Management Discussion & Analysis

FINANCIAL REVIEW

Revenue

Revenue of the Group was HK$4,011.5 million in FY2013, representing an increase of 14.9% from HK$3,490.1 million in FY2012. The growth was primarily contributed from commission from concessionaire sales, sales of goods for direct sales and rental income.

Gross sales revenue, comprising gross revenue from concessionaire sales, sales of goods for direct sales, management and consultancy fees, rental income and other income increased by 15.5% to HK$16,414.4 million in FY2013 from HK$14,207.2 million in FY2012. Gross revenue from concessionaire sales increased to HK$14,895.5 million from HK$13,010.0 million in the Previous Year. Commission income rate was declined from 18.5% in the Previous Year to 17.7% in the Current Year. The decline was primarily due to the lower commission rates recorded by new stores and the sales growth of jewelry and gold, electronic products with lower commission rate and the number of promotions increased in the competitive market. Sales of goods for direct sales was HK$809.6 million in FY2013 compared with HK$676.2 million in FY2012. Direct sales turnover mainly comprised of groceries, housewares and perishables (approximately 50.9%), cosmetic products (approximately 39.9%), ladieswear and menswear (approximately 5.9%), accessories, handbags and underwears (approximately 1.9%). Gross margin of direct sales was 14.4% compared to 15.5% in the Previous Year. The drop was mainly due to the increase in sales contribution from supermarkets which had a lower margin. In FY2013, ladieswear and accessories made up approximately 64.0% of gross revenue from concessionaire sales and sales of goods for direct sales. Menswear and accessories made up approximately 17.8% and sportswear, bread and snacks, electrical appliances, children's wear and personal care products largely made up the rest.

Management and consultancy fees was HK$52.3 million in FY2013, showing an increase from HK$19.2 million in FY2012. The increase was primarily due to the contribution of management fees from new managed stores, namely Ningbo Beilun Store and Yanjiao Store opened in September 2012 and in April 2013 respectively. Also, the Group received fees for the provision of consultancy services for some new managed store projects which were at pre-opening stage in the Current Year.

Rental income increased by 31.2% to HK$510.7 million in FY2013 mainly due to increased leasing area from firstly, recognising a full-year operation of Lanzhou Store and Shanghai Shaanxi Road Branch Store, and Beijing Liying Store acquired in November 2011 and January 2012 respectively, Mianyang Store opened in December 2011 and the completed expansion of Shenyang Jianqiao Road Branch Store in April 2012; and secondly, the opening of new self-owned Yancheng Store and Xi'an Store in December 2012.

Other Income

Other income of the Group was HK$146.3 million in FY2013 compared with HK$112.6 million of FY2012. The increase was mainly due to the increase in government grants and income from suppliers in FY2013.

Other Losses/Gains, net

Loss on disposal of property, plant and equipment and land use rights of the Group in the Current Year was HK$60.4 million (2012: HK$12.8 million). Other gains, net in FY2012 comprised a gain of HK$47.1 million on disposal of certain portion of property and land use right situated in Wuxi City.

Changes in Fair Value of Investment Properties

Changes in fair value of investment properties in the Current Year was HK$70.9 million and related to the properties of Shanghai Shannxi Road Branch Store, Zhengzhou Store and Tianjin Store.

Purchases of and Changes in Inventories

The purchases of and changes in inventories represented the cost of sales for direct sales of goods. It increased by 21.3% to HK$693.1 million in FY2013 from HK$571.2 million in FY2012. The percentage of increase was approximately in line with the increase in sales of goods for direct sales.

Employee Benefit Expense

Employee benefit expense increased to HK$572.3 million in FY2013 from HK$541.6 million in FY2012. This increase was primarily due to the increase in wages and salaries, retirement benefit costs and other employee benefits as a result of recognising a full-year operation of Lanzhou Store, Shanghai Shaanxi Road Branch Store, Beijing Liying Store and Mianyang Store acquired or opened in FY2012. In addition, the expansion of Shenyang Jianqiao Road Branch Store in April 2012 and the newly opened Yancheng Store and Xi'an Store in December 2012 also contributed to the increase of employee benefit expense in the Current Year.

Depreciation and Amortisation
Depreciation and amortisation expense increased from HK$293.8 million in FY2012 to HK$320.3 million in FY2013. This increase was primarily due to a result of recognising a full-year operation of Mianyang Store opened in FY2012, the conversion of Lanzhou Store and Beijing Liying Store from managed stores to self-owned stores in November 2011 and January 2012 respectively, the expansion of Shenyang Jianqiao Road Branch Store in April 2012 and the newly opened Yancheng Store and Xi'an Store in December 2012.

Operating Lease Rental Expense
Operating lease rental expense increased to HK$980.4 million in FY2013 from HK$863.1 million in FY2012, primarily due to recognising a full-year operation of Mianyang Store opened in December 2011, the expansion of Shenyang Jianqiao Road Branch Store in April 2012, the conversion of Lanzhou Store and Beijing Liying Store from managed stores to self-owned stores in November 2011 and January 2012 respectively and the newly opened Yancheng Store and Xi'an Store in December 2012.

Other Operating Expenses, net
Other operating expenses increased to HK$767.6 million in FY2013 from HK$592.5 million in FY2012. The increase in other operating expenses was primarily due to recognising a full-year operation of Lanzhou Store, Shanghai Shaanxi Road Branch Store, Beijing Liying Store and Mianyang Store acquired or opened in FY2012. Moreover, the increase was also due to the expansion of Shenyang Jianqiao Road Branch Store in April 2012 and the newly opened Yancheng Store and Xi'an Store in December 2012.

With regard to the increase in selling, promotion, advertising and related expenses from HK$123.9 million in FY2012 to HK$232.2 million in FY2013, that was mainly due to increased promotional expenses in connection with promotion of our newly opened stores and promotion activities in line with the market situation. An increase in other tax expenses from HK$128.5 million in FY2012 to HK$175.6 million in FY2013 was mainly due to the increase of consumption tax arising from sales of gold related products.

Operating Profit
Operating profit was HK$834.5 million in FY2013 compared with HK$786.8 million in FY2012. Operating profit, excluding other losses/gains and changes in fair value of investment properties, increased by approximately 11.3% to HK$824.0 million from HK$740.4 million in the Previous Year.

Income Tax Expense
Income tax expense of the Group was HK$233.8 million in FY2013 compared with HK$204.8 million in FY2012. The effective tax rate of the Group in FY2013 was 26.7%.

Profit for the Year
As a result of the reasons mentioned above, profit for the year was HK$641.5 million compared with HK$607.7 million in the Previous Year. Profit for the year, excluding other losses/gains, changes in fair value of investment properties and one-off tax adjustment on disposal of properties situated in Wuxi, increased by approximately 9.8% to HK$615.7 million from HK$561.3 million in the Previous Year.

Liquidity and Financial Resources
Cash and fixed deposits of the Group amounted to HK$2,959.5 million as at 30 June 2013 (30 June 2012: HK$3,621.0 million).

The Group's borrowings from banks as at 30 June 2013 was HK$659.3 million (30 June 2012: HK$1,007.7 million) of which HK$632.9 million (30 June 2012: HK$682.9 million) was secured by pledge of assets.

At 30 June 2013, the Group's current liabilities exceeded its current assets by HK$690.0 million. The Group will continue to monitor rolling forecasts of the Group's liquidity requirements to ensure it has sufficient cash to meet operational needs and its liabilities and commitments as and when they fall due.

The capital commitment of the Group as at 30 June 2013 was HK$1,006.6 million which was contracted but not provided for in the statement of financial position. For the contractual payment of HK$1,006.6 million, approximately HK$105.1 million was related to the acquisition of land and building located in Shenyang City, approximately HK$533.7 million for the property redevelopment project in Shenyang City and approximately HK$314.6 million for the acquisition of entire equity interest in Shanghai Hongxin Properties Company Limited.

Pledge of Assets
As at 30 June 2013, investment properties of HK$1,913.9 million (30 June 2012: HK$1,792.7 million) of the Group were pledged as securities for bank borrowings of HK$632.9 million (30 June 2012: HK$682.9 million).

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 to hedge its foreign exchange risk. The Group manages its foreign exchange risk by performing regular reviews of the Group's net foreign exchange exposures.

Contingent Liabilities

The Group did not have any significant contingent liabilities as at 30 June 2013.

OUTLOOK

In 2013, the international capital markets were still enveloped by the European sovereign debt crisis. China's economy managed to maintain a steady growth and make gradual progress amid global economic uncertainties. According to National Bureau of Statistics of China, GDP in the first half of 2013 amounted to RMB24,800.9 billion, representing a year-on-year increase of 7.6%; the total retail sales of consumer goods rose 12.7% year-on-year to RMB11,076.4 billion. Consumption accounted for 45.2% of China's GDP growth, demonstrating that domestic consumption has become the main driver of China's economic growth.

The government has announced its intention of unleashing effective demand in the second half of the year, which will further encourage consumer spending and expand domestic consumption. On the other hand, the government will push forward the people-oriented modern urbanization. Urbanization and urban-rural integration will increase the scale of China's overall consumption and raise the purchasing power of third-tier and fourth-tier cities, thus exposing a large potential market. The Group has already developed strategies in this regard to strengthen its business development in those cities so as to seize the opportunities from urbanization. These government policies will further unleash China's consumption potential, providing strong support to the long-term development of the retail industry. Hence, the Group is prudent but optimistic about the prospect of the industry.

STRATEGIES FOR FUTURE DEVELOPMENT

During the year under review, despite the changes in the operating environment of China's department store sector, a slowdown of retail growth and other challenges, the Group was able to maintain a steady growth with our excellent operations management, diverse marketing promotions and the uplifting effects resulted from the rebranding exercise. Looking forward, to further grasp the opportunities brought by China's economic development and the emergence of the middle class, the Group will continue to evaluate our operations, merchandise, marketing and expansion strategies in a timely manner, and is determined to provide quality merchandises and services to a wider group of customers, and to maximize returns to our shareholders through stringent cost control, more strategic cooperation and store network expansion in order to achieve greater economies of scale.

Operations Strategies

Optimizing Operating Structure to Enhance National Efficiency

The Group has been committed to exercising stringent cost control and enhancing operating efficiency. Following the comprehensive operational restructuring in 2012, which divided our national store network into three operating regions and nine operating districts, the Group will continue to optimize the three-region operations framework to enable higher level of flexibility on resource deployment, regional cost reduction and localization to boost operating efficiency. At the same time, we will further speed up our business expansion through acquisition and provision of store management services to achieve economies of scale. When it comes to determining new store location, we will consider carefully whether the prospective store can generate greater operating synergies with our existing network, in order to maximize the advantages of resource sharing.

Growing Effects from Rebranding Lay Solid Foundation for Development

The Group launched a forward-looking "rebranding program" in 2009 to maintain stores' competitiveness in the highly competitive retail market and bring new excitements to our customers. The Group has categorized the stores into "Fashion Galleries" as thematic department stores with a focus on clothing and accessories as well as "Living Galleries" as one-stop shopping department stores by means of restructuring the merchandise mix and introducing more complementary facilities, such as, dining, leisure and entertainment, into the outlets. These moves were taken to strengthen our brand image through differentiated positioning and to fuel the growth momentum. During the year under review, the

Group's rebranding exercise has largely completed except for four stores, namely Wuhan Store, Wuhan Qiaokou Branch Store, Wuhan Trendy Plaza and Wuhan Xudong Branch Store, with that of the latter two to be completed in September 2013. Taking the new stores into account, as at 30 June 2013, 37 stores were operating in brand new images, which was about 91% of the total GFA. Rebranded stores recorded remarkable increase in their same-store sales growths and have become a confidence booster for the Group's long-term development. In the long run, the Group will accelerate store localization, for instance, when planning for a new store, factors like consumption power, economic condition and industrial structure of the operating area will be taken into consideration to determine its market positioning and interior layout, striving to make a comprehensive plan from the very start. Constant optimization will be made, so as to project a vibrant brand image that caters to the local market. To address the desire for one-stop shopping experience, the Group will give priority to "Living Galleries" projects, aiming to create a more spacious and comfortable shopping environment for consumers.

Comprehensive Talent Development Programs to Support Future Growth

To support the rising demand for talents due to the fast-paced development, the Group will continue to implement comprehensive talent development program with the conviction of "Nurture Talents with Respect, Care and Trust". The Group will provide our staff in all positions with tailor-made training programs, for instance, organizing "Core Talents Nurturing Plan" and "Certificate Program of Further Studies in Retail Operation and Management" with Shanghai Jiao Tong University to nurture middle and senior management, arranging visits to overseas leading department stores, in which staff can pick up some advanced operations philosophies and management methodologies from their foreign counterparts and to bring more new mindsets into the Group. For store-based staff, "Operational Management Training Camp for Store Managers" and skill-enhancing courses are arranged regularly to elevate their professional skills and integrated operating ability, as well as enhancing the Group's customer service quality. On the other hand, "Project Xinpeng – NWDS Management Intern Cultivation" is in place to replenish the Group's talent pool for our development in the long run.

Wider and Deeper Technology Applications to Enhance Shopping Experience

The Group will continue to keep abreast of the latest technologies and enhance their applications in stores to improve operating efficiency and customer experience. In terms of operations, we will comprehensively optimize our operations management systems, for instance, increasing office automation and introducing enterprise resource planning system etc. Internal control will also be strengthened to enhance operating efficiency. At the same time, the Group plans to increase the integration level of back-end systems of concessionaires, direct-sales and e-shopping divisions to create an integrated online and offline platform. As for customer service, the Group will implement a series of initiatives, including VIP system optimization and promotion on multi-purpose VIP cards; more online promotions to address the growing popularity of new media; store information system upgrade, such as, installing mobile cash registers and launching push notifications so that customers can receive discount information anywhere, anytime, to make shopping easier and more convenient.

Merchandise Strategies

Special Maintenance on Categories Killers to Build Strong Merchandise Mix

As a trendsetter, the Group consistently optimizes our merchandise mix to keep up with international and local fashion trends. In addition to bringing in renowned international brands, the Group also rides on the wave of fast fashion and introduces respective clothing lines into our merchandise mix. Also, the Group will continue to introduce new brands and exclusive merchandises in the business circle where the stores located to create a merchandise portfolio with competitive edge. In addition, we will continue to expand our product categories and attach great importance to carefully maintain the category killers, such as, gold and jewelry, ladies' casual wear and footwear, to realize greater revenue. In order to provide a selection of unique merchandises and create differentiation advantages, the Group established a direct sales subsidiary in 2011 to develop our own private labels, which are in high quality but at affordable price, introducing more selected merchandises to customers.

Strengthening Ties with Affiliates to Bolster Collaborative Synergies

The Group will establish closer strategic cooperation with Chow Tai Fook, K11 and other affiliated companies of New World Group, for instance, introducing Chow Tai Fook concessionaires into our stores, to bolster synergies for mutual benefits.

Targeted Supplier Management Mechanism to Foster Strong Partnership

The Group will continue to consolidate and optimize the "Head Office – Region – Store" three-tier supplier management system to carry out targeted brand management and maintenance; besides, the Group will further integrate our supplier data, so that stores can easily access and utilize the information accordingly. The Group has always attached great importance to supplier partnership. In addition to the "New World Net" communication platform, the Group also develops "Strategic Brand Management Approach" to provide guidelines on how to foster closer partnerships, explore collaboration opportunities as well as broaden and deepen bilateral cooperation with major brands in a systematic way.

National Merchandising Team Formed to Handle Leasing Projects

Other than concessionaire sales, the Group will continue to operate in a hybrid model integrating the elements of shopping malls into our stores. Striving to deliver an enriched shopping experience to customers, we will further expand leasing area and incorporate complementary facilities, such as, restaurants, cinemas, beauty salons and education centers, into stores. At the same time, the Group also establishes a national merchandising team as a central office to coordinate the management and planning of leasing projects, aiming to facilitate tenant acquisition and achieve economies of scale.

Marketing Strategies

Optimizing VIP Membership Structure to Retain Top-tier Customers

The Group has always given priorities to VIP relationship management. To foster closer relationship, the Group will further optimize our existing VIP structure to put top-tier VIP customers under special treatment. Also, the Group will continue to perfect in-store member facilities and offer more exclusive discounts to enhance their sense of superiority as a VIP member. During the year under review, the Group held the "Nationwide VIP Day" at the end of November 2012, the largest VIP rewarding campaign as of date, offering exclusive VIP discounts and has successfully generated up to RMB400 million of sales proceeds.

Launching Inter-Store Thematic Sales Promotion Across the Country

To avoid being a sole fighter in the battlefield of sales promotion, the Group will leverage our large retail network to initiate more inter-store thematic promotions nationally and regionally by pooling in the strengths and resources of all stores, enabling to create bigger noise and to offer greater discounts to our customers. During the year under review, the Group held numerous nationwide promotions including the "Nationwide VIP Day" and the "Blast of Joy – Celebrating the 20th Anniversary". In the latter campaign, which was organized in celebration for approaching 20th anniversary, the Group gave away nearly 2,000 Samsung GALAXY S4 smartphones and achieved sales proceeds of RMB670 million with sales growth of over 180% during the campaign period.

New Media Channels to Engage Young Customers

In recent years, the Group has been exploring new media channels to tap into the trend of growing use of online platforms and smartphones to access information. With the extensive use of social media sites, video clips, Weibo, WeChat and mobile platforms for marketing purpose, we aim to be more engaged with the younger segment, and to enhance cost efficiency through improving information transmission efficiency while reducing dependence on traditional advertising channels. During the year under review, the Group has attracted over 3.5 million fans on Weibo and the number of WeChat subscribers soared to nearly 340,000 within a few months after the launch.

Foster Strategic Cross-Industry Collaboration to Deliver Surprises and Privileges

The Group will continue to work with strategic partners from different sectors to bring customers with more diverse and creative promotional activities, which helps expand customer bases and create win-win for both parties. In particular, the Group plans to deepen cooperation with affiliated companies of New World Group, including New World China Land, Chow Tai Fook, K11 and Rosewood Hotel Group, introducing more exclusive promotions and activities to maximize our synergies.

Expansion Strategies

Prudent Expansion Strategies to Accelerate National Expansion

Benefiting from the more-established infrastructure and transportation network as well as the favorable policies encouraging domestic consumption and urbanization, the economy of third-tier and fourth-tier cities are undergoing rapid development. Riding on this momentum, the Group will continue to carry through our expansion strategies of "radiation city" and "multiple presences within a single city". On one hand, the Group will actively seek for potential projects in first-tier and second-tier cities, such as, Beijing, Shanghai, Wuhan, Shenyang and Chengdu to further strengthen our regional competitive advantages; on the other hand, the Group will extend our presence to the surrounding third-tier and fourth-tier cities, and make these high-potential markets as the focus of our future development. Looking ahead, the Group aims to increase the total GFA of our self-owned stores to about 2 million sq. m. by FY2016.

Addition of Self-Owned Stores through Leasing and Acquisition

The Group will continue to increase the number of self-owned stores by means of leasing and acquisition. During our 20 years of operation in Mainland China, the Group has established long-term strategic relationship with many landlords and property developers, which enables us to enjoy competitive leasing terms and stable rentals. Other than leasing, we are also actively gaining access to prime locations in emerging markets quickly through acquisition. In addition, the Group plans to further foster cooperation with industry organizations to acquire high-potential department store projects and suitable lands for development. These strategies will accelerate the Group's entry into the target markets and enlarge our influence in the existing markets.

During the year under review, the Group announced the acquisition of Shanghai Hongxin Trendy Plaza with a GFA of approximately 43,000 sq. m.. The acquisition has been completed at the end of July 2013. In terms of opening self-owned stores, a "Living Gallery" in Yantai City, Shandong Province, will commence business in FY2014, with a GFA of approximately 55,000 sq. m.. Furthermore, Shanghai 118 Project in Putuo District, Shanghai will be opened in FY2015, with a GFA of approximately 62,600 sq. m.. Also in FY2015, in addition to the existing Changsha Trendy Plaza, a new "Living Gallery" in Hengyang City, Hunan Province, will be set up with a GFA of approximately 42,200 sq. m..

In addition to the above, the Group also plans to enlarge our operating area through store expansion to provide customers with a more comfortable and spacious shopping environment. During the year under review, Shenyang Nanjing Street Branch Store Phase II Project, with a GFA of approximately 25,400 sq. m., was under expansion and will be completed in FY2015; the Shenyang Nanjing Street Branch Store Phase I Redevelopment Project will be completed and commence operation in FY2017, with a GFA of approximately 26,300 sq. m..

Managed Stores Expedite Entry to Emerging Markets

Supported by the urbanization policy, third-tier and fourth-tier cities have become the new engines for the country's economic growth. Hence, the consumption potential of these cities should not be overlooked. To lower investment risks, the Group will continue to speed up our moves in entering emerging markets by increasing managed projects. This lays a solid foundation for our development in these markets as it allows us to extend our store network at a rapid pace while earning stable management fees. To increase the attractiveness of their shopping malls, property developers often proactively approach and acquire well-known retailers into their premises, which have made it easier for the Group to negotiate good leasing terms. When the business matures, the Group will thoroughly consider acquiring the managed stores and converting them to self-owned stores to broaden our geographical network. In terms of opening managed stores, the Group's Yantai Shopping Mall Project will commence operation in FY2014, with a GFA of approximately 46,000 sq. m.. In the same year, in view of the strong retail growth in Zhejiang Province, a "Living Gallery" will be set up in Keqiao, Shaoxing City, with a GFA of approximately 42,300 sq. m., as a means to strengthen the Group's influence in the South Eastern China Region. In addition, the Group's managed project in Jiamusi City, Heilongjiang Province will commence operation in FY2016 with a GFA of approximately 40,000 sq. m..