



Prosper

Growth for Future Development

With the rapid development of the PRC retail industry, the Group leveraged on its solid business foundation to become the market leader. The Group is committed to capturing opportunities and creating profitable returns for shareholders.



Chairman's Statement

Dear valued shareholders,

On behalf of the board of directors of Lianhua Supermarket (the "Board"), I am delighted to present the annual report of the Group for the year ended 31 December 2004.

Macro Economy and Market Situation

- During the year under review, the PRC's economy continued its strong growth. The Gross Domestic Product ("GDP") growth of the PRC and Shanghai increased by 9.5% and 13.6% respectively as compared to last year.
- During the year under review, the PRC Government implemented austerity control measures against industries with excessive investment which promoted healthy development of the national economy and thus further stimulated domestic consumption to drive economic growth. Given the rising living standards, total sales of consumer products in the PRC reached approximately RMB5,395 billion, an increase of approximately 13.3% from 2003 (after deducting price factor, an actual growth of 10.2%), while the sales of consumer products reached approximately RMB245.461 billion, an increase of approximately 10.5% from the previous year.

Development of the Retail Industry in the PRC

- In accordance with the undertakings by the PRC upon its accession into the World Trade Organisation, the PRC lifted its restrictions against foreign investments in commercial enterprises with respect to their region, shareholding and numbers since 11 December 2004. Almost all of the 50 largest retail operators in the world have entered the PRC market. Their expansion has shifted from an exploring stage to a rapid expansion stage with large-scale outlet establishment. Since the growth in the PRC retail market is expected to be promising, new and leading retail operators have accelerated their progress of entering the market through mergers and acquisitions.

- The PRC retail market industry underwent material changes during the year. Large-scale local retail groups and foreign retail enterprises will strive to increase their market share through reorganisation as well as mergers and acquisitions more frequently. This will result in a consolidation of the industry.

- Economic development in different regions of the PRC are extremely imbalanced. Development of the retail chain industry in economically developed regions is mature and these regions are the focus and main source of earnings for retail chain operators. The retail chain industry in economically less developed regions has started to enter the initial stage of development. These regions are the major target markets for all retail chain operators in their long-term development. Therefore, all retail chain operators will face the challenges on localisation and differentiation in the near future.

- Income levels continue to rise and urban consumption demand is becoming more diversified. Consumer shopping behaviour and purchase patterns have changed. In addition to the demand for shopping environment, consumer demand has become more rational and diversified. The demand for healthy and green foods has also been increasing.

Our Development

- The Group's businesses continued to maintain robust and healthy growth. For the year ended 31 December 2004, the Group's turnover increased by approximately 16.94% from approximately RMB9,282,248,000 in the previous year to approximately RMB10,854,967,000. The Group has been the largest retail chain operator in the PRC in terms of turnover for eight consecutive years. In order to maintain this position, all 31,318 employees of the Group have made concerted efforts to face the competition and challenges. The directors of the Company (the "Directors") are confident in sustaining our leading position in the PRC retail industry.

❖ Profit attributable to shareholders of the Company also increased by approximately 31.73% from approximately RMB163,623,000 in the previous year to approximately RMB215,540,000. Earnings per share amounted to RMB0.36, representing an increase of 9.09% when compared with the previous year.

❖ As at 31 December 2004, the Group had 3,123 outlets (excluding those operated by the Company's associated companies). Outlets of the Group's top three brand names established a solid foundation in 20 provinces and municipalities such as Shanghai, Zhejiang, Jiangsu and Beijing, spanning across over 80 cities in the nation. The Group has long understood the importance of regional scale advantage to the Group's development from regional to a national scale. All of the newly opened outlets are now concentrated in our established regions. There were a total of 620 new outlets (excluding those operated by the Company's associated companies) during the year under review. Currently, Lianhua Supermarket have a total of 1,298 franchised outlets to share the network value of our chain network.

❖ During the year under review, the Group's associated companies also continued to expand their scale of operations. For the year ended 31 December 2004, Shanghai Dia set up 103 discount stores under the brand name "Shanghai Dia" in Shanghai. Shanghai Carhua also operated 8 hypermarkets under the brand name "Carrefour". Century Lianhua, under the management of the Company, operated 26 hypermarkets under the brand name "Century Mart". All of these have further strengthened the national retail network of the Group.

❖ During the year under review, the Group further accelerated its progression of strategic mergers and acquisitions. Continuing to leverage on the national market as a platform, the Group accelerated its development from a regional company to a national one. It successfully acquired a series of enterprises in regions such as Shenyang, Shijiazhuang and Zhejiang by adopting

active merger and acquisition strategies, so as to strengthen its presence in these established regions.

❖ The fast moving consumer goods provided by our network are becoming an essential part of the lives of Chinese consumers, increasing their confidence in the Company. Currently, we have over 3.5 million members. The Directors are confident that our members will continue to enjoy value-added quality services in our outlets.

Characteristics of Operation and Management

❖ The Group has mandated the operation principles of "development, transformation and enhancement" based on the current market situation. As the Company expands its operational scale, it continues to benchmark against the major operating indicators of leading international retail operators. The Group will continue to increase customer flow and the transaction amount per customer in its outlets and further improve same store sale growth rate. As a result of our continuing effort, our operating profit increased by 21.09% during the year while operating profit margin reached 2.35%.

❖ During the year under review, the Group further leveraged on its integration experience gained from successful mergers and acquisitions. This further strengthened its leading position in the Zhejiang region. In addition, outlets under the brand name "Jia You" of the former Hangzhou Lianhua Huashang were changed to "Lianhua Supermarket" and "Century Mart" based on segmentation of business formats. Turnover and profit attributable to shareholders of the Company in the Zhejiang region as a whole increased by 17.01% and 61.46% respectively as compared with the previous year. In respect of the new outlets acquired during the year, a detailed integration plan was set out based on geographical location and business formats of these outlets for effective integration into the Group's existing business.

Chairman's Statement

During the year under review, the Group further strengthened the establishment of its flagship stores and sample stores. We aimed at continuously enhancing and improving the major operating indicators of these selected stores, rather than just increasing our investment. We also provided human resources and supporting resources for operations to other outlets in the same regions to enhance our competitiveness in these regions. This will also enable the Group to gain experience in its future plans for the establishment of a "next generation store".

During the year, the Group optimized its modern retail techniques, supply chain system, logistics construction as well as integration of its information system as a whole. The Group placed relatively more emphasis on this backup foundation in the course of rapid expansion, the Group believes the construction of infrastructure is where our core competitiveness lies. Upgrading of this infrastructure supports the organic sales growth of our outlets.

Strategies and Plans

Looking forward, the Directors believe that the PRC economy will maintain its robust growth. This will continue to stimulate the development of the PRC retail market, in particular the retail chain industry. The PRC retail market will enter into a new phase of competition. Opening up of the market will bring about a more fair and open market environment. At the same time, retail enterprises in the PRC will face more challenges.

In 2005, the Group will grasp the development opportunity to implement its regional concentration development strategy. Through a combination of direct operations, franchise, mergers, acquisitions, as well as management in trust, the Group will continue to pursue its network expansion in the economically fast-growing areas of the nation. In the next few years, expansion, mergers and acquisitions, reorganisation and integration will continue to be the Group's primary means to achieve

rapid development. We aim to maintain our target of opening around 600 retail outlets in 2005. Meanwhile, the Group will continue to improve the same store sale growth as it accelerates its development to provide investors both short-term and long-term investment values.

The Group is a local retail chain operator in the PRC. Pursuant to the evaluation of the World Brand Lab, the existing value of the Group's brands is RMB 6.7 billion. We will continue to leverage on our strengths in localisation, synergistic advantages of our principal business segments and resource sharing to develop all of our principal businesses segments into top brand names among customers.

In view of the competition the Group faces after the complete opening up of the PRC retail chain business, the Group will learn from international operators with an open attitude. We will continue to innovate, optimize and upgrade the techniques of our retail operations. The Group will enhance the differentiation of our three business segments and their core competitiveness. We will also strengthen the competitiveness of our outlets through innovation.

The Group also aims to reduce operating costs through continuous improvements in management. Lower cost is the key to success in the retail industry. We will strictly control our cost by adopting a stringent and scientific operation model.

In the course of rapid development in the industry, employees sharing our "corporate culture" are the Group's most valuable assets. The Group will place more emphasis on personalised management to provide our employees a satisfactory job and career path.

Strong financial results and business expansion indicated that the Group's directions and strategies of development are on the right track. The Group's value and potential of future development are highly recognised by our

shareholders. The Group successfully placed 34,500,000 H shares on 4 October 2004 and raised approximately HK\$300 million. These proceeds will be used to expedite the development of the Group. To reward our shareholders for their support, the Board recommended a final dividend of RMB0.07 per share for the year ended 31 December 2004. Including the interim dividend of RMB0.05 per share, total dividend for the year was RMB0.12 per share (2003: RMB0.08).

- ❖ It has been our greatest honor to have our independent non-executive Directors who have the expertise and experience to further strengthen the Board. I would like to express my gratitude to them for their contribution to the Group.
- ❖ Finally, on behalf of the Board, I would like to express my gratitude to our shareholders for their trust and support for Lianhua Supermarket, and to our employees for their concerted efforts, dedication and valuable

contribution to the long-term development of the Group during the year. I wish that all of you will continue to join hands and march forward with Lianhua Supermarket.



By order of the Board

Wang Zong-nan

Chairman

19 April 2005

Shanghai, the PRC

