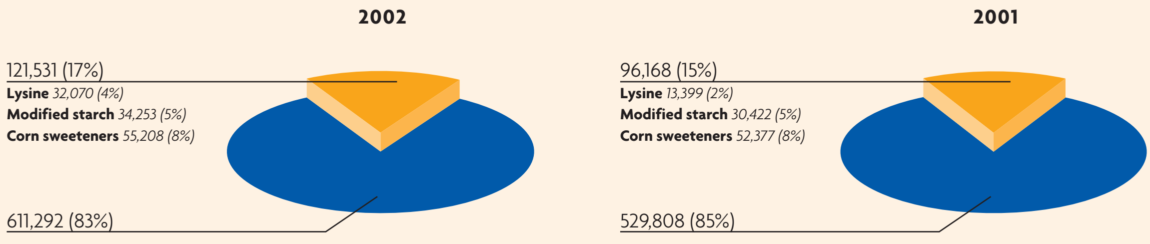
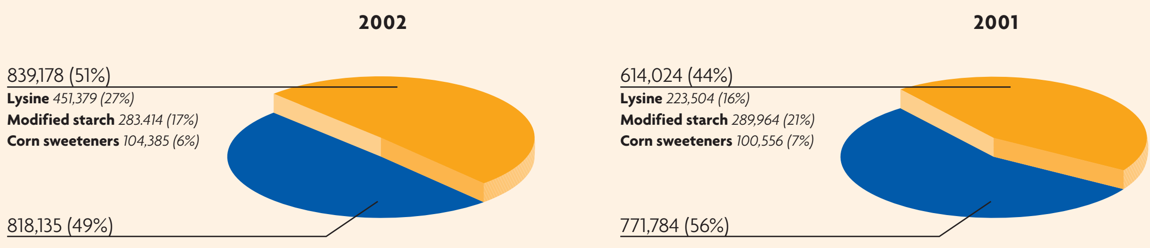
Sales and Gross Profit Analysis

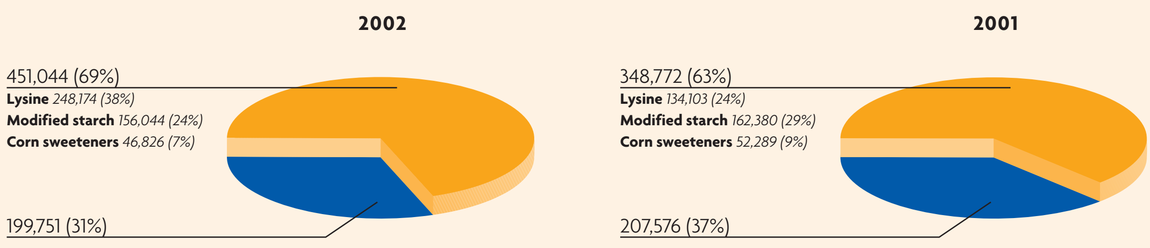
Sales volume (MT*)



Sales amount (HK$'000)



Gross Profit (HK$'000)



Corn refined products   Corn based biochemical products

* MT stands for metric tonne

% in bracket represents the percentage of the Group's total.

BUSINESS ENVIRONMENT

In year 2002, the economy of the PRC recorded continuing growth, with increasing demand on the Group's products, which provided a favourable operating environment, while markets in other Asian regions remained stable.

With the PRC's accession to the World Trade Organisation ("WTO"), changes including reduction in import tariffs, extension of import quotas, and reduction in subsidies towards agricultural products inevitably create pressure on the market price of such products. As a result, downward price adjustment of corn kernels, the principal raw material of the Group, persisted during the year under review, which, in fact, reduced the cost of production. At the same time, the average selling price of most of the Group's products adjusted downward due to increasing competition and the effect arising from the drop in price of their principal raw material.

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FINANCIAL PERFORMANCE

In year 2002, in spite of the drop in selling price of most of the Group's products, the Group achieved continuous growth in its results. Sales and net profit from ordinary activities attributable to shareholders increased 20% and 23% respectively compared to the previous financial year. This sound performance was mainly derived from the success in expansion of downstream products during the year under review.

Sales Overview

With production capacity expansions and continuous growth in demand, the Group's sales amount increased 20% to HK$1.7 billion.

The PRC remained the principal market of the Group and accounted for 93% of the Group's total turnover while the remainder was sales to overseas countries, including Japan, Korea, Malaysia & countries in Europe.

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For the downstream segment, the sales amount increased from HK$614 million in 2001 to HK$839 million in 2002, representing a 37% increase and accounting for 51% of the Group's total sales (2001: 44%).

Such an increase was mainly contributed by the strong growth in sales of lysine, from approximately 13,400 metric tonnes in 2001 to 32,000 metric tonnes in 2002, representing an increase of 139%. It was achieved by the launch of the second lysine production line in April 2002, which increased the Group's annual production capacity of lysine from 15,000 metric tonnes to 40,000 metric tonnes. However, the sales amount of HK$451 million, an increase of 102%, did not grow by the same magnitude owing to the decline in the average selling price of lysine, caused by the dissipation of the price impact arising from the mad cow disease in 2001. Meanwhile, although the average selling price of corn sweeteners and modified starch adjusted downward due to increasing competition, additional output achieved by improved production efficiency was maintained at around the previous year's level.

For the upstream segment, the sales amount increased 6% to HK$818 million in 2002, and accounted for 49% of the Group's total sales (2001: 56%). Such an increase was principally attributable to the launch of the second upstream corn refinery with an annual processing capacity of 600,000 metric tonnes in Changchun in September 2002, and from which additional upstream products of 115,000 metric tonnes were produced and sold in the year under review. As a result, the volume of upstream products sold to customers in 2002 increased 15% compared to year 2001.

However, in 2002, the average selling price of upstream products fell by 8% due to the pressure of increasing competition, and the pressure of the drop in direct material cost, i.e. corn kernels, by 10%.

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Gross Profit growth

In 2002, the gross profit of the Group increased 17% to HK$651 million. Such advancement was mainly derived from the additional sales volume of lysine achieved in year 2002.

Gross profit from lysine operation increased by HK$114 million, representing an increase of 85%, Gross profit margin of lysine dropped by 5% to 55% in 2002 largely because of the increased volume of sales from the new production facility, with an additional capacity of 25,000 metric tonnes per annum, which commenced operation in April 2002, thereby contributing substantial profit to the lysine division.

Gross profit contributed from sweeteners and modified starch dropped slightly by HK$12 million, due to increasing competition.

In spite of the increase in sales volume of upstream products, the gross profit of the upstream division dropped slightly by 4% to HK$200 million in 2002 mainly due to the price pressure mentioned above. In addition, the new refinery commencing operation in September 2002 had not reached its optimal production efficiency during the initial period.

Net Profit Growth

Due to the strong growth in gross profit, net profit from operating activities attributable to shareholders amounting to HK$405 million and representing a 23% increase was recorded during the year under review.

With the expansion of both downstream and upstream capacities during the year, the Group enhanced its operating efficiency. Both selling and distribution expenses and general administration expenses per each sales dollar decreased by 0.4% and 0.3% respectively in 2002 compared to the previous year.

Total net proceeds of HK$738 million raised from the equity market through the issue and placing of new shares in 2001 and funds generated internally from operations this year enabled the Group to reduce its average bank borrowings compared to the previous year. In addition, a substantial portion, HK$11 million, of total bank loans interest was capitalised as construction in progress. This resulted in a reduction of finance costs to HK$15 million. Interest coverage (ie. profit from operating activities over finance costs) increased from 13 times in 2001 to 35 times in 2002.

Most of the Group's companies operate either within an economic technological development zone or in open coastal areas in the PRC, and are enjoying income tax relief according to relevant income tax laws. The income tax relief of two of these companies was reduced from 100% in 2001 to 50% in 2002. As a result, these two companies enjoyed a 50% income tax relief (i.e. 7.5% on taxable income) in 2002 and the second corn refinery with an annual capacity of 600,000 metric tonnes was the only PRC subsidiary which enjoyed 100% income tax relief. The effective tax rate of the Group, as a whole, increased from 6% to 7% this year.

Combining the effect of capacity expansion and stringent control over operating expenses and finance costs, the net profit from ordinary activities attributable to shareholders increased 23% to HK$405 million.

Due to the strong growth in gross profit net profit, from operating activities attributable to shareholders, amounting to HK$405 million and representing a 23% increase, was recorded during the year.

Combining the effect of capacity expansion and stringent control over operating expenses and finance costs, the net profit from ordinary activities attributable to shareholders increased 23% to HK$405 million.

Sales from the HFCS refinery in 2002 was below its planned output since it takes time for the Group's customers to adopt and apply HFCS, a brand new product in the PRC, into their production process. As a result, operating loss of HK$3 million, of which 50% was shared by the Group, was recorded in year 2002.

FINANCIAL RESOURCES AND LIQUIDITY

Year 2002 is a year of expansion. In line with production capacity expansion of the lysine plant and the corn refinery, all non-current assets, inventories and trade receivables increased considerably, which were mainly financed by funds generated internally from operations and external resources (i.e. bank borrowings).

As at 31 December 2002, the total assets of the Group increased by HK$705 million to HK$2.7 billion, which were financed by shareholders' equity of HK$1.9 billion (31 December 2001: HK$1.4 billion), bank borrowings of HK$476 million (31 December 2001: HK$247 million) and other liabilities/minority interests of HK$403 million (31 December 2001: HK$357 million).

The increases in inventories and accounts receivable were mainly attributable to the increase in production capacity and sales.

Capital Expenditure

During the year under review, capital expenditure on non-current assets amounted to HK$518 million, which were mainly used for the expansion of lysine production capacity and the construction of the second corn refinery, amounting to HK$393 million. These projects commenced production and sales activities in April and September 2002 respectively.

Change in Working Capital and Support from External Borrowings

At 31 December 2002, the current assets of the Group amounted to HK$1.1 billion (31 December 2001: HK$879 million), comprising mainly inventories of HK$258 million (31 December 2001: HK$143 million), trade receivable of HK$383 million (31 December 2001: HK$258 million) and cash of HK$433 million (31 December 2001: HK$411 million). The increases in inventories and accounts receivable were mainly attributable to the increase in production capacity and sales.

As most corn kernels were acquired on cash basis, trade payables did not increase in the same magnitude as inventories or trade receivables. In order to support the acquisition of raw material, the Group has to maintain a relatively high cash level of HK$433 million as at 31 December 2002 (31 December 2001: HK$411 million).

In 2002, the aggregate amount of capital expenditure and additional working capital tied up in inventories and trade receivables was HK$758 million. In addition to funds generated internally, external borrowings also played an important role in supporting the development of the Group. As compared to 31 December 2001, the Group increased its bank borrowings by HK$229 million to HK$476 million as at 31 December 2002.

Turnover days, Liquidity Ratios and Gearing Ratio

In 2002, without annualising the sales and cost of sales of those expansion projects commencing operation in 2002, trade receivables, inventories and trade payables turnover periods increased from 68 days, 63 days and 20 days to 84 days, 94 days and 22 days respectively. Had the expansions operated throughout the entire year, the turnovers of trade receivables, inventories and trade payables of the Group would have adjusted to about 68 days, 74 days and 17 days respectively.

In spite of the increase in trade receivables and inventories, the current ratio and quick ratio for year 2002 dropped from 2.6 and 2.1 to 2.1 and 1.6 respectively. The drop resulted mainly from additional bank borrowings, classified as short term portion, of HK$156 million. Moreover, additional bank borrowings also lifted the gearing of the Group. Both gearing ratio (i.e. bank borrowings over total assets) and debt to equity ratio (i.e. bank borrowings over shareholders' equity) increased from 12% and 17% in 2001 to 17% and 26% in 2002 respectively.

Structure of interest bearing borrowings

At 31 December 2002, the Group had interest bearing borrowings of HK$476 million, of which 33% were denominated in Hong Kong dollars or US dollars while the remainder was RMB borrowings. All borrowings, with annual interest rates ranging from 3% to 6%, will be wholly repayable in 4 years except for a mortgage loan of HK$15 million repayable in 9 years. At 31 December 2002, 72% of borrowings were repayable in one year. Certain borrowings were secured by the Group's fixed assets with a carrying value/aggregate net book value of HK$226 million as at 31 December 2002.

Foreign Exchange Exposure

Although most of the operations were carried out in the PRC in which transactions were denominated in RMB, the Directors consider that the Group has no significant exposure to foreign exchange fluctuations in view of the stability of the RMB in recent years. The Directors also consider that there will be sufficient cash resources denominated in Hong Kong dollars for the repayment of borrowings and future dividends. During the year 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 31 December 2002.

Share Options to other corporations

During the year under review, 43 million shares were subscribed by wholly owned subsidiaries of Cargill and Cheung Kong (Holdings) Limited, from which HK$54 million were received by the Group pursuant to the exercise of the share options granted thereto. As at 31 December 2002, options granted to a wholly owned subsidiary of Cargill for subscription of 108 million shares remained outstanding, which are exercisable for a period of 3 years up to April 2005. If these options are fully exercised, an aggregate amount of HK$210 million will be raised, which can enhance the Group's financial position and provides additional resources to the Group for its future development.

It is the Group's mission to become one of the leading vertically integrated corn based biochemical product manufacturers in Asian Pacific Region

FUTURE DEVELOPMENT

It is the Group's mission to become one of the leading vertically integrated corn based biochemical product manufacturer in the Asian Pacific Region. To this end, the Group will strive to enlarge its market share and diversify its product mix, as well as enhance its capability in developing high value-added downstream products through research and development and through strategic business alliances with prominent international market leaders.

EXPANSION OF DOWNSTREAM PRODUCTS

Lysine

The demand of lysine in the PRC has witnessed continuing increase in recent years and over 50% of the demand are currently met by imports. In order to capture the rising demand of the market and to reduce the market share now owned by foreign suppliers, the Group intends to expand its lysine capacity further under appropriate market conditions. Moreover, a new type of lysine, protein lysine, is under development.

Glutamic Acid

The PRC is the largest producer and consumer of MSG around the world. However, the manufacturing process of glutamic acid, the principal raw material for MSG, may create extensive pollution in breach of new environmental regulations in the PRC. It is likely that most of the producers of MSG will source glutamic acid externally to reduce capital expenditure spent on upgrading outdated production facilities. In addition to introducing extensive waste water control and treatment facilities overcoming the pollution issue, advanced technological know-how of the Group enables it to manufacture glutamic acid at a cost lower than MSG producers. The Directors have, thus, decided to start the construction of a glutamic acid plant with an expected annual capacity of 100,000 metric tonnes upon the conclusion of construction or acquisition of a new corn refinery.

Modified Starch

Most of the modified starches now consumed in the PRC are imported from overseas. Moreover, the demand from the paper-making industry increases substantially in recent years, especially after China's accession into WTO. To capture this emerging market, the first phase of the expansion project on modified starch for the paper-making industry with an annual capacity of 100,000 metric tonnes will be completed in the second half of 2003 while the second phase, with another 100,000 metric tonnes of annual capacity, is scheduled to commence construction under appropriate market conditions.

The Group intends to expand annual corn processing capacity by an additional 600,000 metric tonnes to 1,800,000 metric tonnes

SUPPORT FROM UPSTREAM PRODUCTS

To cope with the future expansion and diversification of downstream products, the Directors consider that the existing starch generating capacity of 800,00 metric tonnes per annum is inadequate to support the demand from our planned downstream products development and expansion in the coming 3 years. It is expected that the planned capacity of downstream products by the end of 2004 will consume corn starch of approximately one million metric tonnes. As a result, the Group intends to expand annual corn processing capacity by an additional 600,000 metric tonnes to 1,800,000 metric tonnes either through construction or acquisition of a refinery.

RESEARCH & DEVELOPMENT

In year 2002, in view of the drop in market price of most of the Group's products, which is partially due to emerging competition in the industry, management realised that the continuous growth of the Group depended on its capability not only in developing other high value-added downstream products, but also in improving existing production efficiency.

As a long-range corporate strategy of the Group is to become a leading producer of downstream products, the Group spent approximately HK$23 million (2001: HK$20 million) in the research and development of value-enhanced downstream products, such as certain types of amino acids and modified starches, during the year.

The Group had over 40 experienced scientists working in the research and development department. There is continued research and development on starch and fermentation applications and techniques on new product development, quality control, improvement of production technologies and operational efficiency, application and improvement of micro-organism, etc. In addition, the Group also collaborates with various scientific and academic institutions to enhance the variety and capability of downstream products. Products currently under development include various types of amino acids (including lysine, methionine, glutamic acid), modified starches, biodegradable plastics, and ethanol. It is believed that these products will be launched to market and will provide the Group with substantial return in the coming years.

STRATEGIC BUSINESS ALLIANCES WITH PROMINENT INTERNATIONAL MARKET LEADERS

Joint Venture Project for HFCS

In July 2002, the 100,000-metric-tonne HFCS refinery in Shanghai commenced operation and became the only HFCS manufacturer in the PRC with commercial production capacity that met the stringent requirements of international and local beverage and food groups. The plant has already gained extensive acceptance and support from the local food and beverage producers in Shanghai and surrounding regions.

In February 2003, the joint venture vehicle for the HFCS projects entered into contracts with international bottling plants to supply the sweetener to densely populated cities in China. The amount of HFCS contracted to be supplied by the joint venture already required the utilisation of about half of the production capacity of the HFCS refinery since then.

In view of the massive market of sorbitol in the PRC, the Group has signed a memorandum of understanding ("MOU") with Mitsui Group

Joint Venture Project for Sorbitol

A downstream product, sorbitol, a type of organic chemical generally made from sugar, is an important polyol with a wide range of applications in food, pharmaceutical, cosmetic, and chemical industries. Sorbitol is generally used in large quantities in the manufacture of toothpaste and vitamin C, and as sweetener in snacks and beverages.

In view of the massive market of sorbitol in the PRC, the Group has signed a memorandum of understanding ("MOU") with Mitsui Group for the establishment of a joint venture company ("JVC") in Hong Kong, as an investment vehicle for investing and holding interests in projects for the manufacture and sale of sorbitol products in the PRC. According to the MOU, the Group will hold 51% equity interest of the proposed JVC and the total investment for the project is expected to be an amount not exceeding US$15 million, which will be injected by each joint venture partner according to their equity holding percentage. It is expected that the first sorbitol plant in Changchun, with an annual production capacity of 60,000 metric tonnes, will commence commercial production in the first half of 2004. To ensure a stable supply of quality raw material, the Group will be responsible for the supply of raw materials to the JVC.

The MOU symbolises the Group's latest effort in expanding its product portfolio of high value-added corn based biochemical products.

NUMBER AND REMUNERATION OF EMPLOYEES

At 31 December 2002, the Group has approximately 1,300 full time employees. The Group recognises the importance of human resources to its success. Remuneration is maintained at competitive levels with discretionary bonuses payable on merit basis and in line with industry practice. Other staff benefits provided by the Group include mandatory provident fund, insurance and performance related commission.

During the year under review, no share options were granted to any staff. As at 31 December 2002, a total of 116 million share options are outstanding with exercisable periods up to 20 August 2011 with exercise prices ranging from HK$0.816 to HK$1.316 per share.