Management Discussion and Analysis

"The Group's repositioning as a Mainland oriented enterprise progresses smoothly. Our leading position in the cement markets in Chongqing and Guizhou paves the way for further advances to nearby provinces. The first phase of our large-scale property development project in Shanghai will be launched for pre-sale later this year and should provide a significant and steady income stream for the Group."

Choi Yuk Keung, Lawrence
Managing Director

CONSTRUCTION IN HONG KONG

Turnover for the year continued to decrease materially to HK$1,773 million, a reduction of 39% compared with HK$2,916 million last year. This, together with declining operating margins, led to a pre-tax profit of only HK$27 million for the construction division, representing a 67% decline from the previous year. The public housing programme, which used to provide abundant opportunities for construction and related industries, shrunk substantially following the suspension of the Home Ownership Scheme (HOS). Notwithstanding the continuation of the Government's policy towards public rental apartments, the glut of flats overbuilt in previous years meant opportunities even in this category were limited. Compared with the peak period a few years ago when more than 50 new public housing projects from the Hong Kong Housing Authority (HKHA) were available for tender each year, the current financial year saw no more than ten tenders, of which fewer than half were subsequently awarded.

Margins on successful tenders on non-housing government contracts, including those in the design and build category, as well as private sector works also remained extremely thin. In an increasing number of cases, certain contractors even put forward bids with negative margins, which your Group was unwilling to match.

In anticipation of the significant downturn in business, your Group expedited downsizing during the year and cut salaries with the support of our loyal and dedicated staff, with a view to evolving further into a lean and competitive organisation catering to a far smaller Hong Kong market but flexible enough to rapidly expand should a turnaround in the market materialise. Emphasis on tendering continued to be switched to works of the Architectural Services Department (ASD), which were more varied and often involved design and build capabilities. This shift, together with our attempt to gain market share in maintenance works, has met with some success.

Overall, however, recovery in the construction industry is not expected in the next two years given that the economy is still in a trough.

Public Housing – Shui On Building Contractors Limited (SOBC)

The amount of public housing works performed for the HKHA totalled HK$1.0 billion, equivalent to only 51% of the turnover last year. Four contracts were completed, comprising 5,130 residential units, which included Po Lam Road Housing Development Phase 5, Yau Tong Estate Phases 3 and 5 and Tseung Kwan O Area 59 Phase 9.

Only four maintenance contracts worth a total of HK$390 million were won due, as stated earlier, to contractors scrambling for a very limited portfolio of HKHA works with unrealistic tender prices.

The outlook in the coming year is slightly more promising as more than ten new HKHA contracts are in the pipeline. It is also possible that one or two pilot projects will be available for tendering by the six selected members of the Premier League of Contractors, of which SOBC is one.

Yau Tong Estate Phase 3 is one of the four public housing construction projects completed by SOCAM for the Housing Authority during the year

The Departmental Quarters at Hong Ning Road – the construction division continues to switch its focus to tendering for works of the Architectural Services Department

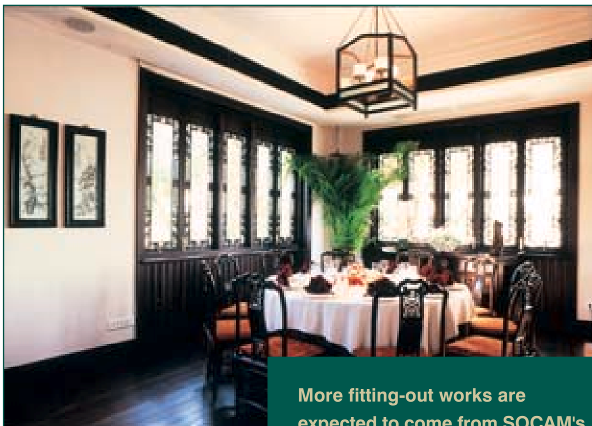
Other Government and Institutional Buildings – Shui On Construction Company Limited (SOC)

The Departmental Quarters project at Hong Ning Road was completed for the ASD. With a much more stringent assessment standard on technical abilities and past performance, SOC won three Government and institutional contracts even though its tender sums were not the lowest. These contracts were for the Welfare Complex at Lai King Headland, the Radiotherapy and other departments at Princess Margaret Hospital, and the Clinical Department Extension of the Prince of Wales Hospital. Together with the contracts for Buildings 7 and 8 of the Science Park and Housing Development at Shatin Area 2B Hin Wo Lane, total sums secured during the year reached HK$1.4 billion, which was encouraging under the depressed market conditions. Spending in excess of HK$15 billion is on the drawing board for more ASD projects for 2003/04, including a variety of educational, health, recreational and other facilities ancillary to the large number of public housing units completed in the past few years.

Renovation and Fitting-out – Pat Davie

In the sluggish economy, property owners, institutions and public organisations were hesitant to incur expenses on major renovation and fitting-out contracts. The total value of projects completed declined further to around HK$170 million, compared with HK$209 million the year before. The dismal occupancies of most luxurious hotels subsequent to the SARS outbreak in March look certain to abort a number of refurbishment plans of a few major hotels, which Pat Davie should have been well placed to compete for following the completion of a renovation contract for the Mandarin Oriental Hotel during the year. Exceptions are the Disneyland hotels for which Pat Davie has pre-qualified as a specialist contractor and which could translate into contracts of substantial value. Despite the trimmed budget allocated to educational institutions, a reasonable stream of work is still available, and Pat Davie's specialisation in this sector has produced a number of contracts. To cope with the shrinking market, Pat Davie has continued to downsize its workforce.

Contrary to the stagnant situation in Hong Kong, works provided by the substantial development projects of the privately held Shui On Properties Limited (SOP) in Shanghai and Hangzhou are increasing rapidly, providing an opportunity for meaningful turnover and contributions in the next few years.



More fitting-out works are expected to come from SOCAM's privately held sister company in the Chinese Mainland

The construction division received 14 gold, silver and bronze awards in the Safe Working Cycle Award Presentation

Contracts on Hand

At 30 June 2003, the gross and outstanding value of contracts on hand of the Construction Division amounted to approximately HK$5.3 billion and HK$3.6 billion respectively which, although at a level much lower than those of previous years, can still provide a steady workload for the division subsequent to the downsizing exercise already implemented.

Health, Safety and the Environment

In 2002, SOCAM further enhanced its safety record with its overall accident rate dropping to 21 per 1,000 workers, representing a substantial improvement of 36% compared with 2001. The overall accident rate for the construction industry in Hong Kong in 2002 was 85 per 1,000 workers.

The Group's outstanding safety performance was widely recognised by the industry. Management was invited to speak on managing subcontractors' safety performance at the International Safety and Health Expo 2003. The company was also honoured with the Gold Award for Safety Management System (Construction) in the Hong Kong Occupational Safety and Health Award organised by the Hong Kong Occupational Safety and Health Council and the Labour Department.

In addition, the construction division won a gold award in the Construction Industry Safety Award Scheme and a silver award in the Good Housekeeping Campaign. It received several gold, silver and bronze awards in the Safe Working Cycle Award Presentation. The Group also received two Considerate Contractor Awards from the Environment, Transport and Works Bureau.

To raise its health and safety management standards further, the Group established a Housekeeping Taskforce in November 2002 with the aim of having its construction sites achieve the same level of tidiness as a well-managed factory by 2004. The Taskforce compiled good housekeeping procedure and measures complete with an audit system, and organised a range of training and activities to promote good housekeeping among site staff and workers.

In environmental management, SOCAM implemented a comprehensive waste management system in all its construction sites, focusing on reducing the consumption of concrete and timber. It also supported the Wastewi$e Scheme organised by the Environmental Protection Department.

An artist's impression of the current phase of Rui Hong Xin Cheng, which will include 30,000 square metres of commercial space and 13 residential blocks

QUALITY HOUSING DEVELOPMENT IN THE CHINESE MAINLAND

Rui Hong Xin Cheng (RHXC)

Shanghai gathered pace in its development as the leader of growth in the Yangtze Basin. RHXC, a quality housing project originally developed by the privately held SOP and transferred to your Group in June 2001 with unanimous approval from minority shareholders, is designed to capture the rising middle-income market composed of the young professional and managerial segments. It is close to the Bund and the central business district of Shanghai. On completion, the various phases will encompass more than 11,000 residential units with a gross floor area of approximately 1.2 million square metres, as well as around 300,000 square metres of retail and commercial space.

A total of 816 units of the current phase, which is situated on top of a subway station due for opening in 2004/05, will be launched for pre-sale in the third quarter this year. The superstructure of these seven blocks is complete and fitting-out works are in progress. Construction of another four blocks with 669 units commenced in April with completion scheduled by end of 2004. The remaining two blocks of this phase with 276 units are expected to be completed by June 2005.

The experienced construction management team in charge of the project, supported by the sourcing capability of the Group's subsidiary, Asia Materials, has been able to substantially reduce the construction costs. At current selling prices, the residential units would yield a reasonable margin. Negotiations with a large retailer as an anchor tenant for over one third of the 30,000 square metres of commercial space in the current phase have reached an advanced stage. Rental income, together with the sale of residential units, should produce a significant and steady income stream for SOCAM in the coming years.

CEMENT OPERATIONS IN THE CHINESE MAINLAND

The Central and Western provinces in the Chinese Mainland continue to enjoy fast economic growth under the "Go West" policy, which has been in full steam for more than three years. The construction of extensive road systems, power plants and other infrastructural projects, together with substantial Central Government funding, have helped create buoyant economies. The cement industry, in which your Group has committed large investments, is among the industries benefiting most from these projects. With the accelerated acquisitions of strategic cement operations in Chongqing and the surrounding areas as well as in Guizhou, a total production capacity of around 7.5 million tonnes per annum (t.p.a.) has been amassed, which puts your Group among the top three producers in the Mainland. Expansion of existing operations alone, including the construction of new kilns

The Group is committed to improving the working conditions in all joint ventures with state-owned cement plants and grinding mills, will add about 3.5 million t.p.a. to your Group's production capacity within the next two years.

Chongqing, the largest municipality in the world with a population of over 30 million, will further consolidate its position in the coming few years as the leading industrial and commercial centre in southwestern China. Meanwhile, Guizhou has consistently ranked as one of the provinces with the highest year-on-year growth in the allocation of development funds from the Central Government. Our leading position in these two areas paves the way for further advances to other provinces.

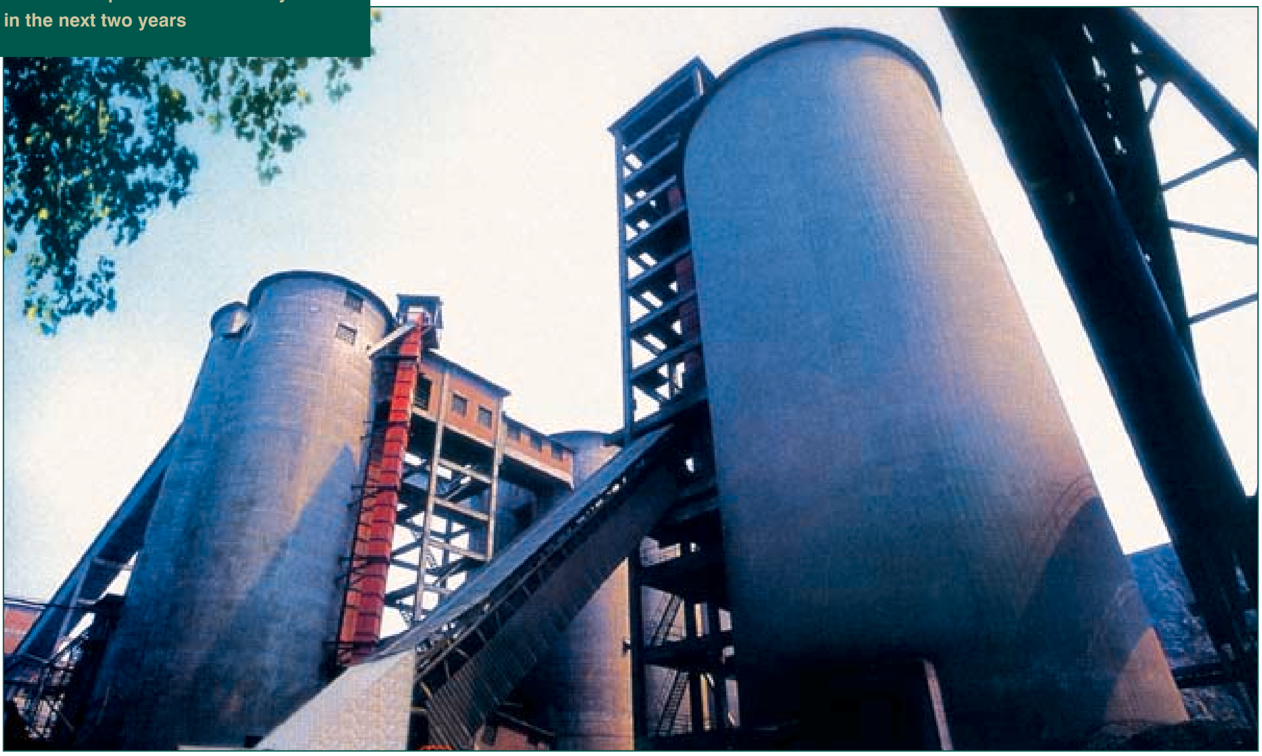
Comprehensive management methods were introduced in all new joint ventures with state-owned cement plants. In addition, local governments and our Mainland partners welcome our efforts in increasing production and sales through adding new kilns and the resultant increase in tax revenues; the upgrading of technology and environmental equipment; and the improvement of working conditions of the employees. The continuation of this approach will form part of our strategy to establish a chain of high quality cement plants in the Chinese Mainland.

Chongqing Operation

TH Cement now controls three of the five largest cement plants in Chongqing and Sichuan Province, with a combined capacity of approximately 5.6 million t.p.a. The two plants in Chongqing command in aggregate over 70% of the high grade cement market in and around this city.

Agreement has recently been reached with Chongqing Steel Corporation, a major state-owned enterprise in the municipality, to establish a joint venture for processing 800,000 tonnes of steel slag for blending with cement. This co-operation will result in lower production costs and further reinforce our competitiveness.

TH Cement plans to add two dry kilns in the next two years



Expansion plans for the next two years include the construction of two dry kilns, the addition of grinding mills and the sourcing of environmentally friendly additives.

The implementation of the above plans will add approximately 2.8 million t.p.a. to our capacity and will push the total capacity past the 8 million tonne mark in Chongqing and Sichuan.

Guizhou Operation

In Zunyi, the new 400,000 t.p.a. dry kiln commenced production in December 2002 and has since attained nearly full production. The encouraging sales and the upcoming infrastructural projects nearby have prompted management to explore the feasibility of adding more kilns of similar sizes in Zunyi.

The greenfield Dingxiao plant of 400,000 t.p.a. capacity in the south-western prefecture Qianxinan was also commissioned in December 2002. Awaiting the granting of a formal permit to sell high grade cement, this plant operates smoothly in the middle market sector and has quickly secured a loyal group of customers. In the south-eastern prefecture Qiandongnan, the addition of a new grinding mill will enlarge the sales radius to the border adjoining Chongqing.

We are in the process of concluding a joint venture agreement to operate the 700,000 t.p.a. Guiyang Cement, the success of which will give us an important foothold in the provincial city.

Our laboratory in Guangzhou has helped devise new and improved formulae of cement products and contributed to the reduction of costs in all plants. The training of local Guizhou staff in Hong Kong has boosted the morale and competence of participants and the programme will continue as part of our effort to improve quality of staff and management.

SOCAM's cement plant in Qianxinan, Guizhou has the first and only rotary kiln in the autonomous prefecture.

Nanjing Operation

The loss sustained in the Jiangnan Cement operation was contained. Both the local and coastal markets remained very competitive despite increased economic activities. Quantities exported to Australia fluctuated and future focus will still be on cost cutting and the enlargement of market share in Nanjing.

CONSTRUCTION MATERIALS IN HONG KONG AND THE PEARL RIVER DELTA

Ready-mixed Concrete – Ken On

The entire Hong Kong concrete market amounted to around 6 to 6.5 million cubic metres in 2002, representing an approximately 20% decrease in the volume recorded for the previous year and a drastic reduction in excess of 40% compared with more than 11 million tonnes achieved in 1997. The continued fall in property prices, the decrease in construction projects as well as the worsening price war, due to new competitors and the untimely move of smaller producers to enlarge their market share, saw no sign of abatement. Average prices for standard-mix concrete were, in most part of the year, below the critical level of HK$300 per cubic metre and inflicted losses on most producers. It is difficult to envisage that such low pricing can persist for a long period of time. Even with the competitive price of aggregates supplied internally and the lowered cement price from our Japanese supplier, Ken On incurred a loss for the first time since the last price war in the early 1990s.

Amid the adverse trading environment, Ken On continued with an extensive cost cutting exercise throughout the year, which included the sharing of facilities as well as the closing down of the Tung Chung and Cheung Sha Wan plants and the major facilities in Chai Wan. Operations were consolidated into the large and well-equipped Tsing Yi site, which can handle both cement and aggregate loading. Ken On's production in Hong Kong amounted to 550,000 cubic metres during the year.

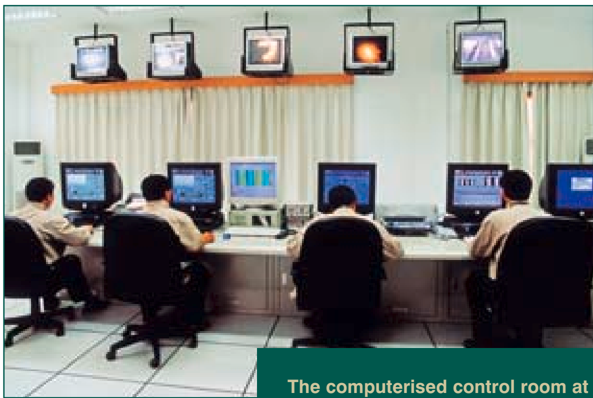
Production of 430,000 cubic metres in the two batching plants in Guangzhou was 9% down from the year before due to delays in a number of large projects. To enhance distribution, the plant in Nanhai district would be closed and orders redirected to the Guangzhou plant and the newly established Panyu operation.

At 30 June 2003, the order book of Ken On in Hong Kong stood at around 450,000 cubic metres which should allow a stable production in the year ahead.

Quarrying Operations

Of the 3 million tonnes of aggregate and other quarry products produced by the Group, approximately 60% were supplied to Ken On. The lack-lustre concrete market in Hong Kong also adversely affected the quarrying operation and production only reached 85% of that of the previous year.

The volume of crushed rocks produced, as by-product of the site formation contract in Guishan Island, Zhuhai, was below the level that could generate a reasonable contribution. In Chik Wan, the total amount of 660,000 tonnes processed represented only 40% of that of the previous year, due largely to Ken On's reduced demand and the completion of the Lamma Power Station contract and its demand for large armour rocks. The supply of other large rock products for the reclamation of Hong Kong Disneyland and Container Terminal 9 continued. The Xinhui quarry relied principally on local customers after the stopping of supply to Ken On's Guangzhou operations due to very low local prices in Guangzhou.



The computerised control room at SOCAM's cement plant in Xinpu

MATERIALS TRADING

Cement Import and Distribution

The trading and distribution of cement from Sumitomo Osaka Cement for Ken On's usage was in its second year of operation following the cessation of our 50% joint venture company Far East Cement. A total of only 300,000 tonnes of cement products was handled following the reduction of some 11% in the overall market size. The mode of import was changed to a combination of both cement and clinker due to the latter's overall cost advantage.

Asia Materials

The launch of Asia Materials' innovative home furniture product line under its brand "HELIOS" earlier this year has met with encouraging response from distributors in the U.S., Germany and Japan. Aggressive marketing and promotion activities are being carried out through its overseas sales network.

The new concrete batching plant and cement silo in Tsing Yi

Asia Materials has capitalised on the growing demand for materials sourcing for property development projects in the Chinese Mainland and achieved significant business growth in this market segment during the year. It has lately been appointed materials sourcing agent for a new casino project in Macau. It has also been supplying materials to manufacturers with a view to building an effective supply chain serving key customers.

PROSPECTS

The already sluggish economy of Hong Kong was further stifled by the recent outbreak of SARS. The extent of the damage is not fully known. Despite the combined efforts of the government and the private sector to revive the economy, it might be some time before the downward spiralling of property prices, deflation and unemployment can be arrested. The revised housing policy of the HKHA to substantially cut public housing spending and to abolish the Home Ownership Scheme exacerbated the already bleak outlook for the construction industry and this major traditional source of revenue for SOCAM will continue to dwindle in the foreseeable future. To cope with the difficult times ahead, the building division will continue its effort to save costs and prepare for a much reduced workload in the coming two years.

In contrast to the difficult position of our Hong Kong businesses, the Group's repositioning as a Mainland oriented entity progressed smoothly and is on target. The extensive measures taken by the Central and local governments to stop the large scale spreading of SARS prevented a would-be pandemic on the Mainland. Infrastructural investment in both Chongqing and Guizhou has hardly slowed down. The "Go West" policy, with full support from the Central Government, will not only provide

To capitalise on the infrastructure boom in the central and western provinces, SOCAM continues to acquire and expand cement plants in strategic locations

immediate opportunities for your Group's cement operations, but will also have a long lasting effect on the demand for cement products as a result of the uplifted economies in these developing areas. We will accelerate the expansion of our investment to nearby provinces in the coming two years to capture the rapid growth in the region and significant profit contributions should be forthcoming in the near future.

Shanghai imposed strict precautions against SARS and avoided the worst of the crisis. Sentiment to acquire properties does not appear to have been dampened. The coming pre-sale of Rui Hong Xin Cheng in the third quarter should mark the beginning of a continuous stream of turnover and profit contribution to your Group. We are also actively exploring opportunities in other Mainland cities where our expertise in property development and construction will give us a competitive edge.

With the encouraging development of our businesses in the Chinese Mainland, the Directors of the Group are confident that, barring unforeseen circumstances, profitability will return in the coming year.

Choi Yuk Keung, Lawrence
Managing Director
Hong Kong, July 2003