

Market Review

According to the China Construction Glass and Industrial Glass Association, there were 98 float flat glass production lines in operation in the PRC as at the end of 2003 with a total annual production capacity of 213 million weight cases. According to the National Statistical Bureau in the PRC, the actual production volume of flat glass in 2003 in the PRC amounted to 252.43 million weight cases, representing a year-on-year increase of 11.1%.

The outbreak of the Severe Acute Respiratory Syndrome in early 2003 did not significantly affect the building materials industry in the PRC. The market prices of flat glass remained stable during the first half of 2003, with an average market price of over RMB55 per weight case. There was a significant increase in the selling prices of flat glass starting from August 2003. The average market price of flat glass in the second half of 2003 rose to over RMB70 per weight case.

The Directors believe that the rise in the flat glass prices was largely due to the increased demand resulting from rapid economic development in the PRC. In 2003, the total investments in real estate development in the PRC surged by about 30% compared to that in 2002. During the same period, the production of automobiles in the PRC also increased by approximately 42% to 4.5 million units.

Business Review

The Group's performance significantly improved in 2003, compared with that in 2002. Apart from the increase in the total output of flat glass products, the Group began to diversify its product range into processed glass products, including insulating glass, tempered glass, mirror glass and laminated glass in the second quarter of 2003 and ultra-thin flat glass in the fourth quarter of 2003.



MANAGEMENT DISCUSSION AND ANALYSIS

Products

Flat glass

In the fourth quarter of 2003, the ultra-thin (less than 3mm) flat glass production line with a daily melting capacity of 400 tonnes commenced production. As a result, the Group's total daily melting capacity has increased to 2,050 tonnes. During the year, the Group produced 12.54 million weight cases of flat glass and achieved a sales/production ratio of approximately 96%. The net turnover of flat glass in 2003 increased by 54% to about RMB780.9 million, compared with RMB506.4 million in 2002. The average selling price of the Group's flat glass was about RMB65 per weight case in 2003, compared with that of RMB55 per weight case in 2002.

During the year, approximately 83% and 16% of the Group's flat glass sales were automotive grade glass and construction grade glass, respectively. Mirror grade glass and substandard products accounted for the remaining 1% of output.

In 2003, approximately 67% and 33% of the Group's flat glass sales were thin glass (4 – 6mm in thickness) and thick glass (8 – 12mm in thickness) respectively. The new ultra-thin production line, which commenced commercial production in the fourth quarter of 2003, produced 46,000 weight cases of ultra-thin glass (less than 3mm) and achieved an average selling price of RMB78 per weight case. The ultra-thin glass is mainly used in the automotive industry, which is undergoing exponential growth in the PRC.

Processed glass

With the production facilities imported from Germany, Austria and Italy, the production of insulating glass, tempered glass, mirror glass and laminated glass commenced in the second quarter of 2003. In 2003, approximately 1.0 million sq.m. of processed glass products were sold at an average selling price of RMB27 per sq.m., achieving a net turnover of about RMB28.1 million. The processed glass products are mainly for use in the construction industry.



MANAGEMENT DISCUSSION AND ANALYSIS

Sales and marketing

During the year, the Group made more sales of flat glass to Shanghai than previous years, as the city has continued its fast-paced development. The Shanghai market accounted for approximately 16% of the Group's turnover in 2003, compared with only 6% of the Group's turnover in 2002. The Group's flat glass sales in its local Zhejiang market, as a result, decreased to approximately 70% of its turnover in 2003 from that of approximately 81% in 2002. In 2003, the Group maintained the similar proportion of sales to Guangdong, Fujian and other provinces as that in the prior year.

Supply of fuel and raw materials

In 2003, the average price of heavy oil purchased by the Group was approximately RMB1,677 per tonne, compared with RMB1,365 per tonne in 2002.

The average price of soda ash purchased by the Group in 2003 was approximately RMB990 per tonne. The market price of soda ash started to rise in the fourth quarter of 2003 and reached approximately RMB1,250 per tonne in early 2004. There were no material fluctuations in the costs of other raw materials.

Financial Review

In 2003, the gross profit margin of the Group increased to 32%, compared with that of 25% in 2002. Although the average selling price of the Group's flat glass has increased by 18% to approximately RMB65 per weight case, the increase was offset, to some extent, by the higher unit cost of sales of approximately RMB43 in 2003 as compared with that of RMB41 in 2002. In 2003, the Group achieved a net profit of approximately RMB182.2 million and a net profit margin of 23%, compared with a net profit of approximately RMB86.3 million and a net profit margin of 17% in 2002.

The Group recorded a subsidy income of approximately RMB24.1 million from the Ministry of Finance of Yangxunqiao Township, Shaoxing County for the compensation of staff costs and manufacturing overheads incurred in 2003, which was received in early 2004. The Group also recognised a subsidy income of similar nature amounting to RMB19.3 million in 2002, which was received in 2003.

The Group's average inventory turnover in 2003 was approximately 25 days, compared with 21 days in 2002.

Outlook

Flat glass

The Directors believe that the demand for the Group's flat glass will remain strong in the coming year as the rapid property development in the Group's major markets, i.e. Zhejiang, Shanghai and Jiangsu, is expected to continue due to the strong economic growth in the Yangtze River Delta. Being the Group's major market, Zhejiang Province achieved a GDP growth rate of 14% in 2003, while the expenditure on fixed assets also grew by 38% in Zhejiang Province for the same period. According to Zhejiang Province Development and Reform Commission, the GDP of Zhejiang Province is forecast to grow at a rate of around 10% in 2004.

The average market price of flat glass in the PRC reached approximately RMB74 per weight case in December 2003 and rose to approximately RMB76 per weight case in March 2004.

The Directors expect that the rising market price of soda ash would increase the unit cost of sales of flat glass by RMB3 to RMB4 per weight case. However, the Directors believe the flat glass industry should be able to transfer part of the increased costs of production to the selling price of flat glass.

Processed and special glass

The Group has successfully diversified its products to other types of glass products. The Group's processed glass production lines commenced commercial production in the second quarter of 2003. The Group's production line for Low-E coated glass (低輻射鍍膜玻璃) is currently under construction and is expected to commence trial production in the second quarter of 2004. Low-E coated glass is widely used as glass panels on the outer wall of buildings as it can save energy and is environmentally friendly.

The Directors expect that the Group's processed glass and special glass products will benefit from the construction growth in the Yangtze River Delta and recent government regulations on the use of safety glass. The "Regulation on Construction Safety Glass Administration" (建築安全玻璃管理規定) promulgated by the PRC central government specifically requires that, effective from 1 January 2004, safety glass (tempered glass, laminated glass, insulating glass and other processed glass) should be used in the construction of buildings of seven or more levels, interior partition and shower cubicles, etc. Therefore, the Directors expect that the demand for processed glass, particularly Low-E coated glass, will further increase.

MANAGEMENT DISCUSSION AND ANALYSIS

Expansion of business operations

The Company plans to further expand its flat glass businesses. It has entered into several co-operation agreements with certain local government authorities in the PRC for the construction of different glass production lines which are pending for the approvals from relevant authorities in the PRC.

- On 29 April 2003, the Company entered into a preliminary co-operation agreement with the industrial development council of Shaoxing county of the Zhejiang Province for the development of businesses mainly in the manufacturing and processing of glass products (“Shaoxing Project”).
- On 6 August 2003, the Company entered into a preliminary co-operation agreement with the People’s Government of Changxing county, Zhejiang Province, for the construction of two special glass production lines with a daily melting capacity of 600 tonnes each and five processed glass production lines (“Changxing Project”).
- On 21 September 2003, the Company entered into a preliminary co-operation agreement with the industrial development council of Pinghu city, Zhejiang Province, for the construction of four float flat glass production lines with a daily melting capacity of 600 tonnes each (“Pinghu Project”).

Soda ash production

In 2003, the Group initiated a strategy of vertical integration by moving up the value chain. Through its subsidiary, Qinghai Soda Ash Company Limited, the Group’s investment in soda ash production in Qinghai Province is expected to secure a stable and low cost supply of soda ash, a major raw material for flat glass production. The Directors consider the abundant reserve of salt (the major raw material of soda ash), lower coal and energy prices in Qinghai to be important factors that, the Directors believe, will lead to the success of the project. As the soda ash market of the PRC is currently experiencing a supply shortage, the Group is well-positioned to enter this foray.

After an assessment of the capacity of the soda ash production facility and the potential growth of the soda ash market conducted by China International Consulting Company, the Directors consider to increase the annual capacity of the soda ash production facility to 900,000 tonnes from the original plan of 600,000 tonnes. However, the proposed increase in capacity is subject to approval from the relevant authorities in the PRC.

Capital Expenditures and Commitments

Total capital expenditures in 2003 amounted to RMB807.4 million, of which RMB537.6 million was spent on the construction of plant and buildings, production machinery and equipment of various new glass production lines and the soda ash factory and RMB269.8 million was paid to the contractors as deposits for the construction of various glass production lines and the soda ash factory, purchases of other fixed assets and the land use rights associated with these production lines.

As at 31 December 2003, the Group's total capital commitments in respect of plant and machinery, land use rights, other fixed assets and investment in subsidiaries amounting to RMB8,865 million. The amount was not recorded as a liability of the Group. Out of the commitment amount, approximately RMB4,939 million was related to the Shaoxing Project and the Pinghu Project mentioned in the sub-section headed "Expansion of business operations" in the section headed "Outlook". The Company has reached agreements with the local authorities that the size and schedule of investment of these two projects have to be examined and finalized by the Group. Except for approximately RMB310 million which will be incurred by the Group for these projects in 2004, no further definite timetable and amounts of investment have yet been determined.

Liquidity and Financial Resources

As at 31 December 2003, the Group's cash and cash equivalents balance amounted to RMB380.1 million, compared with that of RMB423.8 million as at 31 December 2002. As at 31 December 2003, shareholders' funds of the Group amounted to RMB1,240.8 million, representing an increase of RMB157.5 million from that of RMB1,083.3 million as at 31 December 2002.

As at 31 December 2003, the Group had outstanding bank loans amounting to RMB689.1 million, representing an increase of RMB505.9 million from RMB183.2 million as at 31 December 2002. Out of these outstanding bank loans, RMB446.9 million was repayable within one year and RMB242.2 million as repayable beyond one but within two years. Subsequent to 31 December 2003, the Group had successfully renewed RMB258.5 million of the bank loans with a term extending beyond 2004 and the Group has also secured commitments of additional banking facilities of RMB2.3 billion in order to finance its ongoing capital commitment.

The Group's debt ratio as at 31 December 2003 was 30%, compared to 12% as at 31 December 2002. The calculation of the debt ratio is based on total debts of RMB691.1 million (2002 – RMB185.2 million) over total assets of RMB2,312.2 million (2002 – RMB1,547.9 million).