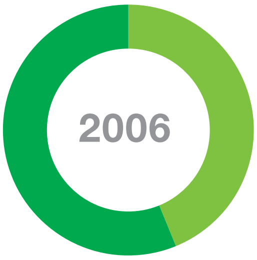
Revenue and Gross Profit Analysis

Sales Volume (mt)

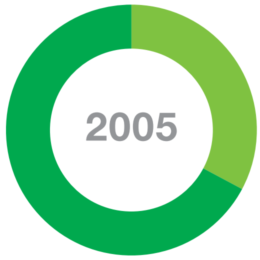
798,944 (44%)
Amino acids *349,870*
Modified Starch *74,285*
Sweeteners *365,114*
Others *9,675*

1,024,604 (56%)



590,828 (33%)
Amino acids *244,446*
Modified Starch *73,708*
Sweeteners *270,549*
Others *2,125*

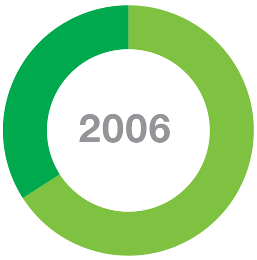
1,210,634 (67%)



Revenue (HK$'000)

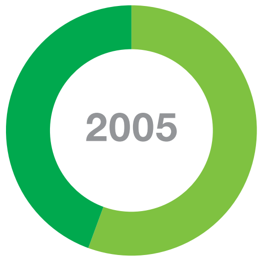
3,126,934 (66%)
Amino acids *2,212,277*
Modified Starch *216,903*
Sweeteners *671,485*
Others *26,269*

1,616,007 (34%)



2,267,417 (56%)
Amino acids *1,581,830*
Modified Starch *230,755*
Sweeteners *441,401*
Others *13,431*

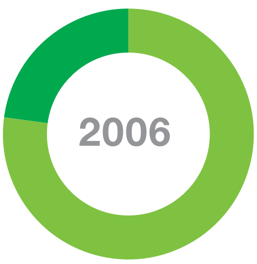
1,811,472 (44%)



Gross Profit (HK$’000)

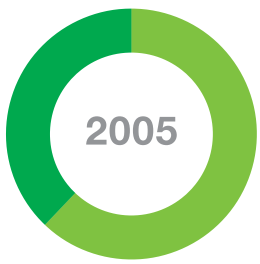
930,863 (77%)
Amino acids *656,081*
Modified Starch *75,673*
Sweeteners *202,882*
Others *-3,773*

275,913 (23%)



653,015 (62%)
Amino acids *404,677*
Modified Starch *107,951*
Sweeteners *140,637*
Others *-250*

398,342(38%)



Downstream products **Upstream products**

mtpa: metric tonnes
%: percentage to the Group’s total

Global Bio-chem Technology Group Company Limited (the "Company"), its subsidiaries (collectively referred as to the "Group") and each of its jointly controlled entities are principally engaged in the manufacture and sale of corn-refined and corn-based biochemical products, categorised into upstream and downstream products. Upstream products include corn-starch, gluten meal and other corn-refined products. Corn starch is then further refined into a wide range of high value-added downstream products including amino acids, corn sweeteners, modified starch and polyol chemical products.

BUSINESS ENVIRONMENT

During the year under review (the "Year"), the prices of oil-related materials for production and transportation remained high. In addition, as corn kernels were one of the key raw materials for the production of ethanol, the supply became tense throughout the Year. As a result, corn kernel price rose substantially as compared to previous year. These pushed up the production and operating costs of the Group.

Global market of lysine became stable and lysine price rebounded from the bottom substantially since the second half of the Year. However, the increasing interest margin of the United States (the "US") and the People's Republic of China ("China" or the "PRC") imposed additional pressure on the finance costs of the Group.

To effect a strategic allocation of client base and in view of keen demand from overseas markets, the Group further extended its sales to other regions other than the PRC. During the Year, such sales accounted for approximately 24% (2005: 19%) of the Group's turnover.

FINANCIAL PERFORMANCE

During the Year, the net profit attributable to shareholders increased by approximately 8% to approximately HK$501 million which was mainly attributable to the additional output of downstream products and rebound of lysine prices.

Upstream Products Segment

(Revenue: HK$1,616 million (2005: HK$1,811 million))
(Gross profit: HK$276 million (2005: HK$398 million))

During the Year, the average selling prices of upstream products increased by approximately 5% which compensated the increase in material cost. At the same time, the volume of upstream products sold to external customers dropped by approximately 15% because of the increased consumption of upstream products by the Group as a result of its continual development of downstream products. Turnover of upstream products segment thus decreased by approximately 11%.

Due to the use of corn kernels to produce ethanol in the PRC, corn kernel supply became tense and price rose substantially. As a result, the production cost comprised mainly material cost increased substantially by approximately 15%. Although the impact was partially shifted to customers, the gross profit percentage of upstream products dropped from approximately 22% in 2005 to 17% in 2006.

In view of governmental influence to avoid excessive consumption of agricultural products for bio-fuel production, stable corn kernel price and stable gross profit margin at current level for coming years is expected by the management.

Downstream Products Segment

(Revenue: HK$3,127 million (2005: HK$2,267 million))
(Gross profit: HK$931 million (2005: HK$653 million)

During the Year, glutamic acid, a type of amino acids, was launched while the production scales of both amino acids and corn sweeteners expanded as compared to last year. Turnover of downstream products, thus, increased by approximately 38%.

The improving operation effectiveness and efficiency were reflected from the increase in sales volume of amino acids by approximately 45%. In addition, the prices of lysine products had rebounded from the bottom since the second half of 2006. Turnover and gross profit of lysine amounting to approximately HK$2,075 million (2005: HK$1,559 million) and HK$637 million (2005: HK$402 million) respectively improved substantially while gross profit percentage increased by approximately 5%.

At the same time, the volume sold and turnover of corn sweeteners including high fructose corn syrup ("HFCS") and sorbitol increased by approximately 35% and 52% to approximately 365,114 metric tonnes (2005: 270,549 metric tonnes) and approximately HK$671 million (2005: HK$441 million) respectively, which contributed to the Group additional gross profit of approximately HK$63 million aggregately.

On the other hand, due to the decrease in selling price and increase in production cost, the gross profit of modified starch dropped by approximately HK$32 million.

In view of the above, the overall gross profit from downstream products segment increased substantially by approximately 43% with a slight increase in gross profit percentage.

Overall Gross Profit % and Product Segments

The improved performance of downstream products segment was insufficient to make up for the drop of the gross profit of upstream products caused by the increase in material cost. As a result, the overall gross profit percentage dropped slightly from approximately 26% in 2005 to approximately 25% in 2006. In line with the Group's strategy to expand the portfolio of downstream products, upstream products available for sales were reducing. During the Year, the turnover and gross profit of upstream products accounted for approximately 34% (2005: 44%) and 23% (2005: 38%) of the Group's total respectively, which were approximately 10% and 15% less than the preceding year respectively.

Operating Expenses, Tax and Profit Shared by Minority Shareholder

Despite the inflation and the additional legal cost in relation to the infringement litigation, operating expenses to turnover percentage of approximately 10% remained at similar level. Such performance mainly resulted from the continuous and stringent control over operating expenses, enhancement in operating efficiency arising from expansion.

The finance costs (after netting-off the amount capitalised as construction in progress of approximately HK$34 million (2005: HK$37 million)) represented approximately 4% (2005: 2%) of turnover. The increase was mainly attributable to the enlarged borrowing size and the increase in interest margin.

With the prevailing income tax laws and regulations, most of the subsidiaries established in the PRC still enjoy income tax relief. Due to the decrease in the profit from low tax rate companies and the expiry of income tax relief of certain subsidiaries, the overall effective tax rate of the Group increased to approximately 10% (2005: 7%).

In 2005, the Group acquired the entire equity interest of the Group's former minority shareholder. Therefore, minority shareholder's share of profit was then no longer necessary (2005: HK$74 million).

Performance of Joint Ventures

The Group has two joint venture projects with Cargill Inc. ("Cargill") and Mitsui Group to engage in the manufacture and sales of HFCS and sorbitol products respectively. During the Year, these joint ventures recorded an operating gain and an operating loss of approximately HK$59 million (2005: HK$8 million) and HK$20 million (2005: HK$7 million) respectively. In view of technological improvement in operating efficiency of sorbitol operation, better return from this joint venture is expected.

Increase in Net Profit Attributable to Shareholders

In view of the rebound of lysine price, capacity expansion of various products and stringent control over operating expenses, the net profit attributable to shareholders increased slightly by approximately 8% to approximately HK$501 million (2005: HK$466 million).

IMPORTANT TRANSACTION

Acquisition of Minority Interests in Joint Ventures for the Production of Polyol Chemical Products

During the Year, the Group entered into the sale and purchase agreement to acquire from the joint venture partners, their respective entire interests in those joint ventures for the production of polyol chemical products at an aggregate consideration of US$500,000. As a result of the acquisition, those joint ventures became wholly-owned subsidiaries of the Group.

The directors of the Company (the "Directors") believe that the acquisition will enhance the efficiency of the Group's administration and control of these companies and their respective research and production facilities. The Directors also believe that, by sharing the Group's research, production and administrative resources and facilities of the joint ventures in the future, the Group's resources can be utilised in a more efficient manner and its operational expenses can be reduced. The Group can then focus its resources on its future research and development of the polyol technology and other different technologies for the production of polyol chemicals.

FINANCIAL RESOURCES AND LIQUIDITY

Net Borrowing Position

To support (i) additional working capital requirement (ii) the huge capital expenditure on projects including the construction of facilities and/or expansion projects in relation to lysine series, glutamic acid, corn sweeteners, polyol chemical products and a new corn refinery of approximately HK$13 million, HK$44 million, HK$79 million, HK$785 million and HK$114 million respectively, the net borrowing as at 31 December 2006 increased to approximately HK$2.3 billion (31 December 2005: HK$996 million).

Structure of Interest Bearing Borrowings

As at 31 December 2006, the Group's bank and others borrowings amounted to approximately HK$4.0 billion (31 December 2005: HK$3.1 billion), of which approximately 30% (31 December 2005: 48%) was denominated in HK$ or US dollars while the remainder was denominated in Renminbi ("RMB"). The average interest rate paid during the Year was approximately 6% (2005: 4%).

Due to the breach of certain financial covenants of the syndicated facilities, the whole balance of loans from syndicated facilities as at 31 December 2006 amounting to approximately HK$1,163 million was classified as current liabilities. Accordingly, the percentage of interest bearing borrowings wholly repayable within one year and in the second to the fifth years were approximately 81% (31 December 2005: 89%) and 19% (31 December 2005: 11%) respectively. As at 31 December 2006, certain borrowings were secured by the Group's fixed assets with a carrying value/aggregate net book value of approximately HK$62 million (2005: HK$260 million).

Turnover Days, Liquidity Ratios and Gearing Ratios

Without any substantial change in policies of trade receivables and inventories, trade receivables turnover days and inventory turnover days remained at similar level of approximately 29 days and 62 days respectively (2005: 28 days and 63 days). In 2005, in order to ensure the compliance of certain financial covenants of syndicated facilities, payment to trade payable in last quarter 2005 was slowed down. As a result, trade creditors turnover days was relatively high. In 2006, the creditors' settlement was back to its normal pattern. So trade creditors turnover days reduced from approximately 38 days in 2005 to approximately 25 days in 2006.

As at 31 December 2006, the current ratio and the quick ratio as at 31 December 2006 dropped to approximately 0.66 (31 December 2005: 0.72) and 0.53 (31 December 2005: 0.60) respectively. In spite of the unfavourable ratios, risk of insolvency is considered minimal because sufficient and additional financial support had been sought subsequent to 31 December 2006.

Meanwhile, gearing ratios in terms of (i) bank borrowings to total assets, (ii) bank borrowings to equity and (iii) net debts (i.e. net balance between bank borrowings and cash and cash equivalent) to equity were pushed up to approximately 37% (31 December 2005: 33%), 75% (31 December 2005: 65%) and 44% (31 December 2005: 21%), respectively. Drop in interest coverage (i.e. EBIDTA over finance costs) to approximately 5 times (2005: 10 times) mainly resulted from the increase in both bank borrowings size and interest margin.

Foreign Exchange Exposure

Although most of the operations were carried out in the PRC in which transactions are denominated in RMB, the Directors consider that there is no unfavourable exposure to foreign exchange fluctuation and that there will be sufficient cash resources denominated in HK$ for the repayment of borrowings and future dividends. During the Year, the Group did not use any financial instrument for hedging purposes and the Group did not have any hedging instrument outstanding as at 31 December 2006.

STATUS OF INFRINGEMENT LITIGATION

The Company and certain of its subsidiaries are currently proposed respondents in an investigation under Section 337 of the Tariff Act of 1930, as amended, in the US. Monetary remedies are not available and the complainant has requested a permanent exclusion order and a cease and desist order against certain of the Group's products in the US. The Directors, based on the advice from the Group's legal counsel, consider that the Group has sufficient grounds to defend the case. All estimated related legal costs arising therefrom have been properly accrued and accounted for in the consolidated financial statements of the Company for the Year.

PROSPECT

It is the Group's mission to become one of the leading vertically integrated corn-based biochemical product manufacturers in the Asia-Pacific Region and then a major player in the global market. To realise this objective, the Group will strive to enlarge its market share and diversify its product mix, as well as enhance its capability in developing high value-added downstream products through research and development and through strategic business alliances with prominent international market leaders.

Amino Acids

Currently, the Group's designed lysine annual production capacity includes 140,000 metric tonnes of lysine and 220,000 metric tonnes of protein lysine while the current annual consumption of lysine in the PRC had been over 200,000 metric tonnes, which is equivalent to approximately 300,000 metric tonnes of protein lysine. Although the price of lysine remained weak during the first half of the Year due to the excess supply in domestic market, the prices have rebounded from the bottom since the second half of the Year.

In addition, in order to stabilise the selling price during the transitional period for the change in the feed formula, to mitigate the risk of over-concentration in a single market and to attain worldwide recognition of the Group's products, the Group enlarged the share of overseas market. During the Year, lysine (including protein lysine) of approximately 103,000 metric tonnes (2005: 50,000 metric tonnes) was exported to regions other than the PRC, which accounted for approximately 31% (2005: 21%) of the Group's production capacity. The Group intends to further increase its export volume of lysine to markets in the US, Europe and Africa.

In addition to the lysine facilities, the construction of the glutamic acid plant in Dehui had been completed and the commercial production commenced in June 2006. The designed production capacity of this glutamic acid plant is 100,000 metric tonnes per annum.

The Group is also dedicated to the research and development of many other high value-added amino acids, including arginine, threonine and valine to fuel our growth momentum.

Upstream Refinery in Dehui

To facilitate the production of amino acids and benefit from cost saving from vertical integration and economies of scale, construction of a corn refinery with corn processing capacity of 600,000 mtpa with sweeteners production capability in Dehui is nearly completed and trial run of part of the facilities in place has begun before the end of the Year.

Polyol Project

Polyol chemical products include ethylene glycol, propylene glycol, glycerin, butanediols and can be used in textile, plastic, construction material, medical, chemical and cosmetic industries. The end products from polyol include polyester fibre, polymer resin and anti-freezer, chemicals applied in the production of coatings, PVC stabilisers, detergents, paint driers, etc. Usually, polyol chemicals are refined from petroleum.

In view of the expected insufficient and expensive supply of petroleum in the foreseeable future, the use of agricultural products as raw material of polyol becomes a feasible remedy to this issue.

The board of Directors (the "Board") is of the opinion that the PRC and other regions in Asia are markets with enormous potential for the polyol chemical products. To capture such potential huge market, the construction work of a new plant in Changchun with an initial annual production capacity of 200,000 metric tonnes of the polyol chemical products has been completed and trial run is scheduled in the second quarter of 2007. Definitely, the success in the polyol project will generate huge contribution to the Group in the coming future.

HFCS Project

In addition to the HFCS refinery in Shanghai, the Group, together with Cargill, is considering having new HFCS refineries situated close to the users. These new refineries will relieve the heavy transportation cost because it will mainly serve the nearby customers. In the case that any new refinery to be built adjacent to our existing corn refinery, it can save production cost through vertical integration where starch slurry, instead of powder form adopted by the HFCS refinery in Shanghai is used as raw material.

Proposed Spin-off

On 3 April 2007, the Company made an application to The Stock Exchange of Hong Kong Limited (the "Stock Exchange") for the approval of the proposed separate listing of the shares of Global Sweeteners Holdings Limited ("Global Sweeteners") in Hong Kong. The Global Sweeteners and its subsidiaries are principally engaged in the manufacture and sale of corn sweeteners, mainly including glucose, maltose, sorbitol, crystallised glucose, HFCS and other corn sweeteners products. The Board believes that the separate listing of Global Sweeteners will be beneficial to both the Company and the Global Sweeteners.

NUMBER AND REMUNERATION OF EMPLOYEES

As at 31 December 2006, the Group had approximately 4,800 full time employees in Hong Kong and the PRC. The Group recognises the importance of human resources to its success, therefore qualified and experienced personnel are recruited in the production capability and the development of new biochemical products. Remuneration is maintained at competitive levels with discretionary bonuses payable on a merit basis and in line with industrial practice. Other staff benefits provided by the Group include mandatory provident fund, insurance schemes and performance related commission.