

## Management Discussion and Analysis

The Group is engaged in the manufacture and sale of upstream and downstream products. Upstream products include corn starch and other corn refined products. Corn starch is refined further into a wide variety of high value-enhanced downstream products including lysine, glutamic acid, modified starch, HFCS and corn sweeteners.

### OPERATING ENVIRONMENT

In the first half of 2002, the continuing growth of the PRC economy sustained a favorable operating environment while markets in other Asian regions remained stable. Sales in the PRC, our principal market, accounted for approximately 92% (2001: 92%) of the Group's turnover.

With the PRC's accession to the World Trade Organisation (the "WTO"), the changes including the reduction of import tariff, extension of import quotas, and reduction in subsidies towards agricultural products inevitably create pressure on the market price of related products. As a result, downward price adjustments in similar magnitude in both corn products and corn kernels, the principal raw materials of the Group, persisted during the Period.

During the Period, the pressure causing a recent high in the price of lysine after the outbreak of the mad cow disease in early 2001 eased. In addition, the increase in production capacity within the PRC and in imports led to a temporary imbalance in demand and supply that brought about a further fall in price. It is expected that the market price of lysine will rebound gradually in the rest of 2002.

### FINANCIAL PERFORMANCE

The Group's unaudited consolidated turnover and gross profit for the Period increased slightly as compared to that of 2001. Meanwhile the weight of both sales and gross profit of downstream products increased further from approximately 45% and 65% to approximately 53% and 71%, respectively.

Despite the decrease in sales volume of upstream products of approximately 6%, mainly due to the increase in internal consumption of corn starch to produce downstream products, and the drop in selling price of upstream products by approximately 9%, the gross profit margin of upstream products of approximately 25% remained at a similar level as that of last year. The high gross profit margin remained due to the drop in price of corn kernels of approximately 9%.

On the other hand, the sales of downstream products increased by approximately HK\$53 million, representing an increase of approximately 17% over the same period last year. In spite of the drop in market price from approximately HK\$17,000 per metric tonne in 2001 to approximately HK\$13,000 during the Period, sales and gross profit of lysine increased to approximately HK\$160 million and HK\$84 million, representing increases of approximately 39% and 20%, respectively, which are resulted from the expansion of production capacity by approximately 25,000 metric tonnes per annum. Furthermore, the improvement in production efficiency of corn sweeteners generated additional gross profit of approximately HK\$4 million or 18% over the same period of last year.

The profit before tax for the Period improved by approximately HK\$17 million or 9%, which resulted from the drop in finance cost by approximately HK\$18 million because of the reduction of interest bearing borrowings for financing working capital requirements after the Initial Public Offering (the "IPO") and share placing completed last year, while additional resources invested for the enhancement of the Group's administration functions since its listing last year had increased administrative expenses by approximately HK\$5 million.

Most of the Group companies operating in the PRC are now enjoying a 50% income tax relief as their free income tax holiday lapsed last year. Accordingly, the effective tax rate of the Group increased to approximately 8%.

#### LIQUIDITY AND FINANCIAL RESOURCES

At 30 June 2002, cash and cash equivalents including pledged time deposits of the Group amounted to approximately HK\$486 million (2001: HK\$430 million). The remaining net proceeds from the IPO included in the cash and cash equivalents amounted to approximately HK\$29 million, and are placed on short term deposits with licensed banks in Hong Kong.

Fluctuations in turnover period of trade receivables and trade payables were mainly attributable to the increase in sales of lysine since the second quarter of 2002 and the increase in purchase of corn kernels from farmers conducted on cash basis respectively. Inventory turnover remained stable during the Period. The current ratio and quick ratio as at 30 June 2002 were approximately 2.3 (31 December 2001: 2.6) and 1.9 (31 December 2001: 2.1) respectively.

Interest bearing borrowings increased approximately HK\$200 million, which was mainly applied towards the construction of a new modified starch plant in Changchun and working capital for the new corn refinery commencing operations in the second half of 2002. Except for a mortgage loan of approximately HK\$16 million (31 December 2001: HK\$16 million) wholly repayable in 10 years, approximately 66% (31 December 2001: 76%) of the remaining interest bearing borrowings as at 30 June 2002 were repayable within one year. Certain assets of the Group have been pledged to secure its borrowings, including bank deposits of approximately HK\$35 million (31 December 2001: HK\$62 million) and fixed assets with a carrying value (aggregate net book value) of approximately HK\$234 million as at 30 June 2002 (31 December 2001: HK\$243 million). The Group's gearing ratio as at 30 June 2002 was approximately 18% (31 December 2001: 12%), which was calculated based on the aggregate amount of interest bearing borrowings of approximately HK\$447 million (31 December 2001: HK\$247 million) and total assets of approximately HK\$2,418 million (31 December 2001: HK\$2,029 million).

During the Period, the Group did not use any financial instrument for hedging purposes and did not have any hedging instrument outstanding as at 30 June 2002.

## PROSPECTS

To support the expansion of downstream products, our new corn refinery with an annual processing capacity of approximately 600,000 metric tonnes has commenced full scale operation in August 2002. The total annual supply of corn starch now reaches approximately 800,000 metric tonnes.

In addition, the second lysine production facility of approximately 25,000 metric tonnes per annum has been operating at full capacity since the second quarter of 2002. It is expected that the annual production volume in 2002 will reach approximately 30,000 metric tonnes, which becomes one of the driving forces to future profit growth.

In order to capture the market of glutamic acid, a type of amino acid and intermediate material for Mono Sodium Glutamate, the glutamic acid plant project with a designed capacity of 100,000 metric tonnes per annum is in progress.

The modified starch expansion project targeted at the paper industry, to be carried out in 2 phases, is underway. The installation of facilities in the first phase with a designed annual capacity of 100,000 metric tonnes is scheduled for completion in 2003. It will then enlarge the profit derived from downstream products further. The second phase is scheduled to commence after the completion of the first phase.

## JOINT VENTURE WITH CARGILL

In 2001, the Group entered into business co-operation and established a joint venture in equal partnership with Cargill. With the enormous effort contributed by both Cargill and the Group, the construction, commencing in October 2001, of an HFCS refinery in Shanghai with a designed annual capacity of 100,000 metric tonnes has been completed within an unexpected short period of time. The refinery became operational in July 2002.

The inauguration of the Shanghai HFCS refinery has enabled the Group to become the only manufacturer in the PRC capable of producing HFCS meeting international standards with commercial production capacity.

### WHAT IS HIGH FRUCTOSE CORN SYRUP ?

- A natural sweetener - substitute for cane sugar
- Produced from glucose derived from corn starch
- Stability and high osmotic pressure nature
- Different levels of concentration in application depending on user needs
- Widely used in soft drinks, baked food and candy

#### USE OF PROCEEDS

The net proceeds from the IPO remained unused as at 31 December 2002 amounted to approximately HK\$40 million. During the Period, approximately HK\$10 million and HK\$1 million have been applied towards research and development activities and expansion of the Group's distribution and sales networks respectively. The Directors do not intend to change the application of the net proceeds. The remaining proceeds of approximately HK\$29 million are placed on short term deposits with licensed banks in Hong Kong.

#### NUMBER AND REMUNERATION OF EMPLOYEES

At 30 June 2002, the Group has approximately 1,018 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 commission.

During the Period, no share options had been granted to any staff. At 30 June 2002 a total of 115,814,400 share options are outstanding with exercise periods up to 20 August 2011 at exercise prices ranging from HK\$0.816 to HK\$1.316 per share.