurant operation, including inter-company transactions with the bakery operation, are summarised as follows:

	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>	Changes + / (-)
Turnover	406,936	465,256	(12.5%)
Other revenues	9,065	7,323	23.8%
Costs of inventories consumed	(120,889)	(140,193)	(13.8%)
Staff costs	(141,236)	(163,389)	(13.6%)
Operating lease rentals	(42,475)	(52,026)	(18.4%)
Depreciation of fixed assets	(16,747)	(22,288)	(24.9%)
Other operating expenses	(86,714)	(96,603)	(10.2%)
Amortization of intangible assets	(155)	(195)	(20.5%)
Operating profit from ordinary operating activities	7,785	(2,115)	N/A
One-off expenses incurred on restaurant closures	–	(17,717)	(100.0%)
Reversal of/(provision for) impairment losses and revaluation gain/(loss) on properties	1,645	(36,720)	N/A
Impairment loss of goodwill	–	(10,067)	(100.0%)
Operating profit/(loss)	9,430	(66,619)	N/A
Share of net profits/(losses) of associated companies	487	(783)	N/A
Profit/(loss) before taxation	9,917	(67,402)	N/A
Taxation	(1,033)	(423)	144.2%
Profit/(loss) after taxation	8,884	(67,825)	N/A
Shop area – sq. ft. at year end	158,400	179,000	
No. of outlets at year end	19	22	

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RESTAURANT OPERATION *(continued)*

The outbreak of SARS in the first half of the year had serious adverse impact on the economy. When SARS was at its peak in April 2003, we boldly decided to close one of our flagship shops in Lam Tin, Pak Fook Chinese Restaurant ("Pak Fook"), which led to decreases in operating expenses in all aspects. Coupled with the drastic drop in sales during SARS period and also temporary closure of six shops during the year, our turnover recorded a drop of 12.5% as compared to last year.

Despite the sales decrease, we are able to achieve a slight improvement in our gross profit from 69.9% to 70.3%, primarily benefiting from the recovery of economy in the second half of our financial year and also increase in supplier discount.

Following our decision to close Pak Fook, we seek to diversify our business risk by leasing out the vacated premises rather than re-open it for self-use. The rental income arose therefrom pushed up other revenue by about 23.8% from HK\$7.3 million to HK\$9.1 million.

Closure of loss-making shops has reduced our operating expenses in all aspects. Our staff costs decreased by 13.6% in absolute term partly due to reduction in the number of shops and partly due to absence of workforce re-structuring costs which were already fully provided for in last year. Therefore our staff efficiency in terms of percentage to sales was enhanced with a reduction from 35.1% for last year to 34.7% this year. Rent concession offered by some landlords during the SARS period relieved our restaurants off this burden for the first half year. The absence of one-off expenses incurred on restaurant closures, property revaluation loss, impairment loss on goodwill has also contributed to our improved results.

Our remaining associated company that runs Japanese restaurants contributed a profit of HK\$0.5 million to the Group as compared to a net loss of HK\$0.8 million reported in last year which was largely due to another loss-making associated company, Arges Limited, which has since been liquidated.

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BAKERY OPERATION

The results of the bakery operation, including inter-company transactions with the restaurant operation, are summarised as follows:

	2004 <i>HK\$'000</i>	2003 <i>HK\$'000</i>	Changes +/(–)
Turnover	537,516	494,492	8.7%
Other revenues	1,702	1,639	3.8%
Costs of inventories consumed	(158,127)	(143,508)	10.2%
Staff costs	(170,163)	(155,765)	9.2%
Operating lease rentals	(48,542)	(50,091)	(3.1%)
Depreciation of fixed assets	(29,823)	(28,623)	4.2%
Other operating expenses	(82,191)	(83,532)	(1.6%)
Amortization of intangible assets	(4,600)	(4,600)	0.0%
Operating profit from ordinary operating activities	45,772	30,012	52.5%
Revaluation loss on properties	–	(4,586)	(100.0%)
Gain on disposal of an investment property	7,159	–	N/A
Loss on deemed disposal of a subsidiary	(6,685)	–	N/A
Profit before taxation	46,246	25,426	81.9%
Taxation	(7,571)	(6,897)	9.8%
Profit after taxation	38,675	18,529	108.7%
Shop area – sq. ft. at year end	70,000	69,000	
No. of bakeries at year end	73	74	
No. of eateries at year end	2	2	

We are enjoying the full year effect of the migration of certain production lines to Shenzhen which have lowered our production costs yet without foregoing our product quality. Our production capacity has been considerably expanded to support on-going large scale promotion campaigns which were interrupted by SARS during when we had to postpone our schedule, while effort was diverted to implement various hygienic measures to maintain public confidence on open shelved food products.

When we resumed our marketing campaigns, we invited a few well-known brands to be our joint promotion partners in order to create a higher noise level for our campaigns as well as opening up cross-selling opportunity to each other. The results were encouraging with sales growth enjoyed by both parties while there were savings in the promotion expenses.

After the launch of our 'Natural Yeast' bread products, we had brought in from Japan the 'Soup-based' technique and marketed it under a new bread product line which was well received by our customers. We also regularly push out new cake and bread items for our conventional lines to sustain their product lives. In deed "St Honore" is now recognized as one of the 'Hong Kong Superbrands' well accepted among the local consumers.

Management Discussion and Analysis of the Operations

BAKERY OPERATION *(continued)*

Even though the economy of Hong Kong has shown signs of recovery, people's buying impulse are still weak and they are reluctant to increase their spending on luxury products. Festive products sale in Hong Kong, recorded only a moderate growth of 5%. Contrast to this, mooncake turnover in PRC increased by over 70% with a booming economy there. To prepare for an expanding market, we replaced a small outlet with two bigger and more lavishly decorated ones which were opened respectively in April and May 2004.

During the year, certain share options which had been granted by a subsidiary, Saint Honore Holdings Limited ("SHHL") were substantially exercised, thereby diluting the Company's interest in SHHL, resulting in a loss on deemed disposal of HK\$6.7 million which represented the shortfall between the exercise prices received and the attributable net asset value of this subsidiary plus goodwill deemed disposed.

LIQUIDITY AND CAPITAL RESOURCES

At 31 March 2004, freely-held cash on hand amounted to about HK\$253.8 million (2003: HK\$203.0 million). The Group's financial position stays healthy with zero gearing. Subsequent to year end, the Group had sold more properties for a total consideration of approximately HK\$112.1 million in cash and the sale proceeds will further enrich our cash reserve in the coming first half of the financial year. The Group's approved capital commitments in the next financial year is estimated to be about HK\$51 million, mainly for expansion of the bakery business in Macau and renovation of the remaining aged shops. These projects will be financed internally and we do not have any need for external fund raising.

EMPLOYEES

At 31 March 2004, the Group had a total of 2,878 (2003: 2,849) full time employees. Employees are remunerated based on basic salaries and sales incentives which are only payable to some operational staff. Bonuses were discretionary in nature and based on the performance of the employees and the Group. The Company and its listed subsidiary, SHHL, adopted their own share option schemes to provide incentive to working staff. During the year, the employees of the Company and SHHL exercised most of their share options granted under the respective share option schemes. Details of the schemes and the exercise are set out in the section headed "Share Options" in the report of the directors.

PLEDGE OF ASSETS

No assets were pledged as at 31 March 2004.

EXPOSURE TO FLUCTUATIONS IN EXCHANGE RATES AND RELATED HEDGES

The Group's operating activities are primarily denominated in Hong Kong Dollars except for the bakery plant in Shenzhen where all its running expenses are paid for in Renminbi ("RMB"). To reduce the Group's exposure to the recent speculation of a revaluation of RMB, we have taken out forward contracts on a running twelve months basis to cover regular payments in this currency. As at 31 March 2004, the Group has committed in RMB forward exchange contracts which amounted to HK\$23 million and expiring within the next financial year (2003: Nil).

CONTINGENT LIABILITIES

The Group had no significant contingent liabilities as at 31 March 2004.

