MANAGEMENT DISCUSSION AND ANALYSIS

Heng Tai Consumables Group Limited (the "Company") and its subsidiaries (collectively the "Group") are principally engaged in investment holding, distribution of packaged food, beverages, household consumable products, cosmetics, cold chain products and fresh fruit. During the year under review, the Group has consistently performed as a fast growing one-stop services platform provider conducting distribution, brand-building and value-added functions for the fast moving consumable goods, cosmetics, cold chain products and fresh produce industry. China's retail and consumer markets continued to be the market place where the Group secured its business and growth.

BUSINESS ENVIRONMENT

During the year under review, China still demonstrated itself as one of the world's strongest growing economies and most exciting markets. According to the official releases from National Bureau of Statistics of China, China's economy continued to grow at a fast pace with the quarterly growth rate of its Gross Domestic Product at approximately 10% for the first 2 quarters of Year 2006. The gradual enlargement in the proportion of the middle-class consumers relative to the PRC's total population and the continued process of urbanisation in the PRC have also generated enormous demands for quality imported consumables. The favourable performance of Renminbi in the foreign exchange market has lifted consumer spending power on imported consumables in the PRC. These various positive factors had continually created favourable macro economic climate under which the Group was well positioned to capitalise prevailing market potentials in the PRC by utilizing its extensive and well-established distribution network and management experience and expertise.

FINANCIAL PERFORMANCE

During the year under review, the Group has achieved continuous growth in turnover and net profit attributable to shareholders. Turnover increased to approximately HK$1,217.0 million, representing an increase of approximately HK$296.7 million or 32.2% when compared with the preceding financial year. The increase in turnover was mainly attributable to (i) the increased sales quantity sold to the established distribution network; (ii) sales of cold chain products achieved by our Shanghai logistics centre since its commencement of operations in October 2005; (iii) sales of nourishing and exclusively licensed branded products; and (iv) share of the post acquisition contribution in turnover from newly acquired cosmetics business.

Gross profit margin improved continually to approximately 18.3% during the year under review when compared with approximately 16.5% in the preceding financial year. The improvement in gross profit margin was mainly attributable to the improvement in client mix to on-premise customers and continuous refinement of product mix as a result of sales of cold chain products, nourishing and exclusively licensed branded products and cosmetics products with their relatively higher gross profit margin contribution. The Group would continue its margin improvement process in the coming years through enlargement of sales mix of such higher profit margin products in its existing product portfolio.

Selling and distribution expenses recorded approximately 59% increase or increased from approximately 4.3% to 5.1% of the turnover when compared with the preceding financial year. Such increase was mainly attributable to the increase in marketing and promotion campaigns, headcounts for sales force and miscellaneous selling expenses with extra outlay for strengthening market awareness of nourishing and cold chain products and the geographical presence for the PRC sales network with establishment of liaison offices in Dalian, Harbin, Mudanjiang and Chengdu during the year under review.

Administrative expenses recorded approximately 110% increase to HK$35.1 million when compared with the preceding financial year. Such increase was mainly attributable to expansion of the Group's existing distribution operations and cosmetics business in the PRC, the newly established operations for nourishing products and exclusively licensed products and the administration costs incurred for our newly established procurement office in Australia and our Shanghai logistics centre since its commencement of operations during the year under review.

Finance costs increased from HK$2.4 million to approximately HK$9.0 million during the year under review. The increase was mainly attributable to the interest expenses incurred for a three-year term loan facility of HK$78 million drawn in June 2005 and the full year effect of the relevant interest expense was recorded during the year under review.

During the year under review, the Group recorded share of a combined result of associated companies of approximately HK$6 million, which consisted of the share of net profit of approximately HK$13 million from Daqing Petroleum & Chemical Group Limited ("Daqing"), a public company listed on The Stock Exchange of Hong Kong Limited with 13.29% equity interest owned by the Group and the share of net loss of approximately HK$7 million from Zhongshan logistics centre with 50% equity interest owned by the Group. Share of the net loss from Zhongshan logistics centre was attributable to our share in its pre-startup expenses. In view of the commencement of operations of Zhongshan logistics centre in November 2006, share of results of associated companies by the Group is expected to significantly improve in the coming years.

Profit from operations increased to approximately HK$128.8 million, representing an increase of approximately 37.4% compared to approximately HK$93.8 million (restated) in the preceding financial year. Though the Group managed an admirable growth in turnover and profit from operation, such increase was levelled off by the increase in finance costs and decrease in share of results of associated companies during the year under review. Net profit attributable to shareholders increased to approximately HK$122.3 million, representing an increase of approximately 16.3% compared to HK$105.1 million (restated) in the preceding financial year.

CAPITAL STRUCTURE, LIQUIDITY AND FINANCIAL RESOURCES

The Group maintained a strong financial position throughout the year under review. The Group financed its operations and business development with internally generated resources, equity funding and banking facilities provided by its principal bankers in Hong Kong.

On 25 July 2005, the Company entered into a top-up placing and subscription agreement for the placing of 164,000,000 ordinary shares of the Company to independent placees at an issue price of HK$1.25 per share. The net proceeds of approximately HK$202 million would provide an enlarged shareholder base with additional resources to the Group's development and as general working capital of the Group.

On 20 April 2006, the Company issued 407,180,000 ordinary shares, on the basis of two offer shares for every five shares held on the record date, of HK$0.01 each to the shareholders of the Company at HK$0.75 per share through an open offer. The net proceeds of approximately HK$298 million are intended to the business development and as general working capital of the Group.

During the year, the Company raised funds from the issuance of 29,000,000 new shares through exercise of share options by option holders with net proceeds of approximately HK$34 million.

At 30 June 2006, the Group had interest-bearing bank borrowings of approximately HK$149.4 million (30 June 2005: HK$188.4 million) of which over 90% of the bank borrowings were denominated in Hong Kong dollars and approximately 50% mature within one year. All of the Group's banking borrowings were floating-interest bearing and secured by corporate guarantees given by the Company and certain subsidiaries of the Company.

A significant portion of sales and purchases of the Group were either denominated in Hong Kong dollars and US dollars. The Directors consider that the operations of the Group are not exposed to any significant foreign currency exchange risk in view of the stability of the exchange rates between Hong Kong and US dollars. The Group did not have any significant hedging instrument outstanding as at 30 June 2006.

At 30 June 2006, the Group's current assets amounted to approximately HK$741.0 million (30 June 2005: HK$355.7 million) and the Group's current liabilities amounted to approximately HK$138.0 million (30 June 2005: HK$122.1 million). The Group's current ratio improved to approximately 5.4 as at 30 June 2006 (30 June 2005: 2.9). The improvement in the current ratio was mainly attributable to the increase in various current assets financed by enlarged shareholders' equity from issuance of share capital and current year's earnings. At 30 June 2006, the Group had total assets of approximately HK$1,363.5 million (30 June 2005 (restated): HK$689.0 million) and total liabilities of approximately HK$224.4 million (30 June 2005: HK$223.7 million) with a gearing ratio of approximately 11.0% (30 June 2005 (restated): 27.3%). The gearing ratio was expressed as a ratio of total bank borrowings to total assets. The decrease in gearing ratio was mainly attributable to the decrease in bank borrowings and increase in total assets financed by enlarged shareholders equity from insurance of share capital and current year's earnings.

BUSINESS REVIEW, DEVELOPMENT AND PROSPECT

The Group is principally engaged in investment holding, distribution of fast moving consumable goods, cosmetics, cold chain products and fresh produce. The product groups distributed by the Group included packaged food, beverages, household consumable products, cosmetics, cold chain products and fresh fruit with their respective contribution of approximately 53%, 5%, 7%, 2%, 9% and 24% to the Group's turnover for the year ended 30 June 2006. The categories of packaged food were mainly biscuits, candies, chocolate, condiments, margarine, milk power products, healthy food, noodles, snacks, rice and nourishing and exclusively licensed branded products. Beverages were mainly beers, wines and soft drinks and the household consumable products were mainly batteries and toiletries. Cosmetics products included make-up, perfumes, fragrance and skin and sun care products. Cold chain products comprised frozen meat, seafood and diary products. Fresh fruit was mainly pipfruit and citrus.

During the year under review, the Group had been making good progress in shifting its customer base to the on-premise sector as part of the management plans for gross profit margin improvement. Though wholesalers were still the main customer category, which accounted for approximately 70% of the Group's turnover, the retailer and on-premise sectors had increased its stake in the client max and accounted for the remaining 30% of the Group's turnover for the year ended 30 June 2006. Such shift in client mix was mainly attributable to continuous refinement of product mix to cater for demands from on-premise customers as a result of sales of newly introduced cold chain products. In the years ahead, the Group will keep on reallocating more resources in expanding its customer base to the on-premise sector to seek for a higher gross profit margin relative to the wholesaler sector. Moderate attention will still be paid for sales to the retailer sector to maintain product publicity while avoiding direct competition with the wholesalers.

Clientele spreading out will still be one of the Group's expansion agenda in the coming year through strengthening of geographical market presence by establishment of liaison offices in certain second tier cities and enrichment of product variety and diversification of product range. During the year under review, the Group had established four liaison offices in Dalian, Harbin, Mudanjiang and Chengdu in the PRC.

The Group's products were mainly sourced from the Southeast Asia, the United States of America, Europe, Australia, New Zealand and South Africa and sold to wholesalers, retailers and on-premise customers mainly in the eastern, southern and northern parts of the PRC. Recognizing the procurement network as one of the key success factors to its core business, the Group had established a procurement office in Australia during the year under review. In the years ahead, the Group will proceed to establish procurement offices in Germany, Korea, Thailand and Holland to strengthen its sourcing network. Further, the Group will keep on in refining its product selection process; enriching the product variety and diversifying the product range; and taking a more active role as a one-stop value-added services platform provider.

In addition to reinforcing its core distribution business, the Group has also successfully diversified from a distribution mentality to a service-oriented conglomerate to broaden its scope of services during the year under review. The investments in the diversification process would turn into the Group's growth drivers to pave the way for top-line growth and bottom-line improvement in the years ahead.

The Shanghai logistics centre became fully functional in October 2005 and now not only serves as the Group's headquarters and a back-up infrastructure to the Group's existing distribution business in the PRC, but also provides cold-chain logistics solutions to overseas frozen and dairy product suppliers with targeted customer base in the PRC. The frozen and chilled products processed by Shanghai logistics centre are all imported and premium-graded and under stringent hygiene and temperature-controlled HACCP cold-chain standard. During the nine months ended 30 June 2006, turnover from sales of cold-chain products represented approximately 9% of the Group's turnover and its client group was mainly on-premise customers. With the Group's established network in the PRC and expertise in distribution, the Shanghai logistics centre will be a significant growth driver to the Group's turnover and net profit in the coming years.

Zhongshan logistics centre is regarded as another growth driver for bottom-line improvement of the Group in the years ahead. Zhongshan logistics centre is principally engaged in the provision of various logistic services in fresh produce such as packaging, grading, export certification systems, marketing and distribution and would become the first mover to operate a nation-wide network of cold-chain distribution and logistic platform for fresh produce in the PRC. A great variety of fresh produce would be processed and repacked in the centre before being distributed to ultimate customers through centre's unbroken cold-chain logistic facilities. Currently, Zhongshan logistics centre has been in its trial-run state and would have its grand opening in early November 2006. To carve the significant moment of its grand opening in China's fresh produce industry, Zhongshan logistics centre has been endorsed by the relevant government authorities to be the host for 2006 China (Zhongshan) International Fruit Trade Fair, Standardization of Fruit and Vegetable Industries Forum and Cold-Chain Management, Fresh Produce Inspection and Quarantine Forum during the period from 9 to 11 November 2006. These trade fair and conference would serve as a meeting point for leading executives from the international fresh produce industry with the local importers and exporters, officials from the PRC Government and various countries to understand the latest cold-chain logistics development for fresh produce in the PRC. Knowledgeable presentations and panel discussions led by experts, international speakers and authoritative professionals of the industries would dwell on China's emerging role in the global fresh produce industry. Most importantly, such Forum and Fair would greatly raise the publicity of Zhongshan logistics centre in China's fresh produce industry.

To maximize the return from the investment in the infrastructure of Zhongshan logistics centre, in addition to the provision of third party logistics services in fresh produce, Zhongshan logistics centre has been well prepared to take up the trading function itself. The trading function would operate from the upper stream of the vertical operation model by performing sourcing function itself, through processing, grading and packaging in Zhongshan logistics centre and reaching the lower stream by distributing to the sales outlets in supermarkets and chain-stores in the PRC. To support the sourcing function, Senox Group, being the holding company and its subsidiaries beneficially owns Zhongshan logistics centre, entered into a sole and distribution agreement to secure the exclusive quality supply from certain collaborative growers of Thai fresh fruit for a five-year term and a acquisition agreement to acquire 60% of Nature Intuition Group. Nature Intuition Group is principally engaged in the cultivation, sales and export of fresh produce in Guangdong province of the PRC. By acquiring Nature Intuition Group, Senox Group is able to participate in the upper stream of the vertical operation and accordingly ensure a steady supply of a wide-variety of quality-assured fresh produce and an unbroken flow of fresh produce from cultivation to ultimate sales outlets and more importantly, a maximization of profitability in its fresh produce operations.

On 25 July 2005, the Company entered into a top-up placing and subscription agreement for the placing of 164,000,000 ordinary shares of the Company to independent placees at an issue price of HK$1.25 per share. The subsequent subscription was completed on 5 August 2005 with 164,000,000 new ordinary shares of the Company issued at HK$1.25 per share. The net proceeds of approximately HK$202 million from the placement were intended to be used as to (i) approximately HK$50 million originally intended for the acquisition of another 20% equity interests in Zhongshan project were subsequently applied as part of the further capital contribution in Zhongshan project; (ii) approximately HK$15 million for enhancement in operating equipment of Shanghai logistics centre; (iii) approximately HK$15 million for establishment of packaging plant for nourishing products in Hong Kong; (iv) approximately HK$15 million for development of brand name used for the Group's products; (v) approximately HK$10 million for expansion of PRC sales network; (vi) approximately HK$10 million for expansion of overseas procurement network; and (vii) the balance of approximately HK$87 million for general working capital for the Group. The placement had also served to increase the liquidity of the Company's shares and would provide an enlarged shareholder base with additional working capital to the Group's business development.

On 9 December 2005, to cope with the business development of Zhongshan logistics centre, the shareholders of Senox Group agreed to increase their total equity investment from HK$130 million to HK$310 million. The Group, being a 50% shareholder had made an additional pro rata capital contribution of HK$90 million to its investment Senox Group. The additional capital contribution was used as to (i) HK$25 million to secure the sole and distribution rights for the exclusive quality supply from certain collaborative growers of Thai fresh fruit for a five-year term; (ii) HK$55 million to acquire 60% equity interest in Nature Intuition Group; and (iii) HK$100 million as additional working capital of Senox Group to support its enlarged operations.

In addition to the two strategically located logistics centres in the eastern (Shanghai) and southern (Zhongshan) regions of the PRC, the Group has been looking for suitable business opportunities in the north-eastern region of the PRC to further expand and complement its distribution network in the PRC. The Group is still in its assessment stage to establish a fresh produce logistic centre in north-eastern region of the PRC. The estimated investment cost for such logistic centre by the Group was approximately HK$160 million. The establishment of the logistic centre in north-eastern region of the PRC would significantly raise the Group's processing capacity and complement its distribution network of imported fresh produce in the PRC together with the two logistic centres in Shanghai and Zhongshan of the PRC.

On 26 January 2006, the Group entered into the acquisition agreement to acquire 70% equity interest of Sunning State Group Limited and its subsidiaries ("Sunning Group") at a consideration of HK$77 million. Sunning Group is principally engaged in the wholesaling and distribution of overseas and domestic brand name cosmetics and skincare products in the PRC. In view of the ample potentials of cosmetics, skincare and toiletries products in the PRC steadily growing market, the acquisition offered the Group an excellent business opportunity to further diversify its product lines whilst at the same time allowed the Group to extend its existing distribution network in the PRC. The addition of new product lines and new distribution network will have a synergic effect to the Group's existing toiletry product lines and distribution network for enhanced economy of scales and efficiency when both the new and existing product lines are channelled for distribution in the integrated and extended distribution network of the Group. Sunning Group had reported an audited consolidated turnover and net profit of approximately HK$64 and HK$14 million respectively for the 9 months ended 30 June 2006. The Group, being entitled to share 70% of the financial results of Sunning Group after the acquisition completion date on 1 April 2006 had been able to share its 70% post-acquisition turnover and net profit in the sum of approximately HK$21 million and HK$4 million respectively in its consolidated income statements for the year ended 30 June 2006.

On 1 March 2006, the Company announced to propose to raise approximately HK$298 million through an open offer, after deducting all the relevant expenses of approximately HK$7 million, by issuing 407,180,000 offer shares on the basis of two offer shares at HK$0.75 each payable in full on application for every five shares held on the record date on 24 March 2006. The estimated net proceeds of the open offer of approximately HK$298 million was intended to be used as to (i) approximately HK$160 million for the establishment of a fresh produce logistic centre in Dalian of the PRC; (ii) approximately HK$70 million for the acquisition of a logistics and transport company operating in the Far East region; and (iii) the remaining balance of approximately HK$68 million as working capital of the Group. 407,180,000 ordinary shares of HK$0.01 each in the Company were issued at HK$0.75 per share on 20 April 2006.

In June 2006, the Group acquired a logistics and transport businesses in the PRC at HK$25 million. Such acquisition would enable the Group to carry out the door to door truck delivery and freight forwarding services in the PRC and was aimed at further catering for the expanded logistics and distribution operations of the Group and complementing the Group's delivery capacity in its well developed one-stop value-added logistics services.

On 24 June 2006, the Group entered into the acquisition agreement to acquire the remaining 30% equity interest of Sunning Group at a consideration of HK$40 million. Since the completion of the first acquisition of 70% equity interest of Sunning Group in April 2006, the Group has been able to carry out progressively the integration of its existing distribution business in toiletry products to the cosmetics business by Sunning Group. To accelerate the realisation of synergic effect and speed up the integration process by further diversifying Sunning Group's cosmetics product categories in the Group's existing distribution network, the Group decided to acquire the remaining 30% equity interest to get hold of the full control in Sunning Group. The acquisition had been completed on 31 August 2006 and the Group would be able to consolidate the entire turnover and net profit of Sunning Group into its consolidated income statement since the completion date for the year ending 30 June 2007.

In the years ahead, the Group will continue to enhance its business model and consistently pursue its mission to become a leading integrated provider of distribution, logistic services and brand building in the fast moving consumable goods, cosmetics and cold-chain products industry.