"Great Wall", one of the three major brands of Chinese wine (dry), enjoys a 37% market share.

Management Discussion and Analysis

Mr. Yu Guangquan
Managing Director

The Group's consolidated turnover for the year under review reached HK$13,694,462,000, representing a substantial increase of 23% compared with the preceding year. Profit attributable to shareholders amounted to HK$409,909,000, an increase of 2% over the restated figures of 2002, but if the non-recurring gains are excluded, this figure increased 25%. The basic earnings per share were 25.1 HK cents, 2% less than the 25.6 HK cents per share recorded in the previous year.

The Group manages five food-related core businesses: edible oils, soyabean meal and related products; wineries; confectionery; flour milling; and trading.

The performance of these businesses during the year under review, as well as other information related to the Group, is set out below:

Edible oils, soyabean meal and related products

The Group is now China's largest edible oils and soyabean meal producer, mainly involved in the oil extraction and sale of "四海" soyabean meal (an important raw material in the feed of domestic animals and poultry); the refinement and sale of retail bulk edible oils and "Fortune" consumer-pack oils; and the manufacture and sale of related products.

During the period under review, this sector recorded a turnover of HK$8,974,607,000, representing an increase of 31% over the corresponding period last year and accounting for 65.5% of total turnover.

In 2003, sales of soyabean meal reached 2,821,484 tonnes, an 25% increase over the previous year; sales of retail bulk edible oils were 1,032,426 tonnes, up 27%; and sales of consumer-pack oils amounted to 388,107 tonnes, for 37% growth.

Over this period, the price of imported soyabeans rose steadily from US$220 per tonne at the beginning of the year to approximately US$300 per tonne in the fourth quarter, putting direct pressure on profitability. But economies of scale together with the Group's market-leading position cushioned the business from threats to the sector's development. In addition, the continually increasing consumer demand for edible oils in China enabled the Group to shift the rising cost of raw materials to customers and thus maintain positive growth for the overall business. "Fortune" edible oils again increased its market share, supported by an excellent operating track record spanning many years, to maintain the second place in the sector, taking 20% of the consumer-pack oils business.

After expanding facilities at both East Ocean Oils & Grains Industries (Zhangjiagang) Co., Ltd. and Great Ocean Oils & Grains Industries (Fang Cheng Gang) Co., Ltd., annual capacity hits 7,000,000 tonnes for oil extraction and 1,500,000 tonnes for oil refining by the end of 2003. In order to increase the range of edible-oil products, in particular peanut oil, which has a higher gross profit margin, the Group and Archer Daniels Midland Company together built a peanut oil extraction plant in Heze, Shandong province. The construction required a total investment of US$16,000,000 and the plant is expected to commence operations in the second half of 2004. Expected annual production capacity of peanut oil is 77,000 tonnes and the plant will also be able to produce both peanut meal and soyabean meal.

Although the price of imported soyabeans will continue to fluctuate, the Group will be able to reduce costs by taking advantage of its comprehensive production chain. Meanwhile, the Group will expand its channels for purchasing raw materials, and control costs and risks by relying on the

"Le Conte" grabbed second place with an 11% market share, after ranking third last year. It is the only domestic brand among the top three in the Chinese chocolate and confectionery market.

experience gained through many years of operation. The Group will continue to promote the "Fortune" brand and improve the sales channel to increase its market share. The Group will also closely follow market trends and adapt production to capture new business. For example, as the living standard rises, Chinese consumers are beginning to adopt healthier eating habits. To take advantage of this development the Group will look to produce healthier edible oils with higher added value. The Group will extend into downstream products such as higher value-added specialty oils, soyabean proteins and related materials that require advanced techniques to manufacture.

Wineries

This business mainly comprises the production and sale of "Great Wall" wine within China. During the year, the turnover of Great Wall wine was HK$890,960,000, increasing 87% compared to last year and accounting for 6.5% of total turnover.

"Great Wall", one of the three major brands of wine (dry) in China, enjoys a 37% market share. The Group took over the remaining 50% equity interest in China Great Wall Wine Co., Ltd ("Great Wall Wine Co.") on 19 March 2003 and dynamically integrated purchasing, sales, management and brand building. The accounts of this company have been consolidated with those of the Group this year.

The Group expects to integrate its three wineries to maximize the potential of each one. The ultimate goals are to integrate production management, market channels and brand names; avoid competition among its wineries; and create a larger consumer base, resulting in increased production and market share.

During the year, wine production capacity reached 70,000 tonnes and sales volume climbed from 45,761 tonnes in 2002 to 51,034 tonnes in 2003. Sales of "Great Wall" wine continue to grow quickly due to greater production capacity, steady enhancement of product quality, continued promotion of the brand name, better marketing and an increase in dealers.

The double-digit expansion of the wine market in China is in sharp contrast to the slow growth of this sector globally. China's wine market has therefore emerged as the one with the greatest potential worldwide. But, as part of the requirement to enter the World Trade Organization, on 1 January 2004, China decreased the tariff on imported wine to 14%, a move that will make the Chinese wine sector vulnerable to competition from foreign brands. The Group, however, regards this challenge as a driving force to develop "Great Wall" wine faster and on a larger scale.

During the year, the Group cooperated with China Agriculture University, a prestigious institution strongly supported by the central government, to establish the Research Center of Great Wall Wine Institute. The emphasis on research and development at this college will facilitate Great Wall's efforts to maintain first class standards and thus retain a strong competitive edge.

Confectionery

The Group produced and distributed confectionery and chocolate products within the country under the brand name "Le Conte". Based on the optimistic outlook for this sector, the Group acquired the remaining 14% interest in Shenzhen Le Conte Foodstuff Co., Ltd (Shenzhen Le Conte) from COFCO (Hong Kong) Limited ("COFCO (HK)"), the controlling shareholder of the Company, on 9 September 2003. As a result, Shenzhen Le Conte is now a wholly owned subsidiary of the Group.

During the year, this sector recorded HK$293,526,000 in turnover, representing an increase of 18% over the corresponding period last year and accounting for 2.1% of total turnover. "Le Conte" chocolates and confectionery remained a major force in the market, grabbing second place with an 11% share; this brand was ranked third last year. "Le Conte" is the only domestic brand among the top three in the Chinese chocolate and confectionery market.

Though a sharp increase in cocoa prices directly affected gross profit margin, the Group was still able to record satisfactory turnover and profit due to effective cost control; flexible purchase, production and sales policies; and a strengthened internal management.

Management Discussion and Analysis

Within this sector, in 2003 the Group manufactured 14 different products comprising more than 80 varieties. Apart from products introduced under the “Le Conte”, “Tastey” and “Just Me” brands in the second half of 2003, the Group launched its “Enchante” series at the end of the year. The Group now has nine production lines for snack foods after building one each for wafer sticks and puffed cereal in 2003. Total production capacity by the end of the year reached 10,000 tonnes of chocolate goods.

Due to the great potential of China’s snack-food market based on an expected high consumer demand, the Group will focus on promotion along with the research and development of new products and packaging. The aim is to develop a high-end confectionery market through a strategy of creating multiple brands and increasing market share, while further expanding sales channels in second- and third-tier cities and controlling costs. In addition, the Group will work to develop other snack foods and enlarge production capacity to fuel both internal expansion and external growth. The Group expects that these measures will result in satisfactory growth for the confectionery and chocolate sector and a positive contribution to business overall.

Flour Milling

During the year, the Group continued its flour milling and related activities. For 2003, flour recorded HK$611,978,000 in turnover, up 20% over the preceding year and comprising 4.5% of total turnover.

During the year, the operating environment for this sector remained difficult due to rising production costs and fierce competition. The Group compensated by strictly controlling costs, strengthening management and monitoring product quality, so that the overall gross profit margin increased compared with 2002. The flour-milling business generated a marked increase in overall operating revenue and profit compared with last year.

In future, to improve profitability, the Group will more actively face any challenges in this market by continuously adjusting the product portfolio through increasing the proportion of high-end flour production, speeding up the pace of development of both new and downstream products, strengthening cost control and product management, and widening the flour sales network. With China’s entry into the WTO, the import of high quality wheat is expected to increase. In addition, the method of wheat planting to enhance domestic wheat quality should improve. These factors will help the Group further refine its high-end flour market strategy.

Moreover, with continued concerted efforts to apply the Group’s strategy of promoting regional products, it is hoped this division will achieve the goal of creating a national brand.

Trading

The Group has been engaged in domestic trade and the import and export of foodstuffs, grains and animal feedstock. During the period under review, the Group was mainly involved in the bulk commodity back-to-back trading of rice, sugar, maize, fishmeal, cotton meal, vegetable meal, cereals, soyabeans, and red beans. The Group also processed raw materials for export. In addition, it carried out foodstuff trade agency services on a commission basis. During the year, the trading business recorded HK$2,923,391,000 in turnover, representing a decrease of 4% compared to 2002 and accounting for 21.4% of total turnover. The ratio, by turnover, of different segments of the trading business was approximately 75% for exports, 20% for imports and the remaining 5% for domestic trade.

During the period under review, operating revenue and profit were less than the preceding year due to adverse factors affecting the market both at home and abroad and the resulting lower price and volume of exports, but the results were still satisfactory. The sector benefited from the

Management Discussion and Analysis

Group's diversified trading business model, more than 50-year experience in the foodstuff industry, established international network, strict risk-management system, and continuing efforts to create new trade channels and commodities. Management believes that the trading business can still contribute healthy and stable operating profit.

As the Group continues to focus on developing an effective strategy to promote its brand name products, the proportion of the trading sector's contribution overall will decrease. Eventually, the Group expects this trend to create a leading role for branded products in its core businesses.

Other Non-core Business

The Group has only one non-core business, the generation of thermal electric power, and will look for an opportunity to sell this in order to concentrate internal resources on the development of core businesses and hence raise returns for shareholders.

Liquidity and Financial Resources

The Group's financial position was sound with a stable cash flow. As at the end of December 2003, the Group's total shareholders' equity amounted to HK$4,130,462,000, representing an increase of 17% compared with last year (as restated). As at 31 December 2003, the Group's cash and bank deposits totaled HK$1,113,800,000 (31 December 2002: HK$1,434,315,000). The Group's net current assets were HK$1,098,178,000 (31 December 2002: HK$1,748,698,000). Taking into consideration all of the above as well as bank loans and other loans and facilities available, management believes that the Group will have adequate financial resources to settle debts and provide funding to meet its daily operational and capital expenditure.

The Group's monetary assets, debts and transactions are principally denominated in Hong Kong dollars, Renminbi and US dollars. Due to the pegged exchange rate between the Hong Kong dollar and greenback, together with minimum fluctuation in the exchange rate between the Hong Kong dollar and Renminbi, the Group believes that its exposure to exchange-rate movement is limited.

Capital Structure

During the year under review, the issued share capital of the Company increased by an aggregate of 177,859,000 shares. An aggregate of 37,859,000 shares were issued to the executive Directors of the Company and employees of the Group as a result of the exercise of share options. On 17 September 2003, COFCO (HK), the controlling shareholder of the Company, exercised in full the conversion rights attached to the 14 Convertible Notes, all dated 26 October 2001, at HK$2.15 per share and converted the principal of the Convertible Notes of HK$301,000,000 into 140,000,000 shares of the Company.

Except for the above-mentioned change of share structure, the share capital remained the same during the year under review.

As at 31 December 2003, except for the loans of several banks; a few shareholders of the Group's subsidiaries; the Company's ultimate holding company, China National Cereals, Oils & Foodstuffs Import & Export Corporation ("COFCO"); and a wholly owned subsidiary of COFCO (HK$2,979,514,000 in total) (31 December 2002: HK$2,078,713,000, which includes HK$301,000,000 capital from convertible notes), the Group did not have any major borrowings. During the year under review, all bank borrowings of the Group bore a fixed annual interest amounting to between 1.38% and 5.84% (31 December 2002: between 1.8% and 6.44%). Other borrowings were exempted from interest or bore accrued interest according to the fixed annual rate ranging from 2.38% to 5.31% (31 December 2002: 2%, 5.04% and 5.85%).

As at the end of December 2003, the Group's total assets were approximately HK$9,671,281,000 (31 December 2002: HK$7,461,078,000, as restated), and the aggregate debts (excluding loans of minority shareholders of subsidiaries that are of a capital nature) were

Management Discussion and Analysis

HK$2,865,148,000 (31 December 2002: HK$1,961,504,000). Based on the above, the Group's gearing ratio was approximately 29.6% (31 December 2002: 26.3%, as restated).

Contingent Liabilities and Assets Pledged

As at 31 December 2003 and 31 December 2002, the Group had no material contingent liabilities.

As at 31 December 2003, certain of the Group's bank loans were secured by charges over its fixed assets with a net carrying value of approximately HK$176,657,000 (31 December 2002: HK$130,172,000).

Employment and Remuneration Policy

As at 31 December 2003, the Group employed approximately 5,117 employees in China and Hong Kong (31 December 2002: 3,720 employees). All employees are remunerated according to their performance, experience and prevailing market rates. On-the-job and professional training are provided as well. The Group provided retirement benefits, either in the form of the Mandatory Provident Fund Exempted ORSO or Mandatory Provident Fund entitlement, to employees in Hong Kong. A similar scheme is also provided for employees in China. Details concerning the retirement benefit schemes are set out in this Annual Report.

The Group has implemented a share options scheme (the "Scheme") to reward eligible employees (including executive Directors of the Company) according to their individual merits. During the year under review, share options in respect of an aggregate of 32,574,000 shares were granted to the executive Directors of the Company and employees of the Group. Moreover, the executive Directors of the Company and employees of the Group exercised share options in respect of an aggregate of 37,859,000 shares during the year. Taking into consideration the above and other relevant movements, a total of 43,585,000 share options of the Company were outstanding as at the end of December 2003. The share options granted can be exercised at any time within four years after the expiration of a period of 12 months from the date when the options were granted.

Additional details of the Scheme are disclosed in this Annual Report in accordance with the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong.

Changes in the Group's Structure

During the year under review, the Group completed the acquisition of the remaining 50% equity interest in Great Wall Wine Co. As a result of this acquisition, Great Wall Wine Company has changed from an associate to a wholly-owned subsidiary of the Group. In addition, the Group also completed the acquisition of the remaining 14% equity interest in Shenzhen Le Conte from COFCO (HK). As a result, Shenzhen Le Conte has also become a wholly-owned subsidiary. The Group has also established two companies selling Great Wall wines through a 60% interest in Yantai Great Wall Wine Co., Ltd. and a 100% interest in Qinhuangdao Huaxia Great Wall Wine Co., Ltd.

Apart from the above, there was no material change in the structure of the Group during the year under review.

Prospects

Since the Group was recognized as the leading food company of China in 2001, its core businesses – edible oils, soyabean meal and related products; wineries; confectionery; flour milling; and trading – have been developing healthily and dynamically. After strong efforts over the past several years, the edible-oils, wine and chocolate products businesses have all developed leading brands "Fortune", "Great Wall" and "Le Conte" – in China. As the economy of China grows rapidly, the population will focus more on improving the quality of life and demand high quality, brand name food products. Therefore, the market for edible oils, wine and chocolate has tremendous potential. The Group will continue to strengthen its brands, further expand its market share and enlarge its sales network to consolidate its leading position in the market.

Management Discussion and Analysis

The Group will seek acquisition and merger opportunities to complement the creation of brand names, explore new markets, better manage production, strive for technological advancements, improve corporate governance and maintain growth momentum in external markets to expand the development potential of the core businesses.

COFCO International is ready and able to develop its business within a climate dominated by fierce competition. During the previous year, the Company has overcome the many hardships brought on by SARS and the soaring prices of raw materials. We are confident about the future and believe that, with a solid foundation and a strong, practical management team, the Group will continue to develop and generate stable returns for shareholders.

Yu Guangquan
Managing Director

Hong Kong, 31 March 2004