



## **FAR EASTERN POLYCHEM INDUSTRIES LIMITED**

**(遠東化聚工業股份有限公司)\***

*(Incorporated in Bermuda with limited liability)*

### **FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2003**

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## **YEARLY RESULTS HIGHLIGHTS**

- Far Eastern Polychem Industries Limited (the “Company”) and its subsidiaries (together the “Group”) are principally engaged in the production and distribution of four major categories of polyester products in the People’s Republic of China (the “PRC”), namely bottle-grade polyethylene terephthalate (“PET”) chips, polyester filaments and polyester staple fibers, and the dyeing and finishing of polyester fabrics.
- The Group achieved a turnover of approximately HK\$2,080 million for the year ended 31st December 2003, with profit attributable to shareholders of approximately HK\$25 million, representing an increase of 9% and a decrease of 69%, respectively, as compared to the year ended 31st December 2002.
- Earnings per share for the year ended 31st December 2003 was HK\$0.06 (Earnings per share for the year ended 31st December 2002 was HK\$0.20).

## **YEARLY FINANCIAL STATEMENTS (AUDITED)**

The Directors of the Company have the pleasure of presenting the audited consolidated financial statements of the Group for the year ended 31st December 2003 and, for comparison purposes, the audited consolidated balance sheet as at 31st December 2002 and figures for the year ended 31st December 2002 in respect of the audited consolidated income statement, cash flow statement and statement of changes in equity as follows:

(a) **Audited consolidated balance sheet**

		<b>As at</b>	
	<i>Note</i>	<b>2003</b>	<b>2002</b>
		<i>HK\$'000</i>	<i>HK\$'000</i>
<b>Fixed Assets</b>		1,349,379	1,428,749
<b>Investment in an associated company</b>		84,343	—
<b>Other non-current assets</b>		11,608	11,517
<b>Current Assets</b>			
Cash and bank deposits		190,912	345,717
Trade and notes receivables	3	221,763	214,828
Deposits, prepayments and other receivables		71,569	51,704
Amount due from a related company		19,500	—
Inventories		<u>365,493</u>	<u>313,312</u>
Total current assets		<u>869,237</u>	<u>925,561</u>
<b>Current liabilities</b>			
Trade, other payables and accruals	4	(353,150)	(379,207)
Taxes payable		(113,958)	<u>(14,279)</u>
Short-term bank loans		(123,708)	(179,131)
Long-term bank loans, current portion		<u>(94,000)</u>	<u>(46,060)</u>
Total current liabilities		<u>(583,816)</u>	<u>(618,677)</u>
<b>Net current assets</b>		285,421	306,884
<b>Total assets less current liabilities</b>		1,730,751	1,747,150
<b>Non-current liabilities</b>			
Long-term bank loans, non-current portion		(424,308)	(425,494)
Deferred tax liabilities		<u>(1,200)</u>	<u>(1,200)</u>
Total non-current liabilities		<u>(425,508)</u>	<u>(426,694)</u>
Minority interests		<u>(395)</u>	<u>—</u>
		<u>1,304,848</u>	<u>1,320,456</u>
<b>Shareholders' equity</b>			
Share capital		410,296	410,296
Reserves		<u>894,552</u>	<u>910,160</u>
Total shareholders' equity		<u>1,304,848</u>	<u>1,320,456</u>

**(b) Audited consolidated income statement**

		<b>For the year ended</b>	
		<b>31st December</b>	
	<i>Note</i>	<b>2003</b>	<b>2002</b>
		<i>HK\$'000</i>	<i>HK\$'000</i>
PET chips		1,283,084	1,188,476
Polyester filaments		221,137	199,649
Polyester staple fibers		320,864	272,194
Finished fabrics		<u>255,409</u>	<u>249,892</u>
Total turnover		2,080,494	1,910,211
Cost of sales		<u>(1,898,894)</u>	<u>(1,667,783)</u>
Gross profit		181,600	242,428
Distribution costs		(124,230)	(99,060)
Administrative expenses		(54,493)	(45,160)
Other operating income		<u>17,507</u>	<u>10,601</u>
Profit from operations	5	20,384	108,809
Other income	6	21,456	—
Finance costs, net	7	(11,599)	(19,005)
Share of loss of an associated company		<u>(2,130)</u>	<u>—</u>
Profit before tax		28,111	89,804
Income tax expense	8	<u>(2,751)</u>	<u>(7,282)</u>
Profit after tax		25,360	82,522
Minority interests		<u>28</u>	<u>—</u>
Profit attributable to shareholders		<u><u>25,388</u></u>	<u><u>82,522</u></u>
Earnings per share (in HK\$)	9		
- Basic and diluted		<u><u>0.06</u></u>	<u><u>0.20</u></u>

(c) **Audited consolidated statement of changes in equity**

	<b>Share capital</b>	<b>Share premium</b>	<b>Reserve fund</b>	<b>Revaluation reserve</b>	<b>Cumulative translation reserve</b>	<b>Retained profits</b>	<b>Total</b>
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Balance as at 1st January 2002	410,296	523,001	52,649	5,645	2,169	346,748	1,340,508
Dividends declared	—	—	—	—	—	(102,574)	(102,574)
Profit appropriation	—	—	33,721	—	—	(33,721)	—
Profit for the year	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>82,522</u>	<u>82,522</u>
Balance as at 31st December 2002	410,296	523,001	86,370	5,645	2,169	29,975	1,320,456
Dividends declared	—	—	—	—	—	(41,030)	(41,030)
Profit appropriation	—	—	16,276	—	—	(16,276)	—
Effect of translation of the financial statements of a foreign subsidiary	—	—	—	—	34	—	34
Profit for the year	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>25,388</u>	<u>25,388</u>
Balance as at 31st December 2003	<u>410,296</u>	<u>523,001</u>	<u>102,646</u>	<u>5,645</u>	<u>2,203</u>	<u>261,057</u>	<u>1,304,848</u>

(d) **Audited consolidated cash flow statements**

		<b>For the year ended</b>	
		<b>31st December</b>	
	<i>Note</i>	<b>2003</b>	<b>2002</b>
		<i>HK\$'000</i>	<i>HK\$'000</i>
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>			
Cash generated from operations		90,977	189,855
Interest paid		(22,544)	(24,362)
Income tax paid		<u>(2,355)</u>	<u>(17,170)</u>
Net cash from operations		<u>66,078</u>	<u>148,323</u>
<b>CASH FLOW FROM INVESTING ACTIVITIES</b>			
Purchase of property, plant and equipment		(72,393)	(114,112)
Purchase of land use rights		(4,619)	—
Proceeds from disposals of property, plant and equipment		478	—
Investment in an associated company		(86,473)	—
Decrease in other non-current assets		1,547	—
Decrease in pledged deposits		—	17,894
Interest received		2,879	4,761
Net cash outflow from disposal of subsidiaries	11	<u>(13,060)</u>	<u>—</u>
Net cash used in investing activities		<u>(171,641)</u>	<u>(91,457)</u>

	<b>For the year ended</b>	
	<b>31st December</b>	
<i>Note</i>	<b>2003</b>	<b>2002</b>
	<i>HK\$'000</i>	<i>HK\$'000</i>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from short-term bank loans	769,695	739,554
Proceeds from long-term bank loans	92,814	500,694
Repayments of short-term bank loans	(825,118)	(799,541)
Repayments of long-term bank loans	(46,060)	(396,793)
Capital contributed by minority interests	423	—
Dividends paid	<u>(41,030)</u>	<u>(102,574)</u>
Net cash used in financing activities	<u>(49,276)</u>	<u>(58,660)</u>
Effect of exchange rate changes	34	—
Net decrease in cash and cash equivalents	(154,805)	(1,794)
Cash and cash equivalents at beginning of year	<u>345,717</u>	<u>347,511</u>
Cash and cash equivalents at end of year	<u>190,912</u>	<u>345,717</u>

## (e) Notes to the audited financial statements

### 1) Basis of presentation

The audited financial statements have been prepared in accordance with International Financial Reporting Standards, as published by the International Accounting Standards Board, and the disclosure requirements of the Rules Governing the Listing of Securities of the GEM of the Exchange.

The audited financial statements have been prepared under the historical cost convention except for buildings included in fixed assets, which have been stated at revalued amount.

The accounting policies and methods of computation used in the preparation of the audited financial statements are consistent with those used in the audited financial statements as at and for the year ended 31st December 2002.

### 2) Principles of consolidation

The audited consolidated financial statements include those of the Company and its subsidiaries.

All significant intercompany balances and transactions, including intercompany profits and unrealised profits and losses are eliminated on consolidation. Unaudited consolidated financial statements are prepared using uniform accounting policies for like transactions and other events in similar circumstances.

### 3) Trade receivables

	As at	
	31st December	
	2003	2002
	HK\$'000	HK\$'000
<b>Accounts receivable</b>		
Current to 30 days	85,484	65,553
31 to 60 days	45,186	33,007
61 to 90 days	17,010	45,505
Over 90 days	<u>44,530</u>	<u>—</u>
	192,210	144,065
<b>Notes receivable</b>	<u>29,553</u>	<u>70,763</u>
	<u>221,763</u>	<u>214,828</u>



## Credit policy

The Group adopted a prudent approach in granting credit to customers. No credit terms were granted to PRC customers except for those with sound financial background and good repayment histories, for which the Group would grant credit terms ranging from 7 days to 60 days. For overseas customers, the Group grants credit terms of 90 to 120 days. In addition, a predetermined maximum credit limit has been set for each customer.

### 4) Trade payables

	<b>As at</b>	
	<b>31st December</b>	
	<b>2003</b>	<b>2002</b>
	<i>HK\$'000</i>	<i>HK\$'000</i>
<b>Trade payables</b>		
Current to 30 days	105,993	236,856
31 to 90 days	167,365	9,037
Over 90 days	<u>23,239</u>	<u>46,879</u>
	296,597	292,772
<b>Other payables and accruals</b>	<u>55,553</u>	<u>86,435</u>
	<u><u>352,150</u></u>	<u><u>379,207</u></u>

## 5) Profit from operations

The following items have been included in arriving at profit from operations:

	For the year ended	
	31st December	
	2003	2002
	HK\$'000	HK\$'000
Cost of inventories	1,898,894	1,667,783
Staff costs	65,640	69,889
Depreciation on property, plant and equipment	141,029	134,128
Amortisation of land use rights	2,601	2,496
Amortisation of deferred assets	1,371	1,371
Operating lease rentals on property	4,551	2,924
Auditors' remuneration	380	384
Gain (Loss) on disposals of property, plant and equipment	353	(34)
Gain on disposal of subsidiaries	<u>4,347</u>	<u>—</u>

## 6) Other income

Other income represented re-investment tax refund income amounting to approximately HK\$21,456,000 arising from the direct re-investment of the Company's share in the undistributed profit of a wholly-owned subsidiary of the Company for the years ended 31st December 2001 and 2002 of approximately HK\$265,200,000. According to the relevant PRC investments and tax rules and regulations, re-investment tax refund income is calculated based on the amount of Enterprise Income Tax previously paid by that wholly-owned subsidiary on the re-invested portion of the undistributed profits.

## 7) Finance costs

	For the year ended	
	31st December	
	2003	2002
	HK\$'000	HK\$'000
Interest expenses on borrowings wholly repayable within five years	22,544	24,362
Less: Amount capitalised as construction-in-progress	(2,291)	(2,444)
Interest income	(2,879)	(4,761)
Net foreign currency exchange gains	(11,136)	(2,487)
Other financial expenses	<u>5,361</u>	<u>4,335</u>
	<u>11,599</u>	<u>19,005</u>

## 8) **Income tax**

The Company is exempted from taxation in Bermuda until 2016. No Hong Kong profits tax was provided as no assessable profits was earned in or derived from Hong Kong.

Pursuant to the relevant laws and regulations in the PRC, the Company's subsidiaries registered in the PRC are subject to PRC enterprise income tax ("EIT") on the taxable income as reported in their PRC statutory accounts adjusted in accordance with relevant PRC income tax laws. Furthermore, in accordance with the PRC "Law of Enterprise Income Tax for Enterprise with Foreign Investment", FEIS, the Company's major PRC subsidiary, is entitled to full exemption from EIT for the first two years and a 50% reduction in EIT for the next three years, commencing from the first profitable year after offsetting all tax losses carried forward from the previous five years. Being registered in a designated high-technology development zone in the PRC, FEIS enjoys a preferable EIT rate of 15%. 2003 is the fifth profitable year of FEIS and it is subject to EIT at a 50% reduced rate of 7.5%.

According to relevant PRC rules and regulations, being qualified as a "High-technology Enterprise" (granted by relevant local authorities on 20th December 2000), FEIS is entitled to a 50% reduced EIT rate, or subject to EIT at a rate of 10% if the reduced rate is lower than 10%, for an additional three years, after the end of the five years preferential EIT treatment as stated above. The "High-technology Enterprise" status is subject to review every year.

	<b>For the year ended</b>	
	<b>31st December</b>	
	<b>2003</b>	<b>2002</b>
	<i>HK\$'000</i>	<i>HK\$'000</i>
Current tax	2,751	7,282
Share of tax of an associated company	<u>—</u>	<u>—</u>

## 9) **Earnings per share**

The calculation of basic earnings per share for the year ended 31st December 2003 was based on the consolidated profit attributable to shareholders of approximately HK\$25,388,000 (2002: HK\$82,522,000) and the weighted average number of 410,296,000 (2002: 410,296,000) ordinary shares in issue during 2003.

There were no potentially dilutive ordinary shares in existence during the year ended 31st December 2003.

## 10) Segmental information

The Company and its subsidiaries operate principally in the production and distribution of PET chips, polyester filaments and polyester staple fibers, and dyeing and finishing of polyester textile products and have four reportable segments based on the Company's four strategic business units ("SBUs"), namely the Chip SBU, the Filament SBU, the Polyester Staple Fiber SBU and the Dyeing and Finishing SBU which are managed separately.

### Business segments

	Chip SBU		Filament SBU		Polyester Staple Fiber SBU		Dyeing and Finishing SBU		Consolidated	
	2003	2002	2003	2002	2003	2002	2003	2002	2003	2002
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Revenue										
Turnover from external sales	1,283,084	1,188,476	221,137	199,649	320,864	272,194	255,409	249,892	2,080,494	1,910,211
Gross profit	123,052	179,105	8,737	12,568	14,797	21,979	35,014	28,776	181,600	242,428
Unallocated corporate expenses									(161,216)	(133,619)
Profit from operations									20,384	108,809
Other income									21,456	—
Finance costs, net									(11,599)	(19,005)
Share of loss of an associated company									(2,130)	—
Profit before tax									28,111	89,804
Income tax expense									(2,751)	(7,282)
Profit after tax									25,360	82,522
Minority interests									28	—
Profit for the year									<u>25,388</u>	<u>82,522</u>

	Chip SBU		Filament SBU		Polyester Staple Fiber SBU		Dyeing and Finishing SBU		Consolidated	
	2003	2002	2003	2002	2003	2002	2003	2002	2003	2002
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Other information										
Segment assets	794,565	813,598	308,971	282,275	266,571	307,932	465,356	465,876	1,835,463	1,869,681
Investment in an associated company									84,343	—
Unallocated corporate assets									<u>394,761</u>	<u>496,146</u>
Total assets									<u>2,314,567</u>	<u>2,365,827</u>
Segment liabilities	195,435	248,072	47,511	41,590	56,788	44,448	43,068	46,112	342,802	380,222
Unallocated corporate liabilities									<u>666,522</u>	<u>665,149</u>
Total liabilities									<u>1,009,324</u>	<u>1,045,371</u>
Capital expenditures	7,091	59,572	18,879	2,516	422	6,029	25,280	7,150	51,672	75,267
Unallocated corporate capital expenditures									<u>27,631</u>	<u>41,289</u>
Total capital expenditures									<u>79,303</u>	<u>116,556</u>
Depreciation and amortisation	54,582	41,398	27,236	22,079	16,880	15,179	34,028	26,219	132,726	104,875
Unallocated depreciation and amortisation									<u>12,275</u>	<u>33,120</u>
Total depreciation and amortisation									<u>145,001</u>	<u>137,995</u>

## Geographical segments

	2003	2002
	HK\$'000	HK\$'000
Turnover from external sales		
PRC	1,504,063	1,388,192
Asia (excluding PRC)	59,702	104,061
Europe	368,429	314,979
Middle East	96,642	11,456
North America	47,289	90,230
Others	<u>4,369</u>	<u>1,293</u>
	<u>2,080,494</u>	<u>1,910,211</u>

Substantially all the Group's assets are located in the PRC where the Group's sole manufacturing plant is based. Capital expenditures are mainly for the Group's plant in the PRC.

## 11) Note to the consolidated cash flow statement - Disposal of subsidiaries

**For the year ended**  
**31st December**  
**2003**  
*HK\$'000*

**Net assets disposed of:**

Fixed assets	14,918
Cash and bank deposits	13,060
Trade receivables	832
Trade payables	<u>(13,657)</u>

15,153

Gain on disposal 4,347

Recorded as receivable from a related company 19,500

**Net cash outflow from disposal of subsidiaries**

Cash consideration	—
Cash and bank deposits disposed of	<u>(13,060)</u>

Net cash outflow from disposal of subsidiaries (13,060)

## **DIVIDEND**

The Directors will recommend the payment of a final dividend of HK\$0.10 per ordinary share for the year ended 31st December 2003, totalling approximately HK\$41,030,000, at the forthcoming Annual General Meeting.

On 14th March 2003, the Directors declared a final dividend of HK\$0.10 per ordinary share for the year ended 31st December 2002, totalling approximately HK\$41,030,000. This dividend has been fully paid.

## **BUSINESS REVIEW**

### **BUSINESS ENVIRONMENT**

In the first quarter of 2003, the US-lead coalition war against Iraq resulted in a rise in crude oil price to US\$30.6 per barrel which represented a 15% and 54% increase when compared to the fourth quarter and first quarter of 2002, respectively. Consequently, there were increases in prices of pure terephthalic

acid (“PTA”) and monoethylene glycol (“MEG”), as both are petrochemical products. The increases in the prices of PTA and MEG were further magnified by the worldwide shortage of their production capacities, especially the latter one.

In the second quarter of 2003, the outbreak of the Severe Acute Respiratory Syndrome (“SARS”) epidemic affected almost all industries in the PRC. Gross Domestic Product of the PRC only grew at a rate of 6.7% during the second quarter of 2003, which was the lowest since 1992.

In the third quarter of 2003, after the threat of SARS eased and in light of the prolonged period of low volume in business activities, the polyester market in the PRC became increasingly competitive. Many polyester producers aiming to recapture lost business and/or clear backlogged inventories reduced their prices, having a further knock on effect on the product margins in the polyester industry.

After much turbulence in the first three quarters of 2003, the polyester industry showed signs of stabilisation in the last quarter. However, industry players were still operating under the threat of over-supply within the PRC.

The business environment in the first quarter of 2004 showed a promising recovery after a prolonged period of depression in the polyester industry. In light of the continuing rise of PTA and MEG prices, certain polyester producers scaled down their production, which immediately alleviated the over-supply situation and rebounds in product prices were observed. Nonetheless, manufacturers still need to face the over-supply problem in the long-run.

## **OPERATIONAL REVIEW**

### **Slight decrease in the Group’s sales volume caused by change in product mix and unfavorable business environment**

As a result of increasing competition, the Group strategically shifted its product mix to produce more high-end specialty products such as low denier filaments and specialty fabrics. Although such products command higher selling prices, they require a more sophisticated manufacturing processes that are more time consuming and eventually lead to a drop in production and sales

volume. In addition, due to the impact of SARS and excessive capacities in the polyester industry, the Group's sales volume, especially PET chips, in 2003 was inevitably affected. The following is a summary of the Group's sales volume in 2003:

	<b>For the year ended</b>		<b>Percentage</b>
	<b>31st December</b>	<b>2002</b>	<b>increase/ (decrease)</b>
	<b>2003</b>		<b>(%)</b>
PET chips (tonnes)	179,064	188,189	(5)
Polyester filaments (tonnes)	21,112	21,689	(3)
Polyester staple fibers (tonnes)	41,863	38,658	8
Finished fabrics (thousand yards)	20,797	24,065	(14)

### **Erosion in the Group's gross profit margins as a result of imbalance between demand and supply**

The imbalance between demand and supply within the PRC domestic polyester industry meant that polyester producers faced increasing difficulties in passing on the incremental raw material costs to customers. It led to a margin erosion, with the Group's average gross margin declining from 13% in 2002 to 9% in 2003. In particular, the gross margin of the Group's major product, PET resins, dropped from 15% in 2002 to 10% in 2003. Noting the rebounds in the first quarter of 2004, the Directors are expectant that the Group might achieve better results in 2004.

### **Political tension led to an increase in crude oil prices**

Average crude oil prices in 2003 were 16% higher than those in 2002. Political tensions throughout the world were a precursor to continuing surges in crude oil prices, which in turn led to increases in the Group's feedstock costs. In light of the current position taken by the Organization of the Petroleum Exporting Countries, the Directors expect crude oil prices to remain high in the near future.



## **Supply of upstream petrochemical products is tight, which in turn kept their costs high. Future trends in raw materials costs are critical to the Group's future profitability**

Prices of upper stream petrochemical products, in particular paraxylene ("PX") and natural gas, which are respectively the major constituents of PTA and MEG, are expected to continue their upward trends due to the lack of new capacity. The Group's profitability in 2004 is likely to be critically dependent on the future trends in raw material costs, which are not expected to decline sharply in the near future.

In order to actively manage its inventory level, the Group formulates its raw material purchase strategy based on forecasts of PTA and MEG prices. By reducing inventory levels when the raw material costs are high and accumulating inventories when the costs are low, the Directors aim to increase the Group's profit margins and therefore maximise profitability.

## **Demand for PET resins in the PRC will sustain considerable growth in the future**

As China reported strong economic growth, demand for PET resins in the PRC grew at a rate of over 20% last year. The annual domestic demand for PET resins reached 800,000 tonnes in 2003. It is expected that domestic demand for PET resins will be sustained at approximately 20% per annum.

## **Supply of PET resins in the PRC is growing**

Given the over-supply situation of PET resins in the PRC, the average utilisation rate of PET resins was in the order of 70% in 2003. However, it is pleasing to report that the Group achieved almost full utilisation in 2003. With a strong emphasis on economies of scale, major polyester producers in the PRC continue to expand their production capacities. Given this trend, and the under-utilisation generally within the industry, the Directors believe that this will trigger smaller producers to consolidate or even suspend their operations, thus stabilising the imbalance between demand and supply within the PRC market. The Directors expect the future polyester market in the PRC will be a market for large producers, which is a positive factor for the Group.

## **Profit margins for the Group's other product lines improved as a result of a re-adjustment in product mix**

As a result of the extensive effort put into research and development, the Group's Dyeing and Finishing Strategic Business Unit ("SBU") has successfully re-adjusted its product mix and produced more specialty fabrics such as fabrics for furnitures and curtains. Such products are produced by sophisticated manufacturing processes and are subject to stringent quality control that cannot typically be offered by other fabric manufacturers in China. Such high value-added specialty products are mainly exported to overseas markets and are well accepted by the customers. Accordingly, the Dyeing and Finishing SBU managed to improve its gross margin from 12% in 2002 to 14% in 2003 in challenging market conditions.

## **Strategic change made by the Polyester Staple Fiber SBU**

Commencing operations in late 2001, the Group's Polyester Staple Fiber SBU has produced quality products that are well accepted by the PRC market. Based on this foundation, the Group will sell more of its polyester staple fibers domestically in the PRC than in overseas markets in 2004 which will allow the Group to enjoy better margins and save certain export expenses. Commencing the fourth quarter of 2003, the Polyester Staple Fiber SBU produces spinning fibers in addition to the conjugate fibers it always produces, and the Group is now able to cater for the needs of a wider spectrum of customers. The Group's production facilities can be freely switched between production of spinning fibers and conjugate fibers, providing additional flexibility to the Group by enabling it to maintain an optimal product mix in an ever-changing market. Despite the poor market conditions in the PRC, the Group's strategy proved effective with an improved gross margin for the Polyester Staple Fiber SBU from 3% for the first three quarters of 2003 to 7% for the fourth quarter of 2003.

## **Expenses, in particular distribution costs, surged due to changes in market conditions, but are expected to stabilize**

Due to continuous increases in polyester production capacities in China since mid 2001, China's market for polyester products has shifted from a seller-oriented mode to a buyer-oriented mode. Reflective of this, distribution costs for PET chips and other polyester products, which used to be borne by the buyers, are now borne by the Group. Although the export ratio increased

only slightly from 27% in 2002 to 28% in 2003, distribution costs increased by 25%. The Directors anticipate that such expenses will stabilize in 2004, with any further increase in distribution costs being proportional to the increase in the Group's sales volume.

### **Investment in a joint venture to produce PTA in the PRC**

In 2003, the Group formed a joint venture, PET Far Eastern Holding Limited, with two connected parties to establish and operate a PTA plant adjacent to the Group's existing manufacturing facilities in Pudong, Shanghai. This PTA plant is now under construction and is expected to commence operation by the end of 2005. This investment will enable the Group to participate in a vertically integrated production process and should strengthen its competitiveness. The Group has contributed capital in the amount of approximately HK\$86 million to the joint venture for an equity interest of 21.7%.

### **Establishment of two subsidiaries**

In 2003, the Group established two subsidiaries, namely 武漢遠紡工貿有限公司 and 上海遠資信息技術有限公司, in Wuhan and Shanghai, the PRC with a connected party. The Group has a 95% equity interest in each subsidiary and contributed, altogether, approximately HK\$8 million towards their capital. The new subsidiary in Wuhan will engage in distribution of products of FEIS to serve the Group's customers in the Wuhan and surrounding regions in the PRC. The new subsidiary in Shanghai will engage in the provision of information technology consultancy services in the PRC to the Group and other customers as well.

### **Disposal of two subsidiaries**

In 2003, the Group disposed of two subsidiaries, Far Eastern Info Service (Holding) Limited and Far Eastern Network Info-Tech (Shanghai) Ltd., to a connected party at a gain of approximately HK\$4 million. These subsidiaries were originally set up for development of computer network software in the PRC. However, after a reassessment of the future profitability of these subsidiaries, the Directors concluded that it was in the Group's best interests to dispose of these subsidiaries.

## **FUTURE PROSPECTS**

**The growth in demand for PET resins is expected to be sustained but the rate of recovery of the PET resin market will depend on the rate of elimination of small-scale or inefficient producers**

The Directors are optimistic about the future growth in PET resins demand in China. As China's economy continues to grow at a fast pace, the Directors expect the market demand for PET resins in China to reach approximately 1,000,000 tonnes per annum in 2004, representing a growth rate of more than 20% over the demand in 2003.

In spite of this, whether the China PET resin market will recover hinges heavily on the rate of elimination of small-scale or inefficient producers. Certain small-scale PET resin producers have been operating at inefficient, loss making levels for prolonged periods since 2002. The Directors expect that a large number of these producers will either shut down production facilities or transform facilities to produce other polyester products.

**The Group will continue to focus on high value-added and specialty products**

The Group will continue to focus on high value-added and specialty products. Diversification and differentiation will be keys to the Group's future development. The Group will continue to position itself at the high-end market, to produce products that involve technology that cannot easily be copied by other producers in China. As always, the Group will continue to focus on the production of high-quality PET chips for carbonated soft drink and hot-filled bottles, low denier filaments and specialty fabrics. It is believed that the Group's current product mix is competing effectively and efficiently under the current adverse market conditions, and the Directors will continue to monitor the market situation so as to achieve the optimal product mix with a view to maximising profit of the Group.

**The acquisition of polymerization facilities from Dupont Suzhou Polyester Company Limited ("DSPC") should complete this year**

After entering into a conditional agreement in connection with the acquisition of polymerization facilities from DSPC in 2002, the PRC government authorities imposed certain conditions on the contracting parties which served as pre-requisites to their approving this acquisition transaction. In 2003, significant progress had been made by the contracting parties to fulfill the above conditions and it is expected that the acquisition will complete in

2004. The facilities, which will cost approximately US\$35.2 million, will provide the Group with an additional 100,000 tonnes per year of polymerization production capacity and ease the production bottleneck in base polymers. Such acquisition represents an important part of the Group's future development.

### **The investment in a joint venture to produce PTA in the PRC**

In 2003, the Group formed a joint venture with two connected parties to establish and operate a new PTA plant adjacent to the Group's existing manufacturing facilities in Pudong, Shanghai. This PTA plant is now under construction and is expected to commence operation by the end of 2005. The Group's investment amounted to US\$11.1 million. Since PTA is a fundamental raw material for manufacturing polyester products, this investment will enable the Group to vertically integrate its production process. The Group is confident that it will also improve its production efficiency and, as a result, strengthen its competitiveness.

## **RESULTS OF OPERATIONS**

### **1. Turnover**

The Group's total sales increased by 9% from HK\$1,910 million in 2002 to HK\$2,080 million in 2003.

Net sales for PET resins increased by 8% from HK\$1,188 million in 2002 to HK\$1,283 million in 2003. This was mainly attributable to an increase in average sales price of 11% driven by the increase in raw material costs. The quantity of PET resins sold decreased slightly by 5%. The lower quantity of PET resins sold in 2003 was due to the low level of sales in the second and third quarters, the usual high seasons in PET resins sales, when the market was most affected by SARS.

Net sales for filaments increased by 11% from HK\$200 million in 2002 to HK\$221 million in 2003. As the Group underwent a shift in product mix to produce more specialty products, such as low denier filaments, quick dry filaments, full-dull filaments and cation filaments, the average unit selling prices increased by 13% during the year 2003, when compared to that of 2002. As specialty filaments require additional processing time, they lead to a slight reduction in production and sales volume.

Net sales for polyester staple fibers increased by 18% from HK\$272 million in 2002 to HK\$321 million in 2003. The increase was mainly due

to the fact that the staple fiber plant commenced operations in the third quarter of 2001, and the desired level of production capacity was not reached until mid 2002. Sales volume for polyester staple fiber increased by 8% from 2002 to 2003. Average unit-selling prices increased by 10% during 2003.

Net sales for finished fabrics increased by 2% from HK\$250 million in 2002 to HK\$255 million in 2003. The increase was mainly attributable to the substantial increase in average unit selling prices of fabrics by 19% in 2003, due to a change in product mix to more high value-added products, such as furniture and curtain fabrics, which demand more sophisticated production technique that cannot easily be copied by others. Sales volume, on the other hand, decreased by 14% as a result of additional processing time consumed in manufacturing those high value-added products.

## **2. Cost of sales**

During 2003, the average unit costs of PTA and MEG rose by 20% and 39% respectively, when compared to those of 2002. Consequently, the cost of sales in 2003 increased by 14%, as compared to 2002, whereas sales only increased by 9%. The unparalleled increase in cost of sales translated directly into a margin squeeze from 13% in 2002 to 9% in 2003.

## **3. Distribution costs, administrative expenses, other income and finance costs**

Since mid 2001, the profile of the China polyester market has shifted from a seller-oriented one to a buyer-oriented one. Distribution costs for many polyester products, which used to be borne by the buyers, are now, typically, borne by the Group, which resulted in a 25% increase in distribution costs over 2002.

Additional administrative costs, including staff salaries, depreciation expenses and other general office expenses increased by 21% from HK\$45 million to HK\$54 million due to an increase in the number of employees and the costs incurred by the new subsidiaries of the Group, established in 2003 for the purpose of expanding the Group's operations.

Other income for the year ended 31st December 2003 represented a tax refund income amounted to HK\$21 million. Based on the investment and tax rules governing wholly foreign owned enterprises ("WFOE") in the PRC, an investor of a WFOE is entitled to a tax refund income upon re-investment of the undistributed profits of the WFOE as its capital. The

amount of tax refund income is calculated based on the amounts of enterprise income taxes previously paid by the WFOE attributable to the undistributed profits re-invested. During the year ended 31st December 2003, the Company re-invested undistributed profits of FEIS in the amount of HK\$265 million and the tax refund income of HK\$21 million was related to enterprise income taxes of FEIS for the years ended 31st December 2001 and 2002.

The decrease in finance costs was mainly due to an increase in exchange gain associated with the Group's bank balances and receivables denominated in Euros, given the appreciation of the Euro against United States dollar in the second half of 2003.

#### **4. Profit before taxation**

Profit before taxation decreased by 69% from HK\$90 million in 2002 to HK\$28 million in 2003.

#### **5. Taxation**

2003 was the fifth profit-making year of the Group's major operating subsidiary, FEIS, and therefore, it enjoyed a 50% reduction in enterprise income tax from 15% to 7.5%. A provision of HK\$3 million for enterprise income tax was made during 2003. After expiration of FEIS's tax holiday in 2003, FEIS, as a "High-technology Enterprise", is subject to enterprise income tax at a rate of 10% from 2004 to 2006. The "High-technology Enterprise" status is subject to review every year.

#### **6. Profit attributable to shareholders**

The Group's profit attributable to shareholders declined by 69% from HK\$83 million in 2002 to HK\$25 million in 2003. The decrease was caused by various factors affecting sales, cost of sales and operating expenses explained above.

### **GROUP LIQUIDITY AND FINANCIAL RESOURCES**

#### **1. Cash and cash equivalents**

As at 31st December 2003, the Group's cash and cash equivalents amounted to approximately HK\$191 million (compared to HK\$346 million in 2002) of which 34% were denominated in United States dollars, 57% were denominated in Renminbi, 8% were denominated in Euros and 1% denominated in British pounds.

## 2. Cash flows

Cash generated from operations decreased from HK\$190 million in 2002 to HK\$91 million in 2003. This was mainly due to the decrease in the Group's profit before taxation from HK\$89 million in 2002 to HK\$25 million in 2003.

Net cash used in investment activities increased from HK\$91 million in 2002 to HK\$172 million in 2003, due to the investment of HK\$86 million in an associated company which will construct and operate a new PTA plant in the PRC.

In 2003, approximately HK\$863 million of bank loans (of which HK\$93 million were long-term bank loans) were obtained for operational purposes and to finance capital expenditure and the investment in an associated company, while approximately HK\$871 million of bank loans (of which HK\$46 million were long-term bank loans) were repaid. Dividends of HK\$41 million were paid during 2003.

## 3. Borrowings

As at 31st December 2003, the Group's borrowings amounted to approximately HK\$642 million (2002: HK\$651 million). Approximately 44% (2002: 59%) of the Group's borrowings were denominated in Renminbi while 56% (2002: 41%) of the Group's borrowings were denominated in United States dollars. Approximately 47% (2002: 61%) of the Group's borrowings were at fixed interest rates and 53% (2002: 39%) were at floating rates. As at 31st December 2003, approximately 81% (2002: 72%) of the Group's borrowings were long-term borrowings and 66% (2002: 65%) of the total borrowings were not repayable within one year.

As at 31st December 2003, approximately HK\$156 million (2002: HK\$164 million) of the Group's real property had been pledged as collateral to secure the borrowings.

As at 31st December 2003, the net debt to equity ratio was approximately 35% (2002: 23%). Gross debt to equity ratio was approximately 49% (2002: 49%). Earnings before interest, taxation, depreciation and amortisation covered the gross interest expense by 8.3 times (2002: 10.3 times).

The Group's capital expenditure for the year amounted to HK\$75 million (2002: HK\$117 million), which was funded by borrowings and internally generated cash. The capital expenditure during 2003 was mainly incurred for the acquisition of additional production facilities for the Filament and Dyeing and Finishing SBUs.



Capital expenditure in 2004 is expected to be approximately HK\$763 million, and is expected to be incurred principally for acquisition of machinery for various SBUs, especially the Chip SBU, to fundamentally upgrade the Group's production capacities. In addition, the acquisition of polymerization facilities from DSPC should also complete in 2004. Internally generated cash and bank borrowings should satisfy all of the funds required.

Committed borrowing facilities that are available to the Group companies, but not drawn as at 31st December 2003 amounted to HK\$1,451 million (2002: HK\$1,438 million).

## **TREASURY POLICIES AND CAPITAL STRUCTURE**

The Group adopts a prudent approach over treasury and funding policies, with a focus on risk management and those transactions that are directly related to the underlying business of the Group. During the year, the Group has re-adjusted its capital structure by borrowing a higher portion of bank loans denominated in United States dollars, given the market expectation that the United States dollar is weakening against the Renminbi. Since most banks in China offer United States dollar loans at floating interest rates, the Group now has a greater portion of borrowings that carry floating interest rates.

## **DIRECTORS' SERVICE CONTRACTS**

Mr. Lih-Teh Chang has a 2-year full-time service contract with the Company which may be terminated by either party thereto giving to the other not more than six calendar months' prior notice in writing. In addition, each of Mr. Shu-Tong Hsu, Mr. Jar-Yi Shih and Mr. Champion Lee and Mr. Chin-Sen Tu has a part-time service contract with the Company, which may be terminated on the same basis as the abovementioned full-time contracts.

## **DIRECTORS' INTERESTS IN SECURITIES**

As at 31st December 2003, the following Directors were interested, or were deemed to be interested, in the following interests and short positions in the shares, debentures or underlying shares of the Company or its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) ("SFO")), notifiable to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO, and as recorded in the Register of Directors' Interests required to be maintained by the Company pursuant to Section 352 of the SFO:

## The Company

### *Long positions in shares of the Company (“Shares”)*

None of the Directors were interested or deemed to be interested in long positions in Shares.

### *Long positions in underlying Shares of equity derivatives*

None of the Directors were interested or deemed to be interested in long positions in underlying Shares of equity derivatives.

### *Short positions in underlying Shares of equity derivatives*

None of the Directors were interested or deemed to be interested in short positions in underlying Shares of equity derivatives.

## Associated Corporations

### *Long positions in shares of Far Eastern Textile Limited (“FET”) (Note 1)*

Name of director	Number of shares				Total
	Personal interests	Family interests	Corporate interests	Other interests	
Mr. Shu-Tong Hsu	66,807,468	Nil	Nil	Nil	66,807,648
Mr. Jar-Yi Shih	1,562,152	27,449,017	Nil	Nil	29,011,169
Mr. Champion Lee	243	Nil	Nil	Nil	243
Mr. Chin-Sen Tu	241	Nil	Nil	Nil	241
Mr. Shaw-Y Wang	110,356	Nil	Nil	Nil	110,356
Mr. Lih-Teh Chang	20,657	Nil	Nil	Nil	20,657

#### *Note:*

1. FET is an associated corporation of the Company as FET is the Company’s ultimate holding company. As at 31st December 2003, FET had a 64.2% interest in the Company, comprising (i) a direct interest of 11.4%; (ii) an indirect interest of 46.8% through its controlling shareholding in Yuang Ding Investment Corporation; and (iii) an indirect interest (arising by virtue of FET’s status as the discretionary object of a discretionary trust) of 6%.

In aggregate, the above interests represented, as at 31st December 2003, approximately 2.7% of the total issued common shares of FET.

### *Long positions in underlying shares of equity derivatives of FET*

None of the Directors were interested or deemed to be interested in long positions in underlying shares of equity derivatives of FET.

### *Short positions in underlying shares of equity derivatives of FET*

None of the Directors were interested or deemed to be interested in short positions in underlying shares of equity derivatives of FET.

Save as disclosed above, the Company had no notice of any interests required to be recorded under Section 352 of the SFO as at 31st December 2003.

## **DIRECTORS' INTERESTS IN CONTRACTS**

No contract, commitment or agreement of significance in relation to the Company's business, to which the Company or any of its subsidiaries was a party and in which any of the Directors had a material interest, either directly or indirectly, subsisted at 31st December 2003 or at any time during 2003.

## **DIRECTORS' RIGHTS TO PURCHASE SHARES OR DEBENTURES**

The Company has a share option scheme approved by the shareholders of the Company on 11th January 2000, under which it may grant options to full-time employees, including executive directors of the Company or of its subsidiaries, to subscribe for shares in the Company.

As at 31st December 2003, no options had been granted under the Company's share option scheme.

## **SUBSTANTIAL SHAREHOLDERS' INTERESTS**

As at 31st December 2003, the following shareholders (not being Directors or chief executives of the Company) were interested, or were deemed to be interested, in the following interests and short positions in the shares, debentures or underlying shares of the Company or its associated corporations (within the meaning of Part XV of the SFO), notifiable to the Company pursuant to Divisions 2 and 3 of Part XV of the SFO, and as recorded in the Register of Substantial Shareholders' Interests required to be maintained by the Company pursuant to Section 336 of the SFO:

*Long positions in Shares*

<b>Name</b>	<b>Capacity</b>	<b>Number of shares</b>	<b>Approximate percentage of interest</b>
FET ( <i>Note 1</i> )	Beneficial Owner	263,400,800	64.2%
Yuang Ding Investment Corporation (“YDIC”)	Beneficial Owner	191,870,160	46.8%
Everest Investment (Holding) Limited (“Everest Investment”)	Beneficial Owner	69,750,000	17.0%
Everest Textile Co. Ltd. (“Everest Textile”) ( <i>Note 2</i> )	Beneficial Owner	69,750,000	17.0%
Far Eastern Investment (Holdings) Company Limited (“FEIH”) ( <i>Note 3</i> )	Beneficial Owner	24,733,040	6.0%
Glorious Victory Limited ( <i>Note 4</i> )	Beneficial Owner	24,733,040	6.0%
HSBC International Trustee Limited ( <i>Note 5</i> )	Trustee	24,733,040	6.0%

*Notes:*

1. FET has interests in 99.99% of the entire issued share capital of YDIC and is accordingly deemed to have an interest in the Company’s shares in which YDIC is deemed to have an interest. FET owns 87.7% of the issued share capital of FEIH and is accordingly taken to be interested in the Company’s shares in which FEIH is deemed to have an interest.
2. Everest Textile has interests in the entire issued share capital of Everest Investment and is accordingly deemed to have an interest in the Company’s shares in which Everest Investment is deemed to have an interest.
3. FEIH as the founder of The Kai Yuan Trust, is deemed to have an interest in the shares of the Company held by Glorious Victory Limited, being the subject matter of The Kai Yuan Trust.
4. Glorious Victory Limited has interests in approximately 6% of the entire issued share capital of the Company. The entire share capital of Glorious Victory Limited is in turn held under The Kai Yuan Trust.
5. HSBC International Trustee Limited is the trustee of The Kai Yuan Trust and as such is deemed to be interested in the shares of the Company held by Glorious Victory Limited.

### *Long positions in underlying Shares of equity derivatives*

No notifiable interest (long positions) in underlying Shares of equity derivatives were held by substantial shareholders.

### *Short positions in underlying Shares of equity derivatives*

No notifiable interest (short positions) in underlying Shares of equity derivatives were held by substantial shareholders.

Save as disclosed above, the Company had no notice of any interests required to be recorded under Section 336 of the SFO as at 31st December 2003.

## **COMPETING INTERESTS**

FET (*Note 1*) and Everest Textile (*Note 2*), being management shareholders of the Company, are engaged in, and have interests in other companies engaged in, the production and sales of petrochemical, polyester and textile products.

During 2003, FET produced approximately 704,647 tonnes of polyester polymer, 264,357 tonnes of various types of PET chips (for PET bottles, food and industrial packaging), 244,294 tonnes of polyester staple fibers, 157,828 tonnes of pre-oriented yarn (POY), 62,057 tonnes of draw textured yarn (DTY), 362,048 bales of yarn, 32,471 thousand yards of finished fabrics and 372,333 thousand pieces of PET preforms. Everest Textile also produced approximately 23,466 tonnes of polyester filaments and 55,778 thousand yards of finished fabrics.

#### *Notes:*

1. As at 31st December 2003, Mr. Shu-Tong Hsu, Mr. Jar-Yi Shih, Mr. Champion Lee, Mr. Chin-Sen Tu and Mr. Shaw-Y Wang, who were Directors of the Company, were also directors of FET.
2. As at 31st December 2003, Mr. Shu-Tong Hsu, Mr. Jar-Yi Shih and Mr. Chin-Sen Tu were also directors of Everest Textile.

## **CORPORATE GOVERNANCE**

In the opinion of the Directors, the Company has complied with the “Board Practices and Procedures” as set out in Rules 5.28 to 5.39 of the GEM Listing Rules throughout the year.

## AUDIT COMMITTEE

The Company has established an audit committee with written terms of reference based upon the guidelines published by the Hong Kong Society of Accountants. The primary duties of the audit committee are to review the Company's annual report and accounts, half-year reports and quarterly reports and to provide advice and comments thereon to the board of Directors. The audit committee is also responsible for reviewing and supervising the Company's financial reporting and internal control procedures. The audit committee comprises three non-executive Directors, namely Mr. Shaw-Y Wang, Mr. Ying-Ho Wong, Kennedy, and Mr. Shih-Hung Chan. The audit committee has met seventeen times since its formation and four times during the year ended 31st December 2003. The annual results of the Group for the year ended 31st December 2003 have been reviewed by the audit committee.

## PURCHASE, SALE OR REDEMPTION OF SHARES

Neither the Company nor its subsidiaries has purchased, sold or redeemed any of the Company's shares during the period from 31st January 2000 (date of listing) to 31st December 2003.

By Order of the Board  
**Far Eastern Polychem Industries Limited**  
**Shu-Tong Hsu**  
*Chairman*

Hong Kong, 10th March 2004

*This announcement will remain on the GEM website on the "Latest Company Announcements" page for at least 7 days from the date of its posting.*

*\* For identification purposes only*