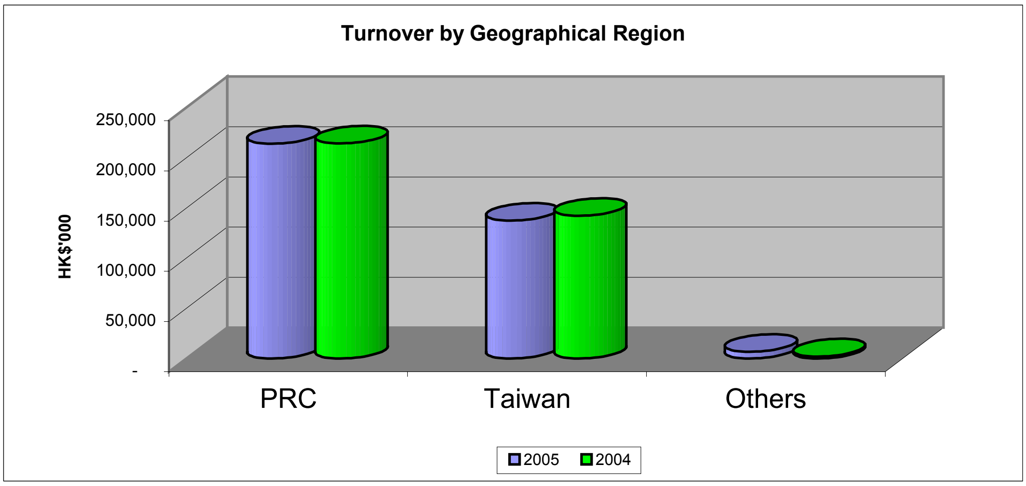
MANAGEMENT DISCUSSION AND ANALYSIS

FINANCIAL REVIEW

Turnover by geographical region	2005 HK$'000	%	2004 HK$'000	%	Changes HK$'000	%
PRC	213,915	59.8%	214,061	59.8%	(146)	-0.1%
Taiwan	137,358	38.4%	142,150	39.7%	(4,792)	-3.4%
Others	6,643	1.8%	1,931	0.5%	4,712	244.0%
Total	**357,916**	**100.0%**	**358,142**	**100.0%**	**(226)**	**-0.1%**



Average sales per store	2005 Average store *	2004 Average store *	2005 Average sales per store HK$	2004 Average sales per store HK$	Changes HK$	Changes %
PRC	1,533.5	1,607.5	139,000	133,000	6,000	4.5%
Taiwan ^	530.0	600.0	259,000	237,000	22,000	9.3%
Group total **	**2,083.5**	**2,209.0**	**169,000**	**161,000**	**8,000**	5.0%

* Average store number is calculated by (opening period total + closing period total) / 2
** Group total does not include Hong Kong and Malaysia turnover and store count.
^ 2004: Hong Kong was under entrustment, average store number in Taiwan adjusted to include Hong Kong Market.

Turnover has slightly decreased by 0.1% to HK$357.9 million in 2005 compared to HK$358.1 million in 2004. The decrease in turnover is attributable to the recession of Taiwan economy and the structural changes of product vs. service income in PRC. The Group average sales per store increased by 5.8% from HK$161,000 in 2004 to HK$169,000 in 2005.

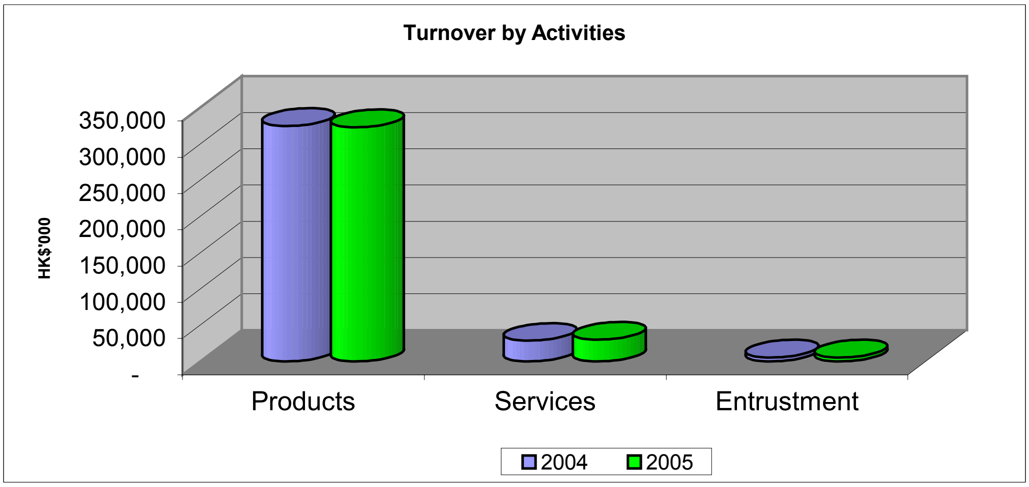
In the PRC, the turnover decreased by 0.1% or HK$0.1 million to HK$213.9 million. The relatively small decrease in PRC turnover is the net effect of increased product sales of HK$10.1 million, increase in entrustment income of HK$0.2 million and the reduction of service revenue of HK$10.4 million. We continued to entrust our self-owned spas in established areas to reputable operators to mitigate our losses, thus resulting in the reduction of our service revenue contributed. However, PRC has recorded a growth in products sales of 5.3% for year 2005 due to the entrustment strategy. We have gross losses on service income as our spas are used as model spas for potential franchisees and are not sales oriented.The products sales, as a result of our brand revamp and store image revamp program started in April 2005, has boosted the average store sales by 4.5% from HK$133,000 in 2004 to HK$139,000 in 2005.

In Taiwan, turnover for the year decreased by HK$4.8 million, or 3.4% to HK$137.3 million in 2005 compared to HK$142.1 million in 2004. The decrease in Taiwan market is mainly attributable to recession of Taiwan economy, and our store revamp program in Taiwan was scheduled to launch in the first quarter of 2006.

Other markets includes Hong Kong and Malaysia, there are 2 stores in Hong Kong and 38 stores in Malaysia as at 31 December 2005. The operations of these regions remain immaterial and account for less than 2% of total turnover to the Group.

BY ACTIVITIES	2005 HK$'000	2004 HK$'000	Variance HK$'000	Variance %
Products				
PRC	200,979	190,880	10,099	5.3%
Taiwan	117,375	131,919	(14,544)	-11.0%
Others	4,493	1,931	2,562	132.7%
Total	322,847	324,730	(1,883)	-0.6%
Services				
PRC	7,681	18,107	(10,426)	-57.6%
Taiwan	19,983	10,231	9,752	95.3%
Others	2,150	-	2,150	n/a
Total	29,814	28,338	1,476	5.2%
Entrustment				
PRC	5,255	5,074	181	3.6%
Taiwan	-	-	-	n/a
Others	-	-	-	n/a
Total	5,255	5,074	181	3.6%

Turnover by activities	2005 HK$'000	%	2004 HK$'000	%	Changes HK$'000	%
Products	322,847	90.2%	324,730	90.7%	(1,883)	-0.6%
Services	29,814	8.3%	28,338	7.9%	1,476	5.2%
Entrustment	5,255	1.5%	5,074	1.4%	181	3.6%
Total	**357,916**	**100.0%**	**358,142**	**100.0%**	**(226)**	**-0.1%**



Products
The Group manufactures and sells three main types of products, namely skin care products, beauty products and aromatherapeutic products under the NB and Bio-up brand names. Sales of products are primarily made through spas and dedicated counters and are the Group's key revenue contributor, accounting for HK$322.8 million, or 90.2% in 2005, compared to HK$324.7 million, or 90.7% in 2004. Gross margin of products remain stable at 85.3%.

The drop in products sales is the net effect of increase in PRC products sales of HK$10.1 million, reduction in Taiwan of HK$14.5 million and improvement in other regions of HK$2.5 million. The increase in PRC product is attributable to the brand revamp program, which including the overall brand image, franchise store image and new product packaging. The reduction in Taiwan market is mainly attributable to the recession of Taiwan economy, and our store revamp program in Taiwan was only scheduled to launch in the first quarter of 2006.

Other markets include Hong Kong and Malaysia and only accounted for 1.4% of total product sales for the year.

Services
Service income including income from self-owned spa with services provided, training income and management fee received from frachisees, and other service related income.

The Group provides skin treatments, beauty and spa services through its self-owned spas. Service income are generated from our self-owned spas as the Group does not share any service income generated in the franchised spas with franchisees under the current franchise programme. Income from these services increased by 5.2% to HK$29.8 million. There was a decrease of service revenue in PRC of HK$10.4 million as we continue to entrust self-owned spas to reputable operators. On the other hand, Taiwan reported an increase in service revenue of HK$9.8 million, arising from the management and training fee received from 201 franchisees amounted to HK$8.0 million. The spas in Hong Kong previously entrusted were operated by the group since 1 January 2005.

While there are needs to establish self-owned stores in new markets as model spas, the Group considers it would be more profitable as a whole to allocate resources to stimulate product sales instead of operating our own spas, due to higher overhead costs compared to franchisees. The Group continues to entrust certain of our spas in explored markets to reputable operators.

Entrustment
In order to allocate our financial and human resources more efficiently, the Group has entrustment arrangements in PRC ranging from one to five years, where our self-owned spas were entrusted to reputable operators in the local areas. The operators will be responsible for all the profits and losses of the operations and the Group receives a fixed annual entrustment income. The Group sells products to the operators as one of our franchises.

The Group believes the entrustment arrangement will be a win-win situation for both the operators and the Group. Local operators can better serve the specific needs of the local customers, and hence generate more product and service revenue. The Group, on the other hand, can secure a steady annual entrustment income while maintaining the distribution location, and to re-allocate our executives to explore new markets.

The entrustment income increased 3.6% to HK$5.3 million in 2005 compared to HK$5.1 million in 2004.

Other operating income
Other operating income mainly represented by rental income of HK$5.8 million, interest income of HK$3.3 million, financial refunds of HK$19.6 million and increase in fair value of investment properties of HK$4.5 million and others for the remaining balance. The other operating income increased by 86.8%, or HK$20.0 million from HK$23.1 million in 2004 to HK$43.1 million in 2005. The increase is mainly attributable to the increase in financial refund

in PRC of HK$9.6 million due to higher operating profits of PRC subsidiaries; HK$4.5 million increase in fair value of investment properties in accordance with the Hong Kong Accounting Standard No. 40, which requires gains or losses arising from the changes in the fair value of investment properties to be recognized directly in the profit and loss for the year in which they arise (previously the changes in the fair value was recognized in the statement of equity); a gain on acquisition of additional interest in a subsidiary of HK$2.7 million and increase in interest income of HK$1.3 million due to increase in interest rate and average bank balances.

Distribution and administrative cost
The Group's distribution costs as a percentage of turnover remained stable at 35.7% compared to 35.4% in 2004. The administration expense reduced HK$1.9 million to HK$62.0 million in 2005 compared to HK$63.9 million in 2004.

Despite of our increased advertising exposure in various media, our group advertising costs has reduced by 4.5% to HK$77.1 million, as we continue to allocate our advertising budget to 4A advertising agencies which have stronger media-buying power, to achieve the operating efficiency. The savings was compensated by the increase in the travel and transportation expenses. The increase in travel expenses of HK$1.9 million was due to our fortifying of our franchisee dual track management system, where our expert teams travel to each city in PRC to provide assistance, to monitor and to ensure the local franchisees achieve the required competence and consistency of service quality, in addition to the local support to franchisees from our subsidiaries. The increase in transportation expense of HK$1.9 million was mainly due to the collaboration of China Post for the warehouse and inventory management, as well as logistics of deliveries in PRC. Capitalized on our experience in collaboration with China Post, we believe it would be more cost effective in enhancing the internal supply chain management and building our own distribution systems. We are currently managing the three warehouses in Shanghai, Beijing and Guangzhou to cover the whole PRC. The delivery of products, is currently out-sourced to other logistics companies in China.

Other operating expenses
Other operating expenses for the year of HK$18.2 million mainly represents provision of obsolete inventory of HK$8.4 million, loss on disposal of fixed assets of HK$3.8 million, donation of HK$1.2 million, bank charges of HK$1.3 million and loss on closure of branches and subsidiaries of HK$2.2 million. The main reason for the fluctuation as compared to last year was due to higher inventory provision was charged in current years, partly due to the product repackaging initiative.

Profit before taxation
The increase in gross profit, other operating income, in couple with the savings in administrative expense, net of the increase in other operating expenses, the profit before tax surged by 21.0%, from HK$99.1 million in 2004 to HK$119.8 million in 2005.

Taxation
Taxation expenses increased 6.9% from HK$36.3 million in 2004 to HK$38.8 million in 2005. The effective tax rate of the Group for financial year ended 31 December 2004 and 2005 were 36.7% and 32.4% respectively. The drop in effective tax rate is benefited from our Taiwan operation, where the Taiwanese Government offered tax reduction for Taiwan manufacturers who re-invest in Taiwan. The relatively high effective tax rate is attributable to the fact that there are withholding taxes on dividends paid by our Taiwan subsidiaries when the dividends were paid outside Taiwan. The total withholding tax expense charged by Taiwan tax authority amounted to HK$2.1 million in 2005 (2004: HK$2.1 million).

Net profit for the year
As a result, the net income for the year increased by 29.2% from HK$62.7 million in 2004 to HK$81.1 million in current year.

Liquidity and financial resources

Cash generated from operations for 2005 was approximately HK$150.9 million (2004: HK$161.8 million). The decrease was primarily due to increase of trade and other receivables balance. As at 31 December 2005, the Group had bank balances and cash of approximately HK$338.7 million (2004: HK$235.9 million) and trading securities (which are mainly capital guaranteed bond funds) of approximately HK$26.5 million (2004: HK$94.4 million) with no external bank borrowing.

In terms of gearing, as at 31 December 2004 and 2005, the Group's gearing ratio was zero (defined as net debt divided by shareholders' equity) as the Group has a net cash balance as at both year end dates. Current ratio of the Group (defined as current assets divided by current liabilities) as at 31 December 2004 and 2005 were 5.3 times and 6.0 times respectively. As at 31 December 2005, the Group had no material contingent liabilities, other than those disclosed in its financial statements and notes thereto. With the cash and short term securities in hand, the Group's liquidity position remains strong and the Group has sufficient financial resources to finance its commitments and working capital requirements.

Charges on assets

Certain freehold investment properties of the Group with a carrying amount of HK$155.3 million (2004: HK$156.1 million) are pledged to a bank. The banking facilities granted by the bank were terminated in 2002 but the charge has not been released to facilitate application of banking facilities in the future.

Treasury policies and exposure to fluctuations in exchange rates

The Group derives most of its revenue denominated in Renminbi and New Taiwan Dollar from the PRC and Taiwan as its operations are mainly concentrated in these two geographical areas. As at 31 December 2005, approximately 68.1% (2004: 85.6%) of the Group's bank balances and cash was denominated in Renminbi, while approximately 21.4% (2004: 4.3%) was denominated in New Taiwan Dollar and the remaining 10.5% (2004: 10.1%) was denominated in United States Dollars, Hong Kong Dollars and Malaysia Ringgits. The Group continued to adopt a conservative approach in respect of foreign exchange exposure management. Review of the Group's exposure to foreign exchange risk will be conducted periodically and derivative financial instruments may be used to hedge against such risks when necessary.

BUSINESS REVIEW

PRC Market

Our brand revamp exercise had been implemented for one year and the benefits started to reflect on the growth of product sales. Our product sales in PRC has increased by 5.3% to HK$201.0 million. We have also started the product repackage process in late 2005. The gross margin of product sales also recorded an improvement from 83.6% in 2004 to 85.1% in current year.

Our entrustment strategy continued to pay off. We entrusted our spas to reputable operators in established areas to mitigate our losses, as our spas are mainly used as model spas for potential franchisees, and are not sales oriented. Despite the service turnover has reduced by HK$10.4 million, our overall gross profit in PRC has increased by HK$13.6 million and the overall gross margin significantly improved from 73.7% in 2004 to 80.1% in 2005.

With the increase in other operating income, mainly the tax refund, the operating profit and net profit, both have surged by 23.6% in current year, to HK$88.2 million and HK$57.2 million respectively.

Taiwan Market

Taiwan has been in recession and our brand revamp exercise for Taiwan market was only scheduled to start in the first quarter of 2006. As a result, the product sales in Taiwan has dropped 11.0% to HK$117.4 million in 2005. The product sales gross margin, has dropped slightly from 88.7% in 2004 to 88.0% in 2005.

Due to the management and training fee received from 201 franchisees of approximately HK$8.0 million, which was introduced in 2005, the service revenue has surged by HK$9.8 million to HK$20.0 million in 2005. The overall gross margin, also recorded a slight improvement from 82.9% in 2004 to 83.1% in current year. The overall gross profit contribution reduced by HK$3.7 million in 2005 as compared to that of 2004.

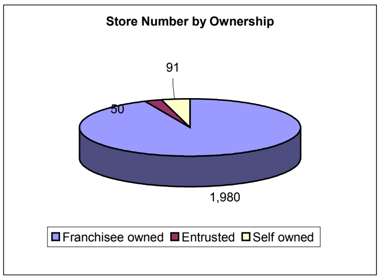
Despite the drop in the gross profit contribution, the centralized advertising initiative has saved advertising cost of HK$14.4 million in Taiwan, and has resulted in the growth of operating profit by 29.4%, or HK$11.9 million in 2005.

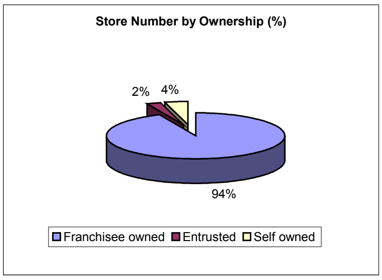
In order to stimulate the Taiwan economy, the Taiwanese government had offered taxation reduction for companies re-investing in Taiwan. The application of such tax benefits by our subsidiaries in Taiwan had been approved and the full benefits started to reflect in current year. The effective tax rate in Taiwan, has been dropped from 22.2% in 2004 to 10.0% in 2005. As a result, the net profit surged by 49.7%, or HK$15.7 million, to HK$47.2 million in current year.

Distribution channels

Store Number by Ownership As at 31 December 2005	Franchisee owned Spa	Entrusted Spa	Self owned Spa	**Total Spa**	Entrusted Counter	Self owned Counter	**Total Counter**	**Grand Total**
Taiwan	527	-	9	**536**	-	-	**-**	**536**
PRC	1,415	28	3	**1,446**	22	77	**99**	**1,545**
Others	38	-	2	**40**	-	-	**-**	**40**
Total	**1,980**	**28**	**14**	**2,022**	**22**	**77**	**99**	**2,121**

Store Number by Ownership As at 31 December 2005	Franchisee owned	Entrusted	Self owned	Total
Taiwan	527	-	9	536
PRC	1,415	50	80	1,545
Others	38	-	2	40
Total	**1,980**	**50**	**91**	**2,121**





The Group principally derives income through our unique distribution channels, namely spas and counters in department stores. There are total 2,121 store outlets as at 31 December 2005, of which 2,022 are spas and 99 are counters. All spas can provide hydrotherapy, facial, body care and skin care analysis to our customers and counters in department stores usually provide skin care analysis.

There are total 1,980 franchisee spas as of 31 December 2005, and 14 spas and 77 counters are directly operated by the Group. There are also 28 spas and 22 counters being entrusted to reputable operators.

Franchise spas are owned by franchisees and they are responsible for the capital investment of their spas, and they are obliged to use “Natural Beauty” or “NB” brand of products in their spas.

Self-owned spas are primarily set up to act as a model spa for potential franchisees. While there are needs to establish self-owned spas in new markets as model spas, the Group considers it would be more profitable as a whole to allocate resources to stimulate product sales instead of operating our own spas, due to higher overhead costs compared to franchisees. The Group therefore has entrusted and will continue to entrust certain of our spas in explored markets to reputable operators.

Entrusted spas are owned by the Group and operated by reputable operators. The spas were previously operated by the Group. In order to allocate financial and human resources more efficiently, the Group has entrustment arrangements in PRC ranging from one to five years, where our self-owned spas were entrusted to reputable operators in the local areas. The operators will be responsible for all the profits and losses of the operations and the Group receives a fixed annual entrustment income from the operators. The Group also sells products to the operators as one of the franchises.

The Group believes the entrustment arrangement will be a win-win situation for both the operators and the Group. Local operators can better serve the specific needs of the local customers, and hence generate more product and service revenues. The Group, on the other hand, can secure a steady annual entrustment income while maintaining the distribution location, and to re-allocate our resources to explore new markets. This entrustment strategy in PRC is proved successful as the overall gross margin has improved from 73.7% in 2004 to 80.1% in 2005, with an additional contribution of HK$13.6 million for current year.

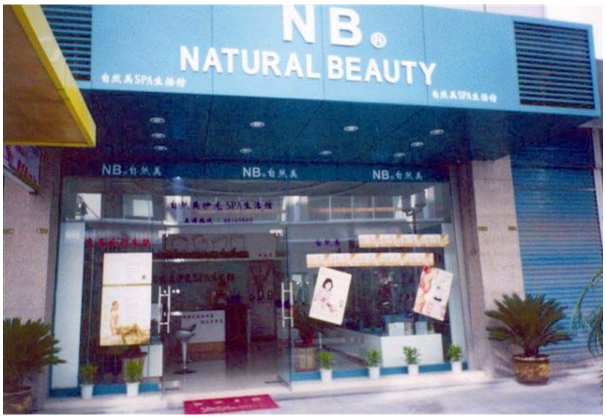
Revamp Brand Image

We recognized the needs to transform our brand image through a more active strategy, to stay competitive. The brand revamp can be summarized in five main areas:

- New Logo
- New Franchise Store Image
- Existing Franchise Spa Store-Front Revamp
- Product Repackaging
- Website Relaunch

New Logo
We are pleased to receive countless applauses on our new logo design, and the new logo have been incorporated in all range of products, ranging from name card, stationery to carrying bags.


New Franchise Store Image
Similar to our logo, all new franchise spas need to have a refreshing and eye-catching image to attract and retain customers. We have set up model spas / image shop for potential franchisees. We will continue to promote and encourage existing franchisees to upgrade to the new franchise store image upon their renewal or renovation of their spas.



Existing Franchise Spa Store-Front Revamp
Since we have a vast network of franchise spa and it is impractical to request all the franchisees to renovate their spas according to our new franchise store image, we have an interim arrangement, for the existing franchise to revamp their spa, with minimum efforts and financial resources. As of 31 December 2005, there were 611 franchise spas have completed their store revamp.

Product Repackaging
Our brand revamp is also extended to product package. We have re-designed all our product packages. In order to offer a consistent image, we have simplified our package type of over 700 products in more than 200 various forms, and turned into 24 standard forms only. As at 31 December 2005, there were 60 products have their product packages changed. We expect to complete the product repackage exercise by end of 2006.

All our new packages are costing less than the original packages, with cost saving ranging from RMB0.06 to RMB12.14. We believe our repackaged products not only would improve the profit margin, the appealing look would also drive the sales of home-use products in the spas, one of our initiatives to further boost the store sales of each franchisee.

Website Relaunch
To facilities the end customers and franchisees, we have re-launched our websites in PRC in 2005 to realign the revamped image and to enrich the contents. The website provides all sorts of beauty tips, company activities, product information and online shopping to the end customers. There is also a section dedicated to potential franchisees. As at 31 December 2005, there were 1,136 visitors have provided personal details and interested in becoming one of our franchisees. The website, also has a Business-to-Business ("B2B") portal for franchisees to order their goods online.

Logistics

We had collaborated with China Post in 2005 to centralize our warehouses in more than 10 locations in China. We had set up three logistics centres with China Post. China Post was responsible for the warehouse management, inventory management and logistics of the delivery of products. Capitalized on our experience in collaboration with China Post, we believe it would be more cost effective in enhancing the internal supply chain management and building our own distribution systems. We are currently managing the three warehouses in Shanghai, Beijing and Guangzhou to cover the whole PRC. The delivery of products, is currently out-sourced to other logistics companies in China.

Research & Development

In order to maintain its competitive edge, the Group takes research and development seriously with a view to improve the quality of its existing products and develop new products. The Group has been collaborating with overseas cosmetic companies on technological development and imported European, American, Japanese and Australian biotechnology materials and applied them in over 700 NB's products. The Group's research and development team comprises 13 members and a number of overseas consultants with experience and expertise in cosmetics, medical, pharmacy and bio-chemistry. NB's products are constantly enhanced and modified with new ingredients developed by its research and development team. The Group believes that the collaboration of different expertise and experience within the team together with Dr. Tsai's over 30 years of industry experience and knowledge can help developing high quality beauty and skin care products. NB principally uses natural ingredients in producing its products and have special formulation to especially suit the needs of the delicate skin of oriental women. NB's products are attentive to the skin's natural metabolism and its benefits are long-lasting.

In developing new products, the research and development team will take into account the feedback and advice from senior management of the Group. Prototype of new products will be distributed to over 1,000 of selected senior beauty professionals. In accordance with the outcome of the tests, refinements or modifications to the products may be made, prior to its full commercial launch thus ensuring the quality, effectiveness and safety standard of NB's products. Where a product requires registration with relevant authorities, it will be done prior to the launch in the market. All NB products are assured to meet all relevant regulations.

In addition to NB's dedicated research and development team, NB has collaborated with a leading researcher, Dr. Chen Ji Dai, in the field of human genome and stem cell technology, in the development of anti-aging NB-1 product family and other products for spot removing, whitening, anti-allergy and slimming. Combining Dr. Tsai's over 30 years of experience in the beauty and skin care industry and together with the strong background of its research and development staff, NB has the competitive advantages in the research and development of beauty and skin care products.

The total research & development cost for the year ended 31 December 2005 amounted to HK$1.3 million (2004: HK$2.0 million).

Products

After the successful launch of our flagship product, anti-aging NB-1 series in late 2003 and NB-1 Whitening series in 2004, this year the Group also launched NB-1 anti-allergy, pore refining series and six kinds of health supplement to our product line. In 2005, there were over 45,000 sets / bottles were sold with a turnover of HK$45.8 million.

We continue to enrich our product range in 2005, apart from the NB-1 whitening series, there were also health supplement and body sculpturing lingerie added. Total sales for the health supplement and body sculpturing lingerie for the year ended 31 December 2005 were HK$7.8 million and HK$5.8 million respectively.

Information Technology

The Group starts to implement ERP system by Oracle to link up the key decision making process throughout the Group's value chain. The ERP system is expected to enhance the Group's information flow, and to enable the generation of more accurate and timely production planning and sales forecast.

The implementation of the ERP in Taiwan was completed and the implementation in PRC is expected to be completed in 2006.

Human Resources

As at 31 December 2005, the Group had a total of 878 employees, of which 682 were based in PRC, 177 in Taiwan and 19 in other areas. Total remuneration (excluding directors' emoluments) for the year ended 31 December 2005 was appropriately HK$62.7 million (2004: HK$52.7 million), including retirement benefits cost of HK$6.0 million (2004: HK$5.9 million). Competitive remuneration packages are maintained to attract, retain and motivate capable staff and are reviewed on a periodical basis.

The Group maintains good employee relations and is committed to employee training and development. Professional training courses are offered to beauticians employed by the Group and its franchisees on a regular basis to promote and maintain the quality and consistency of the services provided.

In addition, the Group adopted a share option scheme on 11 March 2002, for the purpose of providing incentives and rewards to eligible participants who contributed to the success of the Group's operations. The Directors may, at their discretion, invite any employee or director of the Group and any qualified person as set out in the scheme, to subscribe for shares. Up to the date of this document, no share option had been granted under the share option scheme.

Capital Expenditures

The Group's major capital expenditures were related to self-owned spas and machinery in our factories. There were HK$24.9 million additions to fixed assets in 2005 (2004: HK$14.2 million), of which included a property purchased in Guangzhou for HK$12.9 to expand the regional Training Centre for the southern China region.

Franchisees are responsible for the capital expenditures of their spas.

Since our factories in PRC and Taiwan still have spare capacities, current utilization rate estimated at around 70%. The management does not anticipate the need for any new factory in the near future.

OUTLOOK

Natural Beauty's has been the leading professional beauty products & spa services provider in Greater China.

Looking ahead, we will continue to maintain our leading position in Taiwan spa market and we will continue to focus in the PRC, to capture this fast expanding market. We have defined plans for expansion and also plans to maximize our revenues and profitability.

Measures to improve same store sales:
- Revamp corporate and store image to attract new customers
- New package design to stimulate home-use products sales
- Introduction of various skin-care products and health supplements to enrich the product line.

Plan for expansion of franchise network:
- To increase 200 quality stores in 2006

New revenue sources:
- Training fee from courses provided to other interested parties including:
    a) Training for Corporations like Sephora;
    b) Training for individuals including 10 different licensed courses; and
    c) CCTV-MTV summer training camp to target university & college students
- Management fee to be collected from new franchisees.

With the relentless pursuit of excellence, we are confident that we will continue to realize our strategies and to remain as the leading professional beauty products and spa services provider in Greater China.

- End -