# SAN MIGUEL BREWERY HONG KONG LTD.

***INTERIM REPORT***
***January to August 1999***

# The Directors' Statement

*To Our Shareholders:*

## Interim Results

The directors of San Miguel Brewery Hong Kong Limited ("the Company") are pleased to announce **the unaudited consolidated results** of the Company and its subsidiaries ("the Group") for the eight months ended 31st August 1999 as follows:

| *8 months ended 31st August* | **1999 $'000** | 1998 *$'000* | Increase / (Decrease) |
|---|---|---|---|
| **Turnover** | **857,648** | 849,848 | 1% |
| **Operating profit** | **65,465** | 25,342 | 158% |
| **Other (expenses)/income** | **(22,223)** | (10,429) | (113%) |
| **Profit from ordinary activities before taxation** | **43,242** | 14,913 | 190% |
| **Taxation** *(Note 2)* | **358** | 4,714 | (92%) |
| **Profit after taxation** | **42,883** | 10,199 | 320% |
| **Minority interests** | **(2,127)** | 222 | |
| **Profit attributable to shareholders** | **45,011** | 9,977 | 351% |
| **Dividends** | | | |
| First interim dividend of $0.02 per share (1998:nil) | **7,471** | 0 | |
| Second interim dividend of $0.03 per share (1998:$0.01) | **11,207** | 3,736 | |
| **Retained profit for the year** | **26,333** | 6,241 | 501% |
| **Earnings per share** *(Note 3)* | **$0.120** | $0.027 | 351% |

*Notes:*

1. *In this report, all monetary values are expressed in Hong Kong dollars unless stated otherwise.*
2. *Taxation charge is made up as follows :*

| | ***1999 $'000*** | *1998 $'000* |
|---|---|---|
| *Hong Kong profits tax* | ***78*** | — |
| *Overseas taxation* | ***280*** | *4,714* |
| *Deferred taxation* | **—** | — |
| | ***358*** | *4,714* |

*Hong Kong profits tax of $78,000 has been provided against the profit of a subsidiary which derived property income from rentals.*

*No provision for Hong Kong profits tax has been made against income from beer operations (1998: nil) as deductible allowances applied to the profit for the period have eliminated tax which would have been assessed in their absence.*

*Overseas taxation is calculated at the appropriate tax rates on the estimated assessable overseas profits for the period.*

*Deferred taxation is provided at the current rates on time differences to the extent that a liability is expected to crystallize in the future.*

3. *The calculation of earnings per share is based on profit for the period of $45,011,000 (1998: $9,977,000) and 373,570,560 shares (1998: 373,570,560 shares) in issue during the period.*

## Interim Dividends

A dividend of $0.02 per share was declared for the first interim of the year 1999. The directors have declared a dividend of $0.03 per share for the eight months ended 31st August 1999 payable on Friday, 29th October 1999 to shareholders of record on Tuesday, 19th October 1999.

## Closure of Transfer Books and Register of Members

The Transfer Books and Register of Members of the Company will be closed from Tuesday, 19th October 1999 to Wednesday, 20th October 1999, both days inclusive. To qualify for the dividend, shareholders should ensure that transfers are lodged at the Company's share registrars, Central Registration Hong Kong Limited, at 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong for registration not later than 4:00 p.m. on Friday, 15th October 1999.

## Review and Prospects

Against a background of consumer price deflation, competition in the beer markets in Hong Kong and southern China has been even more intense than last year. However, the improvement in the Group's financial results has continued, building on the gains made last year and as forecast to shareholders at the 1999 Annual General Meeting. The improvement is particularly evident in our Hong Kong operations, but less so in the markets served by our subsidiaries in Guangzhou and Shunde. Both subsidiaries have suffered from severe price competition and also from the requirement of the PRC for all brewing companies to replace returnable bottle stocks with a consequent increase in operating costs. Bottle usage costs are expected to decline in the year 2000 and beyond.

Sales revenue rose 1%, reflecting a combination of increased sales volume in both Hong Kong and southern China offset by lower export volume.

Operating profit increased 158%. As in the previous year, 1999 has seen a further improvement in operating profit from beer production and distribution, with lower dependence on investment income.

Net profit attributable to shareholders for the period to end August 1999 was $45.011million, an increase of 351% from the same period last year. Earnings per share increased similarly by 351% to 12 cents per share.

The Group's trading for the eight months to end August 1999 continued to be strongly cash positive, pursuant to high depreciation charges and low capital expenditures, a situation which is not anticipated to change in the foreseeable future. Cash reserves as at the end of August 1999 were 81 cents per share, equivalent to 62% of the market capitalisation of the Company at that time.

In Hong Kong, the programmes initiated at the end of 1997 are now proving very effective in addressing the three major priorities which were identified at the time by the Company. These were, stabilisation of market share, early return to operating profitability and maximisation of positive cashflow. The operating profitability improvement is particularly gratifying for the first eight months to end August 1999, and has made a major contribution to the Group's year to date performance. Market share has shown marginal growth. For the first time since 1988, overall sales volume for the period have increased over the previous year, while industry volume fell 3.5%.

The improved profit performance in Hong Kong has been driven also by the aggressive review of the cost base, which was initiated nearly 2 years ago, and is now producing notable benefits, particularly in the area of fixed costs which have been reduced by $18.869 million for the eight months to August 1999 compared with the previous year and by $33.040 million compared with the first eight months of 1997. These savings are permanent.

The aggressively competitive beer market coupled with price deflation in Hong Kong has put pressure on our pricing and our ability to maintain net sales value. The Company's performance in this area, however, has been helped by the sales initiatives we took last year to improve our service and support to customers.

The Company has continued to maintain a high level of marketing investment in the exploitation of our "Take A Fresh Look" campaign. The results of this campaign show very good response from our consumers and, pleasingly, this positive response is evident across most age groups.

With the recent plant closure by a competitor, the Company is now the only major brewery in Hong Kong, with its modern facility in Yuen Long. Consumer research confirms the perception of San Miguel as Hong Kong's beer.

In China, while its economy weathers the storm caused by Asia's economic problems and gradually gains strength, private consumption has remained weak. Since last year, the rate of beer industry growth has decreased to about 5% compared to double digit rates over the past decade. The industry is going through a consolidation phase as a result of overcapacity and consequent intense competition.

The recent introduction of 'B' bottle regulation, a safety measure, requiring all breweries to use only bottles bearing the embossed 'B' letter has created cost and funding pressures on the industry. Consumer demand for beer is growing mainly in the lower-priced segments causing a significant decline in demand for premium beers.

Despite these impediments, sales volume in southern China grew nearly 2% due mainly to the increasing demand for our popular lower-priced brand, Valor. The Valor brand was launched last year in anticipation of the shift in market demand. While San Miguel Pale Pilsen volume was reduced significantly pursuant to the weak demand for premium beers, the decline was more than offset by the increase in the sales volume of Valor. However the higher proportion of popular brand sales volume caused revenue to fall by 3%.

The significant cost increase resulting from the replacement of a large volume of non-B bottles together with lower average selling prices has caused overall operating profit to fall substantially compared to the same period last year.

In order to ensure future growth, synergy and optimisation of resources, both our subsidiaries in Guangzhou and Shunde have streamlined their respective organisations and reorganised their marketing structures. In Guangzhou the 'Lightboat 21 Programme' was implemented whereby excess and non-core employees were retired to be employed by an independent servicing company. In total, 161 employees will be retired in 1999 and another 100 in the year 2000.

In order to strengthen our focus on making our sales operation more profitable we have capitalised on the use of carefully selected third-party distributors to play a more active and participative role in our sales and marketing effort.

These projects are achieving substantial reductions in our operating costs and increasing our competitive strength in the market.

We will continue the momentum in our drive to reduce costs, expand further the market initiative for our Valor brand and defend our leadership position in the premium beer segment.

The significantly improved results of the Group forecast for 1999 by the Board of Directors at the end of last year are now arriving and are expected to be sustained. It is, therefore, pleasing for the directors to declare a second dividend for 1999, and to anticipate further dividend distribution to shareholders for the remainder of the year.

## Disclosure of Interests

As at 31st August 1999, the directors and their associates had the following beneficial interests in the issued share capital of the Company and its associated corporations as recorded in the register required by Section 29 of the Securities (Disclosure of Interests) Ordinance ("SDI Ordinance"):

| *Name* | *Number of ordinary shares of $0.50 each in the Company* | | |
|---|---|---|---|
| | *Personal Interests* | *Corporate Interests* | *Total* |
| F.C. Eizmendi, Jr. | 2,816 | — | 2,816 |

Save as disclosed herein, none of the directors or their associates had any interests in the issued share capital of the Company or any of its associated corporations.

## Substantial Interests in the Share Capital of the Company

As at 31st August 1999, according to the register required by Section 16(1) of the SDI Ordinance, the Company was notified that the following shareholders had an interest of 10% or more of its issued share capital:

| *Name* | *Ordinary shares held* | *Percentage of total issued shares* |
|---|---|---|
| Neptunia Corporation Limited | 245,720,800 | 65.78% |
| HKSCC Nominees Limited | 70,110,301 | 18.77% |

*Note:*

*San Miguel Corporation ("SMC"), San Miguel International Limited ("SMIL"), San Miguel Holdings Limited ("SMHL") and San Miguel Brewing International Limited ("SMBIL") are all deemed to hold the above disclosed interest of Neptunia Corporation Limited in the Company because SMC has a controlling interest in SMIL, SMIL has a controlling interest in SMHL, SMHL has a controlling interest in SMBIL and SMBIL has a controlling interest in Neptunia Corporation Limited.*

Save as disclosed herein, the Company has not been notified of any other interests representing 10% or more of the Company's issued share capital.

## Purchase, Sale and Redemption of the Company's Listed Shares

During the period, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of its listed shares.

## Year 2000 Compliance of Computing Systems

*Hong Kong*

Compliance, including testing, of 97% of all systems was achieved by the end of September 1999. Full compliance is expected to be achieved by the end of September 1999.

The outstanding items relate principally to brewhouse equipment at our Yuen Long Brewery where compliance will be achieved in September this year following final inspection and testing by the contractor who installed the equipment.

The Company has surveyed all of its suppliers and major customers with respect to their Year 2000 compliance progress with a high response rate.

Contingency plans are in place, the principal component of which will involve a build up in both raw material and packaging supplies and finished goods of an additional several weeks requirement prior to the end of December 1999.

Outstanding capital expenditure to complete compliance is approximately $400,000 which was incorporated in the 1999 budget.

While the Company cannot give guarantees, we are confident that the turnover to the year 2000 will be managed without disruption.

*PRC*

Full compliance is expected to be achieved in September 1999 based on current progress.

Suppliers and customers have been surveyed and where there are concerns, contingency plans have been prepared.

A principal concern is with the supply of utilities. Back up generators will cover any break in power supply, however a cessation of water supplies can only be overcome for a period by building up stocks of finished goods.

Contingency plans have been developed for a build up of several weeks' stock of raw materials, packaging and finished goods at the year end.

Training has been carried out for manual operations of production equipment to cope with any unforeseen failures.

As at the end of August 1999 outstanding capital expenditure required to complete compliance was $120,000.

## Compliance with the Code of Best Practice

None of the directors are aware of information that would reasonably indicate that the Company is not, or was not for any part of the accounting period covered by the interim report, in compliance with the Code of Best Practice as set out in Appendix 14 of the Listing Rules of The Stock Exchange of Hong Kong Limited.

In accordance with the Code of Best Practice, the Board of Directors has established an audit committee on 1st January 1999 to review and supervise the Company's financial reporting and internal control systems. The audit committee now consists of three of the Company's independent non-executive directors.

**Francisco C. Eizmendi, Jr.,**
*Chairman*

**John L. Dunwell,**
*Managing Director*

Hong Kong, 24th September 1999