MANAGEMENT DISCUSSION AND ANALYSIS

Heng Tai Consumables Group Limited (the "Company") and its subsidiaries (collectively the "Group") are principally engaged in investment holding, distribution of packaged food, beverages, household consumable products and fresh fruit. During the year under review, the Group has consistently performed as a fast growing one-stop services platform provider conducting distribution, brand-building and value-added functions for the fast moving consumable goods and fresh produce industry. China's retail and consumer markets continued to be the market place where the Group secured its business and growth.

BUSINESS ENVIRONMENT

During the year under review, China still demonstrated itself as one of the world's strongest growing economies and most exciting markets. According to the official releases from National Bureau of Statistics of China, China's economy continued to grow at a fast pace with an annual growth rate of its gross domestic product at 9.5% and total retail sales of consumable goods reached approximately US$654 billion in 2004. The gradual enlargement in the proportion of the middle-class consumers relative to the PRC's total population and the continued process of urbanization in the PRC have also generated enormous demands for quality imported consumables. The appreciation of Renminbi has lifted consumer spending power on imported consumables in the PRC. These various positive factors have created favourable macro economic climate in the PRC under which the Group is well positioned to capitalise prevailing market potential by utilizing its extensive and well-established distribution network and management experience and expertise.

FINANCIAL PERFORMANCE

During the year under review, the Group has achieved continuous growth in turnover and net profit attributable to shareholders. Turnover increased to approximately HK$920 million, representing an increase of approximately HK$207 million or 29% when compared with the preceding financial year. The increase in turnover was mainly attributable to the increased sales quantity from existing and new products sold to the established distribution network and also expanding network mainly covering certain second tier cities in the eastern, western and northern parts of the PRC.

Gross profit margin improved slightly to approximately 16.5% during the year. The continuous refinement of product mix and client mix, including increase in sales of fresh fruit and to on-premise sector with a relatively higher margin contributed to the slightly uplift in the Group's overall gross profit margin during the year.

Net profit attributable to shareholders increased to approximately HK$106 million, representing an increase of approximately HK$33 million or 44% when compared with the previous financial year. Increase in net profit of approximately HK$10 million was attributable to the share of the net profit of an associated company, Daqing Petroleum & Chemical Group Limited ("Daqing", Stock Code: 362). The increase in the net profit of approximately HK$23 million was attributable to the growth in the Group's core distribution business.

CAPITAL STRUCTURE, LIQUIDITY AND FINANCIAL RESOURCES

The Group maintained a strong financial position throughout the year under review. The Group financed its operations and business development with internally generated resources, equity funding and banking facilities provided by its principal bankers in Hong Kong. During the year, the Company raised funds from the issuance of 48,600,000 new shares through exercise of share options by option holders with proceeds of approximately HK$49.5 million.

Subsequent to the balance sheet date on 25 July 2005, the Company entered into a top-up placing and subscription agreement for the placing of 164,000,000 ordinary shares of the Company to independent placees at an issue price of HK$1.25 per share. The net proceeds of approximately HK$202.1 million would provide an enlarged shareholder base with additional resources to the Group's development.

At 30 June 2005, the Group had interest-bearing bank borrowings of approximately HK$188.4 million (30 June 2004: HK$68.6 million) of which over 90% of the bank borrowings were denominated in Hong Kong dollars and over 46% mature within one year. All of the Group's banking borrowings were floating-interest bearing and secured by corporate guarantees given by the Company and certain subsidiaries of the Company.

A significant portion of sales and purchases of the Group were either denominated in Hong Kong or US dollars. The directors consider that the operations of the Group are not exposed to any significant foreign exchange risk in view of the stability of the exchange rates between Hong Kong and US dollars. The Group did not have any hedging instrument outstanding as at 30 June 2005.

At 30 June 2005, the Group's current assets amounted to approximately HK$355.7 million (30 June 2004: HK$221.5 million) and the Group's current liabilities amounted to approximately HK$122.1 million (30 June 2004: HK$91.3 million). The Group's current ratio improved to approximately 2.9 as at 30 June 2005 (30 June 2004: 2.4). The improvement in the current ratio was mainly attributable to the increase in various current assets financed by enlarged shareholders' equity from issuance of share capital and current year's earnings and increase in long-term bank borrowings. At 30 June 2005, the Group had total assets of approximately HK$716.4 million (30 June 2004: HK$411.6 million) and total liabilities of approximately HK$223.7 million (30 June 2004: HK$97.6 million) with a gearing ratio of approximately 26.3% (30 June 2004: 16.7%). The gearing ratio was expressed as a ratio of total bank borrowings to total assets. The change in gearing ratio was mainly attributable to the increase in long-term bank borrowings obtained by the Group during the year to finance future business development.

BUSINESS REVIEW, DEVELOPMENT AND PROSPECT

The Group is principally engaged in investment holding, distribution of fast moving consumable goods and fresh produce. The product groups distributed by the Group included packaged food, beverages, household consumable products and fresh fruit with their respective contribution of approximately 61%, 7%, 7% and 25% to the Group's turnover for the year ended 30 June 2005. The categories of packaged food were mainly biscuits, candies, chocolate, condiments, margarine, milk power products, healthy food, noodles, snacks, rice and nourishing products. Beverages were mainly beers, wines and soft drinks and the household consumable products were mainly batteries and toiletries, including skincare, beauty and cosmetic products. Fresh fruit was mainly pipfruit and citrus. In addition to the routine refinement for product category items, the Group has also enriched the varieties of product categories during the year. The main categories added to the Group's distribution portfolio included rice and nourishing products for packaged food and toiletries for household consumable products with their respective contribution of approximately 4% and 3% to the Group's turnover by product group for the year ended 30 June 2005.

Wholesalers are still the main customer category, which accounted for approximately 80% of the Group's turnover for the year ended 30 June 2005. The retailer and on-premise sectors accounted for the remaining 20% of the Group's turnover for the year ended 30 June 2005. In the year ahead, the Group will keep on reallocating more resources in expanding its customer base to the on-premise sector to seek for a higher gross profit margin relative to the wholesaler sector. Moderate efforts will still be kept for sales to the retailer sector to maintain product publicity while avoiding direct competition with the wholesalers. Clientele spreading out will be one of the Group's expansion agenda through strengthening of geographical market presence by establishing more liaison offices in certain second tier cities, enrichment of product range and product diversification.

The Group's products were mainly sourced from the Southeast Asia, the United States of America, Europe, Australia, New Zealand and South Africa and sold to wholesalers, retailers and on-premise customers mainly in the eastern, southern and northern parts of the PRC. Recognizing the procurement network as one of the key success factors to its core business, the Group will proceed to establish procurement offices in Germany, Korea, Thailand and Australia to strengthen sourcing network; refine its product selection process; enrich the product range and implement product diversification; and taking a more active role as an one-stop value-added services platform provider.

In addition to reinforcing its core distribution business, the Group is also striving for other growth drivers to pave the way for top-line growth and bottom-line improvement in the years ahead. The Group has been consistently diversifying from a distribution mentality to a service-oriented conglomerate to broaden its scope of services with certain well-defined development projects well underway during the year.

Shanghai logistics centre will not only serve as the Group's headquarters and a back-up infrastructure to the Group's existing distribution business in the PRC, but also focus on providing cold-chain logistic solutions to overseas frozen and dairy product suppliers with targeted customer base in the PRC. Shanghai logistics centre is equipped with international standard distribution facilities and own refrigerated truck fleet to facilitate its distribution functions for a wide variety of frozen and chilled products, such as meat, seafood and dairy products. It is now in trial-run for its cold-chain logistics facilities and will be fully functional by the end of October this year. The frozen and chilled products processed by the centre are all imported and premium-graded and under stringent hygiene and temperature-controlled HACCP cold-chain standard. In its initial stage after commencement of operations, Shanghai logistics centre will also adopt a greater role as a third party service provider offering cold-chain distribution solutions. Such distribution solutions will be provided to foreign and domestic retail groups in the PRC with their warehouse and logistics functions outsourced to third parties. The provision of cold-chain logistics services to third parties will widen the Group's service scope and enlarge its revenue stream. With the Group's established network in the PRC and expertise in distribution, the Shanghai logistics centre will be a significant growth driver to the Group's turnover and net profit for the coming years.

Zhongshan logistics centre is principally engaged in the provision of various logistics services in fresh produce such as packaging, grading, export certification systems, marketing and distribution and will become the first mover to operate a nation-wide network of cold-chain distribution and logistics platform for fresh produce in the PRC. Most of the construction work of Zhongshan logistics centre has been completed by the third quarter and the centre is expected to have its trial-run by early 2006. The fresh produce handled by Zhongshan logistics centre is under stringent hygiene and temperature-controlled HACCP cold-chain standard. Overseas and domestic growers and wholesalers will set up their showcase and distribution shops in Zhongshan logistics centre where buyers and traders from all over the PRC will source their selection of fresh produce and place orders there.

Wholesalers, retailers, supermarkets and hotels all over the PRC will be the ultimate target customer groups with their sourcing at the centre. A great variety of fresh produce will be processed and repacked in the centre before being distributed to ultimate customers through centre's unbroken cold-chain logistics facilities. Rental, processing and repackaging income will be the main revenue stream for the centre. Zhongshan logistics centre is currently positioned itself as a service provider in the fresh produce logistics operations and is seeking for appropriate business opportunities in expanding to the upper and lower stream of its fresh produce vertical operations. The expansion in its vertical operations will include participation in fresh produce cultivation and establishment of direct sales points in supermarkets and chain-stores. Obviously, such vertical expansion will ensure a steady supply of a wide-variety of quality-assured fresh produce and an unbroken flow of fresh produce from cultivation to ultimate sales outlets and more importantly, a maximization of profitability in its fresh produce operations.

On 4 February 2005, all the shareholders of Zhongshan logistics centre agreed to increase their total investment from HK$94.3 million (RMB100 million) to HK$130 million in Zhongshan logistics centre. The Group, being a 30% shareholder at that time made an additional pro rata capital contribution of approximately HK$10.7 million to its investment in the associated company. The capital contribution will be invested to build up extra handling and storage capacity with advanced facilities.

On 1 June 2005, the Group entered into an acquisition agreement with one of the shareholders of Senox Co., Ltd. ("Senox") to acquire 20% of the issued share capital of Senox at a consideration of HK$48,886,000. Senox indirectly owns the entire equity interest in Zhongshan logistics centre. Upon completion of the acquisition, which took place by the end of June this year, the Group became the single largest shareholder of Senox holding 50% of the issued share capital of Senox. Though Senox would remain as an associated company of the Group subsequent to the acquisition and its profit contribution would be accounted for under the equity method by the Group, as the single largest shareholder of Senox, the Group would be in a position to significantly influence and direct the operations and future development strategy of Zhongshan logistics centre and furthermore would be able to accelerate the business synergy of Zhongshan logistics centre with the Group's existing core business in fresh fruit distribution.

On 9 September 2004, the Group, as the single largest shareholder interested in 175,560,000 ordinary shares of Daqing at that time, had irrevocably undertaken to subscribe for 87,780,000 rights shares at a subscription price of HK$0.30 each in the issued share capital of Daqing at an aggregate subscription price of HK$26,334,000. The net proceeds from the rights issue of approximately HK$140,898,000 were mainly used to finance the establishment and expansion of production capacity of vinyl acetate of a PRC subsidiary and as general working capital of Daqing. Subsequent to subscription of the right shares of Daqing by the Group, the Group was interested in 263,340,000 shares of Daqing, representing 18.17% of the issued share capital of Daqing at that time.

On 22 June 2005, the Group entered into a placing agreement and a subscription agreement, pursuant to which the Group would first sell 214,810,000 shares of Daqing at the placing price of HK$0.455 and then subscribed for the same number of new shares from Daqing at HK$0.455. The subscription of 214,810,000 shares of Daqing was subsequently completed on 4 July 2005. The net proceeds of approximately HK$96 million were mainly used to finance the development of Daqing's PVC business and as general working capital of Daqing. The Group, as the substantial shareholder of Daqing and interested in 263,340,000 shares of Daqing before and after the placing and subscription, had only taken up a role in this top-up placing and subscription arrangement as a facilitator to assist Daqing in raising adequate funds for its future development. Subsequent to placing and subscription, the Group's equity interest in Daqing had decreased from 18.17% to 15.82%.

During the year under review, the Group has made substantial progress in its border trade's development through the strong business connection of Daqing in the Northern part of the PRC. In November 2004, the Group signed a memorandum of understanding ("November MOU") with a Sino-Russian trading market developer. Detailed development plans are still being worked out to utilize our management expertise and other resources to complement existing unstructured trade markets in Russia so as to satisfy its huge demand for fast moving consumer goods. Pursuant to the November MOU, the Group would seek to secure the management rights of the wholesale and retail market in the "Asian Commercial City" developed by the Sino-Russian entity in Khabarovsk Krai, Ussurriysk of Russia through provision of centralizing merchandise supplies from global suppliers, logistics and related transportation services, marketing and operational management services. Currently, the Group is still finalizing terms to secure the management rights of the second phrase of the Asian Commercial City so as to make it become a sourcing and transit hub in the Far Eastern part of Russia. The Asian Commercial City has received strong support from the municipal government of Khabarovsk, Russia and Mudanjiang, the PRC in terms of taxation and policy concession and is expected to embark on its second phrase operations by the end of year 2005. Partaking in border trade is considered by the Group to be an important step in reinforcing its core business in the years ahead.

In the first quarter of Year 2005, the Group has started trade in packaged nourishing products in Hong Kong consumer market. Such nourishing products include instant-serving bird's nest, shark's fin, abalone and etc., which are mainly sourced in Southeast Asian countries and sold in supermarkets and chain-stores in Hong Kong. The launch of such products has enabled the Group to catch the ever-escalating demand in nourishing products in the domestic consumer market and uplift the Group's overall gross profit margin with their higher margin contribution relative to the Group's existing products distributed in the PRC market. For the four months ended 30 June 2005 since the commencement of the trade, sales for nourishing products represented approximately 1% of the Group's turnover. Within an apposite timeframe after commencement of the trading, the Group plans to seek for suitable OEM suppliers to launch such products in accordance with the Group's specifications and under the Group's own brand name to further tap on business opportunity in nourishing products not only in domestic market, but also the PRC market.

In February 2005, the Group signed a memorandum of understanding ("February MOU") with New Zealand Trade & Enterprise ("NZTE"), being a New Zealand Government trade organization to promote international trade for New Zealand products. Pursuant to the February MOU, the Group would be appointed by this official trade-endorsed bureau to bring New Zealand products into the full view of the PRC consumer market through a carefully planned and ongoing promotional campaign. Through such campaign, small and medium seized New Zealand suppliers would be offered opportunities to launch their quality and premium products into the PRC consumer market on a government-funded promotional campaign. The campaign will aim at producing a notable increase in the volume of consumer food and beverage products from New Zealand suppliers through the Group's management expertise and well-established sales network. Currently, an internal task force has been formed by the Group and NZTE to screen out suitable suppliers for the campaign.

In June 2005, the Group obtained a three years' term loan facility of HK$78 million. The term loan was initially intended to be partly used for financing the acquisition of 20% equity interest in Zhongshan logistics centre in June 2005 and partly used for as a standby working capital in anticipation for the commencement of operations of Shanghai and Zhongshan logistics centres. In late July 2005, since the Group had been able to raise funds by a placement of shares as described below, such term loan seemed to become excess fund to the Group. Due to the existence of early repayment penalty clause, the lower interest rate charged relative to the Group's existing import-term facilities and the font-end fees already paid for, the Group decided not to prepay the term loan, but use such excess fund to repay short-term import loan facilities.

On 25 July 2005, the Company entered into a top-up placing and subscription agreement for the placing of 164,000,000 ordinary shares of the Company to independent placees at an issue price of HK$1.25 per share. The subsequent subscription was completed on 5 August 2005 with 164,000,000 new ordinary shares of the Company issued at HK$1.25 per share. The net proceeds of approximately HK$202.1 million from the placement were intended to be used as to (i) approximately HK$50 million for acquisition of another 20% equity interest in Zhongshan logistics centre in addition to 50% equity interest already owned by the Group; (ii) approximately HK$15 million for enhancement in operating equipment of Shanghai logistics plant; (iii) approximately HK$15 million for establishment of packaging plant for nourishing products in Hong Kong; (iv) approximately HK$15 million for development of brand name used for the Group's products; (v) approximately HK$10 million for expansion of PRC sales network; (vi) approximately HK$10 million for expansion of overseas procurement network; and (vii) the balance of approximately HK$87.1 million for general working capital for the Group. The placement was expected to increase the liquidity of the Company's shares and would provide an enlarged shareholder base with additional working capital to the Group's business development.

In the years ahead, we will continue to reinforce our core distribution business while compounding our growth through our investments in the logistics business. The Group will consistently pursue its mission to become a leading integrated provider of distribution, logistics services and brand building in the fast moving consumable goods and cold-chain products industry.

SEGMENT INFORMATION

During the year, all of the Group's turnover was attributable to the distribution of packaged food, beverages, household consumable products and fresh fruit and over 95% of the Group's turnover was attributed to the customers in the PRC.

NUMBER AND REMUNERATION OF EMPLOYEES

At 30 June 2005, the Group had 121 staff for its operations in Hong Kong, Macau and the PRC. The Group's employees are remunerated in accordance with their work performance and experience. The Group also participates in a defined Mandatory Provident Fund Scheme for its staff in Hong Kong and a retirement benefit scheme for its staff in the PRC. The Group has adopted a share option scheme of which the Board may, at its discretion, grant options to eligible participants of the share option scheme. At 30 June 2005, a total of 600,000 share options remain unexercised.

DIVIDEND

The Board recommends the payment of a final dividend of HK$0.01 per ordinary share for the year ended 30 June 2005. This proposed final dividend, subject to the approval of shareholders at the forthcoming annual general meeting, will be payable on or before 8 December 2005.

CLOSURE OF REGISTER OF MEMBERS

The register of members will be closed from 16 November 2005 to 18 November 2005, both days inclusive, during which period no transfer of shares will be registered. In order to qualify for the proposed final dividend, all transfers of shares accompanied by the relevant share certificates must be lodged with the Company's share registrar by no later than 4:00 p.m. on 15 November 2005.