

MANAGEMENT DISCUSSION AND ANALYSIS

FINANCIAL PERFORMANCE AND POSITIONS

For the six months period under review, the Group's consolidated turnover decreased by 54% to approximately HK\$2,449 million when compared with the corresponding period. The decline is mainly due to the exclusion of the turnover of Downer EDI Limited ("Downer"), which is no longer consolidated in the accounts of the Group. Excluding the turnover of Downer for the corresponding period, turnover recorded a drop of approximately 17% mainly due to the decrease in construction work in the building sector.

The Group's profit from operations decreased by 82% to approximately HK\$37 million. Such decrease was mainly due to the exclusion of Downer's contribution from operating profits and its reflection as share of results of associates, and the severe competition in the construction market which reduced contract margins. Share of results of associates and jointly controlled entities registered a profit of about HK\$42 million which was mainly attributable to the contribution from Downer. Net investment income of about HK\$23 million comprised mainly interest income. Profit for the period was HK\$55 million and basic earnings per share was 5.6 cents.

I would like to draw your special attention that since Downer ceased to be a subsidiary in mid February 2001 and given that Downer is separately and independently listed on the Australian Stock Exchange, the Group's results for this period refer only to those publicly available information published by Downer. As such, only three months results of Downer ended 30th June, 2001 have been accounted for in the Group's results for this period.

In addition, in order to provide a closer comparative basis between the Group's results for this period and those for the same period in the last financial year, the following proforma comparison has been prepared for your reference. Such proforma presentation was prepared on the basis as if Downer was equity accounted for and reflected as a share of results of associates for the six months ended 30th September, 2000.

	Six months ended	
	30/9/2001 HK\$'000	30/9/2000 HK\$'000
Turnover	2,449,359	2,965,105
Cost of sales	(2,343,470)	(2,766,748)
Gross profit	105,889	198,357
Other revenue	23,829	13,629
Amortisation of goodwill	(1,153)	(1,153)
Administrative expenses	(91,503)	(99,546)
Other operating expenses	-	(12,724)
Profit from operations	37,062	98,563
Finance costs	(24,251)	(20,164)
Investment income (expenses) – net	22,669	(110,232)
Loss on disposal and dilution of interests in subsidiaries	-	(62,160)
Share of results of associates	40,007	55,679
Share of results of jointly controlled entities	2,100	-
Profit (loss) before taxation	77,587	(38,314)
Taxation	(18,638)	(10,706)
Profit (loss) before minority interests	58,949	(49,020)
Minority interests	(3,689)	(8,085)
Profit (loss) for the period	55,260	(57,105)

When compared with the Group's financial position as at last year end, the total assets of the Group decreased slightly by 4% to some HK\$5,930 million and net current assets increased by 11% to some HK\$428 million. Current assets have been maintained at 1.2 times of current liabilities. The net debt to equity ratio increased slightly by 0.06 to 0.26 times at this period end. As a result of the decrease in exchange reserves amounting to some HK\$8 million due to the depreciation of the Australian dollars in relation to the Group's interest in Downer, dividend payable of HK\$10 million and the profit of HK\$55 million during this period, shareholders' funds increased by 1% to HK\$2,872 million.

OPERATIONS

Contracting and construction materials

During the period, the Group secured new contracts with an aggregate attributable value of approximately HK\$1,620 million, which comprised some HK\$711 million of building construction contracts, some HK\$728 million of civil engineering contracts and some HK\$181 million of specialist works. Contracts on hand at this period end increased by 9% to approximately HK\$12,243 million while the value of work remaining decreased by 5% to approximately HK\$5,168 million when compared with the last financial year end. The profile of contracts on hand at the end of this period is as follows:

	Value of contracts on hand as at 30/9/2001 HK\$'million	Value of work remaining as at 30/9/2001 HK\$'million
Building construction	9,525	3,976
Civil engineering	2,343	933
Specialist works	375	259
	12,243	5,168

Some of the major contracts are as follows:-

	Value of contracts on hand as at 30/9/2001 HK\$'million	Value of work remaining as at 30/9/2001 HK\$'million
Cheung Kong Center, Central	3,054	462
Cyberport Development (Contract C1)	1,131	783
The Victoria Towers, Tsim Sha Tsui	951	650
Ko Cheung Court, Ko Chiu Road	937	362
Harbourfront Landmark, Hung Hom	800	227
Lei Yue Mun Estate, Phase 1	796	421
Tiu Keng Leng Stations & Tunnels (MTRC Contract 602) – 70% joint venture	709	114
Site Formation for Lamma Power Station Extension	724	589
Others	3,141	1,560
	12,243	5,168

Subsequent to the period end, the Group secured further new contracts with an aggregate attributable value of approximately HK\$184 million, which comprised some HK\$103 million of civil engineering contracts and some HK\$81 million of specialist works.

Contracts continued to progress well, in general, though margins were reduced due to difficult construction market conditions. In Hong Kong, the turnover in relation to building construction projects and specialist works dropped while civil engineering activities increased as compared with the corresponding period. Both building and civil engineering works made positive contribution to the operating margin while specialist works suffered a loss due to severe competition in the market.

The construction materials division continued to encounter difficult trading conditions with revenue dropping and loss suffered. Intensive and constructive measures have been implemented to improve the situation and to reduce the loss. Therefore, no significant adverse impact on the Group's overall financial performance is expected.

Property, hotel and catering operations

Total value of the property portfolio, excluding those self-occupied properties, amounted to some HK\$1,255 million as at the period end, equivalent to 21% of the total assets of the Group. Included in the property portfolio are Paul Y. Centre, the Group's headquarters in Kwun Tong, Best Western Rosedale on the Park in Causeway Bay, Cathay Lodge and In-Zone in Wanchai and 2 investment properties in the PRC.

Although the overall rental rates of the investment properties had been reduced, the occupancy rate was maintained at the satisfactory level of around 92% at the period end. In-Zone has been 86% let at the period end. Sales of properties were satisfactory during the period which contributed HK\$14 million to the operating margin. Properties held for resale at the period end comprised of some unsold residential flats of Cathay Lodge. Hotel and catering business was severely affected by the stagnant economy and the 911 Event. Intensive measures were implemented to reduce operating costs and to achieve positive operating margin in the remainder of this financial year.

MAJOR ASSOCIATES – DOWNER

Downer reported a revenue of A\$1,604 million (HK\$6,416 million) and a net profit after tax of A\$46 million (HK\$184 million) for the year ended 30th June, 2001. As at 30th September, 2001, the Group holds 352,727,322 shares in Downer which is equivalent to about 44.6% of the then issued ordinary share capital or about 35.2% on a fully diluted basis.

Subsequent to the acquisition of Evans Deakin Industries Limited, Downer has completed its divestment from non-core assets. Downer is now operating with five major divisions, namely Downer Engineering, Works Infrastructure, Roche Mining, Century Resources and EDI Rail.

Downer Engineering, with more than 3,000 employees, is focusing on power and telecommunication infrastructure maintenance as well as process engineering and capital works.

Works Infrastructure, with about 2,750 employees, continues to target the road and rail track maintenance as well as bitumen services, other utilities and infrastructure maintenance services.

Roche Mining, with excess of 1,400 employees, is also focusing on a diversified range of mine management and maintenance services in addition to its traditional open-pit, underground and high-wall contract mining services.

Century Resources, with over 400 employees, offers extensive drilling services in the oil and gas, mineral and geothermal sectors.

EDI Rail, with over 1,000 employees, is the largest provider of locomotive and rolling stock manufacturing and maintenance services in Australia and New Zealand. In addition, it also designs and builds equipment and foundry services for the sugar milling, general engineering and energy sectors.

With Downer on a well defined focus on outsource utility and infrastructural maintenance services sector, the Group is expected to benefit from such successful strategy on a long term basis.

MAJOR INVESTMENT – CHINA STRATEGIC HOLDINGS LIMITED (“CHINA STRATEGIC”)

The 17.45% equity interest in China Strategic, a diversified investment holding and property group with its shares listed on the Stock Exchange, continues to be a long-term strategic investment of the Group. It is expected that the Group will benefit not only from the investment in but also the business networking capabilities of China Strategic in China.

LIQUIDITY AND CAPITAL RESOURCES

The Group currently maintains a variety of credit facilities to meet its working capital requirements. During the period, the Group obtained new bank loans in the amount of HK\$695 million. The loans bear interest at market rates and are with terms of repayment ranging from one year to eight years. The proceeds were used for general working capital purposes and to refinance the repayment of the convertible note. As at 30th September, 2001, the Group's total borrowings amounted to HK\$1,106 million with HK\$353 million repayable within one year and HK\$753 million repayable after one year. Cash balances at 30th September, 2001 amounted to HK\$349 million.

As at the period end, all of the Group's borrowings bear interest at floating rates and are denominated in Hong Kong dollars. The Group's gearing ratio decreased from 0.41 at last year end to 0.39 which is calculated based on the total borrowings of HK\$1,106 million and the Group's shareholders' funds of HK\$2,872 million.

NUMBER OF EMPLOYEES, REMUNERATION POLICIES AND SHARE OPTION SCHEME

Including the directors of the Group, as at 30th September, 2001, the Group employed a total of 2,050 full-time employees. Remuneration packages comprised salary and year-end bonuses based on individual merits. No share options were granted or exercised during the period.

PLEDGE OF ASSETS

As at 30th September, 2001, certain of the Group's properties, listed shares and debtors with an aggregate value of approximately HK\$1,598 million and the issued shares of certain subsidiaries of the Company and its benefits under certain construction contracts, have been pledged to banks and financial institutions to secure general credit facilities granted to the Group.

SECURITIES IN ISSUE

As at 30th September, 2001, there were 992,488,392 shares in issue and outstanding share options over a total of 54,449,206 shares. Subscription prices remained at HK\$0.6048 and HK\$0.5552 for the share options over 38,349,206 shares and 16,100,000 shares respectively.

OUTLOOK

Looking ahead, in the remainder of this financial year, the local construction market conditions will remain difficult, tendering opportunities will be fewer and intensified competition among construction companies for new work is expected and tender prices will be further driven down.

Though facing these difficulties, the Group has responded swiftly by implementing cost reduction measures to maintain its cost competitiveness. These measures include reduction in number of staff, salary cut from director grade to managerial and supervisory staff, improvement in work efficiency at head office and site level, strengthened procurement process and numerous overhead cost saving exercises. With competitive pricing and track records of delivering quality services to its customers, the Group is confident in securing new work in local construction market. Mainland China is the area which provides ample opportunities for the Group's business growth. With established track record and networking in China since the late 80's, the Group has further plans of forming alliances to take advantage of the business opportunities created by China's entry to World Trade Organisation and hosting of the 2008 Olympic Games.

In Australia and the South Pacific region, Downer has continued to increase its forward order book and, as the global trend towards outsourcing engineering services continues, its outlook is encouraging and promising. With its track record of steady earnings growth, our Board is confident that Downer will continue to enhance the Group's ability to maintain a stable income stream and create investment value.

In the years to come, the Group will continue its business and investment diversification strategy by venturing into the China market and investment with earnings growth. Barring unforeseeable circumstances, the Group is well positioned to capture its prospects and meet the challenges ahead.