



GYM & YOGA

Be Healthy &
Energetic





running bare



Management Discussion and Analysis

Business Review

Brand Development

Over the years, the Group has successfully established a series of brandnames to market its comprehensive array of quality beauty and healthcare services, among which include **"Modern Beauty Salon"** for beauty and facial services, **"be Sanctuary Spa"** for spa and massage services, **"Slim Express"** for slimming services and **"Modern Fitness"** for fitness services. Great emphasis has been placed on enhancing the Group's brand recognition and upgrading its service quality. Our efforts have been timely repaid during the financial year 2005/06 with the service centre at Hopewell Centre being awarded the **ISO9001:2000 Quality Certification** by the British Standards Institution in the scope of the design and provision of facial and slimming services as well as the provision of spas and body massage services.

The Group has also developed beauty and skincare products under its own brandname **"be"**. In order to increase the brand awareness of **"be"** products, we further extended the reach of our retail network from the Group's service centres to various renowned personal care chain stores during the year.

In 2006, we forged ahead to diversify our service selection and launch different brandnames to publicise our brandnew business lines. Riding on the rising popularity of beauty and facial services among male customers on the lookout for healthy and modern lifestyle, we aggressively expanded this particular service line under the brandname **"be homme"** with skincare and other related treatments being offered at virtually every service centre in Hong Kong. We revamped and put on a new face for its image to promote brand visibility and awareness. Moreover, a new brand **"Moment of Serenity"** was also introduced during the year under review to provide foot massage services. We will continue to launch new services and products and add more brands to fortify our image as a comprehensive beauty and healthcare service provider in the market.



Network Expansion

The Group's service network continued to expand during the year to meet the ever-increasing demand from customers. Six new service centres were opened, which are situated at Tsimshatsui, Yuen Long, Tai Wai, Tuen Mun and Causeway Bay. This translated into an additional gross floor area totaling up to approximately 52,000 square feet for the Group. At the same time, we consolidated three of our service centres upon expiry of tenancy agreements during the year. Of which, two centres, which were located previously at AR3 of Hotel Miramar Shopping Arcade in Tsimshatsui and New York Life Tower in Causeway Bay, are now housed at 2B3 & 3B1-3 of Hotel Miramar Shopping Arcade and Paliburg Plaza in Causeway Bay respectively.

As at the end of March 2006, the Group operated a network of 17 service centres in Hong Kong, covering an average total gross floor area of approximately 225,000 square feet. Our customer base increased from 131,000 customers as at 31 March 2005 to 154,000 as at 31 March 2006, representing an encouraging growth of 17.6%. Going side by side with our expanding service network is the increase in frontline beauty staff, with the number growing from 762 as at 31 March 2005 to 926 as at 31 March 2006.

In face of growing demand for professional beauty training, we as well expanded and relocated our **Beauty Expert International College** from Carnarvon Road in Tsimshatsui to Paliburg Plaza in Causeway Bay, with the gross floor area posting a more than threefold increase to hit 5,400 square feet. The old site was refurbished to become a boutique service centre offering foot massage services to customers under the brandname of "**Moment of Serenity**".

	As at 31 March	
	2006	2005
No. of service centres	17	13
Average total gross floor area (square feet)	225,000	210,000
No. of customers	154,000	131,000



Management Discussion and Analysis



Number of Employee	As at 31 March	
	2006	2005
Frontline beauty staff	926	762
Back office staff	247	128
Total:	<u>1,173</u>	<u>890</u>



Service Enhancement

With a view to further enhancing the Group's operational efficiency and customer service quality, we kicked off a service enhancement program in 2006. We extended the expiry period of all new prepaid packages from two years to three years with effect from 23 February 2006 to allow for additional flexibility for our customers.



In addition, we launched a special IVRS (interactive voice response system) customer service hotline and devoted a customer service team to handling customers' enquiries in a proactive way. We also put into service a new online booking system at the Modern Beauty website in June this year, providing an extra channel for customers to pick and book their preferred services apart from via telephone, fax, e-mail and in person. The Group will do its level best to boost customer loyalty and satisfaction by continuously enhancing service quality and operational efficiency.

Image Upgrade

During the financial year of 2005/06, we exerted much effort to revamp Modern Beauty's corporate image. On top of launching the service enhancement program, we, upon going public in the market, revisited our website to incorporate the most updated corporate information and operational progress to enhance corporate transparency of the Group. We reached out to media as well as investor communities to heighten effective communication with the public.

As a good corporate citizen, Modern Beauty has made every endeavour to strengthen its commitment to the communities where it does business and has all along been playing an active role in education and caring for the needy. Over the years, we have promoted a caring culture and have collaborated with different institutions including the Labour Department of the Hong Kong SAR Government, the Hong Kong Federation of Youth Groups, the New Territories Association of Societies and the Queen Elizabeth Hospital to provide care and support for the less advantaged in form of job trainings in the beauty service arena.

Apart from community services, we have participated in charitable and fund-raising activities organized by Orbis, the Children's Cancer Foundation and the Community Chest of Hong Kong. In February 2006, Modern Beauty made an endowment of HK\$1,000,000 to the Community Chest of Hong Kong upon its listing through the participation in the latter's "Stock Code Balloting for Charity Scheme".

Without doubt, we would move on to partake in different community programs in particular those with focuses on women and mental health topics going forward.



Management Discussion and Analysis

Financial Review

Financial Performance

During the financial year ended 31 March 2006, the Group had a sound financial performance with a considerable growth in turnover, profit attributable to shareholders and net profit margin. For the year ended 31 March 2006, the Group recorded a total turnover of HK\$498.3 million, representing an increase of 9.1% as compared to HK\$456.9 million in 2005. The profit for the year attributable to shareholders amounted to HK\$122.5 million (2005: HK\$105.2 million), representing a significant growth of 16.5%. The Group's net profit margin also improved to 24.6% in 2006 from 23.0% in 2005. Basic earnings per share for the year was HK21.68 cents as compared to HK19.48 cents in 2005.

Key components of the financial results for the year ended 31 March 2006 extracted from the accounts as set out on page 62 to 111 of this annual report are highlighted as follows:

	2006 HK\$'000	2005 HK\$'000
Turnover	498,265	456,932
Staff costs	(186,757)	(172,043)
Occupancy costs	(47,154)	(42,069)
Depreciation and amortisation	(22,014)	(20,569)
Other operating expenses	(106,068)	(92,442)
Profit for the year attributable to shareholders	122,511	105,171
Dividends	217,360	9,400
Net profit margin	24.6%	23.0%

Turnover

The Group achieved a total turnover of HK\$498.3 million for the year ended 31 March 2006, representing a growth of 9.1% as compared to HK\$456.9 million in 2005. The increase in turnover of approximately HK\$41.4 million was mainly due to the addition of four service centres during the year which increased the average total gross floor area of our service centres from approximately 210,000 square feet in 2005 to 225,000 square feet in 2006. Such expansion of our service capacity facilitated more customers' consumption of the Group's services during the year.



Segment Performance

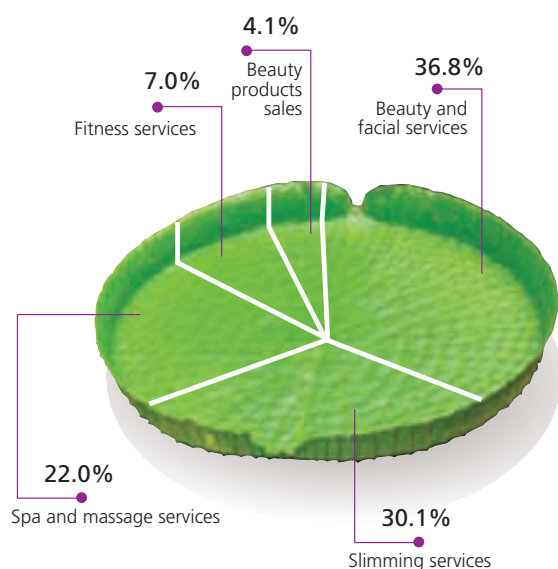
The performance of our major service lines and product sales during the year 2006 is summarized as follows:

Turnover	2006 HK\$ million	2005 HK\$ million
Beauty and facial services	183.4	189.1
Spa and massage services	109.5	88.3
Slimming services	150.2	138.3
Fitness services	35.0	20.5
Beauty products sales	20.2	20.7
Total	498.3	456.9

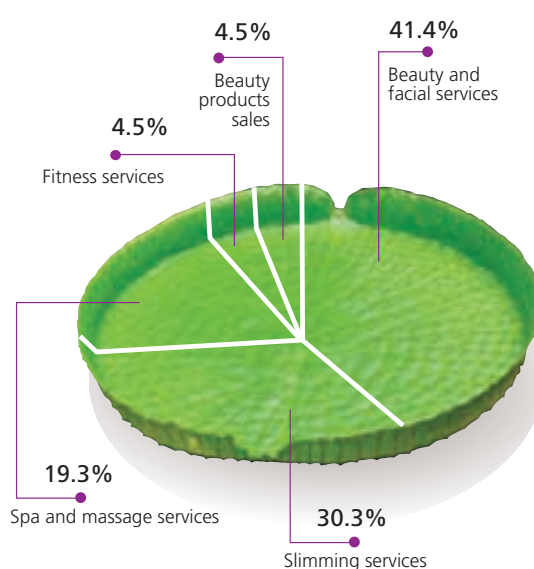
The increase in turnover of approximately HK\$41.4 million during 2006 was mainly attributable to the boost in the sales of spa and massage services by HK\$21.2 million as well as fitness service by HK\$14.5 million, representing an increase of 24.0% and 70.7% respectively as compared to those sales in 2005. Such increase was due to the fact that more spa and fitness centres were opened during the year.

The Group also recorded a healthy growth in the sales of slimming services by 8.6%, increasing from HK\$138.3 million in 2005 to HK\$150.2 million in 2006 albeit the competitive environment in the slimming industry during the year. There was a mild decrease in the beauty and facial service sales by 3.0% as compared to that in the previous year; nevertheless, we will put more efforts to launch the "be homme" beauty services in the coming year to enhance our performance in this service line.

Sales Mix for 2006



Sales Mix for 2005





Management Discussion and Analysis

In terms of segment spread, the spa and massage services as well as fitness services represented 22.0% and 7.0% respectively of the Group's total turnover for 2006, which were increased from 19.3% and 4.5% in 2005 respectively. The portion of beauty and facial services reduced from 41.4% in 2005 to 36.8% in 2006. There was no material change in the proportion of slimming services and beauty products sales during the year.

Revenue Recognition Principle

In accordance with the generally accepted accounting principles, the Group's receipts from prepaid beauty packages are recorded as deferred revenue in the balance sheets at the point of sales. The purchased and free prepaid beauty packages with same nature are aggregated to compute the effective selling price per usage which are applied in the calculation of the deferred revenue for the unused prepaid beauty packages. Sales are recognised when the service treatments are delivered to customers from time to time and in accordance with the terms of the underlying agreements over a period of not more than three years from the date of purchases based on the effective selling price per usage. Prepaid beauty packages over three years from the date of purchase were fully recognised as sales.

During the year, there was a decrease in the sales upon expiring of prepaid beauty packages from approximately 12.8% of the Group's total turnover in 2005 to 10.1% in 2006. Further, the ratio of deferred revenue to consumption even dropped from 1.46 in 2005 to 1.23 in 2006, backed by our greater emphasis on enhancing the service quality which has encouraged more customers' consumption of our services.



Major Expenses

The Group's major expenses principally included staff costs, other operating expenses, occupancy costs, depreciation and amortization and taxation. The breakdown is set out as follows:

Items	% to turnover	
	2006	2005
Staff costs	37.5%	37.7%
Other operating expenses	21.3%	20.2%
Occupancy costs	9.5%	9.2%
Depreciation and amortisation	4.4%	4.5%
Taxation	4.2%	4.7%

Other operating expenses mainly comprised advertising and promotion expenses, bank charges, building management fee and utilities. The major items of other operating expenses are set out as follows:

Major items	% to turnover	
	2006	2005
Advertising and promotion expenses	6.4%	6.5%
Bank charges	3.9%	4.2%
Building management fee	2.7%	2.4%
Utilities	2.1%	2.2%
Cleaning and sanitary	0.8%	0.9%
Fitness coach expenses	0.7%	0.5%
Others	4.7%	3.5%
Total	<u>21.3%</u>	<u>20.2%</u>

There was no material change in respect of the cost structure of the Group for the year 2006 as compared to that in 2005.



Management Discussion and Analysis

Net Profits and Margin

The profit for the year attributable to shareholders reached HK\$122.5 million, posting a significant increase of 16.5% as compared to HK\$105.2 million in 2005. The Group's net profit margin also improved to 24.6% in 2006 from 23.0% in 2005. Basic earnings per share for 2006 was HK21.68 cents as compared to HK19.48 cents in 2005.

Dividend

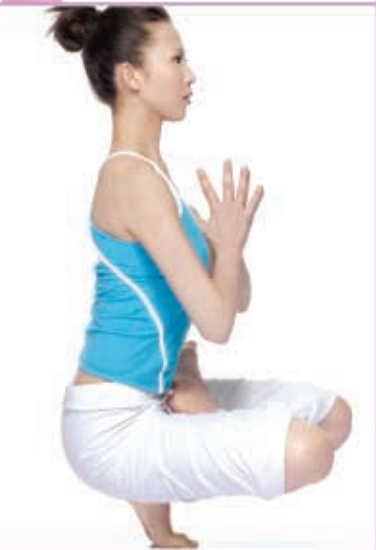
The Board recommended a final dividend of HK13.8 cents per share, totaling HK\$99.36 million for the year ended 31 March 2006 to be payable to the shareholders of the Company. Subject to the approval of the shareholders in the forthcoming annual general meeting of the Company on 15 August 2006, the Company plans to pay the dividend on 25 August 2006 to the shareholders whose names appear on the Register of Members of the Company on 15 August 2006.

Liquidity, Financial Resources and Capital Structure

The total equity of the Company as at 31 March 2006 was HK\$285.3 million. The Group generally finances its operation with internal generated cash flows. The Group had cash and cash equivalents of approximately HK\$565.7 million as at 31 March 2006 (2005: HK\$314.3 million), which were mainly placed as short-term bank deposits, with no external bank borrowing. As at 31 March 2006, the Group had net current assets of approximately HK\$121.7 million (2005: net current liabilities HK\$3.6 million).

Capital Expenditure

The total capital expenditure incurred by the Group during the year ended 31 March 2006 amounted to HK\$48.6 million, which were mainly used in purchase of two properties occupied as service centre and warehouse, leasehold improvements, equipment and machinery in connection with the expansion of its service network in Hong Kong.





Deferred Revenue

The following table illustrates the movement of deferred revenue during the year ended 31 March 2006:

	2006 HK\$ million	2005 HK\$ million
As at 1 April	549.9	520.2
Receipts during the year	454.6	465.9
Sales upon provision of beauty and healthcare services	(427.9)	(377.8)
Sales upon expiring of prepaid beauty packages	(50.2)	(58.4)
As at 31 March	<u>526.4</u>	<u>549.9</u>

The sales upon provision of beauty and healthcare services increased considerably by 13.3% to HK\$427.9 million in 2006, comparing to HK\$377.8 million in 2005. Such increase was mainly due to the expansion of the Group's service capacity as a result of the increase in the average total gross floor area of its service network from 210,000 square feet as at 31 March 2005 to 225,000 square feet as at 31 March 2006. With the Group's greater emphasis on service quality which encouraged more customers' consumption, the sales upon expiring of prepaid beauty packages reduced significantly by 14.0% to HK\$50.2 million in 2006 as compared to HK\$58.4 million in 2005, representing 10.1% of the Group's total turnover for 2006. The receipts during the year also dropped slightly by 2.4% to HK\$454.6 million.

Contingent Liabilities and Capital Commitment

The Board considered no material contingent liabilities as at 31 March 2006. The Group had capital commitment of approximately HK\$3.0 million as at 31 March 2006 (2005: HK\$1.5 million) in respect of the acquisition of property, plant and equipment.

Charges on Assets

As at 31 March 2006, the Group had pledged bank deposits of HK\$52.3 million (2005: HK\$51.5 million) in favour of certain banks to secure banking facilities granted to certain subsidiaries in the Group.



Management Discussion and Analysis

Exchange Risk Exposure

The Group's sales and purchases were mainly denominated in Hong Kong Dollars. The financial assets and certain level of the Group's cash and cash equivalents are denominated in United States Dollars. In view of the relative stability of the exchange rate between Hong Kong Dollars and United States Dollars, the Group does not foresee significant risk in exchange rate fluctuations and no financial instruments have been used for hedging purposes. However, the Group will closely monitor the exposure and, when considered appropriate, will take the necessary actions to ensure that such exposure is properly hedged.

Significant Acquisition

Save and except for the Reorganisation, there was no significant acquisition by the Group during 2006.

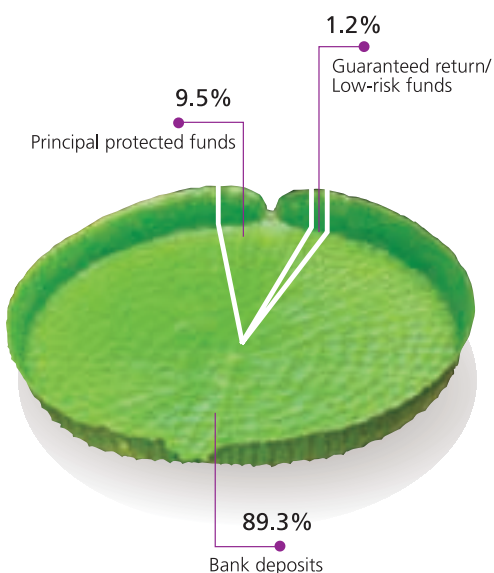
Treasury Policies

The Group adopts a prudent approach in the treasury and investment activities. The Group's surplus funds are mainly held under fixed and saving deposits in renowned banks as well as principal protected investments to increase returns on the surplus funds. As at 31 March 2006, the financial assets of the Group amounted to HK\$68.0 million, representing approximately 10.7% of the surplus funds.

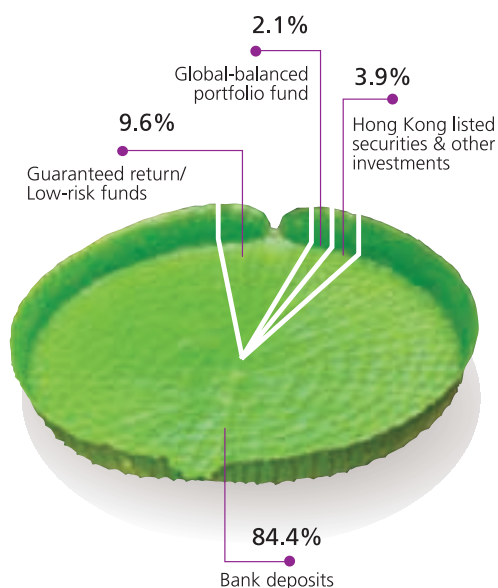


The portfolio of the Group's treasury activities as at 31 March 2006 is depicted as follows:

2006 Portfolio



2005 Portfolio



Employees and Remuneration Policies

The Group employed a total work force of 1,173 employees as at 31 March 2006 (2005: 890 employees). The Group's remuneration policies are in line with the prevailing market practices and are determined on the basis of performance and experience of the individual. The Group has been constantly reviewing staff remuneration package to ensure it is competitive with relevant industries.

Proceeds from Initial Public Offering

The net proceeds from the Company's initial public offering in February 2006 were approximately HK\$161.6 million, after deduction of related listing expenses. During the year ended 31 March 2006, these usage of proceeds were in accordance with the future plans and prospects set out in the Company's prospectus dated 27 January 2006 and within the limit of the net proceeds.



Management Discussion and Analysis

Outlook and Prospects

Looking ahead, Modern Beauty has every confidence of capturing the immense opportunities that come to light in the Hong Kong market to the full. There is also no let-up in our drive to extend our feelers to Mainland China either via opening of direct-managed centres or joint venture partnership with local partners.

Business Environment in Beauty and Healthcare Services Market

Hong Kong

The demand for quality beauty and healthcare services is ever-growing in Hong Kong. According to the 2004/05 Household Expenditure Survey released by the Census and Statistics Department of the Hong Kong SAR Government in April 2006, the average monthly household expenditure on beauty salon services rose from HK\$43 in 1999/2000 to HK\$45 in 2004/05, representing an increase of 4.7%. Besides, the surge in the average monthly household expenditure on fitness, spa, massage and slimming services was up more than three times over the past five years from HK\$11 in 1999/2000 to HK\$48 in 2004/05. Slimming service charges is among the latest items of goods and services being added to the Hong Kong Consumer Price Indices basket as spending on slimming have become increasingly significant.

Riding on the market uptrend, Modern Beauty has experienced a rapid growth particularly over the past few years that attested to the management's foresight and vision. We believe that there is still ample room for expansion for the industry as a whole, given the fact that the average monthly household expenditure on beauty and fitness services has represented only a small portion of people's spending thus far.

With people going after higher quality of living, spa and massage treatments have become the hottest trends in the beauty and healthcare services market in Hong Kong. Today, beauty services are not only targeted at female market, but also offered to men of the new generation. Without doubt, men's salon service is another growing segment offering enormous potential that has yet to be tapped. Customers' urge for top quality and professional beauty and healthcare services works perfectly well to the benefit of Modern Beauty. The Group, with a strong





foundation in the territory, is well placed to capture the growth of the market. We envisage the promising business environment in the beauty and healthcare services industry in Hong Kong will help promote the Group's future development in the long run.

Mainland China

The robust economic development in Mainland China in recent years has led to a considerable surge in average consumer spending, in particular amongst the mid- and high-income groups. Beauty services industry is among the firsts to be benefited from the fast growing track, backed by rising demand for quality and professional beauty and healthcare services.

The beauty services industry, though a newly developed sector on the Mainland, has been expanding at an encouraging growth rate of 15% per annum in these two years with a market value of up to RMB220 billion in 2004. Penetration rate of beauty services stands at less than 20% on the average, offering huge growth potential for players in the market. On the basis that the Chinese female population aged between 15 and 64 exceeds 420 million, there is no doubt that the beauty services market in Mainland China would be advancing ahead at a swift pace in the years to come.

Modern Beauty, leveraging on its strong brand recognition, expertise in developing quality beauty and healthcare services and experienced management team, is well positioned to seize this golden opportunity to expedite its business development in the China beauty market.

Expansion Plans

Expanding service network in Hong Kong

Looking forward, we will spare no effort to strengthen our presence in Hong Kong by continuing with our service network roll-out plan. We plan to open seven more service centres with additional gross floor area of approximately 70,000 square feet to deepen our market penetration in the coming year, leading to a total of 24 service centres in Hong Kong by the end of the financial year 2007. As over half of our customers are residing in newly-developed and high-density residential districts, we will further expand our service network into districts including Tseung Kwan O, Shatin, Aberdeen and Happy Valley to allow for added convenience and flexibility for our customers. Such a strategic move would as well help attract new customers and broaden our customer base.

Capitalizing on the growth momentum of men's beauty services market, we will add more men's beauty salons to our service network and bring in skincare products specially designed for this customer segment. To heighten the brand visibility of "**be homme**" in the market, we will place additional effort on marketing and advertising campaigns by launching a series of advertising activities at mass media channels and engaging celebrities with healthy images as our spokespersons.



Management Discussion and Analysis

Establishing beachheads in Mainland China

The Group is on track to set up its service centres in Mainland China. In the financial year 2006/07, we will, in the first place, focus on first-tier cities including Beijing, Shanghai, Guangzhou and Shenzhen. Targeting to open 20 spa and beauty centres via the setting up of self-owned-and-managed centres as well as joint venture partnership with domestic partners in Mainland China over the next two years, we will also build on our **"be Sanctuary Spa"** platform to introduce and promote **"be"** products on the Mainland.

We have kicked start the establishment of a service centre in Guangzhou with gross floor area of approximately 7,000 square feet. In addition, several partnership projects are under negotiation with the formation of the Shanghai joint venture being in progress, subject to relevant authorities' approval.

Moving forward, we will market our services in the China market through multiple channels including advertising campaigns and beauty seminars to establish a strong brand presence. We also plan to engage spokespersons with healthy images to help promote Modern Beauty's services and products to a broader customer base.

Modern Beauty is committed to becoming one of the leading and premier beauty and healthcare services providers in China and even the region. Leveraging on our competitive strengths, we are confident of establishing a strong foothold in both first and second-tier cities and achieving a nationwide coverage in the long run.



Sustaining service enhancement program

We will continue to implement our service enhancement program with new series of initiatives to meet customers' mounting expectation for quality and professional beauty and healthcare services. We have established a special IVRS customer service hotline and strengthened our dedicated customer service team to promptly handle customers' enquiries. Furthermore, a new online booking system has been launched through the platform of Modern Beauty's revamped website in June this year, providing an additional channel for customers to make their bookings apart from via telephone, fax, e-mail and in person.

We will proactively enhance our customer services by constantly upgrading our service quality and operational systems with a view to providing added value to our customers. We see no pause in continuing on our path of further growth and delivering our services and products that fulfill and even exceed customers' expectations.