

## MANAGEMENT'S DISCUSSION AND ANALYSIS

During the period under review, the consolidated turnover of the Group was approximately HK\$1,649,401,000, representing a substantial increase of approximately 130 per cent. compared to the same period last year. Profit attributable to shareholders amounted to HK\$80,946,000, increased by 46 per cent. compared to the same period of the preceding year. Earnings per share for the period were 9.5 HK cents (Six months ended 30 June 2000: 8.4 HK cents). The performance of the core businesses together with the related information of the Group during the period is summarised as follows:

### International Food Trading

The Group is engaged in the international trading of food and animal feedstock through its wholly owned subsidiary, China Foods Trading Limited ("China Foods Trading"). During the period, China Foods Trading is principally engaged in the bulk trading of certain commodities such as raw sugar, white sugar, maize and fish meal.

During the period under review, the Mainland food trading market had been active alongside a significant increase in the demand for imported commodities in the Mainland. With its experience in food trading in China and its established network, the Group's international food trading business recorded a turnover of HK\$812,254,000 during the period, representing a 69 per cent. increase over the corresponding period last year, resulting in a significant contribution to the Group's operating profit.

In June 2001, the Company announced its proposed acquisition of the entire issued share capital of COFCO (BVI) No. 100 Limited ("COFCO Trading") from its parent company, COFCO (HK). Upon completion of the acquisition, COFCO Trading and its subsidiaries (together the "COFCO Trading Group") will be principally engaged in the import and export businesses of certain agricultural products and aquatic products and the provision of customer management services and market information of certain cereals, oils and foodstuff industries to the Group's ultimate holding company, namely COFCO and its subsidiaries (together the "COFCO Group") in respect of their trading businesses. With China's status as one of the largest agricultural countries and its admission to the World Trade Organisation (the "WTO") in the near future, the Directors are of the view that the international food trading business in China will continue to prosper. Through the acquisition of related trading businesses, the Group will be able to expand its existing trading businesses and further stabilise and strengthen its profitability.

### Edible Oils and Fats Refining

On 16 May 2001, the Company completed its acquisition of the entire issued share capital of COFCO Oils & Fats Holdings Limited ("COFCO Oils & Fats") from COFCO (HK). COFCO Oils & Fats holds interests in certain companies which are primarily engaged in the extraction, refining and sales of edible oils, trading of soyabeans, rapeseeds, foodstuffs and soyabean meal in the Mainland. On 4 September 2001 the acquisition of 40 per cent. equity interests in Great Ocean Oil & Grain Industries (Fang Cheng Gang) Company Limited ("Great Ocean") from COFCO (HK) by the Group was also completed. Great Ocean is a wholly foreign owned company established to engage in the business of soyabean oil extraction, refinery and packaging, and production of soyabean meal.

Following the acquisitions of the COFCO Oils & Fats and Great Ocean, together with the interests in Eastbay Oils and Fats Industries (Guangzhou) Co. Ltd. (“EOFI”) and Southseas Oils & Fats Industrial (Chiwan) Ltd. (“SOFI”) currently held by the Group, the Group has become the largest edible oils producer in China, with an annual extraction volume of approximately 3,300,000 tonnes and an annual production volume of edible oils and fats of approximately 1,200,000 tonnes. Through the acquisitions, the Group is able to consolidate and strengthen its interests in the production and sales of edible oils, and thereby increase its market share in China. The Directors believe that with China’s admission to the WTO, the problem presently caused by the quota scheme would be solved or mitigated. Further, this development would likely bring about a substantial reduction in import tax, hence reducing operating costs.

The unaudited consolidated profit and loss of COFCO Oils & Fats and its subsidiaries from the date of acquisition of COFCO Oils & Fats to the interim balance sheet date are summarised as follows:

|   | <i>HK’000</i> |
|---|---------------|
| Turnover                                | 568,656       |
| Profit from operating activities        | 37,176        |
| Net profit attributable to shareholders | <u>18,068</u> |

During the period, the management adopted cautious business strategies, and launched its edible oils in consumer packs marketed under the brand name “Fortune” which significantly reduced EOFI’s loss during the period compared to the corresponding period last year. The profitability of SOFI’s small package of edible oils and other related business remains stable and continues to contribute to the profit base of the Group’s oils and fats business.

### Wine Making and Beverage

During the period, the Group participated in the wine business mainly through China Great Wall Wine Co., Ltd. (“Great Wall Wine”), in which it holds a 25 per cent. equity interest. On 16 May 2001, the acquisition of the entire issued share capital of COFCO Wines & Spirits Holdings Limited (“COFCO Wines & Spirits”) from COFCO (HK) by the Company was also completed.

COFCO Wines & Spirits principally holds equity interests in a number of companies engaged in the making, sales and trading of wine in the Mainland. COFCO Wines & Spirits and its subsidiaries (together the “COFCO Wines & Spirits Group”) market and sell their wine in the Mainland market under the brand name “Great Wall”. Upon completion of the acquisition, the Group increased its stake in Great Wall Wine to 50 per cent.. The Group also owns certain shareholdings in two other wineries making “Great Wall” wine, namely Huaxia Winery Co., Ltd. and Yantai COFCO Winery Co., Ltd., in which the Group owns 100 per cent. interest and 60 per cent. interest, respectively, and a wholly-owned subsidiary engaged in the import and distribution of wines and spirits.

During the period, the annual production and sales volume of Great Wall Wine were approximately 10,300 tonnes and 10,600 tonnes respectively, representing an increase of 3 per cent. and 8 per cent. respectively compared with the corresponding period last year, and reflecting an immense demand for “Great Wall” wine in the Mainland market. Following the acquisition of COFCO Wines & Spirits, the Group is set to implement new marketing strategies, new purchases and production management policies, and will launch a national marketing campaign to enhance the branding of “Great Wall” and cut down production costs to improve profitability.

The unaudited consolidated profit and loss of the COFCO Wines & Spirits Group from the date of acquisition of COFCO Wines & Spirits to the interim balance sheet date are summarised as follows:

|   |               |
|---|---------------|
|   | <i>HK'000</i> |
| Turnover                                | 36,142        |
| Profit from operating activities        | 6,319         |
| Net profit attributable to shareholders | <u>3,898</u>  |

The acquisition of COFCO Wines & Spirits Group will increase the Group's market share in the Mainland wine market to a significant extent. Following China's admission to the WTO, competition in China's wine industry is bound to be fierce, which will thus act as a stimulus to the development of the Mainland's wine market. The management is of the view that, with the well-established and strong reputation of the “Great Wall” brand name and its significant market share throughout the country, the COFCO Wines & Spirits Group will further expand and develop China's wine market and benefit the Group.

### Flour Milling

The Group is engaged in the flour milling business primarily through its two Sino-foreign joint ventures, namely Zhengzhou Haijia Food Co., Ltd. and Xiamen Haijia Flour Mills Co., Ltd., in which the Group holds 55 per cent. and 60 per cent. equity interests respectively.

During the period, despite the challenging business condition, the Group's flour milling business recorded a considerable increase in turnover. However, due to factors such as an increasingly competitive market and a lowered price of flour, there was a reduction in the overall profits from its flour milling businesses compared to the corresponding period last year.

The Group will continue to actively adopt policies for an effective cost control, management enhancement and to closely monitor its product quality, aiming for an improvement in its operation.

### Other Investments

The Group holds a 28.6 per cent. and a 50 per cent. interest in Jiangsu Jiangshan Pharmaceutical Company Limited (“Jiangsu Pharmaceutical”) and Jiangsu Jiang Yuan Thermal Power Company Limited (“Jiang Yuan Thermal Power”) respectively. These companies are principally engaged in the production of Vitamin C and the operation of a thermal power plant in the Mainland respectively.

During the period, despite the continuous fall in the prices of Vitamin C products and an unstable market condition, Jiangsu Pharmaceutical still recorded satisfactory profits. Jiang Yuan Thermal Power, on the other hand, continues to contribute dividend income to the Group, with its contribution amounting to HK\$1,419,000.

In June 2001, the Company announced its proposed acquisition of the entire issued share capital and certain shareholders’ loans of Prized Development Limited (“COFCO Chocolate”) from COFCO (HK). COFCO Chocolate and its subsidiaries (together the “COFCO Chocolate Group”) are principally engaged in the production and distribution of chocolate products under the brand name “Le Conté”. With the vast potential of the Mainland’s chocolate market, the Directors are confident of COFCO Chocolate’s prospects.

### Liquidity and Financial Resources

The Group’s finance and cash management is carried out at corporate level for better utilisation of the Group’s financial resources.

The Group’s financial and liquidity positions are healthy and stable. As at the end of June 2001, the Group’s aggregate shareholders’ equity amounted to HK\$2,963,952,000, representing a growth of 105 per cent. over the restated figures as at balance sheet date last year. On 30 June 2001, the Group’s cash and non-secured bank deposits amounted to HK\$1,375,242,000 (31 December 2000: HK\$1,060,927,000). Net current assets of the Group was approximately HK\$1,507,925,000 (31 December 2000 : HK\$985,279,000 (restated)). With the aforesaid and the currently available bank loans and other borrowings, the management is confident that the Group’s financial resource is sufficient to repay its debts and to finance its day-to-day operation and capital expenditure. The Group also has sufficient internal resources to finance its acquisition of certain interests in the COFCO Trading Group, the COFCO Chocolate Group (including relevant shareholders’ loans), Great Ocean (including relevant shareholders’ loans) and further equity interests in Northsea Oils and Grains Industries (Tianjin) Co. Ltd., an associate of the Group, which amounted to HK\$496,940,000 in total.

The Group’s monetary assets, liabilities and transactions are principally denominated in Hong Kong dollars, Renminbi and United States dollars. As the exchange rate between Hong Kong dollars and United States dollars is pegged, together with the minimal fluctuation in the exchange rate between Hong Kong dollar and Renminbi, the Group believes its exposure to exchange rate risk to be minimal.

## Capital Structure

During the period under review, the Company issued 884,656,250 new shares in aggregate for the acquisition of COFCO Oils & Fats and COFCO Wines & Spirits, and for the two share placements. Details of changes in the Company's share capital are set out in note 10 to the condensed interim accounts.

As at 30 June 2001, apart from certain bank loans, certain loans from the minority shareholders of the Group's subsidiaries and loans from COFCO (with an aggregate amount of HK\$1,022,521,000) (31 December 2000: HK\$70,950,000), the Group had no other material borrowings. During the period under review, all bank borrowings were interest-bearing on a fixed annual rate of 1.8 per cent. to 7 per cent. (31 December 2000: 1.8 per cent. to 7 per cent.). Other borrowings were either interest-free or interest-bearing on a fixed annual rate of 5.85 per cent. and 6.4 per cent. (31 December 2000: 6.4 per cent.).

As at the end of June 2001, the Group's aggregate shareholders' equity amounted to HK\$2,963,952,000 (31 December 2000: HK\$1,447,482,000 (restated)), whereas interest-bearing borrowings amounted to HK\$806,378,000 (31 December 2000: HK\$54,276,000). Based on the aforesaid, the Group's gearing ratio was approximately 27 per cent. (31 December 2000: 3.8 per cent.).

## Contingent Liabilities and Assets Pledged

Details are set out in notes 11 and 15 to the condensed interim accounts.

## Employment and Remuneration Policy

As at 30 June 2001, the total number of staff of the Group in the Mainland and Hong Kong was 2,058 (31 December 2000: 764). The Group remunerates its employees based on their performance, experience and prevailing industry practice. The Group provides retirement benefits for its employees in Hong Kong in the form of either Mandatory Provident Fund Exempted ORSO or Mandatory Provident Fund, and provides similar schemes for its employees in the Mainland. Details of retirement benefit schemes are set out in the Group's 2000 Annual Report.

The Group has established a Share Option Scheme (the "Scheme") to reward its employees (including executive Directors) for their individual performances. For the six months ended 30 June 2001, the Group has granted a total of 36,650,000 share options to its executive Directors and other eligible employees. Share options granted are exercisable any time for a period of four years starting from the expiry of a 12-month period after the grant.

Further details of the Scheme (including share options granted before the year 2001) were disclosed in 2000 Annual Report. During the period under review, no share option had been exercised.

### **Changes of the Group Structure**

Save as mentioned aforesaid, there was no change to the structure of the Group in the interim report period.