

Business Review

Introduction

2003 was a year with difficulties in operation. With the deregulation of quota management in pond fish, opening up of the chilled chicken market by the State and the effect of bird flu and SARS epidemic, the turnover of live and fresh foodstuffs agency business continued to decrease. Affected by the increase of price of raw materials, feed production and livestock farming were difficult in operation. The sales and gross profit of tinplating business dropped as compared with 2002 due to the shortage of imported raw plate and the increase of price. Facing such a difficult business environment, the Group adopted a series of measures. For example, the production of the more profit making tin-free steel with higher profit margin was emphasized since there was a shortage of raw materials of tinplate and supply was less than demand. In connection with sales, "Five Priorities" sales strategies, representing priority to be given to customers request processing and printing in our plant, customers in Guangdong Province, purchase orders of tin-free steel, cash payment, purchase orders pricing at a level higher than company's standard price, was put into practice. The optimization of the limited resources has been fulfilled by way of the above measures. In addition to such measures, incentive scheme targeted at trading business in live and fresh foodstuffs was introduced and expansion of trading business in famous domestic live chicken were also carried out. Furthermore, the Group decreased the scale in feed production with low profit margin and strictly controlled the credit sales. Apart from gradually withdrawing from feed production, the Group also speeded up the disposal of three pig farms respectively in Dongguan Guangnan, Dongguan Jinhuang and Gaoyao Guangnan Stock Development Co., Ltd. ("Gaoyao Guangnan"). Besides, the Group dedicated its efforts to recover the receivables and strengthen the management and supervision on joint-venture business. Through the adjustment of business plans and strategies and adoption of various effective operational measures, the business risks were effectively under control, resulting in a similar level of profit before tax in 2003 without significant decrease as compared with 2002.

The management considered that the operation was comparatively stable although the production and business in 2003 were under the constraints of outside environment which brought about profit before tax slightly lower than that of 2002. Our main products, including tinplating and tin-free steel, kept an upward trend in sales. Their profit margin maintained at a higher level of 15%. The turnover of live and fresh foodstuffs business decreased by 23.1%, while its operating profit decreased by HK\$3,333,000, a decrease of 23.1% as compared with 2002. The associated companies have obtained better operating performance and the share of associated companies' profit before tax increased by HK\$8,800,000 as compared with 2002, representing an increase of 83.2%. In conclusion, the Group enjoyed a good assets condition, sound financial status, stable operation and fair economic benefits.

Tinplating

The production of tinplate by the Group's subsidiary, Zhongyue Tinplate in 2003 amounted to 94,392 tons and its sales amounted to 94,073 tons, representing a decrease of 14.8% and 15.4% respectively as compared with 2002. The turnover of HK\$538,765,000 decreased by 4.8% as compared with 2002.

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Operating profits decreased by HK\$33,384,000 as compared with 2002, representing a decrease of 36.9%. The decrease was principally due to the shortage of raw materials of tinplate and the significant increase of the price of crude oil. The increase of cost was comparatively more than that of selling price.

In 2003, new tin-free steel product produced by Zhongyue Tinplate was granted as “the brand name products in Guangdong Province” and our production technique was granted a patent by the approval of the State of Intellectual Property Office of the People’s Republic of China. The management considered that the tinplating business made the greatest contributions to our Group’s profit and became the core business with the most promising prospects and it therefore will be our focus of development in the future. Supported by market researches and feasibility studies, our management decided to set up a new production line for tin-free steel in 2004. The project duly commenced and was expected that annual production capacity will rise from current 120,000 tons to 200,000 tons after the launch of the production line in the first half year of 2005. It is expected that the production capacity will be ranked the third in the tinplating industry in China. The Group anticipated that the tinplating business, through the cultivation and development of the profitable business, would have a continuous growth so as to develop the Group into a professional corporate specializing in production and sales of tinplating products. Meanwhile, the Group will dedicate its efforts to the development of its related business by actively reviewing the feasibility of establishing a “base for metal container, packaging and printing in China” in Zhongshan Hi-tech Development Zone.

Property Leasing

The Group’s leasing properties included plant and staff dormitory of Shan Hai, iron printing plant and equipment of Zhongyue Tinplate and office building in Hong Kong. The total revenue of leasing properties owned by the Group was recorded at HK\$37,059,000 in 2003, which increased by 30.6% as compared with 2002. The operating profit of leasing properties totalled HK\$26,491,000, which increased by 38.0% as compared with 2002.

Live and Fresh Foodstuffs Distribution

The turnover of live and fresh foodstuffs business was recorded at HK\$751,901,000 in 2003, which decreased by HK\$225,741,000 as compared with 2002, representing a decrease of 23.1%. The operating profit amounted to HK\$11,100,000, which decreased by HK\$3,333,000 as compared with 2002, representing a decrease of 23.1%.

The management considered that business in live and fresh foodstuffs which was our traditional and core business in the past had made a great contribution on the development of our Group. Following China’s accession to the World Trade Organization, gradual deregulation of the quota management of live and fresh foodstuffs by the State resulted in more intensive market competition. The Group’s agency business in live and fresh foodstuffs was mainly derived from the distribution of live and fresh foodstuffs specified by the State’s policy, the management therefore decided to actively maintain the business as it was, instead of investing more capital.

In order to ensure consistency in the agreements as a whole while acting as the agency in the live and fresh foodstuffs, the Group signed new agreements with all the suppliers of live and fresh foodstuffs in 2004. Under the new agreements, the role of agency remains unchanged but no longer responsible for the risks associated with the trading of goods. Accordingly, the presentation of the profit and loss account will be changed following the accounting policies to better reflect the legal implication of the transactions, starting from January 2004. The turnover, which was previously recorded as the sales of live and fresh foodstuffs, is now replaced by the commission income, i.e. approximately the net difference between the sales and the corresponding costs and expenses.

Feed Production

In 2003, the turnover of feed production business amounted to HK\$115,403,000 which increased by 26.4% in 2002. However, due to a significant increase in price of all raw materials of feed brought from the increase of price of food, provision for bad debt and impairment of fixed assets totalling HK\$35,991,000, the loss before tax of HK\$36,388,000 was recorded and accordingly the Group experienced from profit to loss.

The management considered feed production industry relies heavily on raw materials and its gross profit is very low. The cost of raw materials represents more than 90% of that of products. The sales market is targeted at farm households. Feed industry does not require high technology, hence, over production and keen market competition occur. The industry generally markets its products on credit terms to increase sales, the advance of working capital in sale is therefore rather substantial. Since there are thousands of farm households, the risk of bad debt becomes very high. Having established the development plans on tinplating business by the Group and for the sake of avoiding operating risks, the management will withdraw gradually from feed production. While maintaining the investment in the business, we actively searched for potential buyer of the entire equity interest of Guangnan (Zhan Jiang) Jiafeng Feed Co. Ltd..

Foodstuffs Trading

In 2003, the turnover of the Group's foodstuffs trading business was at HK\$52,190,000, which decreased by 25.0% as compared with 2002. The operating profit amounted to HK\$646,000 which decreased by 45.7% as compared with 2002.

The management considered that foodstuffs trading is a less profitable non-core business, contributing less profit to the Group. Subject to the limited marketing resources after the withdrawal of supermarket business, there is insufficient room for the development of foodstuffs trading business, the management will withdraw gradually from such business.

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Livestock Farming

In 2003, the Group also commenced the plan on gradual withdraw from livestock farming business. After the disposal of the current assets and a portion of fixed assets of the pig farm owned by Dongguan Jinhuang in May 2003, the pig farm and equipment were leased out. In August 2003, 51% equity interest of Dongguan Guangnan held by the Group was disposed of at RMB5,000,000, bringing about HK\$9,097,000 profit to the Group. The management will sell Gaoyao Guangnan.

Financial Position

As at 31 December 2003, the Group's total assets amounted to HK\$955,975,000 and total liabilities stood at HK\$333,342,000, a decrease of HK\$7,078,000 and HK\$114,724,000 respectively when compared with the position as at the end of 2002. The net current assets of the Group increased from HK\$73,049,000 as at the end of 2002 to HK\$126,507,000 and the current ratio (current assets divided by current liabilities) increased from 1.21 as at the end of 2002 to 1.39. The Group's financial position has strengthened further since the end of last year, indicating a steady move towards improving results and paving the way for future business expansion.

Liquidity and Financing Resources

As at 31 December 2003, the Group maintained cash balances of HK\$254,457,000, increased by 4.7% from the cash balances as at the end of 2002. The major cash outflow in 2003 was the early redemption of HK\$80,000,000 interest-bearing convertible notes.

The Group's interest-bearing borrowings are repayable on demand and carry interest at annual rates ranging from 5.3% to 7.5%. At 31 December 2003, the Group's interest-bearing borrowings totalled HK\$57,700,000. Accordingly, the Group's gearing ratio, which was measured on the basis of the Group's total interest-bearing borrowings over the shareholders' fund, decreased rapidly from 28.1% as at 31 December 2002 to 9.6%.

As at 31 December 2003, the Group's total available credit facilities amounted to HK\$269,459,000, of which HK\$104,829,000 have been utilized. The unutilized banking facilities amounted to HK\$164,630,000. With its cash holdings and recurring cashflow from its operations, the Group believes that it will have sufficient funds to meet its present operation requirements and to further develop its business in the foreseeable future.

Charges on Group's Assets

At 31 December 2003, certain of the Group's fixed assets with net book value of HK\$2,814,000 were pledged to secure general banking facilities amounting to HK\$9,004,000 of the Group.

In addition, certain bills receivable of the Group amounting to approximately HK\$40,000,000 as at 31 December 2003 has been pledged with an authorised bank in the PRC in order to obtain a guarantee issued in favour of the Group to the Dongguan Intermediate People's Court in a litigation against a former minority shareholder of a subsidiary for recovering amounts due to the Group of an equivalent amount.

Convertible Notes

On 3 December 2001, the Company issued convertible notes of HK\$185,000,000 to Richway Resources Limited, a fellow subsidiary of the Company, as part of the consideration for the acquisition of Zhongyue Industry Material Limited. The notes bear interest at a fixed rate of 4.5% per annum and are convertible into ordinary shares of the Company at an initial conversion price of HK\$0.155 per share. During the year, a total of HK\$80,000,000 convertible notes were redeemed by the Group on 6 December and 19 December 2003 respectively, in order to reduce interest expense thereof. There was no convertible note outstanding at 31 December 2003.

Exchange Rate Exposure

The Group's assets, liabilities and transactions were primarily denominated either in Hong Kong dollars, US dollars or Renminbi. As the exchange rates of Hong Kong dollars, US dollars or Renminbi were relatively stable during the year, the Group was not exposed to significant exchange risk.

Employees and Remuneration Policies

As at 31 December 2003, the Group has a total of 544 employees, reduced by 264 as compared to the corresponding date of 2002, of whom 29 were based in Hong Kong and 515 were based in the mainland China. The staff remuneration is determined in accordance with the responsibility for the post, workload, skills, hardship, working conditions, individual performance and prevailing industry practice. In 2003, the Group continued to implement control on the staffing, headcount and total salaries of each subsidiary. The performance bonus incentive scheme continued to be carried out. Through the assessment of the performance of each subsidiary and based on the net cash flow from operation and profit after tax, performance bonus was calculated at applicable rate on different profit level. In addition, bonus will be rewarded to the management, key personnel and outstanding staff through assessment of individual performance. All of the above rewards will raise the morale of our staff members.

Future Prospect

Looking ahead to 2004, the operation environment is still challenging. Due to the shortage of raw materials of tinplate and increase of price, its production and sale for the year will experience a "bottle neck". The outbreak of bird flu epidemic after Chinese New Year will severely affect the live and fresh foodstuffs business in the year. Following the realignment of our business structure, the gradual withdraw of livestock farming, feed production and foodstuffs trading will face more pressure on the turnover of the year. Aiming at alleviating unfavorable factors of production and business in 2004 by taking an active role and advocating

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our future development, the Group decided to adopt the following measures: (1) Reform on current management from investment control to direct management. Reform and adjustment on internal management structure will also be implemented by reducing the number of management levels and realizing direct management. (2) Reform on remuneration policy. To activate the working enthusiasm of our staff, a new assessment of the remuneration will be introduced in our principle corporate, Zhongyue Tinplate. The performance appraisal is mainly based on productivity (tons), sales (tons), electricity generation (ten thousand watt) and revenue from property (ten thousand RMB). (3) Problems on the shortage of raw materials of tinplate will be actively solved, such as exploring various sources to import raw materials and alternate materials. Besides, the management will review the possibility of using local raw plate and search of market and production potential to realize our current target. (4) To construct exclusive tin-free steel production line without affecting day-to-day production, aiming at commencing production at the earliest opportunity to achieve our targets on effectiveness. (5) Five-year plan on corporate development will be implemented, organized and carried out. The Group dedicates to develop new products and varieties of tinplate and its related business with promising market prospects. The Group firmly believes, by virtue of the advantage that our tinplate products were granted as brand name products in Guangdong Province in 2003, comparative advantage in producing tin-free steel in China and the sound financial position and strong management team, the Group will realize our aims to establish a professional corporate in the foreseeable years.