

MANAGEMENT DISCUSSION AND ANALYSIS

Products of the Group

The Group's corn refined products mainly comprise corn starch, corn gluten, corn oil and feed. These products are further refined or processed into a wide range of value-enhanced corn based biochemical products, such as modified starch, corn sweeteners and amino acids including lysine.

Operating environment

In the first half of 2001, the continuous growth of the PRC economy provided a favourable operating environment for the Group. Sales and profit margins of corn based biochemical products increased substantially compared with the same period last year. This further consolidated the Group's position as one of Asia's leading integrated agro-biochemical companies.

Despite the gradual price increase in the Group's principal raw material, corn kernels, gross profit margins of corn refined products increased slightly as the Group was able to pass on the increased cost to its customers. The Group adopted a strategy of bulk purchase of raw materials at competitive prices in order to minimise the effect of price fluctuations.

The price of lysine (a substitute of animal-based proteins in animal feed) was stable, except that during the first quarter of 2001, the price increased as a result of the mad cow disease in Europe.

Financial performance

The Group's unaudited consolidated turnover and net profit from ordinary activities attributable to shareholders for the six months ended 30 June 2001 were approximately HK\$686 million and approximately HK\$164 million, representing significant growth rates of approximately 34% and 103% respectively as compared to the same period last year.

The principal market of the Group remains the PRC which accounted for approximately 92% of the Group's turnover. Sales to overseas markets including Korea, Japan and Taiwan together amounted to approximately HK\$52 million, representing an increase of approximately 93% compared to the same period last year.

The Group has been engaged in the commercial production of corn sweeteners and lysine, one of the more widely used amino acids, since mid 2000. In view of the increasing demand for these products, the Group achieved a remarkable growth in the sales of corn based biochemical products to approximately HK\$309 million as compared to the same period last year. The Group's continuing efforts in expanding the production of its downstream corn based biochemical

products led to higher internal consumption of corn starch for the production of such products. As a result, sales of corn based refined products dropped slightly by approximately 7% to approximately HK\$377 million. Profit margins of both corn based biochemical products and refined products increased slightly during the period as compared to that of the corresponding period last year. As a result of the change in the product mix towards higher margin corn based biochemical products, overall gross profit margin increased from approximately 30% to approximately 40%.

With a view to expanding the Group's products and improving its production technology, the Group incurred approximately HK\$9 million on research and development of value-enhanced corn based biochemical products, which was approximately 56% more than the same period last year. Increases in other expenses were in line with the increase in turnover.

The interest expense for the six months ended 30 June 2001 was approximately HK\$23 million. Compared with that of the corresponding period of the previous year which amounted to approximately HK\$16 million, the percentage increase in interest expense was in line with the percentage increase in the amount of bank borrowings. The additional bank borrowings incurred were mainly deployed to expand the Group's production capacity.

As there was no significant change in the bases or rates of profits tax, the effective tax rate on the Group's profit remained at approximately 5%. Net profit from ordinary activities attributable to shareholders increased by approximately HK\$83 million to approximately HK\$164 million.

Liquidity and financial resources

Net current assets of the Group amounted to approximately HK\$233 million as at 30 June 2001 (31 December 2000: HK\$142 million) comprising inventories of approximately HK\$142 million (31 December 2000: HK\$90 million), trade and other receivables of approximately HK\$314 million (31 December 2000: HK\$313 million), cash and bank balances of approximately HK\$430 million (31 December 2000: HK\$96 million) and current liabilities of approximately HK\$653 million (31 December 2000: HK\$357 million). The cash and bank balances included approximately HK\$190 million of net proceeds from the Company's share offer in March 2001 which have not yet been applied. The current ratio slightly decreased from approximately 1.40 as at 31 December 2000 to approximately 1.36 as at 30 June 2001 mainly due to the reclassification of a long term bank borrowing of HK\$150 million as at 31 December 2000 to current liability.

The Group had interest bearing borrowings of approximately HK\$656 million as at 30 June 2001 (31 December 2000: HK\$540 million), representing an increase of approximately 21% over the amount as at 31 December 2000. The increased amount of borrowings was principally utilised for the expansion of the Group's production capacity. Approximately 28% of the total borrowings were denominated in Hong Kong dollars and United States dollars while the remainder was

denominated in Renminbi. The maturity profile of the Group's outstanding borrowings is spread over a period of 3 years, with approximately 79% of the borrowings repayable within one year. Certain assets of the Group have been pledged to secure its borrowings, comprising a bank deposit of approximately HK\$150 million (31 December 2000: HK\$150 million) and fixed assets with carrying value of approximately HK\$226 million as at 30 June 2001 (31 December 2000: HK\$235 million).

At 30 June 2001, the Group had total assets of approximately HK\$1.8 billion (31 December 2000: HK\$1.2 billion) which were financed by current liabilities of approximately HK\$653 million (31 December 2000: HK\$357 million), non-current liabilities of approximately HK\$137 million (31 December 2000: HK\$297 million), minority interests of approximately HK\$204 million (31 December 2000: HK\$172 million) and shareholders equity of approximately HK\$810 million (31 December 2000: HK\$367 million). The Group's gearing ratio as at 30 June 2001 was approximately 36% (31 December 2000: 45%), which was calculated based on the aggregate amount of bank borrowings of approximately HK\$656 million (31 December 2000: HK\$540 million) and total assets of approximately HK\$1.8 billion (31 December 2000: HK\$1.2 billion).

Although significant portions of the Group's borrowings, turnover and purchases are primarily denominated in Renminbi, the Directors consider that the Group has no significant exposure to foreign exchange fluctuations in view of the stability of the Renminbi. The Directors also consider that there will be sufficient cash resources denominated in Hong Kong dollars for the repayment of its borrowings and for future dividends payable to shareholders. During the period under review, the Group did not use any financial instrument for hedging purposes and the Group did not have any hedging instrument outstanding as at 30 June 2001.

Product development and production capacity expansion

Progress of the product development and capacity expansion programs as shown in the prospectus dated 7 March 2001 is summarised below:

- expansion of corn processing capacity in Changchun from 600,000 metric tonnes to 1,200,000 metric tonnes per annum is expected to be in place by the end of 2001;
- expansion of production capacity of corn sweeteners in Shanghai from 60,000 metric tonnes to 150,000 metric tonnes per annum is expected to be completed on schedule at the end of 2001;
- expansion of lysine production capacity in Changchun from 15,000 metric tonnes to 40,000 metric tonnes per annum will be reached before the end of 2001;

- expansion of production capacity of modified starch in Changchun from 30,000 metric tonnes to 230,000 metric tonnes per annum is scheduled for completion in the first half of 2002; and
- trial production of biochemical feed and biochemical fertiliser commenced during the period under review. The Directors intend to launch these products under appropriate market conditions.

In addition to the above, the Group also commenced research and development activities for the production of other types of high value corn based biochemical products such as ethanol and biodegradable plastic. It is the Group's strategy to commercialise at least one new type of corn based biochemical product every two years.

Prospects

The Directors believe that the demand for the Group's products will remain strong in the PRC, its principal market, for the remaining half of the financial year and beyond. Our plan to expand the production capacity of lysine to 40,000 metric tonnes per annum has been accelerated while the expansion plan for the production capacity of corn sweeteners to 150,000 metric tonnes per annum is on track to complement the Group's objective in further expanding its market share of downstream corn based biochemical products. Investments have been made to expand the Group's corn processing capacity by an additional 600,000 metric tonnes per annum and the associated construction work is scheduled to be completed by the end of 2001. Upon completion, the Group will achieve a stable and sufficient supply of corn starch to accommodate internal consumption while enabling it to maintain its market share in corn refined products.

The Directors are optimistic that the Group will benefit from the anticipated growth of the PRC economy after China's accession to the World Trade Organisation. It is expected that it will not only lift the export sales of the Group but also lower the price of corn kernels currently acquired locally or imported from overseas. Furthermore, the continuous improvement in general living standards in China will create favourable market conditions for consumer-related products, such as corn sweeteners, which are widely used in confectionary, frozen and cold desserts, cakes and beverages.

To further enhance the Group's market penetration and its leading position in the industry in the PRC, its distribution network is expanding through the setting up of additional point of sales in five major cities (namely, Chongqing, Dalian, Qingdao, Xian and Zhengzhou). It is expected that these points of sales will become operational by end of 2001. Although the sales to overseas market has shown remarkable growth during the period under review, in view of the economic and political turmoil in most Asian countries, the Group will be extremely cautious in establishing overseas sales office.

The Group is actively identifying new opportunities to provide the Group with a platform to build a sustainable and high growth business. Accordingly, on 8 August 2001, the Company entered into a conditional agreement with Cargill to incorporate the JVC in Hong Kong which will be owned as to 50% by the Group and 50% by Cargill. Cargill, one of the Group's strategic investors, is an international marketer, processor and distributor of agricultural, food, financial and industrial products and services. The JVC, which is to serve as their joint investment vehicle, will establish the JVC Subsidiary in Shanghai to build and operate a refinery for the production of high fructose corn syrup ("HFCS") and other products which both parties may decide from time to time to produce. HFCS is one of the widely used corn sweeteners for soft drinks and other food and beverage products. The Board is optimistic that, upon the commencement of operation of the proposed refinery, the market share and prospects of the Group will increase substantially.

Use of net proceeds from the new issue

The net proceeds from the placing and public offering of the Company amounted to approximately HK\$278 million. At the date of this interim report, the Group has utilised a total of approximately HK\$88 million of the proceeds. Approximately HK\$61 million, HK\$4 million, HK\$1 million and HK\$22 million have been applied towards the construction of a new production plant in the PRC, research and development activities, expansion of the Group's distribution and sales network and as general working capital respectively. The remaining proceeds are placed on short-term deposits with licensed banks in Hong Kong.

Number and remuneration of employees

The Group employs a total of approximately 800 full time employees in Hong Kong and the PRC. The Group recognises the importance of its human resources to its success. Remuneration is maintained at competitive levels with discretionary bonuses payable on a merit basis and in line with industry practice. Other staff benefits provided by the Group include mandatory provident fund, insurance schemes and performance related commissions. On 14 May 2001, the Company granted share options to certain eligible staff including the Directors to acquire a total of 38,400,000 shares of HK\$0.10 each in the capital of the Company at an exercise price of HK\$0.98 per share. The share options are exercisable from 14 May 2001 to 13 May 2011. At the date of this interim report, none of the options have been exercised.