

WORLD COCOA INDUSTRY

Cocoa beans

Cocoa beans are one of the major raw materials used for the production of a variety of food products such as chocolate, beverages and cakes, and various pharmaceutical and cosmetic products such as soaps and moisturisers. Cocoa beans are grown mainly in the tropical rain forests of West and Central Africa, Southeast Asia and South and Central America. The quality of cocoa beans are generally characterised by, among other things, the size and uniformity, solid fat content, flavour and purity, and other general appearance factors of the cocoa beans, which also determine the selling prices of the beans.

Industry structure

Market participants in the cocoa industry can generally be categorised into: (i) cocoa farmers; (ii) cocoa traders; (iii) cocoa processing companies; and (iv) cocoa products manufacturers.

Cocoa plantation and trading

Cocoa farmers normally sell the harvested cocoa beans to cocoa traders, who collect cocoa beans from a number of farmers and resell them to other cocoa traders and/or cocoa processing companies. According to an article published by ICCO in July 1998, approximately 70% of the total supply of cocoa beans in the world in 1998 was produced by individual farmers each providing a relatively small scale of supply. The Directors believe that in order to avoid dealing with numerous farmers, cocoa processing companies often rely on the cocoa traders to collect the required amount of cocoa beans from these individual farmers and then perform quality checks on the collected cocoa beans in accordance with the specifications of the processing companies. In addition, cocoa farmers often rely on cocoa traders to handle the exports of the cocoa beans to the overseas importers and processing companies.

Cocoa beans processing and cocoa products manufacturing

Through a process of roasting, grinding and other processing, cocoa processing companies generally convert cocoa beans into an intermediate product called cocoa liquor, which is further processed into two products: cocoa butter and cocoa powder. Cocoa butter is essentially the fat extracted from cocoa beans and is used almost exclusively in the production of chocolate products, with a small portion being used in the manufacture of various pharmaceutical and cosmetic products. In general, cocoa butter is an essential ingredient of chocolate. Cocoa powder is also used in the

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manufacture of a variety of food products including beverages, cakes, brownies, icing, and cookies primarily to provide the required flavour and colour. The following table sets out the top seven cocoa bean processing countries/regions in the world for the crop years 2000 to 2002:

Top seven cocoa bean processing countries/regions

	2000	Crop year 2001 ('000 tonnes)	2002
European Union	1,175	1,195	1,112
US	439	442	415
Cote d'Ivoire	235	285	290
Brazil	201	195	167
Malaysia	115	125	105
Former USSR	87	103	95
Indonesia	85	83	75
 World total	 2,942	 3,050	 2,859

Source: "Cocoa Commodity Notes", published by Food and Agriculture Organization of the United Nations in March 2003

World cocoa production

In the crop year 2003, Indonesia was the third largest producing country of cocoa beans in the world, and the largest in Asia according to "Cocoa Market Report" published by ED&F Man in October 2003. The following chart sets out the annual production volume of the top seven cocoa bean producing countries in the world for the crop years 2001 to 2003:

Production volume of top seven cocoa bean producing countries/regions

	2001	Crop year 2002 ('000 tonnes)	2003
Cote d'Ivoire	1,185	1,240	1,315
Ghana	395	340	490
Indonesia	388	443	425
Brazil	163	124	162
Nigeria	177	167	150
Cameroon	138	126	140
Ecuador	81	72	78
 World total	 2,821	 2,773	 3,045

Source: "Cocoa Market Reports" (September 2002 and October 2003) published by ED&F Man

Pricing

Cocoa beans are a commodity and their prices are quoted on the London Cocoa Terminal Market and the NYCSCE. Producers of cocoa beans set their prices with reference to, amongst other things, the quoted prices. The quoted prices on the London Cocoa Terminal Market and the NYCSCE are determined with reference to the supply and demand of cocoa beans. Hence, factors which affect the supply of cocoa beans, such as a war in a country that supplies a significant amount of cocoa beans in the world markets, will affect the price of cocoa beans quoted on these commodity exchanges.

Prices of cocoa beans decreased substantially during the period from mid-1998 to 2000 and started to recover in 2001. According to INCA, the price of cocoa beans in the international market began to drop from May 1998. Part of the weakness in prices was attributed to strong reactions to financial crises and economic turmoil in global markets. The subsequent slowdown in economic activity in Asia, the Russian Federation and Brazil, insufficient evidence of a return to growth in these areas and indications of sluggish world consumption in traditional cocoa product consuming countries adversely affected the prospects for world growth in cocoa consumption. Moreover, despite a sustained period of low prices, production in a number of leading cocoa producing countries continued to rise. These developments led some market participants to re-assess the world demand-supply balance of cocoa beans in the future. Consequently, the average cocoa bean price dropped from approximately US\$1,670 per tonne in 1998 to approximately US\$890 per tonne in 2000.

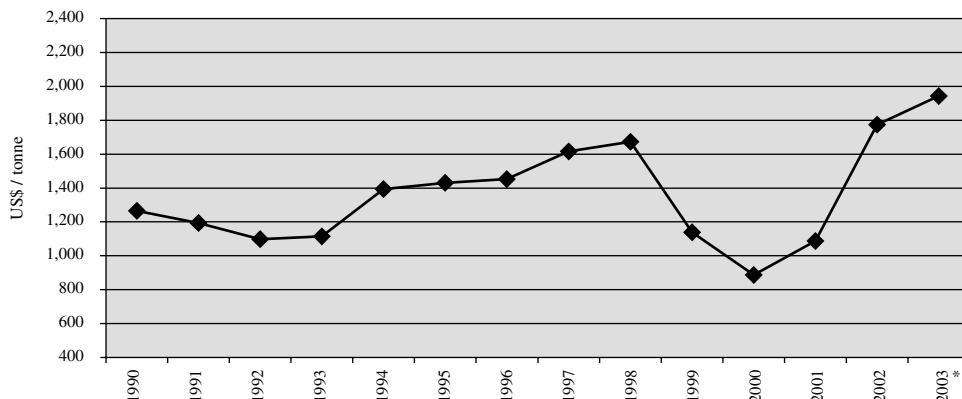
Since 2000, however, confidence in the global economy began to pick up and cocoa market participants had a more bullish outlook for the demand for cocoa products. At the same time, many cocoa producing countries experienced disappointing harvests due to pests and diseases, such as the Cocoa Pod Borer. During the last quarter of 2002, cocoa bean prices were affected by the civil unrest in Cote d'Ivoire, the world's largest cocoa bean producing country. Cocoa bean prices increased sharply as the market was concerned about the impact of the civil unrest on the international supply of cocoa beans.

By the first quarter of 2003, it was apparent that the supply of cocoa beans from Cote d'Ivoire could be virtually unaffected by the civil unrest. In May 2003, a new cease-fire agreement was reached which laid the ground for the re-establishment of civil order in the country. At the same time, a few other major cocoa bean producing countries, including Indonesia, were expected to produce a large crop in 2003. Therefore, cocoa bean prices began to decrease as a result of the stability in Cote d'Ivoire and the expected higher cocoa bean supply. In June 2003, cocoa bean prices averaged approximately US\$1,580 per tonne, down from a peak of approximately US\$2,230 per tonne in February.

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The following chart sets out the yearly average cocoa bean prices for the period from 1990 to 2003*:

World cocoa beans average price (1990-2003*)



* Up to June 2003

Source: ICCO

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Types of cocoa beans

As confirmed by INCA, there is only one type (i.e. grade) of cocoa beans in Indonesia for the export market and such export quality cocoa beans are homogeneous. In general, cocoa beans destined for the export market tend to be larger in size, have a higher level of fat and water content, and less extent of insect damage. On the other hand, cocoa beans sold in the domestic market for domestic consumption in general tend to be smaller in size, contain less cocoa fat and water content, and have more insect damage.

Regulations governing a foreign company operating in the Indonesian cocoa industry

The following information is based on the legal opinion of the Group's Indonesian legal advisers:

Foreign investment activities in Indonesia are governed by the Foreign Capital Investment Law, Law No.1 of 1967 as amended by Law No.11/1970 ("Foreign Investment Law"). Pursuant to the Foreign Investment Law and its implementing regulations, foreign investment shall be conducted by forming a foreign investment company ("PMA Company") in the form of a limited liability company, abbreviated as "PT" (which is governed by the Limited Liability Company Law, Law No.1 of 1995 — "Company Law").

All PMA Companies fall under the coordination of BKPM.

A PMA Company may only be created or formed for business activities which are opened for foreign investment. Pursuant to the existing regulations, export and import and wholesaling of cocoa beans as well as cocoa processing operations are fully open to foreign investment.

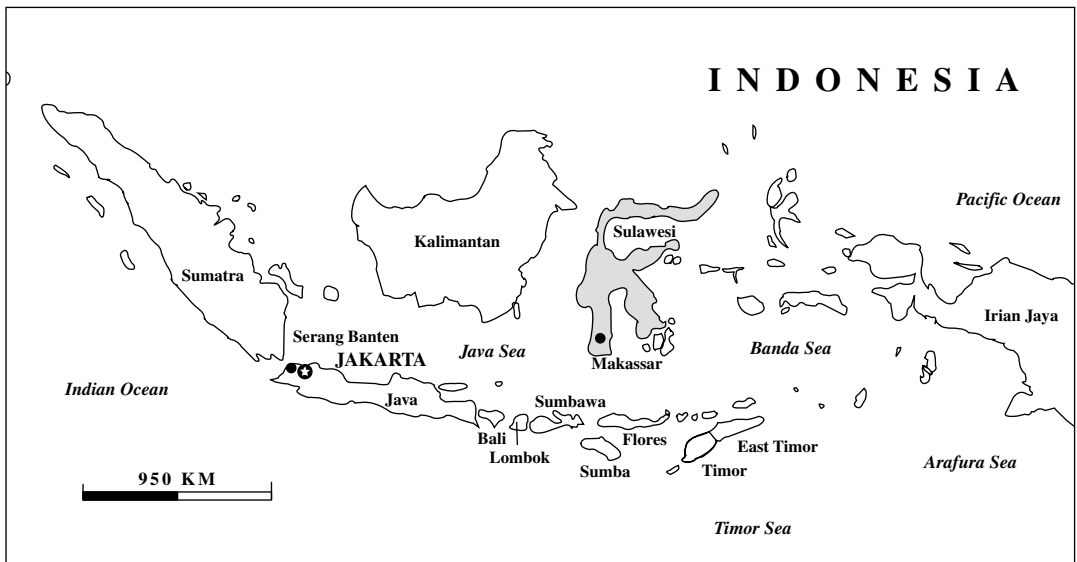
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With due regard to the Law No.24 of 1999 regarding the Foreign Exchange Payment and Exchange Rate System, Indonesia does not adopt foreign currency restrictions. Under this regime, certain companies, such as those having assets not less than IDR100,000,000,000 or those having annual gross sales not less than IDR100,000,000,000, are required to report their activities related to their foreign exchange activities in accordance with Bank Indonesia implementing regulations.

The Group has obtained all required licences to conduct its current businesses including the export and import of cocoa beans activities. In addition, in November 2002, the Group obtained approval from the BKPM for expansion of its business activities to engage in wholesale of cocoa beans to the domestic market.

Geographical distribution of cocoa plantations in Indonesia

The growth of cocoa beans is sensitive to a number of natural factors including soil, rainfall and other environmental factors. According to INCA, approximately 75% of Indonesian cocoa beans come from Sulawesi, which is also the origin of the cocoa beans traded by the Group. The following diagram shows the location of the Sulawesi and other major locations in Indonesia.



Government policies on the cocoa industry

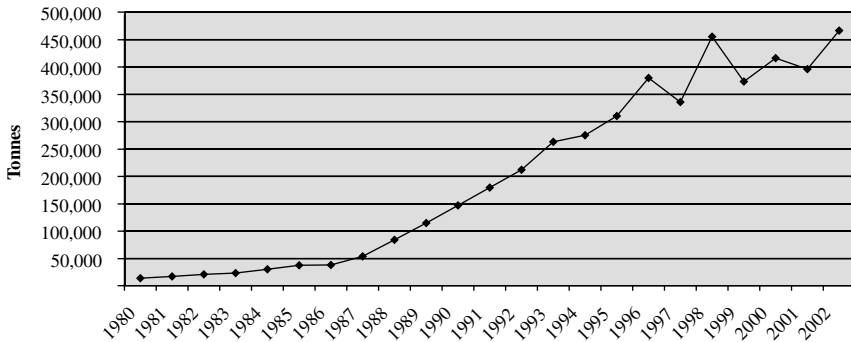
The government has been actively promoting the cocoa industry by (i) granting free or cheap land to farmers for developing cocoa plantations; (ii) providing financial assistance to farmers for setting up cocoa plantations; (iii) providing fertilizers and pesticides to farmers free of charge; and (iv) through INCA, providing education and training to farmers with a view to improving the efficiency and quality of their cocoa harvests.

Cocoa production in Indonesia

Indonesia expanded its cocoa production substantially from the early 1980s onwards. According to INCA, the annual production volume of cocoa beans in Indonesia increased from approximately 10,300 tonnes in 1980 to approximately 460,000 tonnes in 2002.

The following chart shows the amount of cocoa beans produced in Indonesia for the period from 1980 to 2002:

Indonesia's cocoa beans production



Source: INCA, February 2003

The rapid increase in cocoa production from 1980 to 1996 was principally because Indonesia was building up its cocoa production to become one of the major cocoa producers in the world. Indonesia has outstripped all other countries in terms of production growth since the 1980s. In 1981/82 it produced approximately 16,000 tonnes and by 1996/97 it produced approximately 330,000 tonnes. The growth has been assisted by a free economy combined with government support to develop Indonesia's cocoa industry. In 1997, Indonesia's cocoa industry was affected by the Cocoa Pod Borer. Starting in the first quarter of 1998, past experience with the Cocoa Pod Borer enabled Indonesian farmers to control the Cocoa Pod Borer problem which helped improve the national cocoa bean output. After the first quarter 1998, the Cocoa Pod Borer problem was exterminated and production yield recovered. Furthermore, in the first half of the 1990s, there was a large migration of farmers from Java to Sulawesi due to government encouragement to develop Sulawesi as the major center for cocoa production. By 1998, there was an increase in new harvested area (i.e. cultivated land used to grow and harvest cocoa beans) due to the migration of farmers to Sulawesi to cultivate the land for cocoa production. In the beginning of 1999, Indonesia experienced political and social instability due to the fall of president Soeharto which led to different political groups fighting to control Indonesia, and fighting for independence for certain parts of Indonesia (e.g. East Timor, Aceh) which coincided with a lack of government support for the cocoa industry.

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Export markets

According to INCA, the main export markets in 2002 for Indonesian cocoa beans were the US (49.0%), Singapore (13.4%), Europe (10.0%), Brazil (7.2%), Malaysia (7.1%), PRC (6.3%), Philippines (1.5%), Thailand (1.2%), and Canada (1.2%).

INCA has confirmed that around 85% of cocoa beans produced in Indonesia are exported each year. In addition, INCA has confirmed that Europe and the US accounted for around 10% and 49% of Indonesia's total exports in each of the past few years.

OVERVIEW ON THE INDONESIAN ECONOMY

Indonesia is the world's largest archipelago situated between the Indian Ocean and the Pacific Ocean. According to the Institute for Memetic Research, in 2000, Indonesia had a population of approximately 225 million and was the fourth most populated country in the world.

Although Indonesia, like other Southeast Asian countries, has experienced negative and slowing growth since 1997, its economic conditions have exhibited improvements in recent years. According to the Central Bureau of Statistics of Indonesia, the gross domestic product of Indonesia grew by approximately 3.7% in 2002 while Bank of Indonesia, the central bank in Indonesia, estimates a further growth of approximately 3.5% to approximately 4% in 2003. The following table highlights the key economic indicators of Indonesia from 1997 to 2002:

Indonesia: Overall economic performance 1997-2002

	1997	1998	1999	2000	2001	2002*
<i>GDP and major components</i>						
Nominal GDP (US\$ billion)	218	103.1	144.2	151.0	145.1	177.6
Real GDP (% change)	4.9	-13.7	0.3	4.8	3.3	3.5
Total consumption (% change)	5.9	-4.1	3.4	3.9	6.2	6.3
Total investment (% change)	8.6	-40.9	-20.0	17.9	4.0	6.4
Export of goods and services (% change)	7.8	10.6	31.6	16.1	1.9	3.1
Import of goods and services (% change)	14.7	-5.4	40.7	18.2	8.1	9.0
Exchange rate (Local currency/US\$)	4,650	8,025	7,764	8,544	10,256	9,300

* Forecast

Source: "2002 APEC Economic Outlook" published by Asia-Pacific Economic Cooperation, in October 2002

Having said that, investors should note that Indonesia has in the past few years experienced significant economic downturns, social instability and related difficulties. In addition, Indonesia has also experienced various degrees of political and social uncertainty such as the bombings in Jakarta and Bali and the civil unrest in Aceh. However, these three incidents have not affected the Group's supply of cocoa beans (since they happened far away from the Group's source of cocoa beans, Sulawesi) or its sales (since the Group is an exporter). Any instability in the political, social and/or economic environment in Indonesia may have an adverse effect on the operations and income of the Group. A change in currency exchange rates or policy could also increase the Group's costs relative to its revenues.