Greatwall is one of the three major brands of dry wine in China.

Management Discussion and Analysis

Qu Zhe
Managing Director

During the past year, through reorganisation, the Group acquired certain food and beverage businesses and agri-industrial businesses from the controlling shareholder of the company, COFCO (Hong Kong) Limited ("COFCO (HK)"), and disposed certain non-core businesses including the non-rice foodstuffs trading business to COFCO (HK) (the "Reorganisation"). On 31 December 2006, COFCO (HK) injected its beverage business and Shaoxing wine business, biofuel and biochemical business, oilseed processing business, rice processing business, brewing materials business and wheat processing business into the Group. The Group disposed of its non-core businesses to COFCO (HK). Upon completion of the Reorganisation, the enlarged Group (the "Enlarged Group") was engaged in the food and beverage businesses including wine business, beverage business, consumer-pack edible oil business and confectionary business as well as the agri-industrial businesses including biofuel and biochemical business, oilseed processing business, rice trading and processing business, brewing materials business and wheat processing business. On 21 March 2007, the Company span off China Agri-Industries Holdings Limited ("China Agri Holdings"), which owns the agri-industrial businesses, by way of distribution in specie and listed China Agri Holdings shares on the main board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") by way of introduction (the "Spin-off") and China Agri Holdings issued new shares through a global offering. Upon completion of the Spin-off, the Company became a company focusing on branded food and beverage businesses, and China Agri Holdings became a company focusing on agri-industrial businesses.

The annual report of the Company for the year 2006 covers the financial statements of the Enlarged Group which includes China Agri Holdings, as well as the supplemental pro-forma financial information of the Group illustrating the result of the Group, as if the Spin-off and disposal of non-core businesses occurred at the earliest date the financial statements are presented. During the year under review, the Enlarged Group's consolidated turnover was HK$26,012 million, representing an increase of 20.9% over the previous year (restated); profit attributable to shareholders reached HK$990 million, 75.9% more than that in the previous year (restated); basic earnings per share was HK37.28 cents, an increase of HK15.94 cents compared with HK21.34 cents per share (restated) in the previous year. The Group's pro-forma consolidated turnover after the Spin-off was HK$6,510 million, representing an increase of 13.2% over the previous year (restated); pro-forma profit attributable to shareholders reached HK$342 million, 32.9% more than that in the previous year (restated); pro-forma basic earnings per share were HK12.9 cents, an increase of HK3.1 cents compared with HK9.8 cents per share (restated) in the previous year.

The performances of each of the core businesses of the Enlarged Group during the year under review together with further information on the Group are set out below.

WINE BUSINESS

The Group's wine business is mainly engaged in the production and sale of wines under the "Greatwall" and "長城" brands in China. The business consists of the entire value chain from vineyards to wine-making to sales and marketing. During the year, sales volume of "Greatwall" wines increased from 77,700 tonnes in 2005 to 86,100 tonnes in 2006, representing an increase of 11%, and turnover was HK$1,803 million, representing an increase of 16.3% over the previous year (restated), and operating profit (excluding unallocated gains and expenses) was HK$319 million, representing an increase of 8.1% over the previous year (restated).

2006 was a critical year for the development of "Greatwall" wine business. We acquired the remaining 40% equity interest in each of COFCO Greatwall Winery (Yantai) Co., Ltd. and Yantai Greatwall Wines and Spirits Co., Ltd., upon which both companies became wholly owned subsidiaries

Management Discussion and Analysis

of the Company. Due to the sales channel consolidation initiative, the amount of increase in sales volume was slightly lower than the previous year. We initiated pilot schemes in northern China and southern China to explore new sales and distribution model, namely, to devote more resources to brand building. We successfully became the exclusive supplier of wines for the Beijing 2008 Olympics. This will further enhance the image of "Greatwall" and "長城" brands. With respect to operation and management, we have centralized the management of purchasing and production for the three wineries in the Group to further extract synergy and reduce costs.

It is expected that in the next ten years, the wine industry in the PRC will continue to grow rapidly. We consider that this growth potential mainly derives from the following aspects. First, with the increase of Chinese consumers' purchase power, wine is gradually becoming a more affordable fast moving consumer goods. Second, wine being a much healthier form of alcoholic beverage is well accepted by PRC consumers. Lastly, consumers in the PRC are becoming more receptive to western dining cultures, which also facilitate the increase in consumption of wine.

The Group's wine business is a market leader in the PRC wine industry. The "Greatwall" and "長城" wine brands, which are exclusively used by us, have been enjoying a high reputation. We have an extensive sales network and a young, energetic and experienced management team. With clearer brand positioning, product portfolio rationalization and sales channel consolidation, as well as being the exclusive supplier of wines for the Beijing 2008 Olympics, our competitiveness and market position will be further improved.

Shaoxing wine business was injected into the Group upon completion of the Reorganisation. This injection has enabled the Group to move one step further towards the goal of developing our branded wine business with more varieties. The scale of this business currently is relatively small. We expect that Shaoxing wine business will leverage on the sales network and experience of the wine business to increase its market share.

BEVERAGE BUSINESS

Beverage business was injected into the Group upon completion of the Reorganisation. The Group's Coca-Cola bottler group is currently one of the three key bottler groups in relation to Coca-Cola beverages in the PRC, which operates six bottling plants and holds minority interests in 14 bottling plants in the PRC. These six bottling plants are principally engaged in the production and bottling and sale and distribution of Coca-Cola beverages, including sparkling beverages and still beverages such as fruit juices, water and tea in twelve provinces and three other cities in the PRC under franchise from The Coca-Cola Company. Under the current bottler's agreements with The Coca-Cola Company, the term of the franchise is not more than five years and may be renewed by the parties upon agreement.

The Group's beverage business has an extensive sales and distribution network. The beverage business has a professional sales and marketing team. Outstanding performance in quality management and high operating efficiency are also critical success factors for this business. During the past three years, the bottlers operated by us were awarded "Quality Advancement Award" and "Total Product Quality Management Award" by The Coca-Cola Company in the China region. We have been able to continuously improve our production capacity utilization rate while reducing power consumption and logistics expenses.

The consolidated sales volume of this business increased by 22% from that in the previous year. The increase in sales ranked top among the bottlers of The Coca-Cola Company in the China region, of which the increase in sales volume of sparkling beverages was 21% and the increase in sales volume of still beverages was 28%. During the year, the consolidated turnover of this business was HK$2,431 million, which was increased by 26.8% from that in the previous year (restated). Operating profit (excluding unallocated gains and expenses) was HK$109 million, which was increased by 59.3% from the previous year (restated).

Management Discussion and Analysis

It is expected that the beverage market in the PRC will be growing at a compound annual growth rate of 15% in the coming five years. We will continue to benefit from such strong growth trend. By capitalizing on the strong sales and distribution network and the outstanding execution capabilities of the management team, our beverage business will continue to bring rewarding returns to the shareholders.

CONSUMER-PACK EDIBLE OIL BUSINESS

This business is principally engaged in the distribution and sale of consumer-pack edible oil in the PRC under the "福臨門" and "Fortune" brands. The sales were HK$1,854 million in 2006, which was decreased by 2.4% from HK$1,899 million (restated) in 2005. Competition in this business is increasingly intense.

In the course of the Reorganisation, we separated the consumer-pack edible oil business from the oilseed processing business and the sale of bulk edible oil business. The purpose was to allow a professional team to focus on the development of the retail consumer-pack edible oil market.

It is expected that consumers' demand for consumer-pack edible oil in particular high-end edible oil will continue to grow. We plan to make additional investment to improve the brand image of "福臨門" and "Fortune" as representing healthy and high-quality products. We will continue to research the market and to develop new products based on market demand. We plan to structurally increase the proportion of high-end products.

CONFECTIONERY BUSINESS

The Group produces and distributes chocolates and confectionery products in China under the "Le Conte" and "金帝" brands. In 2006, the turnover of this business was HK$421 million, representing an increase of 10.4% over the previous year (restated). However, due to the increase in marketing investment, this business recorded loss for the year. The rising prices of raw materials including nuts and sugar during the year also resulted in a decrease in the gross profit margins.

Although the confectionery business is relatively small within the Group, continuous management attention will be paid to its development strategies and brand positioning to ensure its success in an increasingly competitive market. In order to achieve greater retail coverage, apart from conventional channels such as supermarkets, we have begun to develop dedicated products, distributors network and sales teams to expand to the mass channel. This channel can deeply penetrate into middle and smaller cities and villages, where sales are mainly conducted on cash basis with a lower expense level as compared with conventional channels. In terms of brand building, we plan to invest to rebuild the "Le Conte" and "金帝" brands. We believe that investments in new sales channel structure and brand building will enhance the "Le Conte" and "金帝" brands and add value to this business.

OILSEED PROCESSING BUSINESS

Prior to completion of the Reorganisation, the Group's oilseed processing business was principally engaged in extracting and refining of edible oil and sale of related products, including soybean meal, bulk edible oils, consumer-pack edible oils, as well as other specialty oils in the PRC. Upon completion of the Reorganisation, the consumer-pack edible oil business was separated from the oilseed processing business. During the year, the oilseed processing business (excluding the consumer-pack edible oil business) recorded a turnover of HK$13,489 million, which was increased by 15.6% from the previous year (restated). Upon completion of the Spin-off, this business (excluding the consumer-pack edible oil business) was operated by China Agri Holdings.

WHEAT PROCESSING BUSINESS

During the year, the Group's wheat processing business recorded a turnover of HK$1,764 million, which was increased by 6.2% from the previous year (restated). Upon completion of the Spin-off, this business was operated by China Agri Holdings.

Management Discussion and Analysis

RICE PROCESSING AND RICE TRADING BUSINESS

The Group's rice processing and rice trading business recorded a turnover and operating profit (excluding unallocated gains and expenses) of HK$2,066 million and HK$129 million respectively in 2006, which was increased by 57.2% and 9.6% from the previous year (restated). Upon completion of the Spin-off, the rice processing and rice trading business was operated by China Agri Holdings.

NON-CORE TRADING BUSINESS

In the course of the Reorganisation, we separated the rice trading business from the trading business. The Group's trading business (excluding the rice trading business) recorded a turnover and operating profit (excluding unallocated gains and expenses) of HK$1,619 million and HK$66.78 million respectively in 2006, which was decreased by 17% and increase by 3.6% from the previous year (restated). Upon completion of the Reorganisation, this business (excluding the rice trading business) together with other non-core businesses were transferred to COFCO (HK).

OTHER BUSINESSES

Immediately upon completion of the Reorganisation, apart from the wine business, beverage business, confectionery business, consumer-pack edible oil business, oilseed processing business, wheat processing business and rice trading business, the businesses of the Enlarged Group also included the biofuel and biochemical business, oilseed processing business, rice processing business, brewing materials business and wheat processing business acquired from COFCO (HK). These acquired businesses, together with the Group's oilseed processing business, wheat processing business and rice trading business prior to completion of the Reorganisation, recorded a turnover - continuing operations and operating profit (excluding unallocated gains and expenses) - continuing operations of HK$17,899 million and HK$964 million respectively, representing an increase of 29.6% and 194.2% from 2005 (restated), respectively. Upon completion of the Spin-off, these agri-industrial businesses are operated by China Agri Holdings. Please refer to the 2006 annual report of China Agri Holdings for details of each of these businesses.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2006, the Enlarged Group's total shareholders' equity stood at HK$9,754 million, representing an increase of 67.3% compared with that as at 31 December 2005 (restated). As at 31 December 2006, the Enlarged Group's cash and bank deposits (including pledged deposits) total HK$2,570 million (31 December 2005: HK$1,636 million (restated)). The Enlarged Group's net current assets were approximately HK$3,126 million (31 December 2005: HK$339 million (restated)).

Based on the bank loans and other loans and facilities available to the Group, the management believes that the Group's financial resources are sufficient for all debt payments, day-to-day operations and capital expenditures. As the Group's monetary assets, liabilities and transactions are principally denominated in Renminbi, Hong Kong dollars and United States dollars, the management is of the view that the appreciation of Renminbi to a small extent will have positive effect on the Group. The Group's exposure in exchange rate is not significant.

CAPITAL STRUCTURE

During the year under review, the total number of issued shares of the Company increased by 53,194,000 shares as a result of certain executive directors of the Company and staff of the Group exercising their share options granted in 2003 and 2004.

In December 2006, the Company placed 100,000,000 shares in the share capital of the Company to independent investors at HK$6.94 per share by way of a top-up placing. Net proceeds amounted to approximately HK$685,000,000, which were used as general working capital.

In December 2006, pursuant to the Reorganisation, the Company issued 879,739,382 shares as consideration shares to COFCO (HK) at HK$5.25 per share, which were part of the consideration for the acquisition of certain food and beverage businesses and their relevant shareholders' loans, and agri-industrial businesses and their relevant shareholders' loans.

Management Discussion and Analysis

Save as the above, there were no other changes in the share capital of the Company during the year. As at 31 December 2006, the total number of issued shares of the Company was 2,791,383,356 shares.

As at 31 December 2006, the Enlarged Group had no significant borrowings apart from certain bank loans, loans from minority shareholders of the Company's subsidiaries and loans from a fellow subsidiary totaling HK$5,964 million (31 December 2005: HK$4,046 million (restated)). During the year, all the Group's bank borrowings bore fixed annual interest rates of between 3.00% and 7.01% (31 December 2005: between 4.09% and 7.56%). Other borrowings were interest-free or bore fixed annual interest rates ranging from 4.86% to 6.30% (31 December 2005: from 2.50% to 5.58%).

As at 31 December 2006, net debts (total debts excluding loans from minority shareholders of subsidiaries that were of capital nature less cash and bank deposits including pledged deposits) of the Enlarged Group were HK$3,394 million (31 December 2005: HK$2,410 million (restated)). The gearing ratio was approximately 34.8% (31 December 2005: approximately 41.3% (restated)). The gearing ratio of the Group after the Spin-off decreased significantly, which paved the broader way to financing in the future.

CONTINGENT LIABILITIES AND ASSETS PLEDGED

As at 31 December 2006, the Enlarged Group had no material contingent liabilities.

As at 31 December 2006, certain bank loans of the Enlarged Group were secured by charges over certain time deposits, fixed assets and investment properties with net book value of approximately HK$1,356 million (31 December 2005: HK$806 million (restated)).

EMPLOYEE AND REMUNERATION POLICY

As at 31 December 2006, the Enlarged Group employed approximately 19,000 staff in mainland China and Hong Kong (31 December 2005: 17,300 (restated)). Employees are paid according to their performance, experience and prevailing trade practices, and are provided with on-the-job and professional training. Employees in Hong Kong receive retirement benefits, either under the Mandatory Provident Fund exempted ORSO scheme or under the Mandatory Provident Fund scheme. There is a similar scheme for employees in mainland China. Details concerning employee benefit schemes are set out in note 3.4 to the financial statements headed "Summary of Significant Accounting Policies" under sub-heading "Employee Benefits" of the 2006 Annual Report.

The Company has implemented a share option scheme to reward eligible employees (including executive directors of the Company) according to individual merits. During the year under review, in light of the anticipated change to the capital and structure of the Company as a result of the Reorganisation and the Spin-off, the Board recommended adjusting the vesting period applicable for exercising outstanding options granted under the existing share options scheme, which became effective on 22 June 1997 and was valid for 10 years ("Existing Share Option Scheme"), and as well as adopting a new share option scheme. At the general meeting of the Company held on 21 November 2006, shareholders of the Company resolved and approved by way of ordinary resolution that the outstanding share options in respect of 7,716,000 shares, which would not become exercisable until 20 August 2007, became exercisable prior to the Spin-off and in any event, before the Special Dividend Record Date (as defined in the section headed "Change in the Structure of the Group"), and a new share option scheme was adopted. The Existing Share Option Scheme ceased to operate upon the adoption of the new share option scheme. However, the cessation will not detrimentally affect the outstanding options under the Existing Share Option Scheme and the rights and interests attached thereto. During the year under review, apart from the lapse of share options in respect of 3,910,000 shares, a total of 53,194,000 shares were issued and allotted by the Company upon the exercise of share options by certain directors and staff. As at 31 December 2006, there were no outstanding share options.

The share options granted under the new share option scheme is exercisable in five years according to the schedule after 24 months from the date they are granted. During the year, the Company did not grant any share options to the executive directors of the Company and other eligible employees of the Group under the Existing Share Option Scheme or the new share option scheme.

Management Discussion and Analysis

CHANGE IN THE STRUCTURE OF THE GROUP

During the year under review, apart from completion of the acquisition of the remaining 40% equity interest in each of COFCO Greatwall Winery (Yantai) Co., Ltd. and Yantai Greatwall Wines and Spirits Co., Ltd., upon which both companies became wholly owned subsidiaries of the Company, the Group also conducted reorganization of its businesses and assets, which included the acquisition of certain food and beverage businesses and agri-industrial businesses and the disposal of certain non-core businesses.

On 23 August 2006, the Company incorporated China Agri-Industries Limited ("China Agri") in Bermuda as its wholly owned subsidiary and operating company for the Group's agri-industrial businesses. On 9 October 2006, the Company published an announcement, which set out, among others, the Reorganisation and the proposed spin-off of China Agri and the listing of China Agri shares on the Main Board of the Stock Exchange. A circular ("October Circular") was dispatched to the shareholders on 28 October 2006, which set out, among others, the details of the Reorganisation and the proposed spin-off of China Agri. On 31 December 2006, the Group completed internal reorganization, pursuant to which all agri-industrial businesses, including oilseed processing business, rice trading business and wheat processing business, were transferred to China Agri. The Group also completed the acquisition from COFCO (HK), the controlling shareholder of the Company, of Jumbo Team Group Limited ("Jumbo Team") which owns certain food and beverage businesses, while China Agri acquired from COFCO (HK) Full Extent Group Limited ("Full Extent") which owns certain agri-industrial businesses. At the same time the Group disposed to COFCO (HK) Seabase International (B.V.I.) Limited, COFCO (BVI) No. 99 Limited and First Reward Limited which own certain non-core businesses. Details of the Reorganisation and the Spin-off, as well as the interest in the subsidiaries held by Jumbo Team and Full Extent, and information on their respective businesses were disclosed in the announcement published by the Company on 9 October 2006 and the October Circular.

On 10 January 2007, the Company announced that the company to be spun-off and listed was changed to China Agri Holdings, a wholly owned subsidiary incorporated in Hong Kong. Accordingly, amendments were made to the Spin-off proposal. On the same date, the Company entered into a sale and purchase agreement with China Agri Holdings, pursuant to which, China Agri Holdings acquired all issued shares in China Agri from the Company, and issued and allotted a total of 2,791,383,346 shares in China Agri Holdings to the Company as the consideration for the acquisition. Upon completion of the transaction, China Agri Holdings became the sole shareholder of China Agri. Details of the amendment to the Spin-off proposal were disclosed in a circular dispatched to the shareholders by the Company on 13 January 2007.

The Board announced on 8 February 2007 that it declared a conditional special interim dividend to be satisfied by way of distribution in specie, namely, by transferring approximately one China Agri Holdings share ("Special Dividend") for every one share held by the qualifying shareholders, whose names appeared on the register at 4:00 p.m. on 16 February 2007 ("Special Dividend Record Date"). The Special Dividend was conditional upon the Listing Committee of the Stock Exchange granting the approval for the spin-off of China Agri Holdings and the listing of China Agri Holdings shares by way of introduction, and permission to deal in the China Agri Holdings shares in issue and completion of the Spin-off. Subject to completion of the global offering, the qualifying shareholders could elect (the "Election") to transfer all (or, in certain cases, part) of their entitlements to the China Agri Holdings shares to COFCO (HK). In consideration for such transfer, COFCO (HK) would pay each qualifying shareholder who validly made the Election a cash amount (the "Cash Payment") equal to the total number of China Agri Holdings shares which were the subject of such transfer multiplied by the offer price of new China Agri Holdings shares in the global offering, after deducting any applicable underwriting commissions, stamp duty and other applicable charges for such transfer. Overseas Shareholders, as defined in the announcement published by the Company on 9 February 2007, could only elect to receive Cash Payment. Details of the Special Dividend were disclosed in the announcement published by the Company on 9 February 2007.

Management Discussion and Analysis

On 21 March 2007, the Spin-off became unconditional and the distribution of Special Dividend was simultaneously completed.

After completion of the Spin-off, currently the business of the Group comprises food and beverage businesses involving or related to:

(i) beverage business principally involving the production, bottling, distribution and sale of certain Coca-Cola beverages;

(ii) wine business including, other than the existing wine business of the Group, the production, sale and distribution of a ranges of Shaoxing wines;

(iii) confectionery business; and

(iv) consumer-pack edible oil business.

PROSPECTS

After the Spin-off, the business focus of the Group is clearer. Our vision is to develop the Group into a most valuable foods company in China with multiple brands. We will focus on the creation of valuable brands and the establishment of extensive sales network in the next few years. With this focus in mind, we will continuously review and adjust our development strategies and enhance our execution capabilities in order to create greater value for our shareholders and employees.

Qu Zhe
Managing Director

Hong Kong, 19 April 2007