

Management Discussion and Analysis

INDUSTRY OVERVIEW

The Group is one of the leading players of the FCR sector in the PRC. FCR is a hybrid of fast food restaurants and traditional sit-down restaurants. Standard menus include made-to-order items and table service is provided.

The Mainland Market

With its rapid economic development and rising consumer spending power, mainland China offers excellent opportunities for FCR operators such as the Group. As living in the PRC becomes increasingly fast-paced, especially in urban areas, consumers, in particular the white collar group, are willing to spend more money on dining out at restaurants with decent environment. The F&B market in the PRC is mixed with local restaurants and western food chains. However, it is found that Asian food is preferred over western food by the majority of consumers. All these have given rise to the popularity of Asian FCR and, in particular, Ajisen.

The Hong Kong Market

Hong Kong is ranked first in the world in terms of frequency of FCR visits, in part because home cooking is relatively less common due to limited space in Hong Kong apartments.

Industry Development Trends

Demand for fast food/ fast casual food invariably increases in a modern society, as the time for preparing home cooked meals diminishes. Competitiveness solely based on price will no longer be the only way to succeed in this market. Success in the FCR industry will depend more on brand recognition and customer loyalty. Other trends developing in the FCR market include a greater focus on nutritious and healthy food, good service and appealing dining environments.

BUSINESS REVIEW

The Group was ranked fifth in terms of revenue in China's FCR sector in 2005, according to "China's Top 100 F&B Enterprises" survey, and maintained its position in the top 10 in 2006 (there was no ranking among the top 10 in 2006). In February 2006, Ajisen (China) secured perpetual franchise rights for the Ajisen franchise business in Hong Kong, Macao and mainland China.

Retail chain restaurants

In 2006, our major business and primary source of income continued to be derived from our retail chain restaurants. During the year, our restaurant business contributed RMB529 million, or 88.46%, to the Group's total revenue.



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As of 31 December 2006, the Group had a restaurant portfolio totalling 120 Ajisen restaurants, comprising the following:

	2005	2006	+/-
By type:			
Owned and managed	53	93	40
Managed but not owned	0	24	24
Owned but not managed	3	3	0
Total	56	120	64
By geographical regions:			
Northern China	3	20	17
Eastern China	31	49	18
Southern China ⁽¹⁾	19	45	26
Central China	3	6	3
Total	56	120	64
Total saleable area	10,561 sq meter	34,329 sq meter	23,768 sq meter

Note:

- The number of restaurants in Southern China include 14 and 17 restaurants in Hong Kong in 2005 and 2006 respectively.

Average traffic flow per restaurant and per capita spending of our restaurant in 2006 were respectively 1,860 and 140.

Our restaurants are classified into 3 categories: flagship, standard and economy.

The Ajisen flagship-size restaurants are found in prime locations, such as the central business districts and business centres, in their respective cities. Typically, they occupy a saleable area of 400 square metres or more and have a seating capacity of 151 to 230 seats.

The Ajisen standard-size restaurants are our most common restaurant. They occupy a saleable area of 100 to 400 square metres and have a seating capacity of 71 to 150 seats. Most of our Ajisen standard-size restaurants are located in entertainment centres, shopping malls, airports and train stations.

To expand our urban footprint, we have established Ajisen economy-sized restaurants. These occupy a saleable area of approximately 100 square metres with a seating capacity of 45 to 70 seats, mostly located in supermarkets and large-scale residential areas.



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The following table illustrates our restaurant breakdown by format:

	2005	2006	+/-
By format:			
Flagship	9	16	7
Standard	37	94	57
Economy	10	10	0
Total	56	120	64

Our strong brand name has enabled us to establish our restaurant network in strategic locations, such as prime locations with high pedestrian traffic and easy accessibility for customers, in the cities where we operate.

The success of our business is based on an innovative, evolving and wide-ranging menu, designed to suit the tastes of customers from different regions in the PRC and Hong Kong. Combining Japanese-style dishes with Chinese food culture and dining habits, the dishes we offer currently comprise more than 60 food product offerings on a menu that is updated twice a year. We believe our focus on innovation has enabled us to differentiate our food products from our competitors and strengthened the brand awareness and market share we enjoy.

When opening a new Ajisen restaurant, we have an established set of systematic procedures and management guidelines that we apply to every outlet.

To oversee the operations of our restaurants in their respective areas, we have six autonomous divisional management offices in Beijing, Shandong, Chongqing, Nanjing, Shanghai and Shenzhen respectively. We believe this business and operational model will allow us to grow at a faster and more efficient pace, since each of these regional head offices will have the local expertise needed to expedite our expansion plans. This management model will be replicated in all of our new Ajisen chain restaurants.

Packaged food products

To leverage on the Ajisen brand and complement the FCR business, the Group manufactures and sells packaged noodles under the Ajisen brand name.

For the year ended 31 December 2006, sales of packaged food products recorded RMB69 million, accounting for about 11.54% of the Group's total turnover .

Our packaged noodle products are supplied to Ajisen chain restaurants, other third-party restaurant operators, supermarkets, and other independent Ajisen restaurants located in countries such as Australia, Canada, the Philippines, Singapore and the United States. Our extensive distribution network currently amounts to approximately 6,000 points-of-sale in the PRC and Hong Kong. Our major clients include Wal-Mart, Carrefour, Lotus Supermarket, City Supermarket, JUSCO, Wellcome and Park'n Shop, to name a few.

By selling our noodles through these well-known retailers, we are able to promote the Ajisen brand name in a wider scale.

All packaged noodles are manufactured in Shanghai, Shenzhen and Hong Kong in the Group's own food manufacturing and processing facilities, which cover a total area of over 17,900 square metres. As Japanese ramen production technology is considered among the most advanced in the world, we have adopted Japanese technology in the production of our ramen noodles.

According to the terms of our franchise agreements, our franchisor provides us with technical support in all aspects of our packaged food production operation. In recognition of our stringent quality control standards, we have received several international certifications, such as ISO 9001 and HACCP, attesting to our commitment to quality food products.

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FINANCIAL REVIEW

Turnover

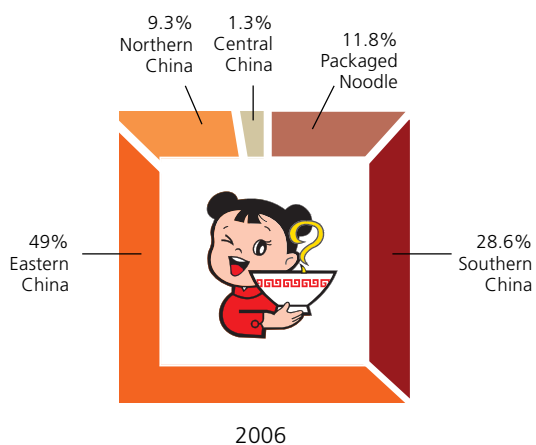
Turnover increased by approximately RMB162 million, or by approximately 37.10% from approximately RMB436.5 million for the year ended 31 December 2005 to approximately RMB598.4 million for the year ended 31 December 2006, primarily due to the significant growth in our turnover from operation of restaurants.

Turnover from operation of restaurants increased by approximately RMB150.6 million, or approximately 39.76% from approximately RMB378.8 million in 2005 to approximately RMB529.3 million in 2006. Such increase was mainly due to an increase in the number of chain restaurants from 56 as at 31 December 2005 to 120 as at 31 December 2006.

Turnover by business



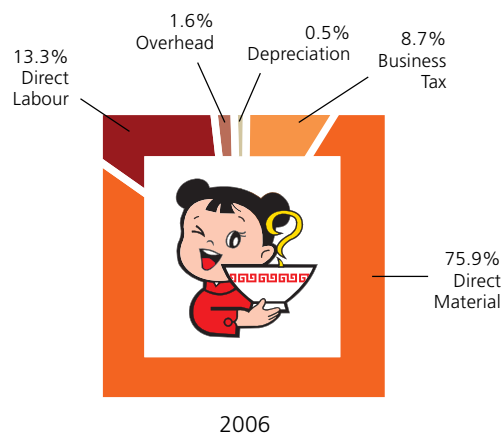
Turnover by markets



Cost of sales

Cost of sales increased by approximately RMB43.8 million, or approximately 24.96% from approximately RMB175.6 million in 2005 to approximately RMB219.4 million in 2006, which increased in line with the growth in our turnover. The increase in cost of sales was primarily due to the increased costs of raw materials and labour cost as a direct result of the increase in the number of our chain restaurants. Thanks to the economies of scale, cost of sales as a percentage of our turnover was approximately 36.67% in 2006, as compared to 40.23% in 2005.

Cost of Sales Breakdown



Gross profit

As a result of the above, gross profit increased by approximately RMB118.1 million, or approximately 45.26% from approximately RMB260.9 million in 2005 to approximately RMB379 million in 2006. The gross profit margin increased to 63.33% in 2006, as compared to 59.77% in 2005.

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Other income

Other income increased by approximately RMB32.3 million from approximately RMB9.5 million in 2005 to approximately RMB41.7 million in 2006, primarily due to the management fees received under the Management Agreement in respect of the Shenzhen operation. We have received management fees of approximately RMB25.7 million under the Management Agreement for 2006. In the event that Shenzhen Weiqian is merged with the Group, such management fees will no longer be chargeable. Instead, the entire net profit of Shenzhen Weiqian will be consolidated to the Group.

Distribution and selling expenses

Distribution and selling expenses increased by approximately RMB47.8 million, or approximately 43.3% from approximately RMB110.3 million in 2005 to approximately RMB158.1 million in 2006, primarily due to the increase in salary and welfare expenses of restaurant staff, utility fees, costs of consumables and utensils and depreciation costs incurred in connection with the increase in the number of chain restaurants and the increase in sales volumes of the packaged noodles and other related products in 2006. Distribution and selling expenses as a percentage of our turnover were approximately 26.43% in 2006 compared with approximately 25.28% in 2005.

Administrative expenses

Administrative expenses increased by approximately RMB9.4 million, or approximately 38.48% from approximately RMB24.3 million in 2005 to approximately RMB33.7 million in 2006, primarily due to an increase in administrative staff salary and director's welfare and expenses incurred in relation to the Global Offering and increase in depreciation costs. Administrative expenses as a percentage of our turnover were 5.57% in 2005 and 5.63% in 2006.

Finance costs

Finance costs increased by approximately RMB0.6 million, or approximately 108.15% from approximately RMB0.6 million in 2005 to approximately RMB1.2 million in 2006, primarily due to an increase in bank borrowings.

Profit before taxation

Profit before taxation increased by approximately RMB71 million, or approximately 98.74% from approximately RMB71.9 million in 2005 to approximately RMB143 million in 2006, as a result of the cumulative effect of the foregoing factors.

Assets and liabilities

Net current assets of approximately RMB28 million and a current ratio of 1.1 as at 31 December 2006. As we are primarily engaged in the restaurant business, most of our sales are cash sales. As a result, we are able to maintain a relatively low current ratio to achieve better use of our working capital.

Cashflow

Net cash inflow from operations for the year ended 31 December 2006 was approximately RMB156 million while our profit before taxation for the same period was approximately RMB143 million. The difference was primarily due to the increase in inventories and the increase in trade and other receivables, partially offset by an increase in trade and other payables. The increase in inventories and the trade and other payables was primarily due to the increased purchase of raw materials and other goods from suppliers as a result of the increase in the number of chain restaurants managed and owned by the Group during the year. The increase in trade and other receivables was primarily due to the higher sales volume in the sale of noodles and related products and an increase in rental deposits due to the increase in the number of chain restaurants managed and owned by us during the year.

Capital expenditure

Capital expenditures was approximately RMB75 million in 2006 which was primarily related to our purchase of property, plant and equipment.

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KEY FINANCIAL RATIOS FOR RESTAURANT OPERATIONS

Comparable restaurant	
sales growth	: 8.8% (Hongkong) and 5.3% (PRC)
Turnover per GFA	: \$31/person
Turnover per day	
per restaurant	: \$13,500/restaurant/day
Traffic flow per day	: 450persons/restaurant/day
Per capita spending	: \$50/unit
Table turnover per day	: 6.5/day

OUTLOOK FOR 2007 AND BEYOND

It is the goal of Ajisen (China) to be the number one FCR chain operator in the PRC.

In order to achieve this goal, we have a strategy that leverages on our established competitive strengths, including our renowned brand name, wide restaurant network, professional management team and reputation for quality.

Three major growth drivers will help us realise Ajisen (China)'s growth potential:

1. *Expansion of the FCR network in the PRC.* By the end of 2007, we aim to have a minimum of 200 restaurants and by 2008 a total of 320 restaurants. This will be achieved via organic growth in existing markets such as Shanghai, Shenzhen, Hong Kong, Beijing and Chengdu. By 2008, we intend to open 35 flagship-size restaurants, 170 standard-size restaurants and 62 economy-size restaurants. As at the date of this annual report, our chain network has already expanded to 144 restaurants.

In addition to organic growth, we will expand through sub-franchising, which we believe is an efficient way to expand the Ajisen network within a short period of time, particularly in mid-tier cities or cities in which we do not yet have a presence. To develop our sub-franchising business, we have hired a professional consultant to work out a sub-franchise

system to ensure Ajisen's quality and brand image are maintained. We plan to start our sub-franchising system in the second half of 2007, with a target of 10 sub-franchises established in that period and 40 sub-franchises in 2008.

We will also explore the possibility of mergers and acquisitions or strategic alliances with other overseas brands.

2. *Diversification of our product offerings and distribution channels.* We will diversify and update restaurant menus as well as introduce a wider variety of packaged food products to meet the various taste buds of our growing customer base. Furthermore, we will launch other products, such as tableware and condiments for noodles, in order to further promote "the Ajisen culture" beyond our restaurants.
3. *Implementation of a multi-brand strategy.* We intend to capture potential business opportunities in the fast-growing FCR market in mainland China and Hong Kong by implementing a multi-brand strategy.

We will leverage on our know-how in Japanese food and Japanese food production technology to expand our customer base and reach new consumer segments in the casual dining value chain. Currently, the "Ajisen" brand is targeted at the mass market with an average spending of around HK\$50 per head in Hong Kong and around RMB30 in mainland China. To reach customers in higher-spending and lower-spending groups, we will cultivate other appropriate brands and products.

By following this strategy, we believe we can succeed in further enhancing the Ajisen brand, penetrating new markets and maximizing shareholder value.