MANAGEMENT Discussion & Analysis

The Group's Turnover	Retail Sales In HK & Macau	The Group's Profit
HK$ 7,845.9 million	HK$ 6,231.6 million	HK$ 383.5 million
12.8%	14.2%	54.3%

Consolidated Income Statement For The Year Ended 31 March 2016

	Full year		First half		Second half	
	2016	2015	**2016**	2015	**2016**	2015
	HK$'000	HK$'000	**HK$'000**	HK$'000	**HK$'000**	HK$'000
Turnover	**7,845,875**	8,992,837	**3,777,940**	4,226,004	**4,067,935**	4,766,833
Cost of sales	**(4,499,866)**	(4,953,590)	**(2,156,275)**	(2,339,129)	**(2,343,591)**	(2,614,461)
Gross profit	**3,346,009**	4,039,247	**1,621,665**	1,886,875	**1,724,344**	2,152,372
Other income	**117,379**	118,445	**58,832**	58,752	**58,547**	59,693
Selling and distribution costs	**(2,664,059)**	(2,816,699)	**(1,315,317)**	(1,358,107)	**(1,348,742)**	(1,458,592)
Administrative expenses	**(341,694)**	(349,957)	**(176,808)**	(184,183)	**(164,886)**	(165,774)
Other gains – net	**3,440**	752	**(823)**	(774)	**4,263**	1,526
Operating profit	**461,075**	991,788	**187,549**	402,563	**273,526**	589,225
Finance income	**9,380**	18,162	**5,775**	10,759	**3,605**	7,403
Finance costs	**–**	(458)	**–**	(394)	**–**	(64)
Finance income – net	**9,380**	17,704	**5,775**	10,365	**3,605**	7,339
Profit before income tax	**470,455**	1,009,492	**193,324**	412,928	**277,131**	596,564
Income tax expense	**(86,985)**	(170,681)	**(40,304)**	(73,166)	**(46,681)**	(97,515)
Profit for the year	**383,470**	838,811	**153,020**	339,762	**230,450**	499,049

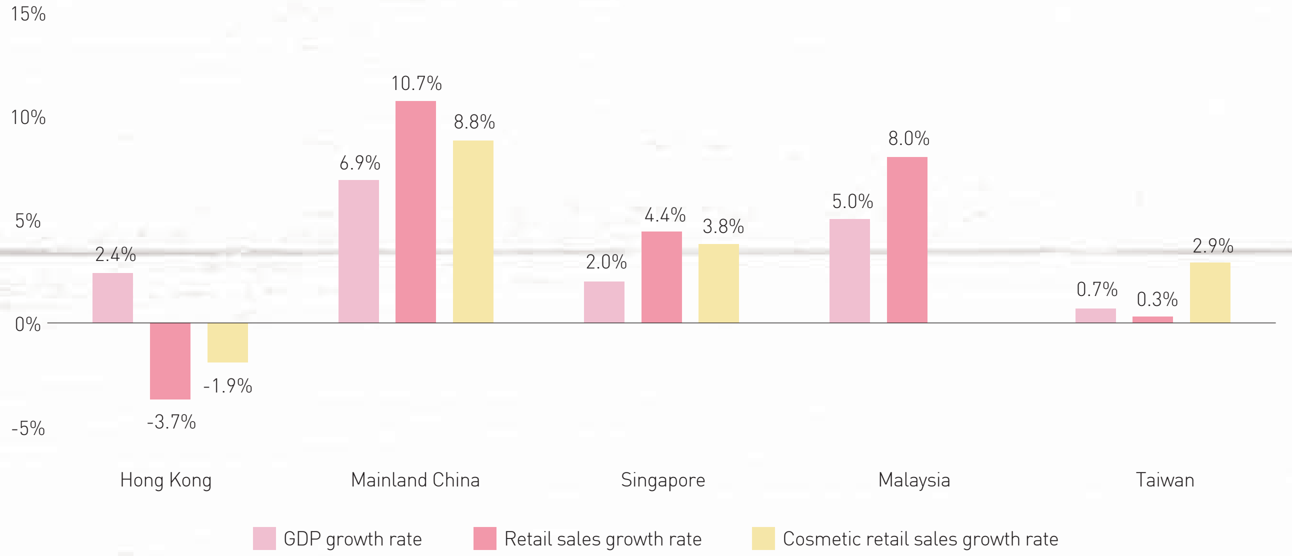
During the fiscal year, the Group's turnover decreased by 12.8% from HK$8,992.8 million in the previous year to HK$7,845.9 million. Retail sales in Hong Kong and Macau decreased by 14.2% year-on-year from HK$7,259.4 million to HK$6,231.6 million. The Group expanded its retail network from 287 to 291, a net increase of six stores for "Sasa" stores and a net decrease of two single-brand stores/counters.

The Group's profit for the year was HK$383.5 million, a decrease of 54.3% over the HK$838.8 million achieved in the last fiscal year. Basic earnings per share were 13.4 HK cents, as compared to 29.5 HK cents in the previous year. Final and special final dividends per share proposed are 14.5 HK cents (2015: 14.5 HK cents), making a total annual dividend of 23.5 HK cents per share (2015: 23.5 HK cents), payable in cash with a scrip dividend alternative.

The Company has been included in the Hang Seng High Dividend Yield Index since June 2015. The Company is a constituent member of the Hang Seng Composite MidCap and has been a constituent member of the Hang Seng Corporate Sustainability Benchmark Index for five consecutive years since 2011. The Company is also an eligible stock in Shanghai-Hong Kong Stock Connect.

Market Overview

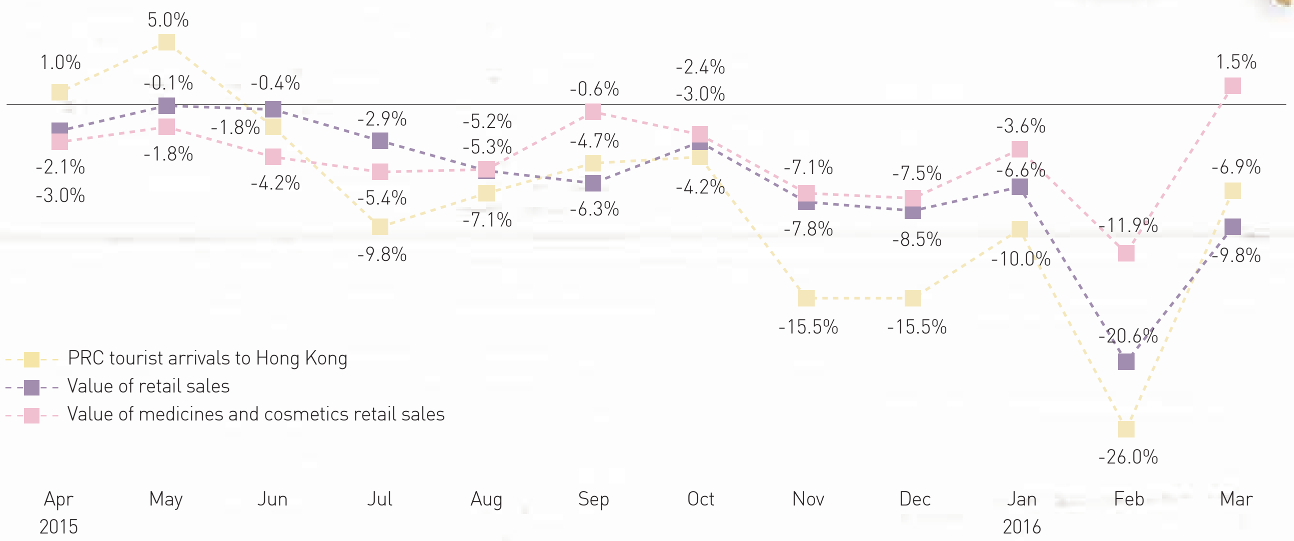
GDP/Retail Sales/Cosmetic Retail Sales Growth By Market, Year 2015



Notes:

1) There were no cosmetics retail sales statistics provided from Malaysia Government.
2) All of the above data were sourced from the corresponding governments' statistics bureaus.
3) There are some inconsistency in definition and survey methodology for cosmetics retail sales by different governments' statistics bureaus.

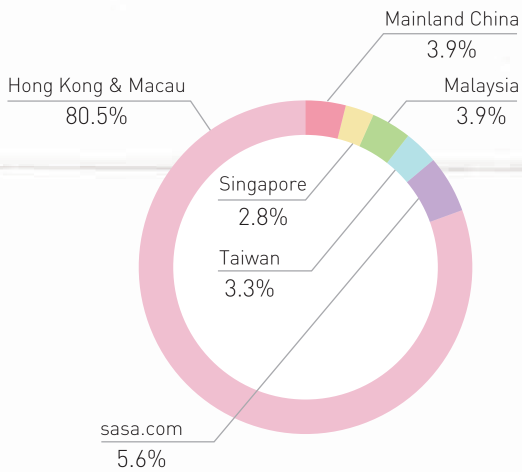
Retail Sales Performance in Hong Kong and PRC Tourist Arrivals in Hong Kong (Year-on-Year Change)



Source: Hong Kong Census and Statistics Department & Hong Kong Tourism Board

Retail and Wholesale Business

FY15/16 Turnover Mix By Market



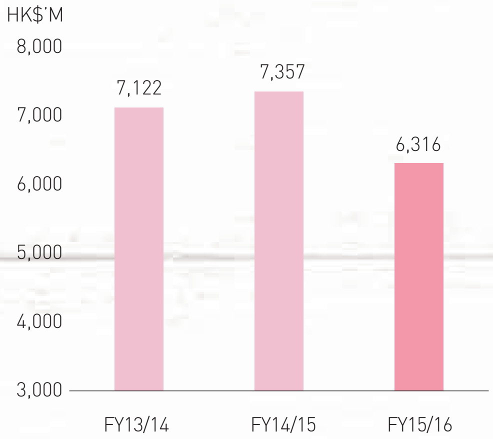
Store Network By Market

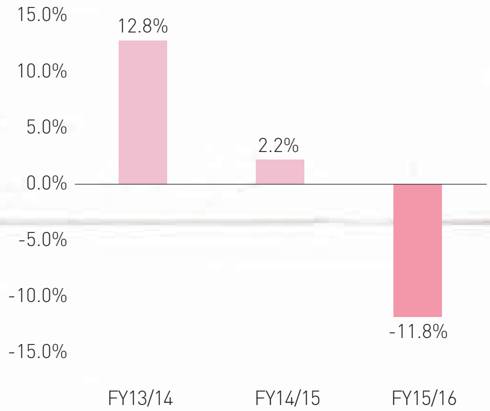
Multi-brand "Sasa" Stores	As of 31 Mar 2015	Opened	Closed	**As of 31 Mar 2016**
Hong Kong & Macau	107	12	8	**111***
Mainland China	62	10	15	**57**
Singapore	21	7	5	**23**
Malaysia	59	10	4	**65**
Taiwan	32	5	6	**31**
Total	281	44	38	**287**

Note:
As at 31 March 2016, there were two single-brand stores/counters in Hong Kong & Macau, and one each in Malaysia and Taiwan, totalling 291 retail outlets for the Group.

* including three Sasa Boutique stores

Hong Kong and Macau

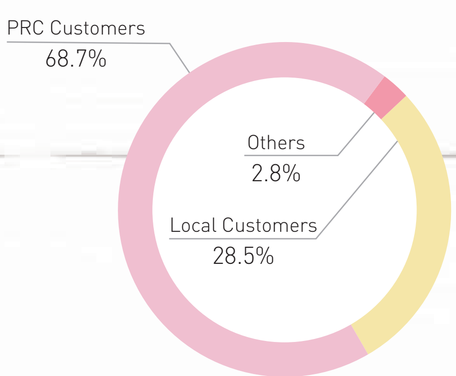


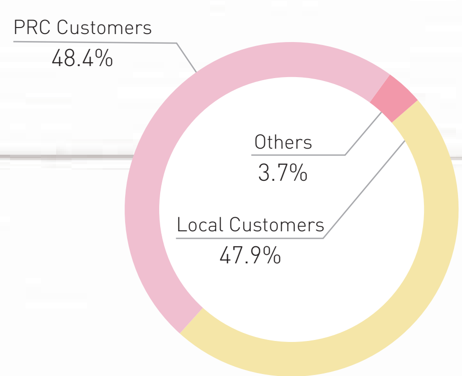


During the fiscal year, turnover in Hong Kong and Macau decreased by 14.2% year-on-year from HK$7,356.7 million to HK$6,315.6 million while same store sales fell 11.8%. The number of transactions dropped 4.4% while the total average sales value per ticket decreased by 10.2%.

To place these figures in context, the number of transactions of Mainland China tourists decreased by 7.1% while average sales value per ticket decreased by 11.2%. The number of transactions by local consumers decreased by 1.2% with an average spending decrease of 3.5%.

Customer Mix (For FY15/16 retail sales)

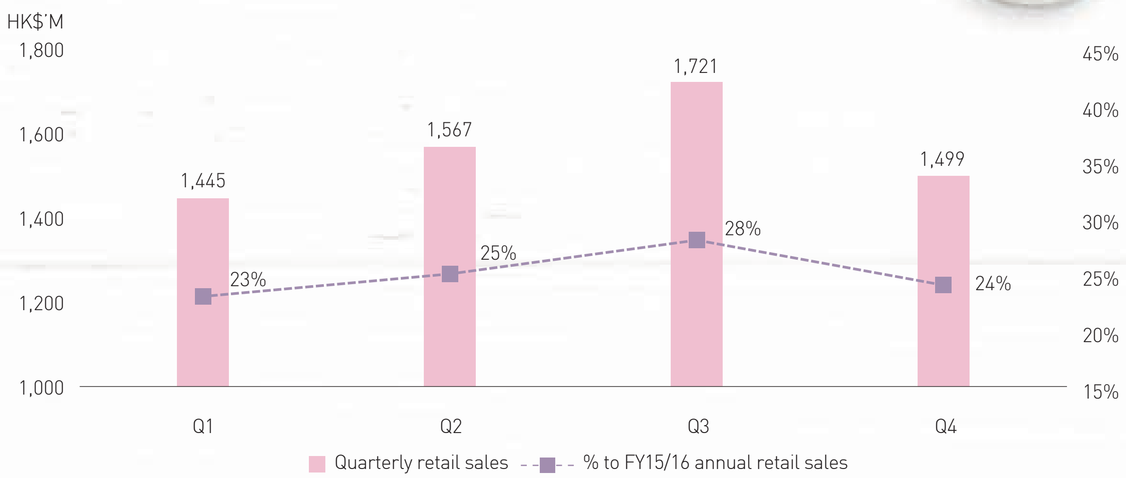




This performance was driven by a decrease in the total number of transactions with mainland tourists, which was in line with the overall deceleration of mainland tourist arrivals in Hong Kong by 8.6%. The weaker performance was exacerbated by the decrease in the average sales value per ticket of mainland tourists. As a result, the sales contributed by mainland tourists decreased from 71.5% last year to 68.7% this year.

Several factors have contributed to this decline in sales growth. The primary reason is the unabated decrease in mainland tourist arrivals to Hong Kong since March 2015.

FY15/16 Retail Sales by Quarter



Note: The above data excludes the impact of deferred income adjustment on customer loyalty programme

Meanwhile, the substantially strengthened tourist facilities and convenient travel policies offered by other countries have improved their attraction to mainland tourists. In addition, the strong Hong Kong dollar and depreciating Renminbi have contributed further to the slowdown in mainland visitors to Hong Kong while stimulating outbound travel by local consumers. The number of Hong Kong resident departures through the Hong Kong International Airport increased by 13.6% as compared to the previous fiscal year.

New restrictions placed on the frequency of visits by Shenzhen permanent residents, reducing from multiple-entry permits to one-visit-one-week permits upon renewal, have seriously impacted the flow of mainland tourist arrivals as the majority of mainland tourists are now day-trippers. As a result, the Mainland tourist sameday visitor arrivals in Hong Kong dropped 9.1% during the year. Meanwhile structural changes in the Mainland China tourist mix towards tourists arriving from lower-tier cities in Mainland China with less spending power has impacted the average ticket size.

This change in tourist flows and in their consumption patterns has been given further impetus by the rise of cross-border e-commerce, which has facilitated much faster market penetration of cheaper and fast-to-market Korean products with concepts that are well liked by Asians, and in particular by the Chinese consumers. Sa Sa has traditionally relied on high price products with long product life cycles that derive mainly from Europe and the US, but the market preference has changed very quickly towards lower price products. These products have very fast launches and a much shorter product life cycle because of the increased efficiency of digital media, allowing the general consumer mass to become aware of new products much quicker than before. This in turn means demand rises and falls much faster than previously, and that the peak in demand is also higher.

The Group's profitability in Hong Kong and Macau market was dragged due to margin pressures. Gross profit margin decreased from 44.8% last year to 42.6% this year. Net profit margin decreased to 7.4% from 11.9%. This performance was due to continuing promotions and discounting to support sales in a slower market as well as a lower house brand mix. In order to further strengthen the competitiveness of our product offerings, the Group adjusted our non-house brand mix in some popular product categories, for instance in Korean products, to make faster adaptation to changing consumer preferences for Korean and lower price products.

Rental costs continued to rise with rental reductions expected to be reflected in total rental costs only over an extended time span of several financial years. The frontline staff costs to sales increased as we strove to maintain our competitiveness in the salary system to retain staff in a slower market.

MANAGEMENT Discussion & Analysis

Mainland China

Overall turnover for our Mainland China operations decreased to HK$303.8 million during the year, a decrease of 9.6% in local currency terms while same store sales decreased 9.9% in local currency for the year. The loss for the year amounted to HK$39.6 million.

Boutique stores of a smaller size continued to contribute to overall profitability, but a change of management in our operations team led to a slight decrease in turnover. Weak operational and product management led to a decline in turnover, as well as an increase in the inventory provision.

The Group launched a new store format: the O2O stores in Shenzhen (Qianhai) and in Shanghai. This new store format serves to broaden our product selections through online offerings, while also increasing exposure for the sasa.com brand.

Singapore

During the fiscal year, turnover for the Singapore market was HK$222.5 million, a decrease of 2.0% in local currency terms, while same store sales dropped by 4.8% in local currency.

The challenge of filling vacancies for frontline staff, high staff turnover and Singapore's acute manpower constraints adversely affected our store productivity. The tourism industry as a whole was impacted by the strength of the Singapore dollar.

Malaysia

The Group's turnover in our Malaysia market was HK$307.4 million, an increase of 9.1% in local currency terms, while same store sales dropped 3.2% in local currency.

The fundamentals of our business in Malaysia are strong. We are the largest beauty specialty store in the country in terms of store numbers and network coverage. We have consistently outperformed the market and are profitable, even though our performance was briefly impacted by the introduction of the Goods and Services Tax (GST) at the beginning of the year. However, this impact began to even out in the second half of the year.

Taiwan

Turnover in the Group's Taiwan business during the year decreased to HK$254.6 million, representing a drop of 7.8% in local currency terms while same store sales fell by 10.1% in local currency.

The sales performance was impacted by changes in management, weak local consumer sentiment, and a drop in mainland tourist arrivals to the region.

E-commerce – sasa.com

Turnover for sasa.com amounted to HK$442.0 million, a rise of 6.2% over the previous fiscal year.

Sales to the Mainland China market continued to increase with 25.9% growth. However, this performance was partly offset by a decrease in sales to other overseas markets. The growth in the Mainland China market was largely due to overall market growth and strong demand for skincare products. A new Mainland China site and Mainland China mobile site were launched during the year, which enhanced the traffic and conversion rate. Also, our performance was strengthened by more focus on flash sales and their associated purchases. However, the limitation on the system's scalability and logistics functions, together with inadequate consumer awareness of sasa.com and our small customer base hindered faster growth.

Profitability was affected due to the resulting decrease in gross profit margin, as well as increased investment and advertising and promotion expenses, such as search engine display advertisements.

MANAGEMENT Discussion & Analysis

Brand Management

During the year, the Group's sales mix of own-label and exclusively distributed products, collectively referred to as House Brands, decreased from 43.3% to 41.0%.

Overall, our strategy aimed at expanding our choices to offer a wider range of parallel import products that are faster time to market, thereby strengthening our competitiveness in a slower market. Due to consumers' preference for low-or-mid price products and Korean products, our high-price house brand products that represent a large percentage of our house brand sales mix recorded a weak performance.

However, on the positive side, in response to the popularity of Korean products, we began to offer a broader range of Korean products, which saw sales of such products rising by 25.8% in Hong Kong and Macau. Leveraging on non-house brand Korean products' faster launches, sales of non-house brand Korean products outperformed sales of our house brand Korean products.

Outlook and Strategies

The Group expects the Hong Kong retail market will continue to face a number of challenges. The strength of the Hong Kong dollar has seen a marked increase in outbound travel by local people and a marked decrease in Mainland China inbound tourism. This trend is likely to continue in the coming year. Local consumption sentiment is expected to remain weak due to a slowdown in the Hong Kong economy, poor stock market performance and a declining property market. At the same time, the Mainland economy will remain weak and face a slowdown in consumption and hence lower average ticket sales per transaction. The one-visit-one-week permits on Shenzhen residents for travel to Hong Kong will continue to have an impact on tourist arrivals, particularly day-trippers, and may lead to fewer transactions.

Overall, consumer preferences are trending more towards lifestyle products and enhancement with budgets increasingly allocated to interesting experiences rather than to shopping. A change in demographics will continue to impact spending, with consumers focusing on low-or-mid price new concept products with short product life cycles. We expect cross-border e-commerce and new product trends will also complicate the retail picture, while competition and deleveraging will put pressure on profitability. The political situation in Hong Kong as well as anti-mainland tourist sentiment will add further uncertainty. As a result, our FY16/17 quarter-to-date (i.e. period up to 19 June 2016) retail sales and same store sales in Hong Kong and Macau declined by 5.1% (FY15/16 1st Quarter: -8.8%) and 4.6% (FY15/16 1st Quarter: -6.8%) year-on-year respectively.

In response to these concerted challenges, the Group has improved the management of our stores in the markets beyond Hong Kong to improve our competitiveness and profitability. For example, we have expanded our Malaysian store network, and integrated our Singapore management with the Malaysia team. We have also begun to operate an O2O business model to enhance the shopping experience and to tap the potential of cross-border e-commerce opportunities.

In Hong Kong itself, we have improved the cost effectiveness of our stores by repositioning and rationalising our store portfolio, optimising store sizes, and centralising operations. We have leveraged the customer base of our physical stores and of our strong product offerings while tapping the potential of our increasingly important online marketing operations. The O2O initiative will significantly broaden our product offerings in our physical stores through online sales and cross-border fulfilment. New store concepts will also attract new customer segmentations.

MANAGEMENT Discussion & Analysis

Hong Kong and Macau

In addition to the challenges mentioned above, the Group faces intensifying competition within the cosmetics industry in Hong Kong due to the increasing number of players and ongoing discount and promotional offers, all of which have impacted our profitability. In response, we propose to take the following measures:

In order to implement effective cost controls, we will continue our policy of store consolidation with aggressive rental cuts targeted at tourist stores or through complete closures. We will reposition our stores more in residential areas with better growth prospects and returns, as well as locating them in the New Territories districts near the Mainland border. We will optimise our store network to maximise store profitability, and we will simplify and centralise workflows at store level to increase productivity and reduce costs. In terms of stock management, we will reduce SKUs more aggressively and clear slow moving stocks to better display new and productive SKUs.

In Macau, we are optimistic about retail sector growth, since the Central Government has listed Macau tourism as a key sector for economic stimulus. At the same time, tourist attractions in Macau are growing rapidly to attract and accommodate tourists.

In order to drive sales and capture new customer segments, we will introduce fresh store formats, enhance productivity with optimised product offerings and displays, develop more lifestyle and trendy offerings to capture young and male customers, and accelerate new product launches.

In order to improve the overall shopping experience, we will emphasise innovative products and product displays to cater to new demand trends, provide a more comfortable shopping environment, facilitate more browsing, and attract impulse purchasers.

Mainland China

The dynamics of the cosmetics market in Mainland China continue to change, with Internet retailing growing at a rapid pace. The Group recognises the need to improve our management resources in the Mainland market. We have appointed a new management team and recruited new staff to serve a revitalised structure while also seconding experienced staff from Hong Kong to improve the attractiveness of our product offerings and our inventory management. We will continue to build the management structure, improve matrix reporting, upgrade the control process and compliance levels, raise the standard of reports, and improve training.

Going forward, we will roll out a trendy and innovative as well as lower cost and more effective boutique store format, which is already being welcomed by customers and landlords. The new format strives to enhance profitability and accelerate O2O business development to match government guidelines.

In terms of new product strategy for the Mainland market, we will introduce fast-moving and trendy items, especially those of Korean origin, as traffic builders to generate sales by increasing the number of transactions. As the dynamics of the market rapidly change towards Internet retailing, with cheaper products attracting increased attention online, more expensive products have to work harder to compete. We will launch well-known and good quality brands through store activities and incentives. We will work with key suppliers to understand their new product launch plans to ensure that new items are in stores at the same time as other retailers launch them and with sufficient stock support from suppliers. We will also leverage our Hong Kong resources to introduce brands that offer a wider and more differentiated range.

Singapore

The Group has restructured our management team for this market, merging the team with the Malaysia team for cost control purposes. Results are already being seen in new synergies and marked improvements in store management.

Malaysia

The Group will continue to focus on team building and succession planning in this market, building out our store network and product portfolio, and broadening our customer base to target the wider Malaysian population.

Taiwan

The business environment remains unfavourable in Taiwan. The Group recognises there are internal weaknesses that need to be addressed. The Group will proactively adjust our management structure and implement new policies to update our operations.

E-commerce – sasa.com

Up to the present moment, sasa.com operated its warehouse and logistic functions based in Hong Kong. The resulting high delivery costs and long fulfilment lead times meant that we had to focus on large basket size orders from customers with higher spending power. Our business was essentially focused on a narrow customer segmentation with low marketing returns and growth. In particular, sasa.com missed out on the high growth segment of customers with lower but rising spending power.

We believe that a new Free Trade Zone warehouse in China will help us overcome these challenges. The shortened fulfilment time of this warehouse will be in line with that of the market. The resulting lowered fulfilment costs will also allow us to serve customers with a small basket size while our marketing returns will increase due to a broader target audience.

Going forward, we will place more emphasis on e-commerce and also begin to gradually integrate our online and offline operations to increase competitiveness. We will offer an improved O2O shopping experience to customers and we will be able to better serve Mainland tourists who visited our stores in Hong Kong after they have returned home.

Ongoing Initiatives

Our immediate priority priorities are to link our online and offline CRM systems and to launch a new mobile app to enable our effective O2O development and help us drive the growth of our business. We will also develop and improve our backend systems to build scalability and improve agility, such as our order management system, to allow for an easy interface with different external platforms in order to support operational effectiveness.

Brand Management

In order to enhance our brand management, we will establish a new dedicated team to source innovative and trendy products. We will establish new functions in our sourcing department and marketing department with fresh structures and new teams, as well as strengthen our overseas sourcing resources.

Overall, we will target new consumer trends and gaps in our product offerings. We will also restructure our house brands to satisfy the market preference for Asian products, focus more immediately on Agent Products, and develop own label products with a certain time lag.

Human Resources

As at 31 March 2016, the Group had close to 5,000 employees. The Group's staff costs for the year under review were HK$1,077.0 million. Details on our human resources programmes, training and development are set out in the "Environment, Social and Governance Report" and the "Enterprise Risk Management Report" sections of this Annual Report.

Conclusion

For many years, Sa Sa has continued to strengthen performance and profits despite many difficult economic environments and cross-currents. We believe we can continue to sharpen our competitiveness in the future and convert challenges into opportunities, such as those offered by O2O, by adapting to new consumer patterns and by leveraging on our proximity to southern China. We remain committed to a vision that builds on the flexibility and scalability of our business model, with its ability to rapidly respond to new markets, situations and trends – a vision that will continue to support our position as a leading provider of beauty products in the Asia-Pacific region. We believe that the flexibility and resourcefulness of our loyal staff and the long-term vision of our dedicated management team will ensure that we continue to deliver sustained, world-class growth for many years to come.