

# Management Discussion and Analysis

## **BUSINESS ENVIRONMENT**

To most people, corn is merely used as feed and food. In fact, corn can be found in many different products from food to industrial chemicals. Traces of corn can be found in a variety of products, including soft-drink, cosmetics, paint and varnish and pharmaceuticals. The components of corn kernels — starch, oil, protein, fibre — are high-valued products. Through fermentation, hydrolysis and other procedures, corn starch, the principal component of corn kernels, starch, can be further refined into high value-added corn based biochemical products, such as lysine, corn sweeteners and modified starch. In some developed countries such as the United States of America (the “US”), food processing and industrial users consume approximately 25% of corn today.

China is the world’s second largest corn producing country, accounting for approximately 21% of global production. In the past 15 years, China’s production of corn has increased dramatically, rising at nearly 5% compound annual growth rate. Corn is now ranked among wheat and rice as one of China’s most important grain crops. Of the huge volume of corn output in the PRC, a substantial portion of which is used for the production of animal feed, while only approximately 3% of output is processed and refined to produce higher value-added products, such as starch, as compared to approximately 25% in the US. In China, the industrial consumption of corn was only approximately 4.7 million metric tonnes, equivalent to only approximately 12% of the level in the US. This low utilisation contrasts sharply with Japan and Korea, the two countries of which are having low corn production, but are ranked among the ten largest corn processors in the world. As China is still at its initial stage of corn utilisation, corn processing can be regarded as an infant industry with substantial room for development. Currently, most of the corn producers in China are in small-scale operations, with a capacity of less than 50,000 tonnes a year.

Equipped with an annual processing capacity of 600,000 metric tonnes and downstream vertical integration, the Group is considered a leader in this industry in China. It is the Group’s intention to expand its production capacity to 1,800,000 metric tonnes before the end of 2003, in order to maintain its leading position in the industry.

In view of the improvements in living standards and the awareness of health care and environmental protection in China, the demand for corn based biochemical products such as amino acids, corn sweeteners and modified starch has been experiencing a substantial increase, and these products are becoming daily necessities. The rapid increase in demand of these corn based biochemical products has created a new era for the growth of the Group.

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## OPERATING RESULTS

The following is a summary of the pro forma combined results of the Group for each of the four years ended 31 December 2000 prepared on the basis set out in note 1 below:

|  | Year ended 31 December |           |          |          |
|--|------------------------|-----------|----------|----------|
|  | 2000                   | 1999      | 1998     | 1997     |
|  | HK\$'000               | HK\$'000  | HK\$'000 | HK\$'000 |
| Turnover   | <b>1,208,026</b>       | 1,046,910 | 534,413  | 172,443  |
| Profit before tax  | <b>280,736</b>         | 147,415   | 53,042   | 13,928   |
| Tax  | <b>(14,227)</b>        | (174)     | (2,338)  | —        |
| Profit before minority interests                                 | <b>266,509</b>         | 147,241   | 50,704   | 13,928   |
| Minority interests   | <b>(36,341)</b>        | (34,483)  | (8,520)  | —        |
| Net profit from ordinary activities attributable to shareholders | <b>230,168</b>         | 112,758   | 42,184   | 13,928   |

Note:

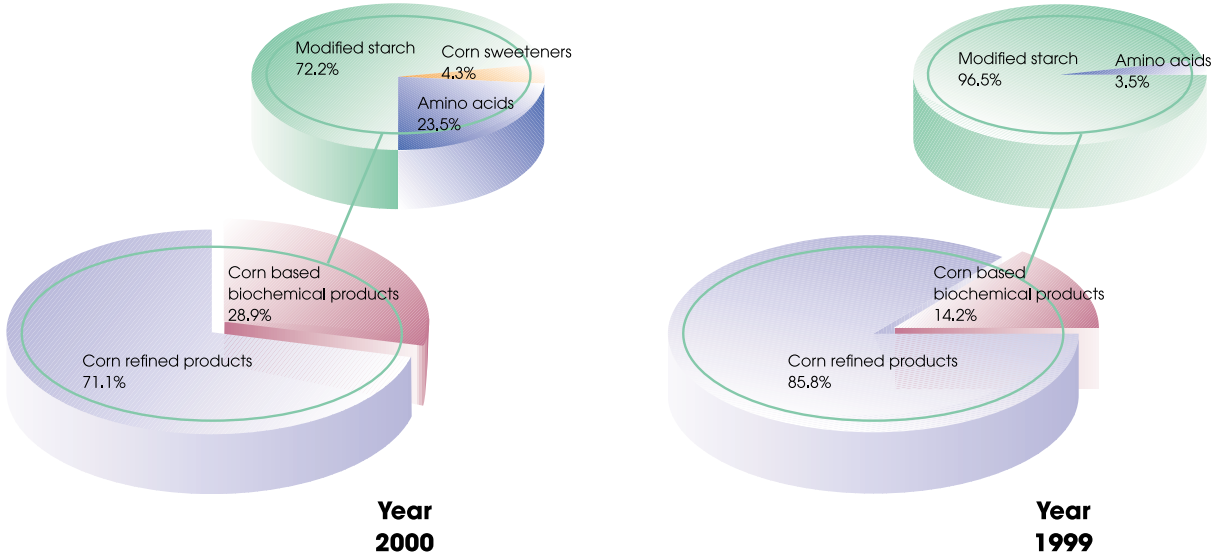
1. The summary of the pro forma combined results of the Group for each of the three years ended 31 December 1999 was extracted from the Company's prospectus dated 7 March 2001. Such summary was prepared in accordance with the audited financial statements of the companies now comprising the Group as if the current structure of the Group had been in existence throughout these financial years and prepared on the basis set out in note 1 of the "Notes to Financial Statements". The pro forma combined results of the Group for the year ended 31 December 2000 are those set out on page 35 of this annual report.

# Management Discussion and Analysis

## GROWTH OF SALES

Below is the sales analysis of the Group:

|                                       | Quantity       |         |         | Sales            |           |         |
|---------------------------------------|----------------|---------|---------|------------------|-----------|---------|
|                                       | Year           |         |         | Year             |           |         |
|                                       | 2000           | 1999    | change  | 2000             | 1999      | change  |
|                                       | MT             | MT      | %       | HK\$'000         | HK\$'000  | %       |
| Corn based<br>biochemical<br>products |                |         |         |                  |           |         |
| Modified starch                       | <b>25,537</b>  | 14,415  | 77.2    | <b>252,562</b>   | 143,931   | 75.5    |
| Amino acids                           | <b>5,478</b>   | 353     | 1,451.8 | <b>82,201</b>    | 5,209     | 1,478.1 |
| Corn sweeteners                       | <b>7,651</b>   | —       | N/A     | <b>14,881</b>    | —         | N/A     |
|                                       | <b>38,666</b>  | 14,768  | 161.8   | <b>349,644</b>   | 149,140   | 134.4   |
| Corn refined products                 | <b>679,970</b> | 693,041 | (1.9)   | <b>858,382</b>   | 897,770   | (4.4)   |
| <b>Total</b>                          | <b>718,636</b> | 707,809 | 1.5     | <b>1,208,026</b> | 1,046,910 | 15.4    |



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In 2000, the volume of the Group's products sold increased by 1.5% as compared to that of the previous year. Although the demand from local and overseas markets for the Group's products increased continuously over the years, the increase in turnover was not significant. In fact, the improvement in sales volume was constrained by the corn processing capacity of the Group. In 2000, the capacity increased slightly as compared to 1999. On the other hand, turnover, same as our expectation, increased by 15.4%, which is mainly attributable to the Group's success in the sale of high value-added products, i.e. corn based biochemical products.

During the year under review, sale of corn based biochemical products increased approximately 134.4% as compared to that of 1999. The significant increase resulted not only from the substantial improvement in the sale of existing corn based biochemical product, i.e. modified starch, of which both sales volume and turnover increased over 70.0% in this year, but also from the mass production and the launch of two new biochemical products, namely, amino acids and corn sweeteners in mid 2000 respectively, which amounted to approximately 8.0% of Group's turnover.

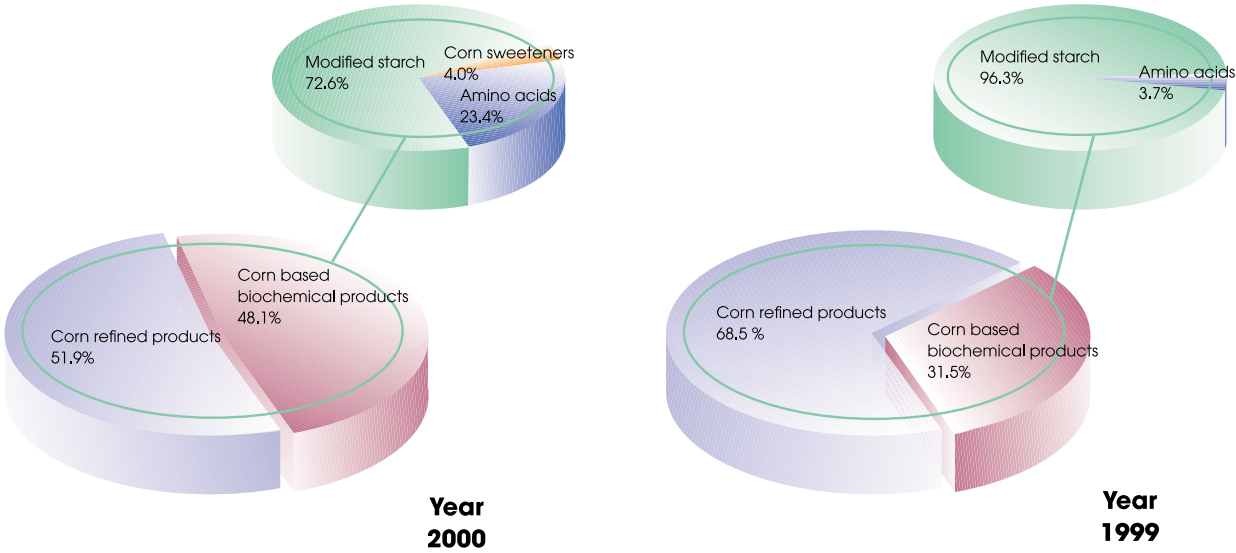
Due to the rapid expansion of those enhanced corn based biochemical products, the increased production of corn refined products, being the raw materials of those downstream products, was utilised internally. As a result, the sale of corn refined products to outsiders remained healthy and strong for the year. Furthermore, in view of the continuous decrease in the price of corn kernels, the Group adjusted its selling price of corn refined products downward to reinforce its competitiveness within the industry. As a result, the sale of corn refined products decreased slightly by 4.4%. Despite the downward price adjustment there was a favorable impact on the Group's operating results as the magnitude of downward adjustment in selling price was less than the decrease in corn kernels price.

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## IMPROVED GROSS PROFIT

Below is the gross profit analysis of the Group:

|                                 | 2000           |             | Year             |       | change<br>% |
|---------------------------------|----------------|-------------|------------------|-------|-------------|
|                                 | HK\$'000       | GP%         | 1999<br>HK\$'000 | GP%   |             |
| Corn based biochemical products |                |             |                  |       |             |
| Modified starch                 | <b>142,587</b> | <b>56.5</b> | 76,572           | 53.2% | 86.2        |
| Amino acids                     | <b>45,925</b>  | <b>55.9</b> | 2,967            | 57.0% | 1,447.9     |
| Corn sweeteners                 | <b>7,980</b>   | <b>53.6</b> | —                | —     | N/A         |
|                                 | <b>196,492</b> | <b>56.2</b> | 79,539           | 53.3% | 147.0       |
| Corn refined products           | <b>212,136</b> | <b>24.7</b> | 172,620          | 19.2% | 22.9        |
| <b>Total</b>                    | <b>408,628</b> | <b>33.8</b> | 252,159          | 24.1% | 62.1        |



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During the year under review, sale of corn refined products of the Group remained at a similar level as compared to that of 1999, while gross profit of the Group increased by approximately HK\$39.5 million, representing an increase of approximately 22.9% as compared to that of the previous year. Such an increase was mainly attributable to the drop in raw materials price of approximately 8.0% as compared to 1999. In order to obtain a cheaper source of raw materials, the Group adopted a new practice of purchasing corn kernels from farmer directly, who are willing to offer competitive prices to the Group in exchange for shorter payment terms. By using computer systems to assist the plant supervisors and technicians to exercise online, real time control over the production process, the Group can maintain operational consistency and assures purity of products with maximum cost efficiency and minimal materials wastage throughout the production process. The high product quality reinforces our product prices while the low production wastage lowers cost of our products. All these are important contributing factors in increasing the gross profit margin of our corn refined products.

For corn based biochemical products, the average gross profit margin remained at a level of over 50% during the year under review. The relatively high profit margin as compared to other manufacturers within the industry evidenced the Group's success in adopting downstream vertical integration. The stable supply of corn starch by our upstream production, coupled with the profits captured from internalising the supply of these intermediate raw materials, provided a wider profit margin to our corn based biochemical products. In mid 2000, two of our corn based biochemical products, amino acids and corn sweeteners, commenced its mass production and were launched to market, from which an additional gross profit of approximately HK\$50.9 million was achieved. At the same time, the production of modified starch was approaching full capacity. Leveraged on the advantage of large scale production and lower raw materials cost, the gross profit margin of these products grew by approximately 3.0%. As a whole, corn based biochemical products contributed approximately HK\$196.5 million to the Group's gross profit in 2000, representing an increase of approximately 147.0% from 1999. Inevitably, corn based biochemical products will continue to be our major sources of income in the coming years.

### OTHER REVENUE, OPERATING EXPENSES AND FINANCE COSTS

|                                   | Year          |            | 1999     | change        |        |
|-----------------------------------|---------------|------------|----------|---------------|--------|
|                                   | 2000          | % to       |          |               |        |
|                                   | HK\$'000      | turnover   | HK\$'000 | % to turnover | %      |
| Other revenue                     | <b>4,933</b>  | <b>0.4</b> | 1,206    | 0.1           | 309.0  |
| Selling and distribution expenses | <b>45,967</b> | <b>3.8</b> | 31,687   | 3.0           | 45.1   |
| Administrative expenses           | <b>36,006</b> | <b>3.0</b> | 26,264   | 2.5           | 37.1   |
| Other operating expenses          | <b>14,905</b> | <b>1.2</b> | 29,713   | 2.8           | (49.8) |
|                                   | <b>96,878</b> | <b>8.0</b> | 87,664   | 8.3           | 10.5   |
| Finance costs                     | <b>35,947</b> | <b>3.0</b> | 23,812   | 2.3           | 51     |

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Other revenue of the Group in 2000 comprised the proceeds from the disposal of certain scrap materials, such as containers, which amounted to approximately HK\$2.1 million (1999: 0.1 million). The remaining balance in other revenue represented the bank interest earned.

As in 1999, the Group exercised stringent control over its selling and distribution and administrative expenses. It is the Group's practice to control these expenses in accordance with its sales performance. In view of expanded overseas sales to Asian countries, the distribution expenses increased while the administrative expenses remained at a reasonable level.

A substantial portion of other operating expenses was attributed to research and development cost. In 1999, the Group acquired the technical know-how related to the corn based biochemical processes which amounted to HK\$22.8 million as a way to strengthen its competitiveness. As the expenditure was not related to any specific product, it was directly charged to the profit and loss account. In 2000, the Group focused on its internal development of new production technology and new products, which are expected to be commercialised in the coming years.

The finance costs increased from approximately HK\$23.8 million in 1999 to approximately HK\$35.9 million in 2000 as a result of the increase in bank borrowings used for the expansion of the Group's production capacity and operations.

## **PROFIT GROWTH**

Combining the effects of changes in gross profit, operating expenses and finance costs, the Group's net profit from ordinary activities attributable to shareholders improved from approximately HK\$112.8 million in 1999 to approximately HK\$230.2 million in 2000. The net profit to turnover also increased from 10.8% to 19.1%. To summarise, the significant growth in net profit from ordinary activities attributable to shareholders was attributable to the sale of corn based biochemical products.

## **FINANCIAL POSITION**

### **Structure of Assets and Liabilities**

As at 31 December 2000, total assets of the Group increased by approximately HK\$286.3 million to approximately HK\$1,193.6 million, while the net current assets of the Group increased by approximately HK\$107.6 million to approximately HK\$141.9 million. The total liabilities increased only by approximately HK\$8.3 million. The shareholders' equity was approximately HK\$367.0 million, representing an increase of approximately HK\$236.3 million over 1999.

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In view of the expansion of the Group's production capacity in corn based biochemical products, both the production facilities and working capital requirement increased during the year, which was financed by the Group's internal resources and bank borrowings. As at 31 December 2000, the total bank borrowings of the Group amounted to approximately HK\$540.0 million. These borrowings were secured by (i) fixed charges on certain leasehold land and buildings, and plant and machinery of the Group; (ii) a corporate guarantee given by a subsidiary of the Company; (iii) fixed deposits owned by certain directors of the Company; (iv) personal guarantees given by certain directors of the Company; and (v) corporate guarantees given by independent third parties. With strong operating results and proceeds from the Share Offer, the Group's reliance on external financing is expected to be lessened.

As at the closing date of the year under review, the Group's current ratio, quick ratio, gearing ratio and debts to equity ratio of the Group were approximately 1.4 (1999: 1.1), 1.1 (1999: 0.9), 60.9% (1999: 79.3%) and 156.0% (1999: 382.1%), respectively. These changes reflected an improvement in the Group's structure of assets and liabilities.

Below is the summary of major balance sheet items:

|                          | <b>31 December</b> |          | Change<br>% |
|--------------------------|--------------------|----------|-------------|
|                          | <b>2000</b>        | 1999     |             |
|                          | <b>HK\$'000</b>    | HK\$'000 |             |
| Non current Assets       | <b>694,295</b>     | 575,366  | 20.7        |
| Current assets           | <b>499,306</b>     | 331,896  | 50.4        |
| <b>Total assets</b>      | <b>1,193,601</b>   | 907,262  | 31.6        |
| Current liabilities      | <b>357,453</b>     | 297,657  | 20.1        |
| Non-current liabilities  | <b>296,729</b>     | 348,229  | (14.8)      |
| <b>Total liabilities</b> | <b>654,182</b>     | 645,886  | 1.3         |
| Minority interests       | <b>172,382</b>     | 130,658  | 31.9        |
| Capital and reserves     | <b>367,037</b>     | 130,718  | 180.8       |