

MANAGEMENT DISCUSSION AND ANALYSIS

FINANCIAL RESULTS

The Group recorded a turnover of HK\$77,070,000 for the year ended 31 March 2005, representing an increase of 27.2% as compared to HK\$60,569,000 for that of last year. Net profit from ordinary activities attributable to shareholders increased from HK\$3,312,000 last year to HK\$4,733,000 for the year under review, whilst the basic earnings per share was HK0.79 cent (2004: HK0.55 cent). The increase was primarily attributable to the full year effect of the acquisition of Yunnan Long Far and the increase in sales volume of the Group's flagship product, Beauty and Healthy (排毒美顏寶).

BUSINESS REVIEW

The Group's operating results for the year were satisfactory despite severe market competition. As Hong Kong economy has gradually recovered from the aftermath of the outbreak of SARS in 2003, retail market improved. The uptrend was also contributed by free-walker travellers from the Mainland China. On the other hand, the SARS disaster has raised public concerns over the importance of maintaining good health, with more consumers in Hong Kong and the Mainland China spending on health products. These factors benefited the Group.

The successful acquisition of Yunnan Long Far in October 2003 not only broadens the asset base of the Group, but also allows the Group's access to the Mainland China pharmaceutical market, though its profit margin is generally lower than that of the Hong Kong market. Upon obtaining the GMP Certificate in February 2004, Yunnan Long Far has successfully expanded its sales network in several provinces in the Mainland China, namely Anhui, Henan, Hunan, Sichuan and Yunnan, under the brand name "Yanta Pai" (雁塔牌). Such expansion has brought the Group's turnover in the Mainland China segment to HK\$14,323,000 (2004: HK\$883,000), representing a more than tenfold increase as compared with the preceding financial year. Among the more than 40 re-launched "Yanta Pai" (雁塔牌) products, Chen Xiang Lu Bai Lu Pian (陳香露白露片), a Chinese gastrointestinal medicine which was widely accepted by the Mainland China citizens, was the best selling product for the year ended 31 March 2005 with turnover of HK\$5,235,000, and ranked as the second best selling product of the Group as well.

The Group's flagship and best selling product, Beauty and Healthy (排毒美顏寶), continued to maintain its dominant position in the detoxification product market and accounted for 70.1% of the Group's turnover. Its turnover increased from HK\$49,684,000 to HK\$54,041,000, representing 8.8% growth as compared to the preceding financial year. The success of Beauty and Healthy (排毒美顏寶) enabled the Group to win many awards in the industry for several consecutive years.

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BUSINESS REVIEW *(Continued)*

During the year under review, the Group launched a brand new product, namely SBL (適鼻靈) with an allergic rhinitis-relieving formula based on the combination of German and Chinese herbs. SBL (適鼻靈) was jointly developed by the Group and CUCAMed Company Limited, a subsidiary company of The Chinese University of Hong Kong Foundation Limited, and was proven by clinical study to be capable to relieve the symptom of allergic rhinitis. The Group is also undergoing a feasibility study and plans to develop markets for SBL (適鼻靈) in Australia where the number of people suffering from allergic rhinitis ranks the highest in the world. The Group is confident of the prospects of SBL (適鼻靈). The Group has introduced two other new products during the year, including, Stomach Essence (養胃良方) and Whitening Nest (白肌燕窩). These three brand new products, accounting for 1.9% of the Group's turnover with total sales of HK\$1,471,000, made satisfactory contributions in broadening the Group's customer portfolio and helping the Group in targeting wider market segments.

Apart from launching new products, new markets development is also the Group's key strategy in coping with the volatile market conditions. The Group has put full effort in the penetration of existing products in Malaysia and Singapore markets, despite the 42.1% decrease of turnover in the Southeast Asian market segment which was due to the restructuring of the distribution network.

BUSINESS OUTLOOK

The successful launch and wide acceptance of Chen Xiang Lu Bai Lu Pian (陳香露白露片) in the Mainland China has paved the way for securing the Group's market share in the Mainland China. In view of the surging demand for healthcare products in the Mainland China market, Yunnan Long Far is actively exploring opportunities to expand its marketing and distribution network for enhancing its penetration of the Mainland China pharmaceutical market.

For the Hong Kong market, the Group will introduce a series of products to enhance its product mix. Super Aboba (日本血型瘦身丸), a natural functional food imported from Japan, will be introduced in the first half of the next financial year ending 31 March 2006. Functional food is divided according to the physiques of people of different blood types. Consumption of functional food in accordance with blood type can aid digestion and increase metabolism for the consumption of unwanted calories, so as to achieve healthy diet and easy weight loss.

The Group expects keen competition to continue in the proprietary Chinese medicinal market and the overall health product market. However, with Long Far's reputable brand name, well-established distribution networks and endeavors in enriching its product portfolio, the management is optimistic about the Group's prospects and will continue its commitment in striving for the best returns for its shareholders.

Looking ahead, the Group will continue its growth momentum by diversifying its products and markets through strategic merger and acquisition and research and development effort, as well as importing effective healthcare and functional products. This helps creating a great deal of synergy from which it will make the Group a much stronger player in the competitive pharmaceutical market in both Hong Kong and the Mainland China.

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EMPLOYEES

As at 31 March 2005, the Group had 226 employees (2004: 189 employees).

The remuneration policy and package for the Group's employees are reviewed and approved by the Board of Directors on a periodical basis. The Group remunerates its employees based on industry practice and performance of individual employees. The Group also offers discretionary bonuses to and makes available a share option scheme for its employees.

LIQUIDITY AND FINANCIAL RESOURCES

The Group has consistently maintained sufficient working capital. As at 31 March 2005, the Group had current assets of HK\$61,647,000 (2004: HK\$57,903,000) and cash and bank balances of HK\$25,793,000 (2004: HK\$26,608,000). The Group's current liabilities as at 31 March 2005 was HK\$13,860,000 (2004: HK\$14,905,000).

As at 31 March 2005, shareholders' funds was HK\$91,419,000 (2004: HK\$86,697,000). The Group had outstanding borrowings of HK\$498,000 as at 31 March 2005 (2004: HK\$713,000). The gearing ratio, being the ratio of total liabilities to shareholders' funds, was 15.6% (2004: 18.0%).

CONTINGENT LIABILITIES

- (a) As at 31 March 2005, the Group had 41,406 (2004: 348,151) outstanding coupons issued to the members of an association (established by a subsidiary of the Group), which entitle the coupon holders to purchase products of the Group from certain retailing outlets in Hong Kong at a discounted price for a period up to 31 October 2005. These retailing outlets, would be entitled to recoup from the Group the amount of discounts given to the coupon holders upon the presentation of the coupons received. As at 31 March 2005, the maximum value of these outstanding coupons, subject to recoup by these retailing outlets, amounted to approximately HK\$1,833,000 (2004: HK\$9,226,000).
- (b) The Group had a contingent liability in respect of possible future long service payments to employees under the Hong Kong Employment Ordinance, with a maximum possible amount of HK\$240,000 (2004: Nil) as at 31 March 2005. A provision has not been recognised in respect of such possible payments as it is not considered probable that the situation will result in a material future outflow of resources from the Group.
- (c) On 13 January 2004, Long Far Herbal Medicine Manufacturing (Hong Kong) Limited ("LFHK"), a wholly-owned subsidiary of the Company, filed its objections to the Trade Marks Registry of the Intellectual Property Department in Hong Kong to oppose certain trade marks applications by a merchant (the "Applicant"). Based on the advice from LFHK's legal advisers, it is likely that a trial would be held at the Trade Marks Registry to determine whether LFHK's objections are valid, and further costs of approximately HK\$300,000 would be incurred by the Group. If LFHK loses the action, LFHK may also have to pay the Applicant's costs estimated to be approximately HK\$500,000. As at 31 March 2005, the Group has not made any provision for such further legal costs subject to the occurrence of the trial.

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POST BALANCE SHEET EVENT

On 14 January 2005, Long Far Investment (Hong Kong) Limited, a wholly-owned subsidiary of the Company, entered into a provisional sale and purchase agreement with an independent third party to acquire a property for a consideration of HK\$31,380,000 of which, HK\$3,138,000 has been paid as a deposit by the Group prior to the balance sheet date. As at 31 March 2005, the outstanding balance of HK\$28,242,000 was included in the amount of capital commitments contracted, but not provided for. Further details of the acquisition are set out in the Company's circular to shareholders dated 28 February 2005. The acquisition was completed on 15 April 2005.

EXCHANGE RISK

The Board of Directors is of the opinion that the impact of foreign exchange exposure on the Group is minimal because its sales and purchases are mainly conducted in Hong Kong dollars and Reminbi which remain pegged to US dollars. The Group does not engage in any hedging contracts.

CHARGE ON GROUP'S ASSETS

As at 31 March 2005, certain of the Group's time deposits totaling HK\$4,412,000 (2004: HK\$4,388,000) were pledged to the banks as security for the banking facilities granted to the Group. An amount of HK\$300,000 (2004: HK\$480,000) of these banking facilities was utilized by the Group as at 31 March 2005.