

# MANAGEMENT DISCUSSION AND ANALYSIS

## *Business Review*

### **Hong Kong Operations**

The Company's Hong Kong operations recorded a loss of \$2.941 million, as compared with the profit of \$0.771 million in 2004. Nevertheless, this result represented an improvement of \$2.389 million over 2004 levels after excluding the tax refund of \$6.101 million.

Faced with a weaker beer market, total industry volume for the six months to June 2005 was 3% lower than the same period in 2004. Despite a marked shift in consumer preference in favour of low-priced brands, the Company's Hong Kong operations nevertheless managed 0.7% volume growth for the period. Exports volume grew 29.1% for the first half of 2005.

In light of the changing beer market and evolving consumer preferences, the Company has adopted different strategies in order to maintain overall market leadership.

Following proactive efforts over the past several years, the Company is now the largest player in Hong Kong's expanding low-priced brand segment. However, even as the Company continues to gain volume in the low-priced segment, the change in volume mix favouring low-priced brands has significantly reduced the Company's profit margins. As a result the Company has had to continually review its operating costs and structure in order to achieve profitability in the face of diminishing profit margins.

While a price increase of San Miguel brand in May 2004 helped improve profit margins, it also generated pressure on sales volumes, significantly diminishing the price difference between San Miguel brand and other premium beer competitors.

Export volumes continued to grow steadily, peaking during the summer season.

### **South China Operations**

The Company's China operations' loss was \$15.727 million as compared with the loss of \$4.848 million

in 2004. The operating profit of San Miguel (Guangdong) Brewery Company Limited was \$0.730 million, a turnaround of \$1.164 million over last year's loss of \$0.434 million. However, the operating loss of Guangzhou San Miguel Brewery Company Limited was \$16.457 million, larger than last year's loss of \$4.414 million.

San Miguel (Guangdong) Brewery Company Limited's sales volume growth of 19.7% is directly attributable to the strength of the local flagship brand, Dragon Beer. The continuous success of Dragon Beer reflects the Company's full ownership and control of the marketing and sales of the brand since August 2003.

With rival brands seeking to take market share from Dragon Beer, San Miguel (Guangdong) Brewery Company Limited will implement programmes and plans to consolidate its market leadership in the Shunde region.

Total sales volume of Guangzhou San Miguel Brewery Company Limited for the first six months of 2005 grew 6.1% over the same period in 2004.

While the sales performance in Guangzhou city and Dongguan city remained steady, Guangzhou San Miguel Brewery Company Limited worked to improve sales and distribution network in other regions of Guangdong province where sales performance was weak.

In the second half of 2005, Guangzhou San Miguel Brewery Company Limited will implement plans and programmes to improve sales performance in these regions and launch marketing programmes in its core markets to strengthen the brand equity of San Miguel brand.

Across the business, the Company has tightly managed costs and cash in an effort to spur margin expansion. Indeed, more operational discipline will ensure that the Company has the required resources to support the brands and the business.

## **Dividends**

The Directors on 25th August 2005 declared an interim dividend of one cent per share for the six months ended 30th June 2005 payable on 30th September 2005 to shareholders of record on 19th September 2005.