



Retail

The retail division consists of the A S Watson group of companies, the world's largest health and beauty retailer in terms of store number.

A S Watson currently operates 12 retail chains in Europe and five retail chains in Asia, with more than 7,700 stores in 36 markets worldwide, providing high quality personal care, health and beauty products; luxury perfumery and cosmetic products; food, fine wine and general merchandise; and consumer electronic and electrical appliances.

A S Watson also manufactures and distributes various bottled waters and other beverages in Hong Kong and the Mainland.



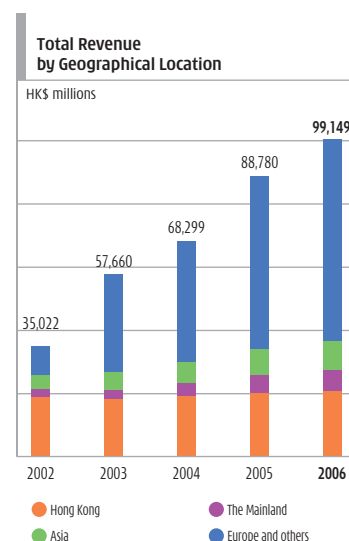
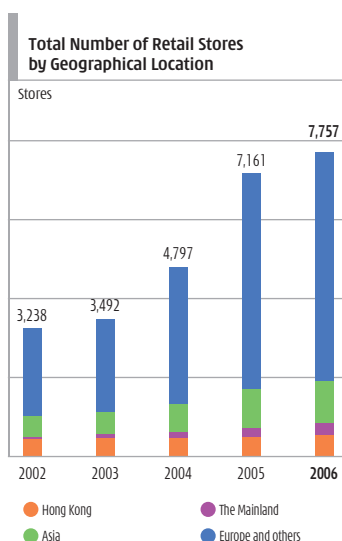
Retail

Total revenue for the retail division was HK\$99,149 million, an increase of 12% compared to last year, mainly due to full-year contributions from Marionnaud Parfumeries (“Marionnaud”) and The Perfume Shop, which were acquired in April and August last year respectively; continued revenue growth of the health and beauty retail chains, including the Rossmann health and beauty retail chains in Germany and Poland, Superdrug in the UK, Kruidvat in the Benelux countries and Watsons in the Mainland; and to PARKnSHOP sales growth in the Mainland. EBIT of HK\$2,720 million was 17% below last year, mainly due to the inclusion of the normal seasonal losses of Marionnaud in the first quarter of the current year’s results but not in last year’s comparable results as Marionnaud was acquired in April 2005, and also due to the restructuring charges incurred by Marionnaud and the health and beauty businesses in the UK and the Benelux countries. These businesses commenced major corporate restructuring and supply chain transformation programmes in the second half of 2006 to improve the operating efficiency. Excluding these normal, early seasonal losses and restructuring charges, the comparable EBIT decrease was 3%, mainly due to continued margin compression in the increasingly competitive health and beauty operations in Europe and Asia, partially offset by the improved results of the PARKnSHOP supermarkets, Watsons and Fortress operations in Hong Kong. This division contributed 45% and 6% to the Group’s total revenue and EBIT from its established businesses respectively.

The Group’s retail businesses are managed under four principal operating divisions: Health and Beauty; Luxury Perfumeries and Cosmetics; Retail Hong Kong; and Manufacturing.

	2006 HK\$ millions	2005 HK\$ millions	% change
Total Revenue	99,149	88,780	+12%
EBIT	2,720	3,261	-17%

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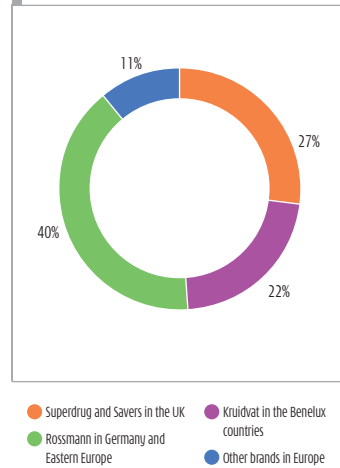
Rossmann is renowned for its unrivalled product range and professional service, with store network covering Germany, Poland, Hungary and Czech Republic.

Health and Beauty

The health and beauty retail chain stores consist of Superdrug and Savers in the UK; Kruidvat and Trekpleister in the Benelux countries; Rossmann in Poland, Hungary, Czech Republic and Germany; Drogas in the Baltic States; Watsons in Asia and certain Eastern European countries; and Nuance-Watson in the Hong Kong and Singapore international airports. During the year, A S Watson completed the acquisition of two small, established health and beauty store chains, Spektr in Russia and DC in Ukraine, in January and November respectively. The health and beauty division's total revenue increased 12% although EBIT declined 18%.

In Europe, the health and beauty businesses reported combined revenue 10% above last year, mainly contributed by continued revenue growth of Superdrug in the UK and Kruidvat in the Benelux countries; increased revenue from all joint ventures with Rossmann, in particular those in Germany and Poland; and also the first-year contributions from Spektr in Russia and DC in Ukraine. EBIT was lower than last year, reflecting intensifying competition in Continental Europe and one-time restructuring charges by Savers in the UK and Kruidvat in the Netherlands and Belgium. Both of these chains undertook major store rationalisation, supply chain transformation programmes and corporate restructuring to improve store concepts and operating efficiency. In the UK, despite continuing weak consumer spending sentiment and intense price competition, Superdrug achieved a 6% revenue increase and healthy EBIT growth. This good performance was offset by disappointing results from the Savers chain, resulting in a combined decline in EBIT compared to last year. In order to improve operating efficiency and capitalise on the

Number of Retail Stores by Brands of Health and Beauty European Division as at 31 December 2006



economies of scale, the Superdrug and Savers logistics and administration activities are in the process of being merged. In the Benelux countries, Kruidvat maintained its market leading position in the health and beauty retail sector and reported an overall revenue growth of 8%, although it reported a decline in EBIT, mainly due to intensifying price competition from supermarkets and costs incurred for store rationalisation and refurbishment programmes. The division's joint ventures with Rossmann in Germany and Eastern Europe overall performed well and reported a combined double-digit growth in revenue and healthy EBIT growth. The health and beauty European division currently has more than 4,200 retail outlets in 14 markets.

OPERATIONS REVIEW

Retail

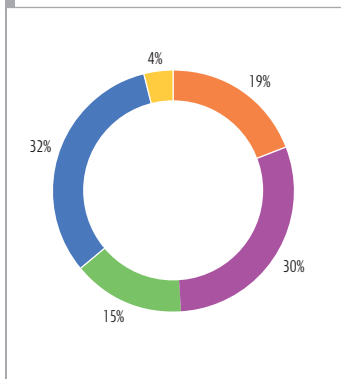
In Asia, the Watsons personal care, health and beauty business continues to be the leading retail chain with strong brand name recognition and extensive geographical coverage, particularly in the Mainland and Taiwan. Although these operations reported a combined revenue 18% above last year, combined EBIT declined mainly due to increased competition and margin pressure which reduced contributions from the operations in Taiwan, Thailand and the Philippines. In the Mainland, Watsons continued to grow its revenue base as it expanded its geographical coverage in this vibrant and growing economy. However, EBIT declined mainly due to intensifying competition in this rapidly growing and changing consumer market. In Taiwan, although revenue was 3% above last year, EBIT also declined, affected by margin compression as a result of keen price competition. Although affected by rising store operating costs, Watsons in Malaysia was able to maintain its competitiveness through improved product offerings and reported increased revenue and stable EBIT compared to last year. Operations in Singapore, Thailand and the Philippines all reported lower EBIT. Retail concessions at the

Hong Kong International Airport and the Singapore Changi Airport, operated by Nuance-Watson, a 50% joint venture, reported strong growth in revenue and combined EBIT and continued to provide a steady contribution to the division. There are currently more than 1,300 Watsons stores operating in eight markets in Asia, excluding Hong Kong and Macau.

Luxury Perfumeries and Cosmetics

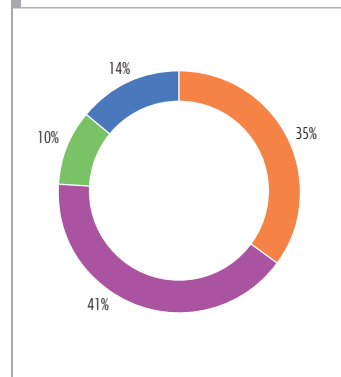
The luxury perfumeries and cosmetics division comprises the two Europe-based luxury perfumery and cosmetics retail chains, Marionnaud and The Perfume Shop, both acquired last year, and ICI Paris XL operating in the Benelux countries. These operations were combined into one division during the year to maximise synergy through integration of systems and processes and to strengthen purchasing power. As a result, restructuring costs were incurred by these businesses. Combined revenue increased 34% over last year, although EBIT declined by 36% mainly due to the restructuring costs.

Number of Retail Stores by Brands of Health and Beauty Asia Division as at 31 December 2006



- Watsons in the Mainland
- Watsons in Malaysia
- Other brands in Asian Countries
- Watsons in Taiwan
- Watsons in other Asian countries

Number of Retail Stores by Brands of Luxury Perfumeries and Cosmetics Division as at 31 December 2006



- Marionnaud in France
- The Perfume Shop mainly in the UK
- Marionnaud in other European countries
- ICI Paris XL in the Benelux countries

Marionnaud is a favourite retail brand amongst European shoppers for perfume and cosmetics.



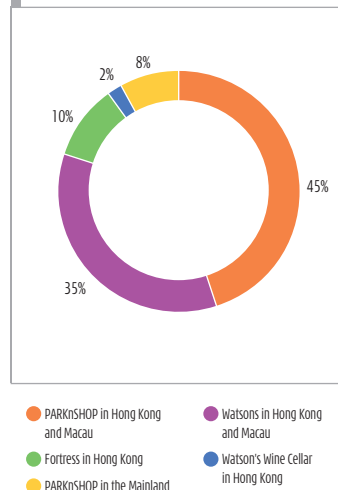
Marionnaud reported combined comparable revenue growth of 2%. However, lower EBIT was reported mainly due to the non-comparable normal seasonal losses included in the current year's results but not in 2005 results as mentioned previously; and also to the one-off charges incurred mainly for the restructuring of the logistics and distribution functions in France to improve efficiencies and inventory management. Excluding the non-comparable seasonal losses and the one-time charges, EBIT reported healthy growth compared to last year. In the UK, The Perfume Shop continued to expand its specialty perfumery store concept. Similar to Marionnaud, The Perfume Shop was acquired in mid-2005 and therefore full-year results are not comparable to 2005 partial year results. On a comparable basis, despite competitive pressures, The Perfume Shop achieved a revenue growth of 6% and healthy EBIT growth through its extensive retail network and comprehensive product mix. In the Benelux countries, ICI Paris XL reported combined revenue growth of 12%, but EBIT was lower mainly due to the additional investment in the warehouse and distribution functions. There are currently over 1,600 stores in 18 markets in this division.

Retail Hong Kong

The Retail Hong Kong division consists of all the retail concepts in Hong Kong, including PARKnSHOP supermarkets, Watsons health and beauty personal care stores, Fortress consumer electronic and electrical appliances retail chain and Watson's Wine Cellar stores. PARKnSHOP in the Mainland and the European fine wine trading businesses are also reported under this division. This division reported a total revenue increase of 1% and an improved EBIT and currently operates more than 500 retail outlets.

While the economy of Hong Kong was healthy and growing in 2006, market competition remained intense and retailers faced rising pressure from increasing rental rates and operating costs. Against these trends, the PARKnSHOP supermarket chain in Hong Kong continued to maintain a leading market share. Through the introduction of new store concepts and conscious cost control, PARKnSHOP reported growth in both revenue and EBIT during the year.

Number of Retail Stores by Brands of Retail Hong Kong Division as at 31 December 2006



Watsons reported slightly lower revenue but better EBIT than last year through tighter cost control and operation rationalisation. Fortress, one of the leading consumer electronic and electrical appliance retail chains in Hong Kong, also reported decreased revenue but increased EBIT with its wide range of product offerings. Watson's Wine Cellar, the specialist wine store chain in Hong Kong, reported growth in both revenue and EBIT.

In the Mainland, PARKnSHOP operations continued to expand and 11 new stores were opened during the year. This operation reported revenue growth, although EBIT contribution was reduced, mainly due to keen competition from both local supermarkets as well as foreign hypermarket retailers.

Manufacturing

The manufacturing division manufactures and distributes well-known brands of bottled waters, fruit juices and soft drinks in Hong Kong and the Mainland. The division reported a 3% revenue growth and a 44% increase in EBIT compared to last year.



PARKnSHOP China continues its expansion in Mainland China to better serve the customers.

Watsons Water has an excellent reputation for meeting the highest standard as the most sought-after drinking water in Hong Kong and the Mainland.

