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Management Discussion and Analysis

The Group's turnover for the year ended 31 December 2006 amounted to HK\$202,130,000, representing a slightly decrease of 3% as compared to HK\$207,551,000 for the previous year. The Group's gross profit and profit attributable to the equity holders for the year ended 31 December 2006 increased by 10% to HK\$70,823,000 and inflated substantially by 28% to HK\$13,030,000 respectively.



Sales of dried meat products which accounted for 53% of total turnover were the major source of the Group's revenue. Sales of convenience frozen food products, flour products and preserved fruits and nuts products accounted for approximately 22%, 5% and 4% respectively of the total turnover, while the remaining was attributable to other products.

BUSINESS REVIEW

Wah Yuen is the market leader of food manufacture, distribution and retail in both Hong Kong and the PRC, offering a diverse range of over 200 types of supreme quality snack products with unique Asian flavour. The Group produces and markets its quality products under three brands, namely "Wah Yuen", "Rocco" and "采楓", as well as the OEM model. Additionally, the Group also engages in the manufacturing and marketing of convenience frozen food products under the Wah Yuen brand and the OEM model.



HONG KONG MARKET

On the back of encouraging economic development and increased consumption power in the local market, the Group maintained satisfactory performance in Hong Kong despite keen competition, while the production and sale of Wah Yuen snack food products and convenience frozen food products remain the core business of the Company.





During the year under review, the Group successfully extended its network coverage and further expanded its sales and distribution channels. With an extensive retail network comprising a total of approximately 2,000 outlets, Wah Yuen cemented its unrivalled position as one of the leading packaged food brands most favoured by Hong Kong consumers, leveraging on its renowned brand equity and diverse range of quality products.

For the year ended 31 December 2006, sales in the Hong Kong market amounted to approximately HK\$108,576,000 and accounted for 54% of the Group's total turnover. The slightly decline of turnover was mainly due to the drop of low-margin trading business.

In 2006, the Group stepped up its new product development initiatives to cater to customers' preferences and attained encouraging results. Stepping up efforts to enhance its product portfolio, the Group launched a number of new products this year, namely Chinese dim sum, fried rice and snack products. Additionally, the Group consolidated marketing efforts in a number of key sales channels. Wah Yuen has particularly focused on strengthening its cooperation with key supermarket chain stores and convenience stores via concessionaries and joint promotion programmes. Boosting an extensive retail network covering all major supermarkets and convenience chain stores, the Group has cemented its market position as one of the most popular packaged food brands in Hong Kong.



THE PRC MARKET

The Group markets its products in the PRC market under the brand names of “Wah Yuen”, “Rocco” and “采楓”, via its comprehensive mainland distribution network spanning 250 cities in 30 provinces.



During the year under review, the Group's sales in the PRC slightly increased by 6% and amounted to approximately HK\$93,554,000, which accounted for approximately 46% of the Group's total turnover for the year ended 31 December 2006.

Despite unfavourable market conditions and competition from increase entrants in the market, the Group maintained its strength in the sales and marketing promotion of its products. As a result, the Group's marketing and distribution expenses increased as it paved the way to facilitate future growth.

OVERSEAS MARKET

The Group attained the “A Grade Certificate” this year in recognition of its production facilities, which demonstrated the Group's longstanding commitment to hygiene standards and quality control. Significantly, Wah Yuen successfully established a strategic partnership with Sojitz Corporation (“Sojitz”; a merger between Nichimen Corporation and Nissho Iwai Corporation), a large listed conglomerate in Japan and a leading international corporation with businesses spanning the globe. Operations of Sojitz consists of five core businesses - machinery and aerospace; energy and mineral resources; chemicals and plastics; real estate development and forestry products; as well as consumer lifestyle business.





Under the aforementioned partnership, Wah Yuen will provide manufacturing services to Sojitz and its subsidiaries for a period of 15 years commencing in 2006, exporting its premium fried rice, dim sum and convenience frozen food products to Japan through the distribution and retail network of Sojitz. Wah Yuen is confident that under this long-term strategic agreement, the Japanese market will become the Group's future growth driver, cultivating immense

potential to enhance its profitability and business scope.

PRODUCTION FACILITIES

The Group currently owns and operates three production facilities in Hong Kong and the Huadu District, Guangzhou, Guangdong Province. The Company was granted the internationally recognized HACCP certificate, acknowledging the compliance of its production lines with the strictest hygiene standards throughout the entire food production process, from the procurement of raw materials, to packaging, processing and distribution.

During the year, the Group has continued to upgrade its manufacturing and production facilities to enhance its capacities, while capitalizing on its 10 state-of-the-art and highly efficient production lines to deliver its renowned quality products.

FUTURE PROSPECTS



Looking forward, the Group aims to strengthen its market presence and consolidate its image as a reputable household brand, as well as to boost product sales and profit growth. This will be achieved through the continued delivery of quality products to consumers and the strengthening of its brand position via effective marketing and joint promotion campaigns with various supermarkets and convenience store chains.

Wah Yuen will also enhance its core competencies with the introduction of various new products, continuous improvements in its product mix as well as further expansion of its product distribution channels in Hong Kong and the PRC markets.

Meanwhile, the Group's strategic partnership with Sojitz fully demonstrates its confidence in the quality products and manufacturing facilities of Wah Yuen. The Group will work closely with Sojitz to explore more cooperative opportunities in Japan. Under the long-term partnership, the Group is optimistic towards its business development in Japan, which is poised to become a significant growth driver for the Group in future.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2006, the Group had total assets of HK\$407,779,000 and its total current assets were HK\$294,032,000. As at that date, the current and non-current liabilities of the Group totaled to HK\$175,213,000 and HK\$38,023,000 respectively. The Group's bank borrowings amounted to HK\$170,704,000 (2005: 174,826,000). Most of these bank borrowings were denominated in Hong Kong dollars and bearing floating interest rates. As at 31 December 2006, the gearing ratio of the Group improved at 30% (2005: 42%), calculated on the basis of total borrowings less cash over total assets at that date.

EXPOSURE TO FLUCTUATION IN FOREIGN EXCHANGE

As at 31 December 2006, the Group had no foreign exchange exposure and related hedge.

CAPITAL EXPENDITURE

During the year, the Group invested approximately HK\$10,569,000 in fixed assets, of which 89% was used for purchasing production machinery and the remaining related to other assets.

As at 31 December 2006, the Group had no capital commitments.





CHARGE ON ASSETS

As at 31 December 2006, certain assets of the Group with aggregate carrying value of approximately HK\$127,699,000 were pledged to banks to secure banking facilities granted to the Group.

RIGHTS ISSUE

A resolution was passed by the shareholders of the Company at a special general meeting on 5 June 2006 to approve the allotment of 321,000,000 shares at a price of HK\$0.1 per share on the basis of three rights shares for every two existing Company shares. The rights issue was completed on 7 July 2006 and net proceeds of approximately HK\$30,656,000 was received.

EMPLOYEES AND REMUNERATION POLICIES

As at 31 December 2006, the Group's total number of employees stood at approximately 650. Total staff costs for the year under review were approximately HK\$18,837,000. Wah Yuen offers its workforce comprehensive remuneration and employees' benefits packages. Additionally, share options and discretionary bonuses were also granted to eligible staff members based on their performance and the results of the Group.