FINANCIAL REVIEW

The second half of 2003 showed noticeable improvements in the Group's performance over the first half when business was affected by the SARS outbreak. During the year under review, Harbin Brewery recorded a turnover of HK$1,402 million, an increase of 25.3% from 2002. Apart from organic growth, full integration was completed during the year in respect of all the acquired breweries, bringing significant contributions to the Group's turnover.

The Group achieved an output volume of 1,148,676 kl in 2003, representing a growth of 27.3% over 2002. The average price was HK$1,220.4 per kl in 2003, a slight decrease of 1.4% as compared to 2002. The overall gross margin for the year was 43.6%, increasing from 42.4% in 2002. This was attributable to the effective cost control brought about by higher operating efficiencies as well as the change in the product mix during the year, offsetting the unfavourable impact caused by the SARS epidemic.

In 2003, the profit from the operating activities of the Group amounted to HK$190 million, a drop of 10% over 2002. This was caused by an increase in promotion and marketing expenses for expanding the geographic coverage, as well as the inclusion of administrative expenses from the acquired breweries. However, the net profit attributable to shareholders during the year was HK$114 million, representing a slight increase of 3.8% from 2002. This was contributed by the tax refund policy facilitated by reinvestments of profits. Basic earnings per share were HK11.71 cents in 2003.

BUSINESS REVIEW

The Group implemented stringent cost control measures and effective management practices which successfully improved the operating efficiencies of the acquired breweries, while also helping to offset the undesirable impacts caused by the poor market sentiment as a result of the SARS epidemic during the first half of 2003. The encouraging operating results in the acquired breweries helped to enlarge Harbin Brewery's market share and to further strengthen its market position in the PRC.

(i) Turnover analysis by product mix

The Group's products are divided into three categories: Original, Classic and Premium, targeting at the provision of quality beer products for the mass, middle-income and premium markets respectively.

The sales of the Original products achieved the highest growth and remained as the major income source for the Group during the year, representing 81.8% of the total turnover. Turnover of the Original products increased by 32% to HK$1,147 million.

With an expanded distribution network and stronger marketing efforts after the SARS outbreak, sales of higher-end beer products, Classic and Premium products, maintained a growth of 1.9% in 2003, contributing to 18.2% in aggregate to the Group's total turnover. The sales of the Classic products, contributing to 11.7% of the total turnover, dropped by 4% to approximately HK$164 million owing to weak consumption incentives from sectors such as hotels and restaurants during the SARS epidemic. On the other hand, the turnover from the Premium products recorded an increase of 14.5% in 2003 to reach HK$91 million, accounting for 6.5% of the total turnover.

(ii) Turnover analysis by geographic location

Turnover from the Northeast Region of China amounted to HK$1,243 million, representing an increase of 17.5% over 2002. This accounted for 88.7% of the total turnover, and remained as the major market for the Group.

As the single largest market, the sales in Heilongjiang Province contributed 60.8% to the Group's total turnover. Turnover from Jilin Province recorded an increase of 11.3%. Liaoning Province and the Non-Northeast Region of China recorded the highest growth rates of 49.1% and 161.5% respectively in terms of turnover.

(iii) 2002 & 2003 Acquired Breweries

The three breweries acquired in 2002 ("2002 Acquired Breweries") were under smooth operations during the year. In addition, the two breweries acquired in 2003 ("2003 Acquired Breweries") underwent complete integration in 2003. These acquired breweries in aggregate contributed 22.5% to the total turnover during the year, and brought about positive contribution to the Group's profit. The Group expects that these breweries will generate more impressive contributions in the coming years.

(iv) Overall production operations

The Group's business scale expanded substantially in recent years through acquisitions and internal upgrades. Currently the Group operates 13 breweries in the PRC, with an aggregate designed production capacity reaching approximately 1,300,000 kl per annum. The utilisation rate of all breweries during the year was 88.4%.

(v) Market penetration

Being a key market player in the Northeast Region of China, the Group is set to extend its market penetration outside the region. During the year, the Group set up new sales offices in Shanghai, Hangzhou, Xian, Zhengzhou, Guangzhou and Shijiazhuang to strengthen Harbin Brewery's foothold in these areas. In addition, with an increase in the total number of distributors nationwide, the Group has set up a much extensive network for its "Harbin" products.

CHANGE OF SUBSTANTIAL SHAREHOLDER

On 27 June 2003, SABMiller Holdings Limited ("SABMiller Holdings"), through Gardwell Limited ("Gardwell", which is beneficially owned as to 95% by SABMiller Holdings and 5% by the Group's certain executives), entered into a conditional sale and purchase agreement with CEDF (Brewery) Holdings Limited ("CEDF Brewery"), the Group's substantial shareholder, to acquire 295 million shares of the Company from CEDF Brewery, which is equivalent to approximately 29.64% of the Company's enlarged share capital (upon completion), at a consideration of HK$675.55 million. The sale and purchase agreement was completed on 28 July 2003. On the same day, the Company and SABMiller Asia BV entered into the Strategic Investor Agreement for a three-year term for the purpose of regulating their relationship with each other and certain aspects of the affairs of and their dealings with the Group.

PROSPECTS

Although the China beer industry is expected to reach the peak of merger and acquisition activities in the near future, competition in the beer market remains intense. This continues to bring new challenges to brewers to stay ahead of the marketplace. Harbin Brewery will expand by improving the operating efficiencies of all its breweries for a higher output capacity and further maximise their utilisation rate. At the same time, the Group will remain prudent in its development through strategic acquisitions for optimal returns.

An extended market coverage and proactive response to consumers' tastes are necessary to sustain Harbin Brewery's business growth in the highly competitive market in China. The Group, while upholding its position as a leading regional brand in the Northeast Region of China, will continue to establish a stronger presence in markets like the Northern China and Southern China to raise the profile of the "Harbin" brand.

China is one of the largest beer consuming nations in the world, and is the one recording the highest growth rate. With an increased population in the middle class, their changing spending pattern and preference have facilitated a favourable market environment for mid- to high-end products. Harbin Brewery will step up its marketing initiatives to capture this high growth segment in the coming years and elevate its profit level.

FINANCIAL RESOURCES AND LIQUIDITY

The Group's total assets increased by 23% from approximately HK$2,282 million as at 31 December 2002 to approximately HK$2,802 million as at 31 December 2003. Net assets increased by 32% from approximately HK$810 million as at 31 December 2002 to approximately HK$1,070 million as at 31 December 2003. The increase in net assets was attributable to the net proceeds raised from the completion of the top-up placement in March 2003 and the net cash inflow from the Group's operating activities. Cash and bank balances amounted to approximately HK$140 million as at 31 December 2003.

The debt to equity ratio of the Group was 79% as at 31 December 2003, further improved from 97% as at 31 December 2002. The net debt to equity ratio of the Group was 66% as at 31 December 2003.

USE OF PROCEEDS FROM NEW ISSUES

The net proceeds from the share offer of the Group's listing on the Stock Exchange on 27 June 2002 and the over-allotment option exercised on 15 July 2002 were approximately HK$345 million. As at 31 December 2003, the Group had fully utilised the net proceeds. Of that amount, the Group utilised approximately HK$149 million for the repayment of shareholders' and bank loans. A further approximately HK$109 million was used for the acquisition and capital expenses of the 2002 Acquired Breweries. Approximately HK$87 million of the remaining net proceeds was used for the Group's working capital requirements, of which approximately HK$70 million was used for the purchase and downpayment of raw materials, such as barley.

On 10 March 2003, the Group raised net proceeds of approximately HK$90 million by issuing 44 million new ordinary shares at HK$2.1 per share upon the completion of the top-up placement. As at 31 December 2003, the Group fully utilised the net proceeds for the acquisition and capital expenses of the 2003 Acquired Breweries.

HUMAN RESOURCES AND REMUNERATION OF EMPLOYEES

As at 31 December 2003, the Group employs a total of 7,540 full time employees in Hong Kong and the PRC. The Group recognises the importance of its human resources to its success. Remuneration is maintained at competitive levels with discretionary bonuses payable on a merit basis and in line with industry practice. Other staff benefits provided by the Group include mandatory provident fund, insurance schemes and performance related commissions.

SIGNIFICANT EVENTS

On 9 January 2003, the noteholders exercised their rights to fully convert the notes into 13,974,358 shares of the Company at HK$1.56 per share, representing approximately 1.51% of the enlarged issued share capital of the Company as at the same day.

On 10 March 2003, the Company completed the top-up placement in raising net proceeds of approximately HK$90 million by placing a total of 44 million shares, equivalent to 4.53% of the enlarged issued share capital of the Company as at the same day.

On 17 March 2003, the Group completed its acquisition of a 70% equity interest in Shenyang Xinyisi Brewery Company Limited (currently renamed as Harbin Brewing (Shenyang) Company Limited) at a cash consideration of HK$18 million.

On 9 April 2003, the Group completed its acquisition of a 60% equity interest in Yanji Nuobao Brewing Company Limited (currently renamed as Harbin Brewing (Yanji) Company Limited) at a cash consideration of HK$20 million.

On 22 May 2003, Mr. Lee Kong Leong, Mr. Chen Zhixiong, Mr. Tse Kwok Lam and Mr. Chong Tao Boon retired as directors at the Company's annual general meeting. On the same day, Mr. Zhu Wenwei, Mr. Louis W. Moelchert, Jr. and Mr. Martin A. Murbach were appointed non-executive directors while Mr. Sam Zuchowski was appointed independent non-executive director of the Company.

On 27 June 2003, SABMiller Holdings, through Gardwell, acquired 295 million shares from CEDF Brewery, equivalent to approximately 29.64% of the Company's enlarged issued share capital upon completion, at a consideration of HK$675.55 million. The sale and purchase agreement was completed on 28 July 2003. On the same day, Mr. Louis W. Moelchert, Jr. and Mr. Martin A. Murbach resigned as non-executive directors, while Mr. Roy E. Bagattini and Mr. Jonathan F. Solesbury were appointed non-executive directors of the Company.

On 28 July 2003, the Company and SABMiller Asia BV entered into a Strategic Investor Agreement for a three-year term for the purpose of regulating their relationship with each other and certain aspects of the affairs and their dealings with the Group.

On 21 August 2003, the Group completed its acquisition of an additional 30% equity interest in Harbin Brewing (Songjiang) Company Limited at a consideration of approximately HK$13 million, resulting in Harbin Brewing (Songjiang) Company Limited becoming 100% owned by the Group.

PURCHASE, REDEMPTION OR SALE OF THE COMPANY'S LISTED SECURITIES

Neither the Company, nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the year.

COMPLIANCE WITH THE CODE OF BEST PRACTICE

In the opinion of the directors, the Company has complied with the Code of Best Practice (the "Code") as set out in Appendix 14 of the Listing Rules of the Hong Kong Stock Exchange, throughout the accounting period covered by the annual report, except that the non-executive directors of the Company are not appointed for specific terms as required by paragraph 7 of the Code, but are subject to retirement and re-election at the general meeting of the Company in accordance with the Company's articles of association.