

Quality Food International Limited

RELATED PARTY AND CONNECTED TRANSACTIONS

The Group had the following significant related party transactions during the period:

Name of related party	Name of transaction	Notes	2000	2000
			HK\$'000	HK\$'000
Fu Qing Sanhua Forage Co. Ltd.	Purchaser of raw materials			
	and finished goods	(i)	17,455	6,530
	Royalty income received	(ii)	3,304	1,004
Bright & Shine Corporate Finance Limited	Consultancy fees paid	(iii)	–	300
Great Global Limited	Disposal of interests	(iv)	–	19,080

Notes:

- (i) Fu Qing Sanhua Forage Co. Ltd. (“Fu Qing Sanhua”) is an associate of the Company (within the meaning of SSAPs). The directors consider that the purchases were made at cost.
- (ii) According to an agreement between Fu Qing Sanhua and the Group, the royalty fee relates to the use of the Group’s eel feed formulae by Fu Qing Sanhua and is based on 10% of the gross sales amount of Fu Qing Sanhua attributable to the use of eel feed formulae, except those related to sales to companies of the Group.
- (iii) The consultancy fees, which represented charges for giving advice on the Group reorganization and flotation, were charged on the basis of rates agreed with Bright & Shine Corporate Finance Limited.
- Mr. Juleus Lee, a director of the Company, was directly interested as a director and beneficial shareholder of Bright & Shine Corporate Finance Limited.
- (iv) A 29% equity interest in Fuqing Qixiang Food Co. Ltd. (“Fuqing Qixiang”), a 99% owned subsidiary of the Group, and a 51% equity interest in Fu Qing Sanhua, a wholly-owned subsidiary of the Group, were disposed of to Great Global Limited (“Great Global”), a company owned as to 99% by Mr. Lam Hau Mei and 1% by Mr. Lin Hou Yun, who are both directors of the Company, at an aggregate cash consideration of US\$2,465,000 computed based on the unaudited net asset value of the relevant equity interests disposed of as at 1 September 1999, the effective date of disposal. Thereafter, Fuqing Qixiang became a 70% owned subsidiary of the Company and Fu Qing Sanhua became an associate of the Company.

Additionally, during the period, Fuqing Qixiang, a 70% owned subsidiary, sold finished goods amounting to HK\$146,750,000 (1999: HK\$12,936,000) to Qixiang Food Limited, a wholly-owned subsidiary, at prices which were based on 90% of the selling prices charged by Qixiang Food to other customers.

On 19 October 1999, the Company entered into an option agreement, pursuant to which the Company has an option to acquire from Mr. Lam Hau Mei and Mr. Lin Hou Yun, directors of the Company, a 100% equity interest in Great Global at a consideration to be based on the net asset value of Great Global at the date of exercising the option. The option is exercisable within three years from the date of the option agreement. As at the date of this report, Great Global held a 29% equity interest in Fuqing Qixiang and a 51% equity interest in Fu Qiang Sanhua.

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The transactions between the Group and Fu Qing Sanhua and between Fuqing Qixiang and Qixiang Food were connected transactions under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

LIQUIDITY AND FINANCIAL RESOURCES

The Group generally finances its operations with internally generated cash flow and banking facilities provided by the principal bankers in the PRC. As at 31 October 2000, the Group's net asset value stood at HK\$163 million with total assets over HK\$261 million, out of which included cash and bank balances of HK\$41 million. The Group's bank borrowings at 31 October 2000 amounted to HK\$49.9 million of which approximately HK\$42.4 million, was secured by the Group's leasehold land and buildings in the PRC. The remaining bank loans of approximately HK\$7.5 million were secured by guarantees executed by a related company. The gearing ratio of the Group at 31 October 2000 calculated as a ratio of total bank loans to total assets was 19%. Net current assets was approximately HK\$97 million and current ratio was maintained at a healthy level of approximately 209%.

With the above, the Group has adequate capital resources to finance its business operations.

BUSINESS REVIEW AND PROSPECTS

For the six months ended 31 October 2000, the turnover of the Group increased by 11% from HK\$190 million to HK\$211 million when compared to the corresponding period in the previous year. Profit attributable to shareholders was HK\$25.9 million. Earnings per share was 1.85 HK cents. (1999: 2.37 HK cents after the adjustment of the bonus issue of eight shares for every two shares held by shareholders whose names appear on the register of members on 30 October 2000)

The Group is the largest manufacturer of processed eels in the world. Premium processed eels are manufactured in its two facilities which are located in Fuqing, the PRC, and are marketed to Japan under its own brandname "Qixiang". During the review period, sales was up by approximately 17% to HK\$166 million for 1,680 tonnes (1999: 1,300 tonnes) against last year's figure of HK\$142 million. The processed eel business accounted for approximately 78.5% of the Group's total turnover.

During the review period, the cost of live eels increased substantially due to the shortage in supplies of premium grade eels. The Directors expect to adjust selling prices in the second half of the financial year, in view of the market situation to ensure steady returns in profit. The maximum production capacity is 6,000 tonnes of processed eels per year in its two production facilities. It is expected that production will reach approximately 4,300 tonnes for the entire fiscal year. With eight high efficiency vacuum packing machines and approximately 1,000 tonnes large capacity cold storage facility, the Group is able to keep an optimal level of inventory in the slack season to cater for the enormous demands generated in the peak periods.

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With the obtaining of ISO 9002 and HACCP quality assurance accreditation, the Group has adopted the most stringent manufacturing and quality control standards. Due to its continuous efforts to pursue quality processed eels, the Group has established a strong foothold in the industry with a reputation for manufacturing both a top quality and tasty delicacy. With the ever-increasing popularity of Japanese food and the trend in pursuing health conscious life styles, processed eels are highly popular in the market as they are rich in protein and vitamins. Japan which is the world's largest processed eel importing country which forms the Group's major market. During the review period, the Group's processed eels were all exported to Japan. The Group is now also considering expansion into other regions which possess large market potential.

Apart from its core processed eel manufacturing business, the Group also engages in a secondary business line, manufacturing and sale of quality eel feeds to approximately 250 eel farms in the PRC under the "Sanhua" brandname. The eel feed business serves as a complementary arm to the Group's processed eel manufacturing business. Leveraging its extensive experience in the processed eel industry, the eel feeds business contributed approximately 60% of the Group's profit during the period under review.

As stated in the annual report, the Group is committed to improving the quality of its processed eels. On 31 October 2000, the Group entered an agreement with Grobest International Development Limited ("Grobest"), the largest seafood feeds manufacturer in the PRC, to jointly develop and upgrade the quality of eel feeds.

Under this cooperation, Quality Food, as an user, will utilize its industry know-how and provide the valuable information and input on how to improve the quality of feeds. At the same time, based on Grobest's expertise and R&D capability, it will be able to employ the advanced biotechnology engineering which is capable of developing top-class and improved eel feeds. The improved eel feed is undergoing testing and is proving to be a success in enhancing the immune system of eels and enriching the texture of their meat. As a result, the Group will source the improved live eels, enhancing the quality of processed eels and stimulating demand for improved quality processed eels. This improvement process will enable the Group to enlarge its existing market share even further.

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Looking into future, the Group is well positioned to grasp the opportunities ahead by leveraging its competitive edge and established leadership position in the industry. It will then maximize advantages of its business by engaging in a vertically integrated eel feed and processed eel manufacturing model. In addition, with the joint efforts being made to improve the quality of eel feeds with the application and study of the latest biotechnology technique with Grobest, the quality of processed eels will be greatly enhanced. In the meantime, the Group will continue to adopt prudent cost control policies and remain committed to maintaining a healthy financial position. With the popularity of Japanese food around the world, the Group is confident of its promising business growth which will bring rewarding returns to shareholders.

EMPLOYEES

The Group had a total of approximately 580 employees in Hong Kong and the PRC as at 31 October 2000. The Group ensures that pay scales of its employees are rewarded on a performance related basis within the general framework of the Group's remuneration strategy.