



Hong Kong's best seller of packaged egg rolls in 2003 (AC Nielsen)

Hong Kong's market leader of packaged snack meat products in 2004 (AC Nielsen)

Hong Kong's "Superbrands" in 2004 (Superbrands)

MANAGEMENT DISCUSSION AND ANALYSIS

INDUSTRY OVERVIEW

Packaged food is the product and an integral part of the modern society. Rapid economic development and people's continued pursuance of a higher living standard has quickened the pace of everyday urban lifestyle. As a result, the market demand for quality, value-for-money and diversified convenience food has continued to increase.

Hong Kong's retail market of packaged food is highly mature and has entered the stage of stable growth. Despite the outbreak of Severe Acute Respiratory Syndrome (SARS) during the first half of 2003, the packaged food industry was minimally affected. The increasing customer demand for improved taste, variety and quality, the presence of numerous local and overseas convenience food manufacturers coupled with the introduction of various types of innovative packaged food by Japanese, English, American, etc, dealers further intensified the already keen market competition. Renowned brand name, comprehensive product portfolio and extensive sales network are the three essential elements in order to excel in the packaged food market in Hong Kong. In recent years, manufacturers have been proactively launching new products, ameliorating packaging and strengthening the marketing and promotion of products.

As for the PRC market, people's lifestyle has been changing as the economy develops, packaged food is becoming a trend and a way of life with continually improving quality, diversity and value. Meanwhile, it is expected that more foreign brands will enter the food retailing market following the opening up of the PRC market pursuant to the PRC's accession to the World Trade Organization (WTO). In light of the changing lifestyles and the more favourable business environment, the prospects of the packaged and convenience food industry in the PRC is promising, especially since consumers' taste and style for products are becoming similar to that of the Hong Kong market.

BUSINESS REVIEW

Wah Yuen is the leading food manufacturer, distributor and retailer in the Hong Kong and PRC market, producing and offering over 200 types of top quality snack food products with a unique Asian flavour under three brands, namely Wah Yuen, Rocco and 采楓. The Group also produces convenience frozen food under the brand name Wah Yuen and the OEM model.



Hong Kong Market

In 2003, the Group's business development in the Hong Kong market remained stable. Leveraging on the comprehensive sales network spanning 2,300 retail outlets in Hong Kong as well as its well-recognized renowned brand identity, Wah Yuen's products continued to be one of the most popular packaged food products in Hong Kong. According to AC Nielsen's latest market research reports, Wah Yuen has again become Hong Kong's market leader and best-seller in packaged snack meat products and gift packaged egg rolls respectively. In addition, Wah Yuen was awarded the "Superbrands" status in January 2004, representing valuable market recognition of its strong brand name equity.



As for the Group's products, Wah Yuen further extended its range of packaged snack food and convenience frozen food by launching a number of new products, such as Japanese Style Deep Fried Sweet Potatoes, a series of new Chinese dim sum, a series of fried rice and noodles, as well as packaged snack food.

In order to strengthen its leading market position and to enhance its corporate image, the Group participated in and undertook a number of marketing and promotional activities in 2003, including participating in the 38th Hong Kong Product Expo organized by The Chinese Manufacturers' Association of Hong Kong and launching new advertising and free trial promotion programs.

The PRC Market

The Group's products are mainly sold under the brand names of Wah Yuen, Rocco and 采楓 and have achieved successful market penetration into over 250 cities in 30 provinces. As at 31 December, 2003, the Group's branch offices span across 7 cities nationwide, namely Beijing, Shenyang, Changchun,



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Dalian, Wuhan, Changsha and Nanning, which enabled effective management of the Group's sales and distribution in the PRC. Currently, the Group's products are supplied to over 500 customers in the PRC, which mainly comprise supermarket chains, independent trading companies, convenience store chains, healthcare store chains and individual grocery stores.

Foreseeing the immense potential of the PRC retailing market, the Group's products are also supplied to "Wah Yuen speciality stores" (「華園滋味屋」) which are established and operated by independent PRC business partners. As at 31 December, 2003, the Group opened 50 Wah Yuen speciality stores which are expected to contribute to the Group's business growth in the PRC in 2004. In addition, the Group is also negotiating with several major potential customers for launching convenience frozen food products to the PRC market in 2004.



Production Facilities

At present, the Group has three production facilities. As at 31 December, 2003, a total of 10 production lines are located in Hong Kong and the Huadu District, Guangzhou, Guangdong Province. The Group's two production facilities in the PRC, namely Wah Yuen (Guangzhou) Foods Co., Ltd. and Rocco Foods Enterprise (Guangzhou) Co., Ltd., were awarded the internationally recognized HACCP certificates in July 2003 as a testimony of the Group's highest international food hygiene standards, which helped to enhance consumers' confidence in the Group's products.



FUTURE PROSPECTS

The Group will continue to focus on diversifying its product portfolio and strengthening its brand presence in future. In recent years, convenience frozen food products have become more popular and widely accepted. The Group will develop different types of packaged snack food and convenience frozen food products, so as to satisfy

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consumers' need for quality food. With the growing demand for frozen food products in the PRC, the Group will introduce more frozen food products for its customers.

The Group endeavors to consolidate its business in Hong Kong and the PRC while developing sales and distribution network in overseas markets. The Japanese orders have commenced production and are targeted for shipment to Japan in the first half of 2004. In addition, the Group participated in Foodex, one of the largest food exhibitions in Japan, in March 2004 to promote and market the Wah Yuen's brandname and its products. The Group will also continue to negotiate sales plans with Japanese distributors and speed up its strategic journey in developing the global market.



As a unique one-stop food enterprise, Wah Yuen will continue to bring new tastes and excitement to customers and maximize its market penetration in Hong Kong and the PRC. The Group is committed to heightening its "Superbrands" status and introducing more quality food to the world.

FINANCIAL REVIEW

The Group's turnover for the year ended 31 December, 2003 amounted to HK\$198,934,000, representing a slight growth of 3% as compared to HK\$192,865,000 for last year. The Group's gross profit and profit for the year ended 31 December, 2003 reached HK\$81,869,000 and HK\$20,143,000 respectively.

Sales of dried meat products which accounted for 58% of total turnover were the major source of the Group's revenue. Sales of convenience frozen food products accounted for about 19%, sales of flour products accounted for about 10%, sales of preserved fruits and nuts products accounted for about 4% and the remaining turnover was attributable to other products. These figures were similar to that of last year.



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LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December, 2003, the Group had total assets of HK\$352,011,000 and its total current assets were HK\$244,821,000. As at that date, the current and non-current liabilities of the Group totaled to HK\$174,734,000 and HK\$49,949,000 respectively. The Group's bank borrowings amounted to HK\$133,199,000 (2002: HK\$118,281,000). Most of these bank borrowings were denominated in Hong Kong dollars and Renminbi and bearing floating interest rates. As at 31 December, 2003, the gearing ratio of the Group was 49% (2002: 51%), calculated on the basis of total borrowings over total assets at that date.

As at 31 December, 2003, the Group had total trade receivables of HK\$131,306,000. Up to 15 April, 2004, HK\$68,700,000 has been fully settled. The Group granted a long credit period for certain customers with long established relationship and good past repayment histories.

USE OF LISTING PROCEEDS

For the year ended 31 December, 2003, the Group had applied part of the listing proceeds as follows:

- Approximately HK\$6,000,000 for expanding its sales and distribution network in the PRC;
- Approximately HK\$6,000,000 for acquiring new equipment and upgrading its production facilities in the PRC;
- Approximately HK\$2,000,000 for financing its research and development on food products;
- Approximately HK\$1,000,000 for setting up a sales and distribution network in Japan;

The unused proceeds are placed on deposits with banks.

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EXPOSURE TO FLUCTUATION IN FOREIGN EXCHANGE

The Group's monetary assets and liabilities are denominated in Hong Kong dollars and Renminbi which were relatively stable during the year. The Group is not exposed to any other significant exchange risk.

CAPITAL EXPENDITURE

During the year, the Group invested approximately HK\$17,542,000 in fixed assets, of which 87% was used for purchase of plant and machinery and the remaining related to other assets.

As at 31 December, 2003, the Group had capital commitments of approximately HK\$9,831,000 in respect of acquisition of new machinery and renovation of a new production line.

CHARGE ON ASSETS

As at 31 December, 2003, certain assets of the Group with aggregate carrying value of HK\$143,728,000 were pledged to banks to secure banking facilities granted to the Group.

EMPLOYEES

As at 31 December, 2003, total number of employees of the Group were approximately 85 in Hong Kong (2002: 83), and approximately 821 in the PRC (2002: 718). The Group offers a comprehensive remuneration and employees' benefit package to its employees. In addition, share option and discretionary bonuses are also granted to eligible staff based on the performance of the individual as well as the Group.