

## Chairman's Statement

Dear Valued Shareholders,

Lianhua Supermarket maintained its dominance as China's largest supermarket chain.

With our slogan ***"Development, Transformation and Enhancement"***, we were able to meet our goal of enhancing long term competitiveness.

On behalf of the board of directors of Lianhua Supermarket (the "Board"), I am delighted to present the annual results of the Group for the year ended 31 December 2005.

The macroeconomic austerity measures of the PRC government started to take effect, which not only modified and reset the pace of the long-term economic growth of the country, but also established a platform for stimulating domestic demand and potential purchasing power. In 2005, China's gross domestic product ("GDP") grew by 9.9%, to 18,232.1 billion, and the living standard of the people improved gradually with overall consumption increasing in line with the economic growth. According to the statistics released by the National Bureau of Statistics of China, total retail sales of consumer goods in China increased by 12.9% over 2004 to RMB6,717.7 billion in 2005. Personal income also recorded stable increase. Urban residents' income grew by 9.6%

compared to 2004. On the other hand, economic growth extended to rural area, and tremendous purchasing power is expected.

In 2005, competition in the PRC retail sector intensified due to the full-scale opening of the market to foreign capital. In the course of market deregulation and competition, retail chain enterprises expedited their expansion and cross-regional development through acquisitions, streamlining and restructuring of retail networks.

The Group maintained its status as the PRC's largest retail supermarket chain enterprise, with a leading turnover among the nation's retail chain operators for the ninth consecutive years. During the period under review, we adhered to the direction of "development, transformation and enhancement" and placed great emphasis on the enhancement of internal management while reinforcing its development progress. Through diversification of customers' demands, optimisation of supply chain system, minimization of operating costs and enhancement of internal management efficiency, we successfully accomplished our goals of fortifying our long-term competitiveness, creating value in our network and establishing our brand image.

The Group acknowledges the importance of its regional advantages in its growth from a regional company to a nationwide corporation. During the year under review, the Group further strengthened its regional retail networks by accelerating its network penetration in existing regions followed by the expanding of the networks' advantages. The Group maintained strong network expansion capability, and the new outlets were located in the existing markets of the Group. There were an aggregate of 486 new outlets, excluding those operated by associated companies. As at 31 December 2005, the Group had 3,609 outlets, excluding those operated by associated companies. Outlets under the Group's three major brands

established a strong foothold in throughout 21 provinces and municipalities, including Shanghai, Zhejiang, Jiangsu and Beijing. Franchise operators were entitled to enjoy the values in the network and business established by the Group's chain outlet networks. As at 31 December 2005, the Group has an aggregate of 1,614 franchised stores.

During the year under review, the hypermarket business of the Group maintained its strong growth momentum with the largest contribution to turnover. The Group started to establish a world-class supply chain management platform system ("B2B project") for the hypermarket segment. As at 31 December 2005, suppliers made preliminary use of this online platform during its trial-run with a substantial growth in order value and with a high satisfaction rate of 77% from supplier. The Group conducted successful supermarket business transformation. As at the end of 2005, 10 outlets had undergone transformation resulting in sales increased by 48.84%, and average purchase per transaction of customers increased by 23.04%. Earnings as well as satisfaction of customers towards the Group's supermarket business also improved remarkably. The Group is the pioneer of transformation and upgrading of supermarkets, which is also part of our strategic plan for the development in this industry. The Group intended to complete the business transformation of 100 supermarket outlets in Shanghai in 2006. On the other hand, convenience store operation in Hangzhou, Ningbo and Beijing regions became the cities followed Shanghai and Dalian to record a profit. 400 convenience stores of the Group have adopted the new corporate identity design.

During the year under review, the Group embarked on a modernisation project with a total investment of approximately RMB47,150,000 on the Room Temperature Distribution Centre in Shanghai. The project optimised the workflow and introduced world-class logistics equipment. Upon completion

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of such project, the Distribution Centre's distribution error rate and commodity damage rate reduced by 91.89% and 94.67% to 0.03% and 0.0016%, respectively. The successful renovation of the Shanghai Room Temperature Distribution Centre substantially improved the efficiency of the entire supply chain and rate of outlets order satisfaction.

During the year under review, the Group recorded a turnover of approximately RMB14,312,503,000, representing an increase of approximately 31.85% from about RMB10,854,967,000 of the previous year. Profit attributable to shareholders also increased from approximately RMB215,540,000 last year by approximately 11.20% to approximately RMB239,677,000 for the year under review. Earnings per share was RMB0.39, representing an increase of 8.33% compared with the previous year. Such achievement represented the concerted efforts of over 40,000 staff of the Group in tackling the competition and challenges.

The remarkable performance and expansion speed reflected the appropriate development objectives and strategies of the Group as well as high recognition of the Group's values and growth potential from the shareholders. In response to the shareholder's staunch support, the Board recommended the payment of a final dividend of RMB0.07 per share for the year ended 31 December 2005, together with the interim dividend of RMB0.06 per share, total dividend for the whole year amounted to RMB0.13 per share (2004: RMB0.12 per share).

Looking forward, the Directors believe that the retail chain market is filled with both opportunities and challenges. The sustained robust growth of the PRC economy will continue to propel the development of the country's retail market, particularly the retail chain sector. On the other hand, the retail sector will enter into an era of intense competition as the market opens up. In the coming year, the Group will sustain its development strategy with a focus on quality and efficiency to continue the format transformation and innovative development, so as to maximise the integrated effects of the resources of the Group. In 2006, persistent efforts will be committed to implementing the following strategies:

We will take advantage of centralisation strategy in high-growth regions in the PRC, by locating 80 percent of new store area in the Eastern region. We plan to establish strict standards and to optimize outlet development flow in evaluating new locations to maintain quality development. Our target for the year of 2006 is development pace of about 500 new outlets.

We will continue to explore opportunities for mergers and acquisitions.

We will actively identify appropriate franchise modes, expedite the establishment of a framework of supply chain for franchise operations, encourage consumer-oriented management, conduct research on the needs of franchise operators, and provide franchise operators with better services through brand building.

We will endeavour to improve individual store performance, operating efficiency, and sales growth.

We will encourage scientific management, innovation and strict cost controls.

We will further the transformation of supermarkets and plan to complete the transformation of one-third of the directly operated supermarkets (approximately 100) in Shanghai district.

We will promote synergies between different regions and segments, integrating supply chain management between different business segments in the dominant regions.

We will implement the "B2B" project of supply chain management, in order to minimize inventories, increase order satisfaction levels and improve inventory turnover so as to improve the efficiency of the supply chain.

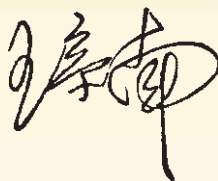
We will strengthen our brand building efforts for membership system, enhance analysis of consumers' needs, and encourage greater volume and order frequency among our members.

We will formulate nationwide logistic plan and implementation proposal with the plan for the establishment of a logistics centre in Jiangsu for distribution to hypermarkets and supermarkets in the region.

We will work to improve our corporate culture, staff training and organisational capability.

Finally, on behalf of the Board, I would like to express my gratitude to our shareholders for their trust and support for the Group, and to our employees for their concerted efforts, dedication and valuable contribution to the long-term development of the Group during the year under review. I wish that all of you will continue to join hands and march forward with the Group. In face of the changing and competitive market environment, the Directors are confident that the Group will persistently enhance its core competitiveness and, leveraging on its understanding of the local market, advanced retail skills and operating philosophy and its professional management team with international expertise, the Group will be able to maintain its leading position in the ever-changing retail market of the PRC.

By order of the Board



**Wang Zong-nan**  
Chairman

18 April 2006  
Shanghai, China





Lianhua Supermarket continues to pursue the objectives of *internationalisation, consolidating domestic predominance, optimising nationwide network, strengthening core competitiveness* and focusing on its *three core business segments* to fulfill the needs of customers and further strengthen its leading position in the PRC.