

Chairman's Statement and Management Discussion and Analysis

I am pleased to report the activities of South China Industries Limited (the "Company") and its subsidiaries (together the "Group") for the year ended 31 December 2002.

BUSINESS REVIEW

The Group recorded a turnover for the year ended 31 December 2002 of HK\$1,707.9 million which showed a slight decrease of 0.7% as compared to the previous year despite the difficult operating environment. Profit from operations for the year ended 31 December 2002 amounting to HK\$10.2 million representing a significant revival of the Group's performance over last year. The turnaround of the Group's operating result was mainly attributable to the improved results of Wah Shing International Holdings Limited ("Wah Shing") as well as the contribution from the growth in operating profit of the Groups' leather shoes and garment operations. A net gain on disposal of subsidiaries of HK\$99.8 million was realized in the current year resulting from the financial restructuring of South China Information and Technology Limited ("SCIT") (now known as Guorun Holdings Limited) and the disposal of the Group's 49% equity interest in Wah Shing Electronics Company Limited ("WSE") which were both completed during the year (details of these disposals were set out in Material Acquisitions and Disposals of Subsidiaries and Associates section below). Profit attributable to shareholders amounted to HK\$15.2 million which was a marked improvement from a net loss of HK\$137 million of the previous year. The Group shared a loss on interest in associates of HK\$75 million relating to the provision of Group's property projects due to declining property market in the year 2002.

Manufacturing and trading business

Wah Shing recorded satisfactory profit albeit in difficult economic conditions. Turnover of Wah Shing increased by 8% comparing to the prior year. Gross profit margin and net profit improved due to its continuous efforts in corporate restructuring, streamlining and relocating of existing operations, changing product mix and stringent overhead control.

During the year, Wah Shing acquired additional 49% and 2% interests in WSE from a wholly owned subsidiary of the Group and an independent third party respectively. WSE became a 70% owned subsidiary of Wah Shing group. This was done to group WSE, a toy-related electronics manufacturing company, under our key toy-manufacturing group, Wah Shing. Consequently, the Group's effective interest in WSE was diluted from 59% to 37%.

Revenue from WSE dropped because of the loss of business resulting from the corporate failure of a major customer and the shrinkage in demand of high-end electronic toys as a result of weaker consumer spending.

Nority International Group Limited ("Nority") found the year under review a difficult year for its operations. Its customers were very cautious in placing their orders given the global economic downturn and this caused the decrease in both turnover and operating results of the year by 22% and 51% respectively. The net profit for the year 2002 was HK\$7.7 million.

Turnover of trading of leather shoes operations and garment operations both showed an encouraging growth when compared with the previous year. This was attributable to the success of their marketing efforts and the support of their major customers. The performance of these operations was greatly improved.

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Legal proceedings which are instituted by the Group against the subordinate corporations of Tianjin Second Bureau of Light Industry, our Chinese partner in tools and a tannery, and against the subordinate corporation of the Head of Tianjin Garment Company Limited, our Chinese partner in garment manufacturing, which are in breach of the Joint Venture Agreements are still in progress.

Information and Technology and related business

Compared to 2001, turnover from the information and technology ("IT") related businesses declined by 23% from HK\$109.0 million to HK\$83.8 million. However, the loss attributable to the Group from IT operations narrowed down from HK\$7.4 million in 2001 to HK\$1.9 million in 2002 as a result of restructuring of business operations throughout 2002.

Property Development and Investment

After the acquisition of the entire property portfolio from the disposed subsidiary SCIT in mid-2002, rental revenue and profit attributable to the Group rose to HK\$11.1 million and HK\$6.3 million respectively. The occupancy rate of the investment properties improved despite the average rent per square foot dropped as a whole.

The 30% owned property project, "The Centrium" in Central had leased out about 60% of its total rentable area by the end of 2002. Another 20% owned property development project, a residential and commercial complex in Shanghai was put on sale and well received in 2002 due to the active property market environment in there. Completion on these sales will be in 2003.

Travel and Related Services

The travel industry worldwide generally recovered in 2002 from the September 11 incident in the US. However, the operating environment remained harsh with intense price competition. The travel and related services operated mainly through Hong Kong Four Seas Tours Limited ("Four Seas Travel"), a company with a solid history in the travel industry for over 30 years benefited from the devoted efforts of its sales team and reported the increase in both turnover and profit in 2002.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2002, the Group had cash and bank balances of HK\$129.4 million. The Group had a current ratio of 1.2 and a gearing ratio (long-term bank borrowings of HK\$72.7 million over equity of HK\$665.8 million) of approximately 10.9%. The Group's operations were mostly financed by both bank borrowings and internal resources.

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EXPOSURE TO FLUCTUATIONS IN EXCHANGE RATES AND RELATED HEDGES

As at 31 December 2002, the Group had no significant exposure to fluctuations in exchange rates and any related hedges.

CAPITAL STRUCTURE

The Group had no other debt securities or capital instruments as at 31 December 2002 and up to the date of this announcement.

PROSPECTS

Manufacturing and trading business

Wah Shing group will strive to upgrade its product engineering, machinery and equipment for production as well as computer applications in order to capture large volume orders and promotional items. Efforts will be made to source raw materials in the PRC to counteract the recent rise in plastic price driven by the fear of war in the Middle East. Additional sewing capacity has been set up in western part of Guangdong to leverage the relatively lower labour wages in the area and it is anticipated to begin operation in the middle of 2003. Dedicated attention will be given on monitoring the credit risks against any possible corporate failure of the overseas customers.

The leather shoes and garment trading and manufacturing businesses are to a certain extent also affected by the frightening news of atypical pneumonia in late March this year. Some of the new overseas customers have already deferred their trips to visit our operations in Hong Kong and the PRC until later this year depending on the health situation. We expect these operations will sustain a steady profit though their growth may not be as good as the last year.

Nority believes the consumer market of Mainland China is full of potential and opportunities. It has already invested in Dingshanhu Town, Kunshan City, Jiangsu Province, where it is taking its first step to commence construction of a production plant. Continuing efforts will be made to reduce costs and explore new markets to cope with the adverse influence of the global economic downturn on its operations.

Information and Technology and Related Business

The progress varies substantially among the joint ventures engaging in the IT business in the PRC. We intend to scale down all unprofitable joint ventures and to concentrate resources on those profitable ones. One of the joint ventures in Chongqing concluded a system development project with the local tax authority at the end of 2002. We are exploring the possibility to market the system which is applicable to the tax bureaus across the whole country.

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Property Development and Investment

The property letting market for commercial and industrial properties is expected to stay stagnant or weak in 2003. Rental income from the Group's investment properties should remain around the same level in this year. More flexible terms will be offered to attract and retain tenants. Poor occupancy properties will be renovated to increase marketability. The Group will benefit from the profitable sales of the recently completed Shanghai property development project in the year 2003.

Travel and Related Services

Four Seas Travel generated reasonable profit early in the year, but the situation has rapidly changed since then. The tourist industry, particularly the routes related to the mainland, is now greatly affected by the outbreak of atypical pneumonia in Hong Kong and China. Revenue from our travel and related services is likely to decline in the first half of 2003. Immediate actions have been taken in mitigating the impacts in order to survive the difficult periods to come. Staff policy and general operating costs are immediately revised to be more variable and responsive to cater for any sudden changes. We believe that with the strong foundation laid down by Four Seas Travel in the past years as one of the top consolidators in the air-ticketing industry, it will be one of the quickest among its competitors to get back on track when the market rebounds.

Notwithstanding the spread of the disease, the Group will continue to keep an eye on the PRC travel market in the long run. A first established office in Guangzhou has obtained its license to operate in April this year.

MATERIAL ACQUISITIONS AND DISPOSALS OF SUBSIDIARIES AND ASSOCIATES

SCIT, previously a listed subsidiary of the Company, completed a financial restructuring ("Financial Restructuring") on 28 June 2002. The effects of the Financial Restructuring on the Group were the acquisition of the entire property portfolio of SCIT together with the related mortgages, 49% equity interest of its travel related business and a number of its subsidiaries engaged in information and technology related businesses in the PRC (the "Acquisition") and the dilution of the Group's equity interest in SCIT to 7.17% (the "Deemed Disposal"). The Company paid an aggregate consideration of HK\$239 million to SCIT for the Acquisition of which HK\$238 million was used to set off its outstanding loans due to the Company and the remaining HK\$1 million was paid in cash. Simultaneously, the Company received HK\$65 million in cash from SCIT out of the Deemed Disposal as partial repayment of the balance of its outstanding loans due to the Company. Subsequently, the Group disposed of part of its remaining interest in SCIT (the "Disposal"). As a result of the Deemed Disposal and the Disposal, the Group in total realised a gain amounting to HK\$91.2 million.

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On 30 July 2002, the 49% equity interest in WSE previously held by a wholly-owned subsidiary of the Company was sold to a wholly-owned subsidiary of Wah Shing group for a cash consideration of HK\$56 million. The Group realised a deemed gain of approximately HK\$9.0 million.

On 13 December 2002, the Group acquired the remaining 51% equity interest in travel related business from Shanghai Century Holdings Limited (formerly known as Fourseas.com Limited) ("SCHL") for an aggregate consideration of HK\$8 million of which HK\$0.5 million was satisfied in cash and the remaining HK\$7.5 million was satisfied by a set off against an equivalent amount owed from SCHL to the Group.

CHARGES ON ASSETS

As at 31 December 2002, details of charges on assets of the Group are set out in note 43 to the financial statements.

CONTINGENT LIABILITIES

As at 31 December 2002, details of the Group's contingent liabilities are set out in note 42 to the financial statements.

EMPLOYEES

As at 31 December 2002, the total number of employees of the Group was approximately 15,000. Employees' cost (including directors' emoluments) amounted to approximately HK\$325.2 million for the year.

The Group considers its employees as its most valuable asset. In addition to salary, other fringe benefits such as medical subsidies, provident fund and subsidised training programmes are offered to all employees of the Group. Performance of the employees is normally reviewed on an annual basis with adjustment compatible to the market. Individual employee may also receive a discretionary bonus at the end of each year based on performance. The Company adopted an employee share option scheme on 31 May 2002.

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APPRECIATION

On behalf of the Board, I wish to express my gratitude to our customers and shareholders for their continued support and all our staff members for their hard work and dedicated services.

On behalf of the Board
Ng Hung Sang, Robert
Chairman

Hong Kong Special Administrative Region
of the People's Republic of China
25 April 2003