

Management Discussion and Analysis

EcoGreen Fine Chemical Group Limited ("the Company") and its subsidiaries ("the Group") is the leading natural fine chemicals company in the PRC and is principally engaged in the research and development, production and sales of fine chemical products. Using botanic essential oils as raw material, the fine chemical products are extensively applied in pharmaceutical industry, healthcare industry and personal care industry.

The Group's fine chemical products are broadly categorised into three main product groups, namely (i) chiral pharmaceuticals raw materials and pharmaceutical intermediates which are principally used in the production



of chiral pharmaceuticals, (ii) natural pharmaceutical raw materials which are used as functional ingredients in the production of healthcare products, and (iii) aroma chemicals which are broadly used as ingredients in flavor and fragrance products to be applied in a wide range of personal care products, cosmetics and household products.

BUSINESS REVIEW

Riding on the impressive performance in previous years, the Group continued to record a remarkable business growth for the year ended 31st December 2003. Turnover and profit attributable to shareholders reached RMB223.2 million and RMB54.7 million, respectively, representing a year-on-year increase of 52.0% and 61.4% as compared to RMB146.8 million and RMB33.9 million in 2002. For the four years ended 31st December 2003, the compound annual growth rates for the Group's turnover and net profit amounted to approximately 43.7% and 52.2% respectively. Earnings per share also increased from RMB11 cents in 2002 to RMB18 cents in 2003.

The notable growth in turnover was mainly attributable to the launching of two new chiral pharmaceuticals raw materials and pharmaceutical intermediates and one new aroma chemical products during the year and the impact of a full year's operation of the enhancement of the Group's production facilities which was completed in June 2002, the annual processing capacity of botanic essential oils was increased from 8,000 metric tonnes to 9,500 metric tonnes. With the expansion of the Group's sales volume, together with the benefits brought forth by economies of scale and improvement of operational efficiency, the Group successfully adopted a competitive pricing policy for its products.

In addition, the Group has continued to enlarge its customer base through expansion of sales and distribution network to overseas market. In 2003, overseas sales of the Group's fine chemical products surged significantly by 85% as compared to that of 2002.

During the year of 2003, the gross profit margin of the Group increased from 38.0% in 2002 to 38.8% in 2003. The improvement was attributable to the improvement of operational efficiency, economies of scale of production and the change in sales mix towards higher gross profit margin products.

OPERATIONAL REVIEW

Product Diversification

Leveraged on its advanced production technologies and techniques, the Group is well positioned to develop new products in a timely manner and swiftly adjust the product mix in accordance with the market demand. During the year under review, approximately 30 types of fine chemical products were produced. An analysis of the Group's turnover by product types and the gross profit margin of the Group's products for the year ended 31st December 2003 and 31st December 2002 is as follows:

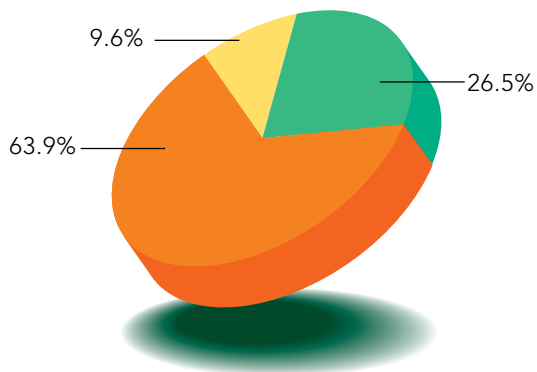
	Gross profit		Gross profit	
	Turnover 2003 RMB'000	margin 2003 %	Turnover 2002 RMB'000	margin 2002 %
Chiral pharmaceuticals raw materials and pharmaceutical intermediates	21,374	78.5	6,727	68.5
Natural pharmaceutical raw materials	59,253	38.2	42,712	37.9
Aroma chemicals	142,525	34.6	97,322	36.1
	223,152	38.8	146,761	38.0

With the Group's emphasis on the development of fine chemical products that are mainly applied as functional ingredients or intermediates for a wide range of downstream applications, the growing demand for downstream products in the PRC and the international market lead to an overall increase in the demand for the Group's products. Above all, the growth in turnover of chiral pharmaceuticals raw materials and pharmaceutical intermediates was faster than other products of the Group, contributing to a change of sales mix. With the increase of turnover of the high-margin chiral pharmaceuticals raw materials and pharmaceutical intermediates, its contribution to the Group's gross profit becomes more predominant.

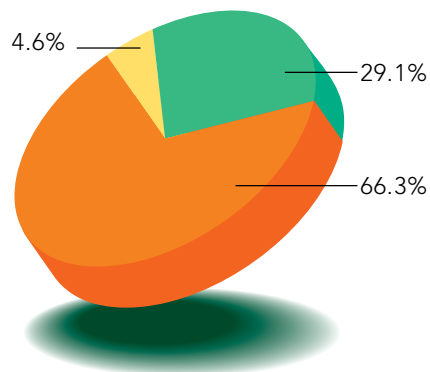


TURNOVER BY PRODUCT TYPES

2003



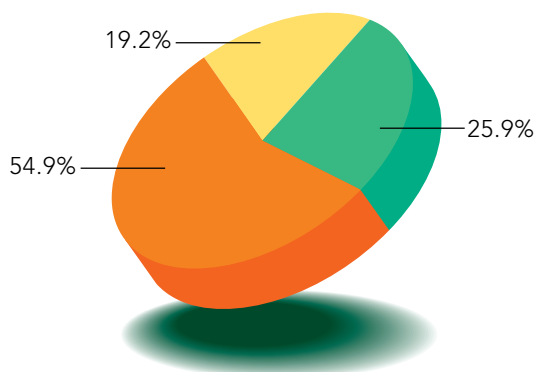
2002



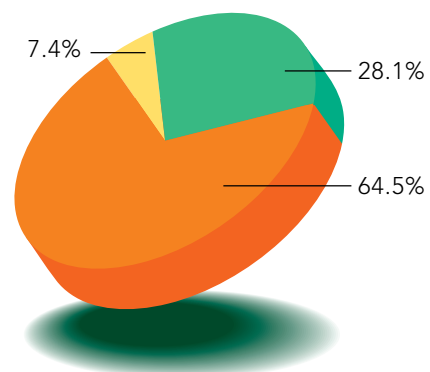
- Chiral pharmaceuticals raw materials and pharmaceutical intermediates
- Natural pharmaceutical raw materials
- Aroma chemicals

GROSS PROFIT BY PRODUCT TYPES

2003



2002



- Chiral pharmaceuticals raw materials and pharmaceutical intermediates
- Natural pharmaceutical raw materials
- Aroma chemicals



The sales of chiral pharmaceutical raw materials and pharmaceutical intermediates increased by 217.7% to RMB21.4 million in the year ended 31st December 2003, from RMB6.7 million in the previous year. It accounted for 9.6% (2002: 4.6%) of the Group's turnover. The market launch of new products, comprising intermediary polysaccharides and resveratrol which are of higher profit margins and the cessation of selling lower profit margin pseudo ionone contributed to the impressive increase of the gross profit margin of this product group.



The sales of natural pharmaceutical intermediates increased by 38.7% to RMB59.3 million in the year ended 31st December 2003, from RMB42.7 million in the previous year. It accounted for 26.6% (2002: 29.1%) of the Group's turnover. The progressive growth in the sales of the Group's natural pharmaceutical raw materials was the result of an increasing demand for downstream products in the PRC. The Group's economies of scale, continuous refining of production technology and the reduction in unit production cost of the Group's natural pharmaceutical raw materials improved the gross profit margin of this product group for the year.



The sales of aroma chemicals increased by 46.4% to RMB142.5 million in the year ended 31st December 2003, from RMB97.3 million in the previous year. It accounted for 63.9% (2002: 66.3%) of the Group's turnover. The prominent overseas sales of the Group's products and the enhancement of the Group's processing capacity of botanic essential oils were the driving force of the remarkable increase in the sales of aroma chemicals. With a view of satisfying the needs of some of the Group's largest customers and utilising redundant production capacity in the production plant, the Group received orders of some new aroma chemicals with lower gross profit margin, which caused the decrease in the overall gross profit margin of the Group's aroma chemicals in 2003.



Extensive Clientele Base

The Group has established a solid and extensive customer base with over 100 customers, including trading companies and industrial companies that are the major multinational manufacturers of pharmaceuticals, flavour and fragrance products. During the year 2003, turnover generated from the Group's

five largest customers reduced from 26.0% to 20.7%. The Group's extensive customer base minimises the adverse impact of any over-exposure to a particular customer, industry or any significant seasonal fluctuation in sales pertaining to any particular industry.

Production Facilities

The Group's existing production facilities have a site area of approximately 27,000 sq. m. and an aggregate gross floor area of approximately 8,400 sq. m. located in Xiamen, Fujian Province, PRC. The Group's facilities enjoy close proximity to Xiamen's container port and extensive transportation network, ensuring efficient delivery and reduction of transportation costs. After the enhancement project on the existing production facilities which was completed in 2002, the annual processing capacity of botanic essential oils of the Group increased from 8,000 metric tonnes to 9,500 metric tonnes. Based on optimal product mix, the average annual utilisation rate of the existing production facilities is approximately 91%.



Research and Development

For the year ended 31st December 2003, product development costs incurred and capitalised by the Group amounted to approximately RMB6.2 million (2002: RMB1.5 million) whereas the Group's amortisation of product development costs amounted to RMB2.2 million (2002: RMB2.1 million), representing 2.8% (2002: 1.0%) and 1.0% (2002: 1.4%), respectively, of the Group's turnover.

With the availability of sophisticated ancillary facilities and the abundant resources provided by a number of PRC academic and research institutes, the Group bolstered its research and development capability through the collaborations with some leading academic and research institutes in the PRC, including Xiamen University, Nanjing University, The Shanghai Institute of Organic Chemistry of Chinese Academy of Sciences and The Guangzhou Institute of Chemistry of Chinese Academy of Sciences.

During the year, the Group has cooperated with Xiamen University Assets Operations Co., Ltd. to invest in Xiamen Xiada Taigu Pharmaceutical Co., Ltd., a domestic enterprise established in the PRC which is principally engaged in the research and development of biological and chemical pharmaceutical products. As at 31st December 2003, the Group had 10% (2002: Nil) interest in this company.



RECOGNITIONS

In December 2003, Xiamen Doingcom Chemical Co., Ltd., one of the subsidiaries of the Company, was accredited with a "ISO9001: 2000" certificate for its Quality Management System for its unparalleled management of the research and development, manufacture and service of flavor and fragrance, botanic aroma essential oils and their derivants.

Chemical wastes discharged by the Group's production facilities were kept under the statutory level and complied with the requirements of the environmental authority under the local government. In addition, Xiamen Doingcom Chemical Co., Ltd. was accredited "ISO14001: 1996" certificate in December 2003 for its eminent Environmental Management System implement on the research and development, manufacture and service of aroma flavour and fragrance, botanic aroma essential oils and their derivants as well as the associated environmental management activities.

EMPLOYEES AND REMUNERATION POLICY

As at 31st December 2003, the Group has 218 full-time employees of which 215 are based in the PRC and 3 in the Hong Kong office. The Group has always maintained a good relationship with its employees and training is provided to its staff on business knowledge including information on the application of the Group's products and to maintain clients' relationship. Remuneration packages offered to the staff are in line with the prevailing market terms and reviewed on a regular basis. Discretionary bonuses may be rewarded to employees after assessment of the Group's and the individual's performance.

The Group participates in state-sponsored retirement plans which are administered by the local government in the PRC for its PRC based employees. The Group has also set up a retirement scheme in accordance with the mandatory provident fund requirements prescribed by the Mandatory Provident Fund Schemes Ordinance for all its Hong Kong based employees.

The Group has also adopted a share option scheme on 16th February 2004 for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. The Directors may, at their discretion, invite any employees or Directors of the Group and other selected participants as set out in the scheme, to subscribe for shares in the Company. For the period up to the date of this report, no share options had been granted under the share option scheme.

FINANCIAL REVIEW

Liquidity, Financial Resources and Capital Structure

During the year under review, the Group's primary source of funding included cash generated from operating activities and credit facilities provided by its principal banks in the PRC. Net cash inflow from operating activities amounting to approximately RMB22.7 million (2002: RMB22.8 million) which was resulted from the Group's capability in working capital management to develop and strengthen a net cash surplus from operation. As at 31st December 2003, the Group had cash and bank deposits of approximately RMB65.9 million (2002: RMB11.7 million).

The Group's financial position remains healthy. As at 31st December 2003, the net current assets and the current ratio of the Group were approximately RMB40.9 million (2002: RMB23.0 million) and 1.32 (2002: 1.31), respectively.

As at 31st December 2003, the Group had total assets of approximately RMB283.9 million (2002: RMB194.5 million), bank borrowings of approximately RMB90.6 million (2002: RMB59.0 million), government loans from State Development and Reform Commission, Xiamen Development Planning Commission and other PRC government bureaus to finance the Group's product development activities and expansion of production facilities of approximately RMB36.2 million (2002: RMB31.0 million), convertible bonds of RMB37.2 million (2002: RMB37.2 million), trade and other payables of approximately RMB34.0 million (2002: RMB25.1 million) and shareholders' equity of approximately RMB85.9 million (2002: RMB42.3 million).

The Group's gearing ratio as at 31st December 2003, which is represented by the ratio of total debts to total assets, was approximately 57.7% (2002: 65.9%). Moreover, the Group's return on assets was about 19.3% (2002: 17.4%), which indicated that the Group's assets were employed and utilised efficiently and effectively.

With the positive cash inflow from operations, its available banking facilities and the proceeds from the Company's issue of new shares and the exercise of over-allotment option at the time of listing on the Stock Exchange on 9th March 2004, which, after deduction of related issuance expenses, amounted to approximately RMB149.2 million (equivalent of HK\$140.8 million), the Group has sufficient financial resources to meet its commitments, working capital requirements and future investments for expansion.

Charges on assets

The Group's bank borrowings were secured by pledge of certain of the Group's land and buildings of approximately RMB37.2 million (2002: RMB38.3 million), corporate guarantees provided by certain unrelated third parties of approximately RMB25.5 million (2002: RMB19.5 million) and pledge of input value-added tax recoverable of approximately RMB3.1 million (2002: nil).

Contingent Liabilities

As at 31st December 2003, corporate guarantees in the amount of RMB1.5 million (2002: RMB1.0 million) were provided by the Group for bank loans of an unrelated third party. Subsequent to 31st December 2003, such guarantees were released.

Capital Commitment

As at 31st December 2003, the Group had capital commitments of approximately RMB21.0 million (2002: RMB9.1 million) in respect of purchases of property, plant and equipment and construction-in-progress, capital injection to a subsidiary and product development projects.

Treasury Policies and Exposure to Fluctuations in Exchange Rates

The Group's transactions are mainly denominated in Renminbi, United States dollars and Hong Kong dollars with operation mainly in the PRC. As at 31st December 2003, the Group's bank borrowings were denominated in Renminbi and bearing interest at rates ranging from 5.6% to 6.6% per annum whereas the Group's cash and cash equivalents denominated in Renminbi amounted to 97.2% of the total balance with the remaining balance denominated in United States dollars and Hong Kong dollars. The Group's exposure to the foreign exchange fluctuations was minimal and has not experienced any material difficulties or affects the operations or liquidity as a result of fluctuations in currency exchange rates during the year. Nevertheless, the Group will conduct periodic review of its exposure to foreign exchange risk and may use financial instrument for hedging purpose when considered appropriate.

Business Outlook

Looking ahead, the Group will capitalise on the surging market demand for chiral drugs, natural pharmaceuticals and personal care product, with the view of propelling business growth. "Business specialisation and product diversification" has been, and will continue to be, the goal for the Group's long-term development.

Leveraging its solid foundation for aroma chemicals products, the Group will further strengthen and expand this market, while diversifying its existing product portfolio to other fine chemicals products. The Group endeavors to utilise botanic essential oils as the principal raw material and develop new products with high growth potential. High value-added products, comprising mainly chiral pharmaceuticals raw materials and pharmaceutical intermediates and natural pharmaceutical raw materials, will further be developed in order to increase the Group's market share and the sales of the abovementioned products.

The Group will complete the expansion of the existing production facilities by 2004 and the construction of a new plant by 2005. The expansion will enhance the Group's processing capacity of botanic essential oils to 11,000 metric tonnes and to 16,000 metric tonnes in 2004 and 2005, respectively, and strengthen its plan for business expansion.

With the objective of maintaining intimate customer relationship and creating customer values, the Group will actively establish direct communication channels with product users to thoroughly understand customers' needs and adopt a more effective control over distribution channels, so as to respond to market changes and customer's needs. The setting up of a representative office in Guangzhou enables the Group to have direct access to potential users, which motivates further expansion of the extensive customer base in the PRC. To increase direct exports to overseas market, the Group endeavors to provide comprehensive and quality services and establish a strong foothold in the European and the US market by setting up logistics support centre in Rotterdam, the Netherlands, the transportation and logistics hub of Europe, as well as a representative office in New York, the US in 2005.

Amidst the backdrop of the promising market, the Group will continue to seek for appropriate opportunities to acquire advanced research and development facilities and recruit high caliber professionals for speeding up the effective commercialisation of its research and development results. Leverage on its unique market insight, unrivalled research and development competence and sound financial position, the Group is confident of capturing any cooperation opportunities with renowned local and overseas research institutes and further enhancing its long-term competitiveness.

