

MANAGEMENT DISCUSSION AND ANALYSIS

FINANCIAL RESULTS

The Group recorded a turnover of HK\$57,533,000 (2005: HK\$77,070,000) for the year ended 31 March 2006, representing a decrease of 25.3% compared to that of last year. The Group also recorded a loss attributable to ordinary equity holders of HK\$9,881,000 (2005: profit attributable to ordinary equity holders of HK\$4,733,000), while basic loss per share was HK1.65 cents (2005: basic earnings per share of HK0.79 cent).

BUSINESS REVIEW

During the year under review, the Group experienced remarkable challenges as a result of continuous and severe competition among the wide range of healthcare products available in the market. The Group was realigning the marketing strategy in Mainland China and overseas markets, which slowed down the pace of market expansion.

The Group's operating results were adversely affected by the competitive climate in Hong Kong medicinal healthcare industry, and its turnover in this market fell by 28.1%. On the other hand, along with its diversification strategies, the Group allocated substantial resources for brand building and product marketing, which led to an increase in selling and distribution costs.

During the year under review, the Group successfully tapped into the immense pharmaceutical market in Mainland China under the "Yanta Pai" (雁塔牌) brand name. Among more than 40 licensed "Yanta Pai" (雁塔牌) products, the Group's best-selling product in Mainland China was "Chen Xiang Lu Bai Lu Pian" (陳香露白露片), a Chinese gastrointestinal medicine. Other products such as "Pudilan Xiaoyan Pian" (蒲地藍消炎片) and "Wei Kang Ling Jia Nang" (胃康寧膠囊) were also well accepted by the residents in Mainland China. However, due to increase in selling and distribution costs, the Group focused on the realignment of marketing strategies in Mainland China market during the year and recorded a loss for this region during the year under review.

The Group's flagship product, "Beauty and Healthy" (排毒美顏寶), remained to be the Group's best-selling product, accounting for 64.0% of the total turnover during the year under review (2005: 70.1%). Two innovative products, "Super ABOBA" (日本血型瘦身丸), a natural functional food imported from Japan, and "PROTECT U Cold & Flu" (抗感清), a hot drink that strengthens immunity and prevents cold & flu, were launched during the year under review. Turnover of "SBL" (適鼻靈), an allergic rhinitis-relieving medicine and "Female Essence" (補氣養血寶), which is especially made for women to invigorate "氣" (qi) and to enrich the blood, increased by 31.8% and 151.3% respectively. The Group will proactively diversify its products and markets, and broaden its customer and revenue bases.

The Group's high-quality products have gained recognition among the industry and the public. The Group has been awarded "The Superbrands Award" (超級品牌大獎) for three consecutive years. The Group has also been awarded 2005/2006 category winner in the "Healthcare & Pharmaceutical category" (保健及醫藥組別大獎) in "The Superbrands Award" (超級品牌大獎) during the year under review. The Group was also awarded the "Hong Kong Top Brand Award" (香港名牌) from the Chinese Manufacturers' Association of Hong Kong during the year under review.

"Beauty and Healthy" (排毒美顏寶) has won the "Best Detoxification Product Award" (至FIT排毒獎) in the Mannings Health & Beauty Awards for four consecutive years including the year under review. It also received the "Best-selling Detoxification Product Award" (最暢銷排毒產品獎) for the fifth time and the "Best of the Best Award" for the fourth time in the Watson's 6th Health & Beauty 2005 Awards.

"Whitening Nest" (白肌燕窩) won the "Beautiful Skin Award" (活膚美肌獎) in the Mannings Health & Beauty Awards 2005/06; while "SBL" (適鼻靈) won the "Best-selling Allergic Rhinitis Product – Silver Award" (最暢銷鼻敏感產品銀獎) in the Watson's 6th Health & Beauty 2005 Awards.



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BUSINESS OUTLOOK

In the mature but competitive local medicinal healthcare market, the Group will continue to implement operating strategies of product diversification and market penetration. The Group's pioneering position in the medicinal healthcare market, comprehensive distribution networks, expertise in research and development and advanced manufacturing technology have put the Group in a good position to tap business opportunities in Hong Kong and Mainland China, and ultimately improve its overall profitability.

The Group has successfully tapped into the pharmaceutical market in Mainland China under the "Yanta Pai" (雁塔牌) brand name. With this comparative advantage, the Group will continue to expand its marketing and distribution network, so as to increase its penetration of pharmaceutical market in Mainland China. On 19 October 2005, the Company established a wholly-owned subsidiary in Macau, in order to explore the market in Macau as well as other Portuguese-speaking countries. In addition, the Group is confident in developing the Southeast Asian market. The Group strongly believes that its business in Southeast Asia will be revived after realignment of marketing strategies. The Group will also seek investment opportunities, with the aim to explore more overseas markets.

For the research and development and importation of new products, the Group will seek opportunities to cooperate with tertiary education institutions in research and development of new products so as to enhance product competitiveness. The Group will also continue to identify and import more highly effective healthcare and functional products from overseas in order to further diversify the product range of the Group and to widen income source.

The Group's acquisition of new office premises in Kwai Chung on 15 April 2005 will provide it with both long-term cost-reduction benefits and enhancement of the Group's fixed-asset base in the future.

Looking ahead, the Group will maintain its growth momentum through strategic mergers and acquisitions. The Group will intensify its publicity campaign, and remain committed to educating the public about healthier lifestyles, popularising the Group's healthcare products in every household, and striving for higher return to shareholders.

EMPLOYEES

As at 31 March 2006, the Group had 431 employees (2005: 226 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 makes available a share option scheme and offers discretionary bonuses to its employees.

LIQUIDITY AND FINANCIAL RESOURCES

The Group has consistently maintained sufficient working capital. As at 31 March 2006, the Group had current assets of HK\$55,869,000 (2005: HK\$61,755,000 (restated)) and cash and bank balances of HK\$14,277,000 (2005: HK\$25,793,000). The Group's current liabilities as at 31 March 2006 was HK\$21,356,000 (2005: HK\$13,860,000).

As at 31 March 2006, total equity was HK\$82,510,000 (2005: HK\$91,419,000). The Group had outstanding borrowings of HK\$25,713,000 as at 31 March 2006 (2005: HK\$498,000). The gearing ratio as at 31 March 2006, being the ratio of total liabilities to total equity was 48.8% (2005: 15.6%).

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CONTINGENT LIABILITIES

- (a) As at 31 March 2006, the Group had 8,578 (2005: 41,406) outstanding coupons issued to the members of the International Health Association (established by a subsidiary of the Company), 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 30 June 2006. 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 2006, the maximum value of these outstanding coupons, subject to recoup by these retailing outlets, amounted to approximately HK\$429,000 (2005: HK\$1,833,000).
- (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\$321,000 (2005: HK\$240,000) as at 31 March 2006. The contingent liability has arisen because, at the balance sheet date, a number of current employees have achieved the required number of years of service to the Group in order to be eligible for long service payments under the Employment Ordinance if their employment is terminated under certain circumstances. 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 trademarks applications by a merchant (the "Applicant"). LFHK filed its evidence and the statement of grounds of oppositions on 15 January 2005 and 24 January 2005, respectively. The Applicant filed a counter-statement and an amended counter-statement on 13 April 2004 and 12 February 2005, respectively. The Applicant filed its evidence on 15 September 2005. However, the Applicant failed to supply legible copies of the exhibits of the evidence to the Company for inspection. LFHK is currently applying to the Registrar of the Trade Marks Registry to strike out the Applicant's application. If the striking out application is not permitted, it is likely that a trial would be held at the Trade Marks Registry to determine whether LFHK's objections are valid, and estimated further costs of approximately HK\$300,000 would be incurred by the Group. If LFHK loses the action, LFHK may have to pay also the Applicant's costs estimated to be approximately HK\$500,000. As at 31 March 2006, the Group has not made any provision for such further legal costs subject to the occurrence of the trial.

DIVIDENDS

The directors of the Company do not recommend the payment of any dividend in respect of the year ended 31 March 2006 (2005: Nil).

EXCHANGE RISK

The Board 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. The Group does not engage in any hedging contracts.

PLEDGE OF THE GROUP'S ASSETS

As at 31 March 2006, the Group's bank deposits of approximately HK\$4,546,000 (31 March 2005: HK\$4,412,000) and leasehold land and buildings with an aggregate net book value of approximately HK\$43,917,000 (31 March 2005: Nil) were pledged to secure banking facilities granted to the Group.