Management Discussion and Analysis

Overall performance

Turnover of the Group reached HK$471,091,000 for the reporting period, an increase of 13.9% from HK$413,760,000 booked in the same period last year. Gross margin improved significantly to 10.8% from 8.0% of the corresponding period last year. Profit attributable to shareholders amounted to HK$41,095,000 (six months ended 30 September 2004: HK$21,249,000 (restated)), an increase of 93.4% year-on-year. Profit attributable to shareholders of HK$24,148,000 (six months ended 30 September 2004: HK$11,950,000) rose 102.1% over that of the last corresponding period, before the inclusion of a gain of HK$16,947,000 (six months ended 30 September 2004: HK$9,299,000) on the disposal of a property during the reporting period. Earnings per share were HK33.13 cents (six months ended 30 September 2004: HK17.15 cents (restated)).

Business review

Through the efforts of a proactive management team and with favorable market sentiments, the Group's business achieved a promising result for the six months ended 30 September 2005. The marked progress in both turnover and operating profit was primarily a result of strong brand recognition supported by trendy and refurbished stores, innovative menus and improved quality of products and services.

Increases in both customer headcount and average spending had contributed to the improvement in sales during the reporting period. Same-store sales recorded a double-digit percentage growth reflecting the Group's success in launching Fairwood's revamped brand image in late 2003.

In spite of the rising level of rental and food costs, the Group managed to improve its gross profit margin through enhanced operational efficiency and price adjustments. Operational efficiency was seen as a result of better cost control and enhanced operational procedures facilitated by the Group's upgraded management information system and new point-of-sale system. The Group had successfully accomplished price lifts with the offer of upgraded quality of products and services. The Group's continuous efforts in enhancing product values not only allowed for price adjustments which had contributed wider profit margins to the Group, but also helped enhancing Fairwood's revamped brand image.

Having its restaurants rejuvenated through renovation in a young, vibrant and trendy style and stores relocated to prime locations were some of the approaches of the Group to fully capture the immense opportunities. These moves were proven a success with the Group's increased number and broadened spectrum of clientele characterized by young and affluent customers from the "professional and executive" occupational group.

The Group's business in the Mainland continued to remain profitable with sales recording an increase of 10.2% during the period under review.

During the period under review, the Group opened 5 new fast food outlets including 4 outlets in Hong Kong and 1 outlet in the Mainland, and renovated 12 existing stores. As at 30 September 2005, the Group operated a total of 86 outlets, including 66 fast food outlets, 2 institutional catering outlets, 5 Buddies Cafés and 4 specialty restaurants in Hong Kong as well as 5 fast food outlets and 4 institutional catering outlets in the Mainland.

Prospects

The local economy appears to be on a reasonably stable footing, but retail environment remains very challenging under the pressure of high rental, rising labour costs and the uncertainty associated with the possible outbreak of an avian flu in Hong Kong. The management is well aware of the continuing need to improve operational efficiency and believes that the Group will continue to deliver solid growth through improved product quality and services.

Looking ahead, the Group believes that there is still much room for expansion in the local market and will continue its focus on the core business in Hong Kong. Fairwood's revamped brand identity has transformed customers' traditional perception of fast food into a culture of the new era. The Group will take full advantage of the strength and market recognition of its new image and strive for increasing the market share through further expansion.

In the second half of the fiscal year, the Group's target is to open 6 new outlets in Hong Kong to capture the growing demand and to close 2 under-performing outlets, bringing the total number of its fast food outlets to 70. Marketing activities will be launched for promoting new outlets and for boosting brand awareness. The Group is also on the track to meeting the goal of its 3-year brand revamp campaign and approximately two-third of the outlets will have been upgraded to the new brand image by the end of the fiscal year.

To cope with the market response and for enhancing operational efficiency, the "Octopus" payment system is under installation in the Group's outlets and the entire chain of outlets is expected to be fully-installed with the system by December 2005. The Group believes that the easy method of payment by means of "Octopus" will offer convenience to customers and further improve efficiency.

Leveraging on the experience of its canteen operation in the manufacturing plant of Johnson Electric Holdings Limited in the Mainland, the Group plans to expand its institutional catering networks as part of its drive for business development in the Mainland.

In light of the positive economic outlook and the Group's continuous efforts in refining business strategy, the management is cautiously optimistic on the business performance of the Group in the second half despite the challenges posed by the general increase in costs and the possibility of an outbreak of avian flu. The Group will strive for improvements against the ever-changing market and fine-tune its "Ah Wood" products to reflect its commitment to bringing the best value to customers.

Financial review

Working capital

At 30 September 2005, the Group's working capital rose by HK$21,780,000 or 62.3% to HK$56,721,000 (31 March 2005: HK$34,941,000). The current ratio, being the proportion of total current assets against total current liabilities, was 1.4 (31 March 2005: 1.3). The Directors consider that the present working capital level is sufficient to meet the upcoming expansion need.

Cash flow

At 30 September 2005, net cash and cash equivalents was HK$145,343,000 (31 March 2005: HK$99,354,000). During the period under review, the net cash generated from operating activities was HK$64,390,000 (six months ended 30 September 2004: HK$30,796,000). The increase was mainly attributable to the improvement in operating profit from the core business. Net cash used in investing activities was HK$3,244,000 (six months ended 30 September 2004: net cash from investing activities was HK$38,988,000) with capital expenditures of HK$30,749,000 (six months ended 30 September 2004: HK$16,655,000) off set by the net proceeds of HK$27,505,000 (six months ended 30 September 2004: HK$55,643,000) from the disposal of a property. Net cash used in financing activities was HK$15,157,000 (six months ended 30 September 2004: HK$33,869,000), primarily related to the dividend distribution paid of HK$11,448,000 (six months ended 30 September 2004: Nil) and net repayment of bank loans of HK$4,166,000 (six months ended 30 September 2004: HK$33,009,000).

Liquidity and financial resources

The Group maintained a strong financial position for the period. At 30 September 2005, the Group had total assets of HK$440,761,000 (31 March 2005: HK$380,816,000) and the equity attributable to shareholders of the Company was HK$274,479,000 (31 March 2005: HK$241,646,000 (restated)).

The Group finances its business with internally generated cash flows and banking facilities. At 30 September 2005, the Group had total bank loans of HK$14,767,000 (31 March 2005: HK$18,933,000) and the unutilised banking facilities were HK$109,500,000 (31 March 2005: HK$81,500,000). The gearing of the Group was 3.0% (31 March 2005: 4.4%), which was calculated based on the non-current bank loans over shareholders' equity. The Directors believe that the Group has maintained sufficient liquidity in both Hong Kong Dollars and Renminbi.

Charges on Group's assets

At 30 September 2005, the net book value of properties pledged as security for liabilities amounted to HK$58,263,000 (31 March 2005: HK$67,965,000).

Commitments

The Group's capital commitments outstanding at 30 September 2005 amounted to HK$3,331,000 (31 March 2005: HK$5,314,000) were mainly associated to store renovation. The Group also had outstanding other commitments of HK$2,394,000 (31 March 2005: HK$2,908,000) in respect of the contracting fee for operation of a fast food restaurant.

Contingent liabilities

At 30 September 2005, the Company had contingent liabilities in respect of guarantees given to banks in respect of banking facilities extended to certain subsidiaries amounting to HK$174,850,000 (31 March 2005: HK$146,000,000).

Employee information

At 30 September 2005, the total number of employees of the Group was approximately 3,300 in Hong Kong and the Mainland. Employees' remuneration is commensurate with their job nature, qualifications and experience. Salaries and wages are normally reviewed on an annual basis based on performance appraisals and other relevant factors.

The Group continues to offer competitive remuneration packages, share options and bonuses to eligible staff, based on the performance of the Group and the individual employees. Also, the Group had committed to provide related training programme to improve the quality, competence and skills of all staffs.