

Management's Discussion and Analysis

OPERATING RESULTS

In 2006, the core business of the Group remains the production, distribution and sales of Kingway beer, primarily in Guangdong Province, the PRC, while a proportion of the beer sales volume came from the adjacent areas of Guangdong Province as well as Tianjin, Xian and Chengdu cities respectively.

The consolidated profit for the year was HK\$110 million (2005: HK\$200 million), representing a decrease of 44.8%. The dividend per share for the year was 3.0 HK cents (2005: 4.0 HK cents), representing a decrease of 25.0%.

Consolidate revenue for the year was HK\$1,408 million (2005: HK\$1,200 million), representing an increase of 17.3% over the previous year. The average price per tonne of beer sold was HK\$2,187 (2005: HK\$2,260), representing a decline of 3.2% from the previous year, which was primarily due to the Group's adoption of localized marketing strategies of each of the subdivided markets and refinement of product mix according to different market demands for full-scale expansion of the Group's shares in various major markets in Guangdong Province. The increase in sales volume from the markets reduced the overall average price per tonne of beer sold. Domestic sales accounted for 95.0% of the consolidated revenue, which percentage increased by 18.1% from the previous year. Overseas and Hong Kong sales accounted for 5.0% of the consolidated revenue, which percentage increased by 4.9% from the previous year.

The average unit costs per tonne of beer increased by 3.0% from HK\$1,262 in 2005 to HK\$1,300 in the year. The increase was primarily resulted from the increase in the depreciation and amortisation charges. The Group will continue to source materials by way of public tender under the "Sunshine Programme" and exercise strict control over various production costs, so as to relief the pressure on production cost arising from increasing prices of raw materials. As a result of the decrease in average price per tonne of beer sold and increase in costs during the year, gross profit margin decreased from 44.2% in the previous year to 40.6% in the year.

OPERATING EXPENSES AND FINANCE COSTS

Competition in the PRC beer market remained intense. During the year, the Group committed additional resources for market expansion and establishment of sales teams and distribution network in areas such as Tianjin, Xian and Chengdu, as well as for the exploration and consolidation of the beer markets in the Pearl River Delta area in Guangdong, with the aim of paving the way for the commencement of operation of its local brewery plants in the coming year. As a consequence, selling expenses of the Group for the year increased tremendously compared with the previous year. Selling expenses of the group for the year was HK\$370 million (2005: HK\$302 million), representing an increase of 22.5% from the previous year. Average selling and distribution expenses per tonne of beer sold for the year was HK\$574 (2005: HK\$570), representing an increase of 0.7% from the previous year.

Administrative expenses for the year was HK\$98.56 million (2005: HK\$67.86 million), representing an increase of 45.2% from 2005. The increase was primarily resulted from the commissioning of two new brewery plants during the year and the construction-in-progress of three other new plants which incurred additional human resources and administrative expenses. Further, there was a decrease in the amount of reinvestment tax refund of approximately HK\$18.7 million and an impairment of the amount due from the purchaser of Amber Brewery of HK\$5.74 million during the year. Finance costs for the year was HK\$3,722 thousand (2005: HK\$213 thousand). The increase in finance costs was due to the increase in bank borrowings during the year and the full year recognition of interest expenses of bank loan borrowed in 2005.

TAXATION

The rates of Profits Tax and Corporate Income Tax applicable to the Group's subsidiaries remained unchanged during the year except for Kingway Plant 2 in Shenzhen. Corporate Income Tax for the first two profit-making years and a 50% tax relief in the following three years were granted to certain subsidiaries in the PRC. Kingway Plant No. 2 in Shenzhen was the first year of 50% tax relief, and its Corporate Income Tax rate was 7.5%; Kingway Dongguan plant enjoyed its first year of tax exemption during the year as 2006 was the first profitable year of operations. Kingway plants in Shantou, Tianjin, Xian, Chengdu and Foshan had not used its tax exemption or relief during the year.

Management's Discussion and Analysis *(Cont'd)*

CAPITAL EXPENDITURE

The Group incurred capital expenditure (cash basis) of approximately HK\$688 million (2005: HK\$680 million) during the year, an increase of approximately 1.2% from the previous year, mainly representing the construction costs of the brewery plants in Tianjin, Xian and Chengdu.

In 2007, the major capital expenditure project of the Group will include the construction of brewery plants in Xian, Chengdu and Foshan. The anticipated capital expenditure will be slightly less than the year.

FINANCIAL RESOURCES AND LIQUIDITY

The Group's net asset value was HK\$1,949 million (2005: HK\$1,853 million) as at the end of the year, representing an increase of 5.2% compared the previous year. The net asset value per share was HK\$1.40 based on the number of ordinary shares issued as at the end of the year (2005: HK\$1.33 per share).

As at the end of the year, the group had total cash and bank balances of HK\$348 million (2005: HK\$382 million), including pledged and restricted bank balances of HK\$21.65 million (2005: HK\$7.98 million), representing a decrease of 8.9% from the previous year. The decrease was mainly attributable to the capital expenditure of new plants construction during the year. Of the balances at the end of the year, 72.4% was in USD, 2.4% was in EUR, 4.5% was in HKD and 20.7% was in RMB. Cash generated from operations for the year amounted to HK\$353 million (2005: HK\$308 million), representing an increase of 14.6% from the previous year.

The current cash balance and cash inflow from operating activities of the Group is sufficient. However, with the construction of new brewery plants in 2007, the Group will be examining various means of funding to provide sufficient financial resources for the future business development of the Group.

DEBTS AND CONTINGENT LIABILITIES

As at the end of the year, the Group had bank loan balance of HK\$696 million (2005: HK\$296 million), which bore interest at a rate based on LIBOR or HIBOR. Of the total outstanding bank loan, HK\$296 million are denominated in USD with an average life of approximately 2.9 years and the remaining HK\$400 million are denominated in HKD with an average life of approximately 3.0 years. For the bank loans denominated in USD, a cross-currency interest rate swap contract was entered into for hedging purpose. The aim for this was to lock the interest rate and exchange rate between USD and RMB, thereby mitigating the Group's exposure to movements in interest rate and exchange rate as well as lowering the effective loan interest rate by capitalizing on the market expectations for the appreciation of Renminbi.

As at the end of the year, the gearing ratio of the Group was 19.0% (2005: Net cash, which represented the Group's interest-bearing loan at the end of the year was less than its cash and cash equivalents balance), indicating the sound financial structure of the Group. None of the assets of the Group was pledged to creditors and there were no contingent liabilities existed as at the end of the year, except for HK\$21.65 million of the bank deposits which have been pledged or restricted for specific purposes.

HUMAN RESOURCES

The Group employs approximately 2,105 (2005: 1,663) staff as at the end of the year. Total remuneration for the year was approximately HK\$120.0 million (2005: HK\$99.6 million). The Group provided various basic benefits to its staff. In addition, there was an incentive policy which links the staff remuneration to the sales volume and results of the Group and their performance, which effectively stimulated the initiatives of the staff.