

BUSINESS REVIEW AND PROSPECT

The Group believes that the key success factors in the healthcare industry in the People's Republic of China, excluding Hong Kong (the "PRC") are: quality products, a well-known brand name, an energetic team, and an extensive distribution network. In line with its consistent strategy, the Group increased its investments in the above areas so as to build a solid foundation for the Group to continue its development amidst the highly competitive healthcare industry in the PRC.

As regards the product aspect, the Group's consistent health philosophy covers the three major components of human living, namely "sleeping", "drinking" and "eating". The related major products are BIOenergy® products, multi-functional water generators and healthcare food products.

BIOenergy® products

The BIOenergy® products adopted the BIOenergy® compound and MBF®, and the principal products are Healthy Sleeping System including healthy pillows, healthy mattresses, healthy quilts and other bedroom accessories. Besides obtaining the 《3.15》 Consumer Confidence Label (《3.15》消費者信心標誌) awarded by the China Consumers' Association (中國消費者協會), the Group was granted in September 2005 the "China Top Brand" (中國名牌產品) by the State General Administration of Quality Supervision, Inspection and Quarantine of the PRC (國家質量監督檢驗檢疫總局) based on the assessment of the State Top Brand Promotion Committee (國家名牌推進委員會). The Group is the third corporation in Zhuhai receiving this award. For the financial year ended 30 June 2005, the turnover of the BIOenergy® products was approximately HK\$44.62 million, dropped by 32% when compared with that of 2004 due to the competitive market and insufficient new product development.

During the year, the Group developed BIOenergy® Compound A, B and C from the original BIOenergy® Compound, which are targeted at improving micro-circulation, releasing negative ions, and killing and resisting germs, respectively. BIOenergy® Compound C uses silver nano and photocatalyst complex anti-germs materials (光觸酶複合抗菌材料). In September 2005, the Group introduced the "Nobel Endless Spring" Healthy Sleeping System series, which uses the above technologies, with encouraging sales. The Group expects reasonable growth contributing from this new product and will continue in the further research and development of the BIOenergy® products in order to expand the product range for meeting different customer needs.

Multi-functional water generators

The production bases of the multi-functional water generators are in Hefei (合肥天年美菱環保科技有限責任公司), the shares of which are held as to 80% by the Group (the "Hefei Factory") and in Suzhou (at the joint venture with OSG Corporation Co., Ltd. ("OSG"), the shares of which are held as to 40% by the Group) (the "Suzhou Factory"). Also, the Group imports water generators from OSG's Japan factory to balance the sales mix of the Group. During the year ended 30 June 2005, the Hefei Factory was in the stage of adjustment. As the new series of water generators has not yet obtained the official production approval, the turnover of the water generators dropped, which affected the overall gross profit margin of water generators of the Group.

The Suzhou Factory has just completed the production preparation phase. According to our plan, the Suzhou Factory will manufacture water generators of compatible functional features, for substituting the imported OSG water generators. As the cost decreases, the competitive advantages will be enhanced and the gross profit margin of the Group improved. Yet, the production schedule of the Suzhou Factory has been delayed and the Group was required to import the more expensive Japan-made water generators from OSG to meet the customers' needs.

To sum up, although the turnover of the multi-functional water generators increased from approximately HK\$68.87 million in 2004 to approximately HK\$90.87 million in 2005, with an increase of 32% (approximately HK\$22 million), the respective gross profit contribution decreased from approximately HK\$19.55 million last year to approximately HK\$16.99 million, with a decrease of 13% (approximately HK\$2.56 million).

With the commencement of production by the Suzhou Factory and the Hefei Factory obtaining the official production approval for its new model of water generators in 2005, the Group is determined to rationalize its product sales mix, hoping to improve the Group's gross profit contributions.

Management Discussion & Analysis

After the Group spending years of promoting water generators in the PRC, there have been different water generator models entered into the market, in some cases, by means of certain irresponsible short term actions and/or poor in quality. In July 2005, the Ministry of Health of the PRC issued "Document No. 10", which accused fake and exaggerate promotion activities of water generators. The Document created a significant impact on the confidence of some customers and affected the Group's sales performance in the short term. Yet, the Group believes that the Document will enhance the self-discipline of the industry and unqualified manufacturers will be eliminated in the long run. Therefore, as a deputy chairman entity of the China Healthcare Association, we will actively cooperate with its Functional Water Sub-association in establishing rules and regulations for the industry. The Group still regards the multi-functional water generators a long term business and the Document's effect is only short term. The Group believes that it will maintain a significant market share in the reorganized multi-functional water generators industry by continuous research and development and marketing efforts.

Healthcare food products

The Group's healthcare food products recorded an increase in turnover of 34% (approximately HK\$1.98 million) to approximately HK\$7.76 million. The Group was committed on the development of new healthcare food products and Vitop Propolis was introduced during the year. The Group is now seeking opportunities to cooperate with other local and/or overseas famous corporations on developing other healthcare food products. The Group expects a stable growth in turnover from the healthcare food products.

Brand name

The Group has been granted the 《3.15》 Consumer Confidence Label (《3.15》消費者信心標誌) by the China Consumers' Association (中國消費者協會). The Group's "Vitop Healthy Sleeping System" was granted the status of the "State Free of Inspection Product" in September 2004 and the "**China Top Brand**" (中國名牌產品) by the State General Administration of Quality Supervision, Inspection and Quarantine of the PRC (國家質量監督檢驗檢疫總局) in September 2005.

This reflects the Group's established reputation in the market, and the Group will proceed with the next stage of marketing and promotion. With strong brand equity, the confidence of the customers will be enhanced, helping the marketing of the Group's products.

Team

The Group firmly appreciates that a highly effective marketing and management team can improve the profit generating capability of the Group and is an essential element of the continuous, long term development of the Group. Therefore, the Vitop International Training Institute was established in February 2005. Well-known professional training organizations in the industry are engaged in providing training to the Group's personnel and the distributors, which, we believe, can build up a good foundation on the development of the team.

Distribution networks

In order to strengthen the existing distribution network and to provide more support to the distributors, the Group rationalized its distribution network strategically. Experienced distributors were appointed to expand to new markets and take over the neighborhood badly performed markets. Therefore, the number of distributors reduced from that of the previous year. As at 30 June 2005, there were 278 distributors (2004: 355 distributors) in 451 cities (2004: 355 cities) and there were 686 (2004: 647) points of sales outlets distributing the Group's products. With the strengthened network coupled with better training, supervision and motivation, the Group believes that the productivity of the distribution networks will be improved.

The Group believes that a strong and extensive distribution network is an important asset, which will guarantee an effective marketing channel for introducing new healthcare products to the market in the future.

Back-end systems

After promoting for over one year, the CRM system shows a positive impact on the network. Customer database will be used for after-sales services and customer demand analysis.

Management Discussion & Analysis

FINANCIAL REVIEW

Turnover

For the year ended 30 June 2005, the financial performance of the Group is unsatisfactory. Turnover increased slightly by 4% to approximately HK\$146 million as compared to 2004 due to the increasing competition in the market.

Multi-functional water generators recorded a turnover of approximately HK\$90.87 million, an increase by 32% when compared with that of 2004. It represented 62% of the total turnover of the Group. BIOenergy® products recorded a turnover of approximately HK\$44.62 million, a drop of 32% when compared with that of 2004 as there were no new products being introduced to the market. A new series of multi-functional BIOenergy® product, "Noble Endless Spring", was introduced in September 2005. With the encouraging market response, the Group expects the introduction of the new series will improve the sales performance of the BIOenergy® products. For the healthcare food products, due to the continued introduction of new products, the turnover increased by 34% to approximately HK\$7.76 million.

Gross profit

Gross margin decreased by 6 percentage points to 49% as compared with 55% in 2004. The decrease in gross margin is due to a change in sales mix and the more competitive market. Multi-functional water generators, with a lower gross profit margin, represented 62% of the total turnover and the imported water generators, with the lowest gross profit margin, represented 26% of the total turnover. This is the main reason for the drop of gross margin from 46.3% in 2004 to 42.4% in 2005. We believe that with the completion of the production adjustment at the Suzhou Factory and the localization of production of water generators, there will be a significant increase in gross profit margin. The gross profit margin of the BIOenergy® products was 61%, representing a drop comparing to 63% in 2004, as the Group focused mainly on new products with planned aggressive clearance of stocks on hand. As regards the healthcare food products, in order to compete with other bee propolis products in the market, the Group adopted a low margin strategy to stimulate sales of these products to distributors, resulting in a drop in gross profit margin from 66% last year to 55%.

Net profit

Although turnover increased, gross profit dropped by 8% from approximately HK\$76.95 million in 2004 to approximately HK\$70.81 million in 2005 due to the above-mentioned reasons. To meet the competitive market, the Group made significant investments in the advertising and marketing of products and in the improvement of operational management skills. Thus, operating expenses increased by 13% from approximately HK\$55.65 million in 2004 to approximately HK\$62.93 million in 2005. The increase in other operating expenses of the Group by approximately HK\$5.94 million as compared with that of 2004 was mainly due to a provision for receivables from an ex-distributor. During the year, one of the major distributors closed down and the trade receivables from that distributor became uncollectible.

As operating expenses increased and gross profit dropped, operating profit dropped by 84% to approximately HK\$3.79 million. For the financial year ended 30 June 2005, the profits tax expense was approximately HK\$0.77 million, which was calculated at a preferential tax rate (half of the normal profits tax rate). Meanwhile, after deducting for the share of losses of a jointly controlled entity of approximately HK\$0.76 million and the minority interests of approximately HK\$1 million, the net profit of the Group dropped from approximately HK\$20.19 million in 2004 to approximately HK\$1.27 million in 2005.

LIQUIDITY AND FINANCIAL RESOURCES

During the year, the Group generated cash inflow of approximately HK\$8.92 million from operating activities. With the payment of approximately HK\$7.09 million for capital expenditures and intangible assets, and the final dividend for the financial year 2004 of approximately HK\$6.80 million, cash on hand as at 30 June 2005 decreased by approximately HK\$3.99 million to HK\$44.78 million. Total bank borrowings amounted to approximately HK\$0.50 million.

Management Discussion & Analysis

PLEDGE OF ASSETS AND GEARING

As at 30 June 2005, the Group's gearing ratio, measured on the basis of total borrowings as a percentage of total shareholders' equity, is 0.5% (2004: Nil). The bank loan of HK\$0.50 million is secured by a pledge of a deposit of the Group at the bank amounting to HK\$2.50 million.

SIGNIFICANT INVESTMENTS

During the year, there was no significant investment held by the Group.

MATERIAL ACQUISITIONS AND DISPOSALS OF SUBSIDIARIES AND ASSOCIATED COMPANIES/JOINTLY CONTROLLED ENTITIES

During the year, there were no material acquisitions or disposals of subsidiaries and associated companies/jointly controlled entities.

EMPLOYEES AND REMUNERATION POLICIES

As at 30 June 2005, the Group employed a total of 260 employees, of which 253 are based in the PRC and 7 are based in Hong Kong. The total salaries and other remuneration (excluding directors' emoluments) of approximately HK\$16.98 million were incurred for the year. Remuneration packages comprised salary, mandatory provident fund, bonus, medical coverage and share options.

MAJOR EVENTS

During the year, on 5 January 2005, Mr. Lee Kwok Ming ("Mr. Lee") resigned as an executive director of the Company and remains a non-executive director of the Company. Upon his resignation, Mr. Lee entered into with the Company a termination agreement on the same day terminating the service agreement between the Company and Mr. Lee in relation to his appointment as an executive director of the Company and the subscription agreement between the Company and Mr. Lee in relation to the subscription of an aggregate of 7,752,000 new shares in the capital of the Company at the subscription price of HK\$0.31 per share and the grant of options to subscribe for 20,000,000 shares at the exercise price of HK\$0.495 per share under the share option scheme of the Company adopted on 23 January 2003. Details of these transactions have been disclosed in the announcement made by the Company on 5 January 2005.

SECURITIES IN ISSUE

During the year, a total of 3,725,348 shares were issued, as to 1,938,000 shares and 1,727,348 shares pursuant to the subscription of the first and second tranches of the subscription shares by Mr. Lee, respectively, at the subscription price of HK\$0.31 per share as referred to in the subscription agreement dated 5 January 2004 and made between the Company and Mr. Lee, and as to 60,000 shares pursuant to the exercise of the subscription rights attaching to the options by the option holder of the Company at the exercise price of HK\$0.30 per share.

As a result of the new issue of 3,725,348 shares upon the subscription of shares and the exercise of share options as referred to above, the total number of issued shares of the Company as at the date of this annual report is 681,923,748.

OUTLOOK AND FUTURE PROSPECTS

The further opening up of the PRC healthcare market with many overseas competitors entering into the PRC market will put the Group under tremendous competition. But this will bring in both opportunities and challenges. The Group's competitive advantages in such a highly competitive environment lie in its 13-year sales experience, a well-known brand name and the reputation among customers.

The Group will continue its investments in the development of quality products, well-known brand name, an energetic team and an extensive distribution network. The Group will capture new opportunities and maintain its market share by building a solid foundation with gradual improvement in sales.