

*Rising Star: Supreme Fitness -
Go PISTIC and PICA!*



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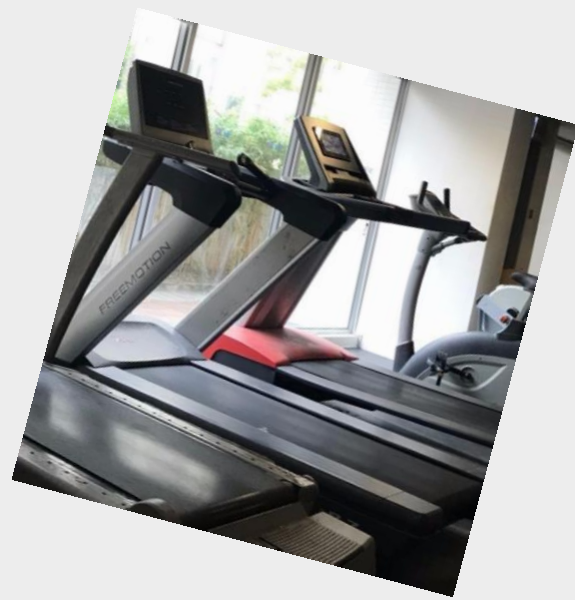
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Executive Summary

This report aims to provide an ethical plan to deal with the Central centre incident and solve the problems Supreme Fitness is facing, such as the lack of high-end brand, which caused the decline in profitability. PISTIC plan is provided to reduce the impacts brought by the incident while PICA aims to alleviate the identified problems. It is believed that these recommendations could improve the profitability and liquidity of the company, boosting the overall performance of Supreme Fitness. Together, PISTIC and PICA can path the company's road to the foreign market.

Business Analysis

Supreme Fitness ('Supreme') is a listed company in Hong Kong Stock Exchange founded 30 years ago. In 2017, It has 10 fitness centers accommodating 18,700 members. Although the business is profitable, its net profit margin is decreasing due to factors such as unclear market positioning in advertisements, and a more competitive fitness market. SWOT analysis is used to evaluate the internal and external factors.

However, the business is facing a public relation crisis involving an accident in one of the core centers which has injured members and staff. If the crisis is not addressed properly, it could be fatal to the company's image and worsen the threats that the company is facing now.

Strength

- cash rich
 - able to invest in new equipment for expansion
- high level of recognition
 - able to expand without worrying no new members
- large membership base
 - allow Supreme to collect users' feedbacks easily

Weaknesses

- high uncertainty avoidance
 - unwilling to expand the company for sustaining growth
- poor quality of working environment
 - unable to retain the staff and members
- non-current assets suffer from wear and tear
 - drive away customers as they seek a comfortable and safe environment

Opportunities

- considerable growth of HK economy¹
 - considerable growth rate in market size of fitness industry
- increasing health awareness²
 - more people are willing to try fitness programs
- declining willingness in paying high prices
 - favorable as Supreme is a low-end brand

Threats

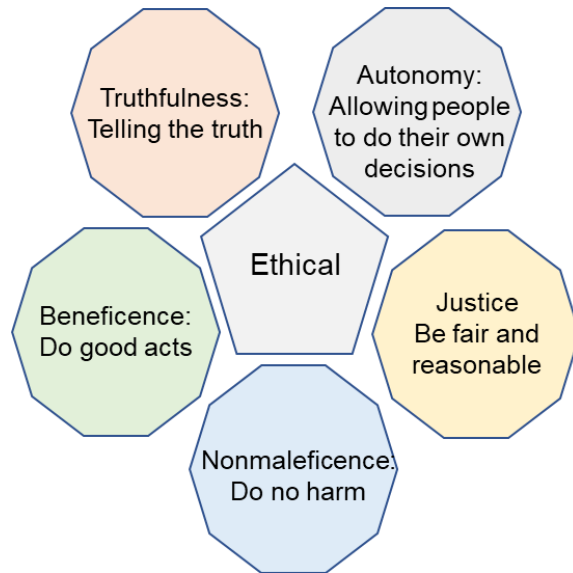
- increasingly competitive fitness market
 - difficult to differentiate Supreme from other brands
- long weekly working hours³
 - slow fitness penetration growth rate
- increasing labor costs⁴
 - difficult to lower operating costs

Remedies to Recent Incident

Ethical Considerations

The collapse of the ceiling has injured several members and staff. This indicates that Supreme may not have provided a safe working environment, which violates the Occupational Safety and Health Ordinance (Chapter 509)⁵. Besides, the act of destroying related reports is an obstruction of justice, which is unethical.

To resolve this issue, Supreme should consider the interests of the injured members and staff, and the five ethical principles, which are truthfulness, autonomy, beneficence, nonmaleficence, and justice⁶. These considerations are crucial in proving that Supreme is a responsible and ethical company that cares about its consumers as well as its employees.



If Supreme continues to do nothing and deny responsibilities, it could suffer from a vast lapse of memberships in the coming financial year. Therefore, it is suggested that Supreme should implement the following **PISTIC** plan to restore Supreme’s image:

Ethical Considerations	Recommendations
<i>Trustfulness and Justice</i>	Informing the Public of the Incident
<i>Nonmaleficence</i>	Inspecting the Fitness Centers
<i>Beneficence and Autonomy</i>	Providing Subsidies to Staff for Trainings
<i>Beneficence</i>	Hiring Well-Trained Staff
<i>Nonmaleficence</i>	Hiring Third-party Inspectors
<i>Beneficence and Autonomy</i>	Changing Corporate Governance Practices

Immediate Solutions

1. Informing the Public of the Incident (Trustfulness and Justice to Public)

Supreme is responsible to inform the public regarding the incident under integrity and apologizing to them. It should disclose the information such as the date and the venue so that the members could prevent going to that center before its refurbishment.

2. Inspecting the Fitness Centers (Nonmaleficence to Members)

All centers should be inspected and worn out equipment should be renewed according to their urgency. The inspection should start from temporarily closing the Central center that has recorded an accident of ceiling collapsing. After such safety checkup, the remaining centers would be checked one by one at a time to minimize the inconvenience to consumers. This ensures complete safety to members and staff in the gym centers. To compensate for the inconvenience caused, Supreme should offer an extension for the subscription period by one month to the members.

3. Providing Subsidies to Staff for Trainings (Beneficence and Autonomy to Staff)

Supreme should benefit its staff by subsidizing them to attend training for acquiring personal trainer licenses⁷ or interested areas, thus improving its service quality for its members. In addition to ethical considerations, Supreme's declining reputation due to the recent incident could trigger staff to leave as some staff would start worrying about the poor working environment. Subsidization could effectively reduce the incentives of staff being poached by competitors and prevent a sudden high turnover rate.

4. Hiring Well-Trained Staff (Beneficence to Members and Staff)

Supreme should consider hiring well-trained staff with personal trainer license to deliver superior service to members. The newly recruited staff can provide appropriate

assistance and advice on equipment use so that accidents can be avoided. Their efficiency and working style can influence and motivate another workforce to strengthen their quality of service, therefore helps to build a better brand image in the long term for Supreme.

Prevention to Similar Crisis

5. Hiring Third-party Inspectors (Nonmaleficence to Members)

Supreme should hire third-party inspectors to examine whether there are defects in the interior design before opening a new fitness center and to investigate the faulty components in the existing fitness centers annually. Third party inspections could produce unbiased and credible reports, which are strong supporting documents to convince the Board of Directors to sanction the investment required for repairing the centers.

6. Changing Corporate Governance Practices (Beneficence and Autonomy to Managers)

Supreme should ask its center managers to submit a monthly sustainability report tailored for each center regarding the needs to replace certain machines, staff's morale, members' feedbacks, and center-specific matters. This allows the central administration to review the status of each center in a more structured and accurate way, so that preemptive measures can be implemented to prevent foreseeable crises.

Current Financial Analysis



The primary source of revenue of Supreme is the subscriptions from members. However, the number of memberships slumped by 1766 during the year ended 30

September 2017, mainly due to the unsafe environment and outdated equipment. This resulted in the decrease of the revenue in the past two financial years.

Other notable facts are the shrank of net profit ratio and return on capital employed. Net profit ratio shrank from 13.22% in 2015 to 9.33% in 2017, and return on capital employed plummeted by 8.01% from 2016 to 2017. This indicates that the operating expenses of the company are relatively more significant, and the company utilizes the assets worse than before. The ability to generate profit will be undermined if Supreme does not improve the profitability.

Liquidity

Supreme faces liquidity risk in the past few years. The current ratio and liquid ratio of Supreme in 2017 are as low as 0.44:1 and 0.4:1 respectively. This shows that the liquidity position of the company is so weak that the liquid assets of the firm may not be able to repay its immediate liabilities. This raises concern regarding the poor asset and liquidity management that would worsen the ability to meet short-term obligations.

Return on Investment

The earnings per share decreases from HK\$0.234 in 2015 to HK\$0.163 in 2017, which indicates that the business is contracting. Also, the dividend cover for ordinary shares decreases from 1.65 times in 2015 to 1.41 times in 2017, showing the aggregate dividend policy. This dividend policy would reduce the proportion of net profit retained for future investment, which worsens the sustainability of Supreme.

Strategic Planning

As the financial situation is not desirable, a long-term strategic plan PICA should be implemented aiming for increasing the net profit margin of 10% from 2017 to 2022:

Introducing: **Preme**
 Implementing **Influence Marketing Plan by Website and Online Advertisement**
 Retaining **Current Members**

Access to new market segment
 Attract new members
 Retain members
 Long-term profits

Closing Underperformed Centers and Re-Allocating Resources

Introducing: *Preme*

Problems: High-income group takes about 43.3% of the fitness market in 2018⁸, which is the majority. However, Supreme fitness failed to capture this potential customer segment and was only able to find potential members in the continually shrinking low-to-medium-income group market. Besides, the market positioning of Supreme is unclear. As Supreme is at the lower end of the market, it is strange that it regards fashionable high-end locations as the key selling point instead of low membership fees.

Therefore, it is suggested that Supreme should establish a high-end brand Preme:

Target Customer: Preme would target high-income customers, such as the managers, who wish to have superior service quality and a wide range of start-of-the-art training equipment. This market positioning also prevents direct competition with Supreme.

Business Portfolio of Preme

Location:	Central District
Target Customer:	High-Income Group
Service Quality:	Industrial Leader

Location: Supreme could convert the center in Central District where the recent incident happened to the first Preme center since that center would be refurbished.

Training Equipment: Supreme should purchase the state-of-the-art training equipment for Preme and new equipment for other centers together from the new factory of its supplier before the end of 2018 by leasing for enjoying a much lower cost for the investment. Furthermore, leasing could avoid initial cash outlay on purchasing non-current assets by one-off payments. This enhances better financial planning as rental expenditure per

month is fixed. Also, the risk of obsolescence is shifted to the lessee so that Supreme fitness possesses the flexibility to switch for any upcoming released new models.

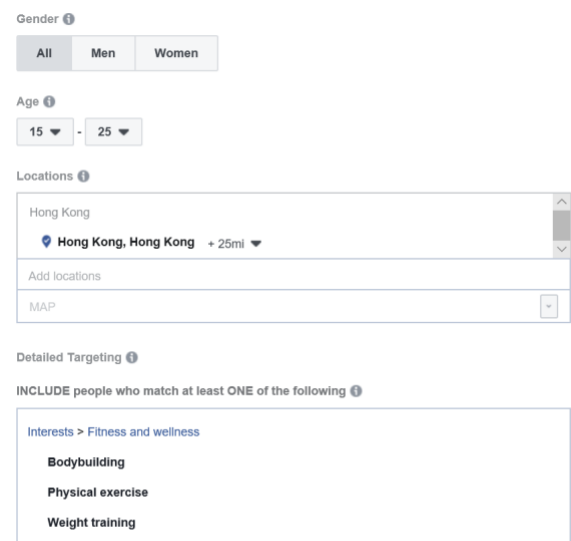
Human Resources: Preme needs high-quality human resources for providing superior service quality. It is proposed that Supreme should extend its bonus scheme to junior Preme center staff for poaching staff from competitors and encouraging the freelance personal trainers transiting to permanent staff.

Membership: It is proposed that current Supreme members could still enjoy using the refurbished Preme center until their memberships lapse. These members could enjoy a discounted price for upgrading to Preme membership which can access all Preme and Supreme centers and enjoy 1 free individual session per month. Number of membership of Preme after its launch is shown in Appendix 1.

Implementing Influence Marketing Plan by Website and Online Advertisement

Current Situation: Supreme has minimal online presence, but it invests in outdoor advertising, which is costly and limited by factors like weather conditions and human resources allocation. Besides, the performance of outdoor advertising cannot be measured quantitatively. Supreme should switch the marketing method to a hybrid of outdoor advertising and digital influence marketing gradually, aiming to reduce the marketing cost to \$3.0m by 2020 with better marketing results.

Detail: It is proposed that Supreme should create a Facebook page for posting its newest promotions. Also, it should outsource the creation of a new e-commerce

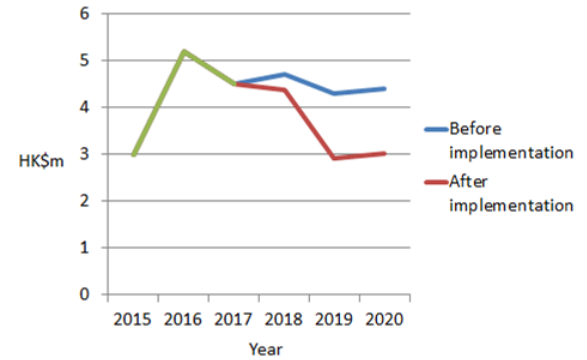


Sample Facebook Advertising Tool Targeting Students

website which allows its customers to subscribe its membership via online payments. Then, Supreme could promote its website and brands by Facebook advertising tool targeting a specific audience (e.g. students for Supreme). It is believed that some of the potential customers may subscribe to the membership online after they are attracted by the Facebook advertisement.

Cost incurred by...	FY 2017 - 2018	FY 2018 - 2019 and thereafter
Website	HKD 5,600	HKD 2,820
Facebook advertisement	HKD 448,000	HKD 448,000

Cost of Influence Marketing^{10,11}



Projected Marketing Cost before and after the implementation of the plan

Future: After Preme has satisfactory performance, it is suggested that Preme should have a separate website and Facebook page for marketing, boosting its performance.

Retaining Current Members

Problem: The percentage of lapsed membership to original membership is 64.1%, which is very large. While the above strategic solutions can attract potential members, it is vital to fulfilling members' wishes for preventing members from lapsing. With the below strategic planning, it is estimated that the percentage would decrease to 50% by 2020.

Increasing the number of types of training: Members wish to have a broader range of fitness options. While Supreme may not have the required human resources which are skilled in other fitness areas (e.g. yoga) in the short term, it will acquire them after the implementation of providing subsidies to staff for training in the PISTIC plan. It can then arrange sessions for different types of training, increasing members' engagement in the centre and thus retaining members.

Selling healthy food: Members wish to buy healthy food conveniently after the workout. However,

	2018	2020
new membership	13628	14879
lapsed membership	10828	11827
required percentage	57.91%	50.49%

Projected Results

cooked food may not be able to sell as this requires restaurant licensing from the government⁹. Therefore, it is suggested that Supreme offers prepackaged food supplements such as protein and vitamin shake at the service counter. Not only could this suit members' needs, but also generate extra revenue for Supreme.

Launching member referral program: Members may lapse their membership because they are referred by their friends to other fitness centers. Therefore, Supreme should start its member referral program for preventing this. Referral plans can be attracting current members to invite 2 new friends to join Supreme fitness with a benefit of extending membership for 2 months, while the new members can enjoy healthy food or souvenir discount coupons. Family plans can offer a discount rate of the number of people joining the program so that it encourages more cohorts to enroll.

Closing Underperformed Center and Re-Allocating Resources

Problem: The operating profits of centers 4, 8 and 9 are negative, showing that they were unable to generate sufficient revenue to cover their variable costs and they reach the shutdown point. Another problem concerning the operational condition of center is that the lack of staff in some centers, which caused a center manager to leave Supreme in the recent incident.

Closing Centre 8: Supreme fitness is advised to close center 8 after the current lease is expired. The reason behind the action of only closing center 8 is to prevent the possible panic caused by the shutdown of 3 centers. It is suggested that Supreme would realize the equipment in center 8 and reallocate the human resources to other centers evenly, easing the work pressure of the managers. The centres 4 and 9 would be closed if they are determined not profitable.

Implementation

Gantt Chart



Operational Risk Analysis: key risks are highlighted with contingency plans, proving their feasibility

Policy	Risk	Contingency Plan
Introducing: Preme		
	The lease contract is too complicated to be signed in accordance with the implementation plan.	Delay the launch of Preme by at most 2 quarters. If the lease contract cannot be signed after the delay of 1 quarter, Supreme should start negotiating with other suppliers.
	Extending the bonus scheme to junior staff is not enough to attract quality trainers.	Approach the freelance personal trainers one by one for examining what is lacked for attracting them.
	The original members of Supreme do not wish to switch to Preme and lapse the membership.	It is expected that some members may lapse their membership as the target customers of the brands are different. However, it can persuade its members to stay by offering 1 free personal training session for letting them try superior service.
Implementing Influence Marketing Plan by Online Advertisement and Website		
	The website outsourced cannot be completed according to the timeline.	Change the advertising target from its website to one of its key promotion post
	Hackers may invade into the system for personal details, such as bank account passwords and HKID number.	Close the system and report to government agencies and the members immediately. Hire external IT specialists for repairing the system.
	Facebook may block the posts of Supreme.	Appeal Facebook decision immediately and re-post with similar wordings
Retaining Current Members		
	Members are not interested in the new training sessions provided by the trained staff.	Promote the benefits of the new sessions (e.g. able to increase the efficiency of trainings) while encourage the staff to learn more popular training areas.
	Prepackaged food could not be supplied due to unforeseeable difficulties of delivery.	If Supreme does not have enough stock, it should notify its members immediately via SMS and Facebook as soon as possible so that they can prepare food for themselves.
Closing Underperformed Centers and Re-Allocating Resources		
	Members complain that the nearby centers are closed and quit the membership.	Encourage members to try working out at different locations with more comfortable environment and more advanced equipment for persuading them to continue their subscriptions.
	Some staff is unable or unwilling to switch working location.	Offer transportation cost subsidies and more flexible working schedule to some staff for retaining them.

Financial Risk Analysis

The firm is facing liquidity risk currently. Supreme's ability to meet short-term obligations is weak, so Supreme may have trouble when a massive amount of liquid assets is needed for implementing the plan above. To obtain sufficient cash, it is suggested that Supreme borrows long-term loan of at least HK\$60m and slightly reduce the dividend to improve the cash flow of the company. The possibility of Supreme being unable to repay the short-term debts is reduced.

Financial Projection in the Upcoming Five Years

Profitability: The primary source of revenue would still be subscriptions from members, but it would decrease to about 60% of the total revenue, and the income from personal training and by-products take 20% each respectively. The revenue of the company is expected to skyrocket by about 15% per annum, with the revenue driver being the membership retainment programme and the new brand 'Preme'.

It is expected that the net profit ratio would increase from 9.33% in 2017 to 19.89% in 2022. The operating expenses would be relatively smaller due to the more effective online marketing, reduction in maintenance costs of the equipment and the benefits brought by economies of scale.

Liquidity: By 2022, the current ratio and liquid ratio would jump to 0.78:1 and 0.71:1 respectively. The escalated ratios are mainly due to the surge of cash because of the long-term loan and the increasing net profit.

Returns on Investment: By 2022, the earnings per share would increase from HK\$0.16 to HK\$0.69. Also, the dividend cover for ordinary shares would rise to 1.67 times as the proportion of net profit reserved for future investment is higher.

References and Appendices

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Appendix 1: Statement showing Membership and Sales Revenue

	2018	2019	2020	2021	2022
Number of Members:					
Supreme	20500	21525	23247	25107	27115
Preme	1000	1900	3230	4845	5814
Total	21500	23425	26477	29952	32929
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
Revenue from Subscriptions	157.20	173.22	198.39	227.28	251.04
Subscription Segment Share	0.67	0.66	0.64	0.62	0.60
Personal Training	55.98	60.36	68.20	76.98	83.68
Sundry Sales	20.06	28.87	43.40	62.32	83.68
Total Sales	233.23	262.45	309.98	366.58	418.40

Appendix 2: Statement of Profit or Loss

		2018	2019	2020	2021	2022
	Assumption	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
Sales Revenue	See Appendix 1	233.23	262.45	309.98	366.58	418.40
Staff Costs	180 staff in the company	28.08	28.92	29.79	30.68	31.60
Outsourced Labour Costs	10% of sales	23.32	26.25	31.00	36.66	41.84
Occupancy Costs	45% of sales	104.96	118.10	139.49	164.96	188.28
Depreciation	8.5% of non-current assets	9.71	11.26	13.60	16.41	18.82
Advertising and Marketing		4.38	2.92	3.01	3.10	3.19
Other Operating Expenses	2018: 16% of sales -> 2022: 12% of sales	37.32	39.37	43.40	47.66	50.21
Total Operating Costs		207.77	226.82	260.29	299.47	333.95
Profit before interest and tax		25.46	35.63	49.69	67.11	84.46
Interst payable	0.5% of sales	1.17	1.31	1.55	1.83	2.09
Interst income	0.2% of sales	0.47	0.52	0.62	0.73	0.84
Profit before taxation		24.77	34.85	48.76	66.01	83.20
Income tax expense	HK: 16.5%	4.09	5.75	8.05	10.89	13.73
Profit after taxation		20.68	29.10	40.72	55.12	69.47
Dividends	60% of net profit after tax	12.41	17.46	24.43	33.07	41.68
Retained Profit		8.27	11.64	16.29	22.05	27.79

Appendix 3: Statement of Financial Position Appendix 4: Statement of cash flows

	2018	2019	2020	2021	2022
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
Non-current assets:					
Leasehold improvements	107.89	125.08	151.12	182.32	209.09
Fixtures, fittings and equipment	3.38	3.91	4.73	5.70	6.54
Gym and other equipment	<u>2.97</u>	<u>3.44</u>	<u>4.16</u>	<u>5.02</u>	<u>5.76</u>
Total non-current assets	114.23	132.43	160.01	193.05	221.39
Current assets:					
Inventory	2.24	2.52	2.98	3.52	4.02
Receivables	3.81	4.29	5.07	5.99	6.84
Cash	<u>72.33</u>	<u>63.06</u>	<u>49.78</u>	<u>37.13</u>	<u>34.81</u>
Total current assets	78.39	69.88	57.83	46.64	45.67
Total assets	192.62	202.31	217.84	239.69	267.05
Current liabilities:					
Payables	15.49	16.91	19.40	22.32	24.89
Deferred income	10.56	11.19	11.94	12.82	13.82
Borrowings	<u>24.00</u>	<u>23.00</u>	<u>22.00</u>	<u>21.00</u>	<u>20.00</u>
Total current liabilities	50.05	51.10	53.34	56.14	58.72
Non-current liabilities:					
Long term loan	60.00	57.00	54.00	51.00	48.00
Equity:					
Share capital	10.00	10.00	10.00	10.00	10.00
Reserves	<u>72.57</u>	<u>84.21</u>	<u>100.50</u>	<u>122.55</u>	<u>150.34</u>
Total equity	82.57	94.21	110.50	132.55	160.34
Equity and Liabilities	192.62	202.31	217.84	239.69	267.05

	2018	2019	2020	2021	2022
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
Cash flows from operating activities:					
Profit before tax	24.77	34.85	48.76	66.01	83.20
Depreciation	9.71	11.26	13.60	16.41	18.82
Net interest paid	0.70	0.79	0.93	1.10	1.26
(Increase)/decrease in receivables	-0.41	-0.48	-0.78	-0.93	-0.85
(Increase)/decrease in inventory	-0.24	-0.28	-0.46	-0.54	-0.50
Increase/(decrease) in payables	1.49	1.42	2.49	2.92	2.57
Increase/(decrease) in deferred income	<u>0.56</u>	<u>0.63</u>	<u>0.75</u>	<u>0.88</u>	<u>1.01</u>
Cash generated from operations	36.57	48.18	65.30	85.86	105.51
Net interest paid	0.70	0.79	0.93	1.10	1.26
Dividend paid	12.41	17.46	24.43	33.07	41.68
Income tax paid	<u>4.09</u>	<u>5.75</u>	<u>8.05</u>	<u>10.89</u>	<u>13.73</u>
Net cash from operating activities	19.38	24.19	31.89	40.79	48.84
Cash flow from investing activities:					
Acquisition and Proceeds of property, plant and equipment	<u>-21.74</u>	<u>-29.46</u>	<u>-41.18</u>	<u>-49.45</u>	<u>-47.16</u>
Net cash used in investing activities	-21.74	-29.46	-41.18	-49.45	-47.16
Cash flows from financing activities:					
Increase/(decrease) in borrowings	<u>58.00</u>	<u>-4.00</u>	<u>-4.00</u>	<u>-4.00</u>	<u>-4.00</u>
Net cash from financing activities	58.00	-4.00	-4.00	-4.00	-4.00
Net increase/(decrease) in cash and cash equivalents	55.63	-9.27	-13.28	-12.66	-2.32
Cash and cash equivalents at 1 October	16.70	72.33	63.06	49.78	37.13
Cash and cash equivalents at 30 September	72.33	63.06	49.78	37.13	34.81

Appendix 5: Accounting Ratios

	2018	2019	2020	2021	2022
Profitability and Liquidity					
Net Profit Margin	10.62%	13.28%	15.73%	18.01%	19.89%
Return on Capital Employed	32.47%	40.32%	48.55%	55.23%	57.67%
Liquidity					
Current Ratio	1.57:1	1.37:1	1.08:1	0.83:1	0.78:1
Liquid Ratio	1.52:1	1.32:1	1.03:1	0.77:1	0.71:1
Management Efficiency					
Total Assets Turnover	1.21 times	1.30 times	1.42 times	1.53 times	1.57 times
Returns on Investment					
Earnings per Share	HK\$0.21	HK\$0.29	HK\$0.41	HK\$0.55	HK\$0.69
Dividend cover for ordinary shares	1.67 times	1.67 times	1.67 times	1.67 times	1.67 times