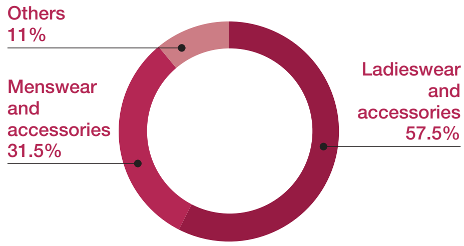
Management Discussion & Analysis

FINANCIAL REVIEW

REVENUE

Revenue of the Group surged to HK$982.2 million in FY2007 representing an increase of 31.0% from HK$749.9 million in FY2006. The growth primarily resulted from strong performance of all sources of revenue including commission income from concessionaire sales, sales of goods for direct sales and management fees, which increased by 22.7%, 34.5% and 139.6% respectively from last year.

Gross sales revenue, comprising gross revenue from concessionaire sales and sales of goods for direct sales, increased by 24.7% to HK$3,693.5 million in FY2007 from 2,962.2 million for last year. Despite the disposal of three department stores in current year, gross sales revenue showed an increase primarily because of firstly, strong SSS growth of approximately 16.5% for stores having operations for more than three years, secondly, the gross sales revenue contribution of recognizing a full year's operations of certain stores opened in last year and thirdly, the gross sales revenue contribution of certain new stores opened in current year under review. Commission income rate was 21.2% in FY2007 which was slightly below the rate of 21.5% for last year. In FY2007, ladieswear and accessories made up approximately 57.5% of gross sales revenue. Menswear and accessories made up approximately 31.5% and kidswear, sportswear, watches, gifts and stationery largely made up the rest of gross sales revenue.



Management fees increased by 139.6% to HK$106.4 million in FY2007, primarily as a result of the opening of certain new managed stores including Changsha Trendy Plaza, Chengdu Store, Chongqing Store, Shanghai Wujiaochang Branch Store, Beijing Trendy Store. Dalian Store, Kumming Store and Ningbo Trendy Store, which became managed stores in FY2007, also contributed to the growth of management fees.

OTHER INCOME

Other income of the Group was HK$97.1 million in FY2007 representing an increase of 18.7% or HK$15.3 million from HK$81.8 million for last year, primarily as a result of an increase in rental income of HK$7.8 million or 13.7% and an increase in interest income on bank deposits of HK$6.0 million or 103.5%. Both the increases in rental income and interest income were on the back of strong retail market in Mainland China and operational performance of the Group.

PURCHASES OF AND CHANGES IN INVENTORIES

The purchases of and changes in inventories represent the cost of sales for direct sales of goods. In line with the increase of direct sales of goods, the purchases of and changes in inventories increased by 31.2% to HK$85.3 million in FY2007 from HK$65.0 million for last year. As a percentage to direct sales of goods, gross profit margin increased by 1.8% to 26.8% in FY2007 from 25.0% for last year, primarily due to the strategy of promoting merchandise mix to higher margin products.

EMPLOYEE BENEFIT EXPENSE

Employee benefit expense increased by 14.4% from HK$128.8 million in FY2006 to HK$147.4 million in FY2007. This increase was primarily due to increase in wages and salaries and other employment benefits as a result of recognising a full year's operations of certain stores opened in last year and new stores openings in current year under review. Employee benefit expense as a percentage to revenue decreased by 2.2% in FY2007 primarily due to improved operating efficiency.

DEPRECIATION AND AMORTISATION

Depreciation and amortisation expense increased by 19.8% from HK$81.4 million in FY2006 to HK$97.5 million in FY2007. This increase was primarily due to increase in depreciation and amortisation as a result of recognising a full year's operations of certain stores opened in last year and new stores openings in current year under review. Depreciation and amortisation expense as a percentage to revenue decreased by 1.0% in FY2007 primarily due to strong performance of revenue.

OPERATING LEASE RENTAL EXPENSE

Operating lease rental expense increased by 14.1% from HK$234.7 million in FY2006 to HK$267.7 million in FY2007, primarily due to the effect of recognising a full year's operations of certain stores opened in last year and new stores openings in current year under review. Operating lease rental expense as a percentage to revenue decreased by 4.0% in FY2007 mainly as a result of operating leverage of the expense.

OTHER OPERATING EXPENSES

Other operating expenses increased by 23.8% from HK$149.8 million in FY2006 to HK$185.5 million in FY2007. This increase was primarily due to a HK$13.7 million increase in water and electricity expenses relating primarily to the newly opened stores and the effect of recognising a full year's operations of certain stores in current year, a HK$6.4 million increase in promotion, advertising and related expenses. Other operating expenses as a percentage to revenue decreased by 1.1% in FY2007.

GAIN ON DISPOSAL OF SUBSIDIARIES

Gain on disposal of subsidiaries of HK$58.0 million was primarily a result of the HK$31.9 million gain on disposal of Dalian Store on 1 July 2006 and the remaining HK$26.1 million gain on disposal of subsidiaries mainly represented the gain on disposal of Kunming Store and Ningbo Trendy Store to Solar Leader Limited, a related company of the Group, on 1 January 2007.

OPERATING PROFIT

Operating profit, including gain on disposal of subsidiaries, as a percentage to revenue increased by 13.1% to 36.0% in FY2007. Operating profit, excluding gain on disposal of subsidiaries, as a percentage to revenue increased by 7.2% to 30.1% in FY2007, primarily as a result of strong growth of revenue and lower expenses percentages of revenue.

FINANCE INCOME

Finance income decreased by HK$8.5 million primarily due to decreased net foreign exchange translation gains. This decrease in translation gains is primarily attributable to accounting treatment of the HK$-denominated amount due to New World Development Company Limited ("NWD"). Pursuant to an agreement reached with NWD on 28 December 2006, an amount of HK$397.7 million was capitalised during FY2007.

INCOME TAX EXPENSE

Income tax expense increased by 115.8% from HK$24.7 million in FY2006 to HK$53.3 million in FY2007, primarily as a result of increase in profit before income tax of 95.0% or HK$173.5 million to HK$356.1 million for the same year. Income tax expense as a percentage to profit before income tax in FY2007 was 15.0% which was slightly above 13.5% for last year.

PROFIT FOR THE YEAR

As a result of the reasons mentioned above, profit for the year increased by 91.8% to HK$302.8 million in FY2007 from HK$157.9 million in FY2006. Net profit margin excluding gain on disposal of subsidiaries increased to 24.9% in FY2007 from 21.1% for last year.

LIQUIDITY AND FINANCIAL RESOURCES

Cash and cash equivalents of the Group increased by HK$478.8 million to HK$967.5 million as at 30 June 2007 (30 June 2006: HK$488.7 million). This increase was primarily as a result of net cash generated from operating activities which was mitigated by the effect of cash outflow due to leasehold improvements of stores.

The Group had no borrowings as at 30 June 2007. The balance of HK$397.7 million due to NWD as at 30 June 2006 was capitalised pursuant to an agreement on 28 December 2006.

The capital expenditure and capital commitments of the Group as at 30 June 2007 were HK$105.2 million, of which HK$5.4 million were contracted but not provided for in the balance sheet.

The operating lease commitments of the Group as at 30 June 2007 were HK$3,861.9 million, of which HK$2,742.6 million were payable after five years.

PLEDGE OF ASSETS

Assets of the Group were not pledged as at 30 June 2007.

TREASURY POLICIES

The Group mainly operates in Mainland China with most of the transactions denominated in Renminbi. The Group is exposed to foreign exchange translation risk, arising from the exposure of Hong Kong dollars against Renminbi. The Group has not used any forward contracts or currency borrowings to hedge its foreign exchange risk.

CONTINGENT LIABILITIES

The Group did not have any significant contingent liabilities as at 30 June 2007.

GUARANTEE

The Group provided guarantees in favour of certain landlords in respect of lease rental and property management obligations of certain tenants, who were independent third parties, of some of our managed stores. All such issued guarantees were released prior to March 2007.

DISPOSAL OF SUBSIDIARIES

On 1 July 2006, the Group disposed of 100% interest in Dalian Store to independent third parties for RMB1. On 1 January 2007, the Group disposed of 100% interests in Kunming Store and Ningbo Trendy Store to Solar Leader Limited, a related company of the Group, for an aggregate consideration of RMB2. Pursuant to management consultancy agreements entered into between the Group and these three stores, the Group continued to manage them and receive management fees.

Management Discussion & Analysis

STRATEGIES FOR FUTURE DEVELOPMENT

For over 10 years, the Group has been developing the department store business in China as we carry out our corporate mission of becoming the dominant department store operator in the PRC. With reference to the latest market trends and consumption patterns in China, we have formulated a comprehensive, long-term development strategy.

REALISING THE POTENTIAL OF THE CHINESE RETAIL MARKET

The Group believes in the formidable potential for growth of the retail sector in China. According to official data from the National Bureau of Statistics, China's GDP grew by 10.7% to RMB20,940.7 billion in 2006, up 0.3 percentage point year-on-year. GDP for the first half of 2007 totaled RMB10,676.8 billion, up 11.5% from the previous year, or 0.5 percentage point year-on-year. Total retail sales for consumer goods increased by 15.4% to RMB4,204.4 billion. We believe the national economy will maintain a steady growth in the latter half of the year.

GROWING AND REINFORCING OUR NATIONWIDE NETWORK AND MODE OF OPERATION

The Group's retail network, comprising currently 16 self-owned stores and 12 managed stores, effectively covers the whole country. We have adopted a three-tier management structure with distinct, well-defined management responsibilities. On the top tier is Central Management located, respectively, at our headquarters in Hong Kong and our management centre in Shanghai. In the middle tier is Regional Management, which is located in stores where regional general managers are based. The third tier is Local Management, located in individual stores.

Central management functions are split between our Hong Kong headquarters and Shanghai management centre. The Central Management holds responsibilities for evaluating and making decisions on investments, negotiating major contracts, formulating nationwide strategies, business development plans, setting business targets and supervising the performance of our Group.

We group our business into six operational regions: eastern China, central China, northern China, northeastern China, southwestern China and Shanghai municipality. Each region has a regional general manager, from a store located within the region, who will take responsibility for operations within that region.

On the local management level, management personnel at individual stores enjoy relative independence, under the supervision of the relevant regional general manager, in marketing and sales, contracting with local concessionaires and direct sales suppliers, maintaining customer relations, servicing customers and communicating with the local government.

BENEFITING FROM PRIME LOCATIONS WITH HEAVY PEDESTRIAN TRAFFIC

We exercise great care in qualifying potential sites for new stores. We target major cities that are populous and economically well developed. We look for prime locations in major business districts or residential areas with convenient transport facilities and heavy pedestrian traffic.

The Shanghai Pujian Store, Liaoning Anshan Store, Wuhan Xudong Store and Beijing Liying Store are expected to open, respectively, in September, October and December of 2007 and before the end of 2008, the Olympic year. We also plan for new stores in cities where the potential for department store business is rich, such as Nanjing, Xi'an, Zhengzhou and Taiyuan.

CAPTURING ACQUISITION AND OTHER OPPORTUNITIES TO LOCATE NEW STORES

We will develop our business in the most cost-effective way, through acquisition of the current stores under our management, and of other commercial properties and department stores that meet our requirements. We will also consider buying land from the government or real estate developers as well as taking ownership of commercial properties with large retail space on street level for construction of department stores according to our requirements.

In addition, we will consider operating on suitable leased properties. In such instances, when we negotiate on terms for lease, we will always try to include provisions for the right to extend the lease agreement and the right of first refusal to acquire.

ADOPTING MODES OF OPERATION FOR GREATER EFFICIENCY, TRANSPARENCY AND GROWTH

To stand out from the increasingly competitive retail market, and to maintain our market advantage, we will adopt a series of operative modes and business strategies that can enhance efficiency, transparency and growth in our three areas of business operations: concessionaire sales, direct sales and management consultancy services.

One such strategy is enriching the portfolio and merchandise mix for direct-sales products so that we can improve our profit structure and keep an edge on competitors in net profit.

Another way to better meet market demand and give a quick boost to sales volume is to optimise our direct sales product portfolio to include a larger proportion of sales for cosmetics category.

Yet another strategy is to continue to reinforce relationship with loyal customers through further promotion and enrichment of the VIP card programme.

In short, by fast-tracking network expansion, we can keep a dual focus on self-owned and managed stores; by optimising merchandise mix, we can increase the conversion rate and the size per ticket of customer orders.

CULTIVATING PARTNERSHIP WITH CONCESSIONAIRE OPERATORS AND SUPPLIERS

We have always stressed the importance of maintaining amicable partnership with suppliers. After more than ten years in the business, we have already lined up a stable team of suppliers. A number of schemes and platforms have been drawn up as well, for immediate and future implementation, including the "Strategic Partnership" scheme, the "Maintenance for Top 150 Brands" scheme and the "New World Net", which provide a communication platform operating on both national and regional levels to allow our concessionaires and direct sales suppliers to communicate their views to us.

In cultivating closer partnership with concessionaires and suppliers as we pursue growth, affording our partners an effective sales platform will turn out to be mutually beneficial.

GROOMING AND FURTHER GROOMING CORE MANAGEMENT FOR GREATER SUCCESS

We have a strong management team from a diversity of backgrounds, with substantial expertise and experience in the PRC retail industry. Most of the members of our senior management team have over 10 years of experience in the retail industry and have been with us for more than five years.

In future, we will place greater emphasis on training up local middle-tier management personnel and formulating training plans for regional management teams, taking into account requirements for regional development. We believe that a whole new generation of experienced management talents will emerge from our training to spearhead our expansion and operation across all regions of the PRC.

UTILISING HIGH-EFFICIENCY INFORMATION MANAGEMENT SYSTEMS

During the year under review, our Group successfully developed a graphical analysis software programme, which could greatly enhance the capabilities of our headquarters in regional management and deployment. In future, we will continue to strengthen the performance of our computer network to bolster efficiency in data transfer between headquarters and branch stores, allowing headquarters staff to grasp the operational status of the stores within a shorter time.

We will also strengthen our financial management system to enhance management's abilities in financial management and control and in performing various financial analyses, including ROI assessments for new projects. Beside the new software will further facilitate analyses of VIP consumption patterns and visitor traffic at our stores, allowing for effective deployment of corporate resources in meeting customer demands.

EMPHASISING HUMAN RESOURCES TRAINING

We seek to continually upgrade staff quality by developing and offering training courses. These are classified into four categories, namely corporate culture, service delivery, daily operations and leadership. We have set up New World Department Store Management Academy and jointly offered specialized courses with Shanghai Jiao Tong University. With these, along with regular overseas study trips and a variety of in-house seminars on development strategies, we have successfully broadened the outlook of our colleagues in mid-to-senior level management.

By reference to our corporate culture, which we have inculcated with tripartite attributes of “vision-mission-core values”, and based on the model of “New World Core Competencies” that we have developed, we can effectively undertake career planning for our key executives.