Management Discussion and Analysis

REVIEW OF OPERATING RESULTS

A summary of the performance of the Group's major businesses during the year under review is as follows:

Water Distribution

Profit contribution from the Water Project remained significant to the Group. The lower volume and revenue due to the rainy climate in the southern part of the Guangdong Province during the first six months of the year was more than recovered in the second half of the year. For 2002, the total sales volume of water in the Shenzhen and Dongguan areas reached 718 million (2001: 608 million) cubic meters while the contracted volume of water supplied in Hong Kong reached 800 million (2001: 790 million) cubic meters.

Effective cost and management controls and an improved tariff collection mechanism in the Dongguan area contributed to a further increase in the operating results from the Water Project. The operating profit before finance costs of the Water Project in 2002 was HK$1,634,804,000, 11.14% higher than the previous year (2001: HK$1,470,951,000).

Electric Power Generation

Sales of electricity by the Shaoguan Power Plant D (the "Shaoguan PPD") were adversely affected by a series of shutdowns that occurred after a major repair in July 2002, heavy rains during August and September, and a reduction in tariffs that become effective in August 2002. Sales of electricity by the Shaoguan PPD amounted to HK$464,370,000 (2001: HK$578,001,000), 19.66% lower than 2001. The electricity sold in the year was amounted to 1,280 million kwh (2001: 1,460 million kwh), 12.33% lower than 2001. The operating profit before taxation of the Shaoguan PPD in 2002 was HK$46,595,000 (2001: HK$212,533,000), a decrease of 78.08%.

The associated company of Shaoguan PPD namely, 廣東省韶關粵江發電有限責任公司 (Guangdong Shaoguan Yue Jiang Power Supply Limited (the "Yue Jiang PP")), had its first full year commercial operation in 2002. The share of the operating profit before taxation of the Yue Jiang PP in 2002 amounted to HK$12,111,000 (9 months' soft operation in 2001: HK$4,539,000). The related amount of electricity sold in the year was 177 million kwh (9 months' soft operation in 2001: 91 million kwh).

Share of sales of electricity by the Group's power plant in Meixian, an investment of an associated company, amounted to 171 million kwh (2001: 170 million kwh). The related sales revenue and operating profit before taxation respectively were HK$62,985,000 and HK$29,388,000 (2001: HK$66,113,000 and HK$31,261,000).

Management Discussion and Analysis (continued)

REVIEW OF OPERATING RESULTS (continued)

Toll Roads and Bridges

In 2002, an after-tax profit of HK$105,829,000 (2001: HK$70,645,000) was generated from the "2 Roads and 2 Bridges" projects. The considerable increase in profit was driven by a large savings in interest expense that arose after a refinancing of the projects' loan facility in June 2001.

The Qinglian Highway, which links Qingyuan and Lianzhou in the Guangdong Province, recorded a slight increase in traffic flow, and revenue in 2002, HK$272,000,000 (2001: HK$269,000,000). The average daily traffic in 2002 was 31,815 vehicle trips as compared to 31,551 vehicle trips in 2001. The Company's effective interest in this project is 7.23%.

The Guangzhou-Shantou Highway (Huizhou Section) recorded an increase of 6.7% in traffic flow, resulting in an increase in revenue to HK$120,000,000 in 2002 (2001: HK$115,000,000). The average daily traffic in 2002 was 23,558 vehicle trips as compared to 22,072 vehicle trips in 2001. The Company's effective interest in this project is 26.01%.

The Shantou Haiwan Bridge recorded an increase of 10.5% in traffic flow. The average daily traffic in 2002 was 12,764 vehicle trips while in 2001 it was 11,553 vehicle trips. The annual revenue was HK$123,000,000 in 2002 (2001: HK$109,000,000). The Company's effective interest in this project is 15.3%.

The Humen Bridge recorded growth of 16% in the traffic flow. The average daily traffic in 2002 was 30,280 vehicle trips while in 2001 it was 26,082 vehicle trips. The annual revenue reached HK$395,000,000 in 2002 (2001: HK$336,000,000). The Company's effective interest in this project is 15.3%.

The performance of the two Pak Kong Bridges in Qingyuan remained stable, generating a steady cash return to the Group. The Company's effective interest in this project is 24.5%.

The average daily traffic of Yingkeng Highway increased by 5% in 2002. The annual revenue reached HK$8,587,000 in 2002 (2001: HK$7,785,000). As a result of using an improved surveillance system, Yingkeng Highway has beaten its budgeted revenue target. The Company's effective interest in this project is 70%.

Management Discussion and Analysis (continued)

PROPERTY INVESTMENT AND DEVELOPMENT

Mainland China

Teem Plaza continued to enjoy high occupancy rates with an average of more than 97% (2001: 97%) and strong rental income, despite the well known downturn in the regional property sector. The rental income for the year reached HK$263,100,000 (2001: HK$257,491,000), a slight increase of 2%.

The Group at the balance sheet date held a 24.8% interest in the Riverside Garden project in Panyu, Guangzhou. The project contributed an attributable profit of HK$5,160,000 to the Group in 2002. The Group disposed its entire interest in the Riverside Garden project following the completion of the Assets Disposal on 31 March 2003.

The Group sold the hotel commercial project under development in Suzhou GD Plaza at a consideration of approximately RMB70 million in October 2002. The Group is now in the final stage of selling to a third party its entire interest in Suzhou Yuehai Real Estate Development Co., Ltd. ("Suzhou Yuehai"), which currently owns the remaining unsold carparks and shop units in Suzhou GD Plaza. With the sale of the interest in Suzhou Yuehai, the Group will complete its asset sale in Suzhou.

Hong Kong

Average occupancy rate of Guangdong Investment Tower (the "GDI Tower") dropped from 100% to 80% during 2002. In addition, the current depressed state of the local commercial rental market has led to a reduction in average rentals in respect of lease renewals and new leases. The full effect of these factors will not be felt until 2003. Rental for the GDI Tower amounted to HK$24,040,000, a 8.15% decrease (2001: HK$26,172,000).

Guangdong Parking Limited's interest in the car parks located in North Point continued to show an operating loss (before the property revaluation deficit) for the year of HK$724,000 (2001: HK$1,880,000).

The Group entered into an agreement with an independent third party (the "Purchaser") on 31 March 2003 to dispose of its entire interest in GD Parking and the assignment of related intercompany debts at a nominal value of HK$1. As an integral part of the transaction, the Company will be released from all its obligations under its guarantee for the GD Parking's bank loan after certain partial prepayment upon completion (which bank loan after the partial prepayment will be approximately HK$63,000,000). The transaction has not yet been completed at the date of this report.

Management Discussion and Analysis (continued)

HOTEL OPERATIONS AND MANAGEMENT

Mainland China

While the average occupancy rate of Shenzhen Guangdong Hotel decreased from 91.8% in 2001 to 85% in 2002, the average occupany rate of 珠海粵海酒店 (Yue Hai Hotel, Zhuhai) ("Zhuhai Hotel") increased to 86.5% in 2002 (2001: 71.8%). This increase at Zhuhai was mainly due to an increase in long-term business tenants.

Hong Kong

Local tourism enjoyed a modest recovery in 2002. The number of visitors in Hong Kong grew by 22.7%, with visitors from Mainland China growing fast.

Despite keen competition in the Hong Kong hotel market, the average occupancy rate at The Wharney Hotel Hong Kong and Guangdong Hotel, Hong Kong remained high at 92% (2001: 88%) and 89% (2001: 85%) respectively.

Cost controls and effective utilisation of available resources resulted in a significant increase in the hotel group business profits (before the hotel property revaluation surplus) to HK$44,698,771. (2001: HK$8,022,000)

OTHER BUSINESSES

Discontinuation of Other Businesses

Upon the completion of the Assets Disposal on 31 March 2003, the Group disposed all of its interests in the non-core businesses of brewery, tannery, malting and tours/travel. Such businesses of the Group have been discontinued on the same date.

Brewery

The beer market in South China continued to be very competitive. Following the establishment of a new marketing team, the implementation of new marketing plans and better business opportunities arising from the 2002 FIFA World Cup, sales volume of Guangdong Brewery Holdings Limited ("Guangdong Brewery") increased substantially, by 39.13% to 224,000 tonnes in 2002 (2001: 161,000 tonnes). However, fierce competition led to price cuts and as a result total sales in value only increased by 9.03% to HK$593,052,000 (2001: HK$543,922,000).

Effective cost controls, open tender systems, result-oriented incentive schemes and debt-free financial position, all contributed to an improvement in margin, and as a result attributable profit to the Group amounting to HK$58,810,000, a 137.21% increase over the previous year.

Management Discussion and Analysis (continued)

OTHER BUSINESSES (continued)

Tannery

The attributable loss to the Group of Guangdong Tannery Limited ("GD Tannery") narrowed to HK$53,297,000 (2001: HK$67,805,000). Provisions for inventories and doubtful debts, respectively, of HK$11,057,000 and HK$28,531,000 were recorded.

Sales for the year decreased by 31% compared with 2001 while the gross margin dropped from 10.58% in 2001 to 2.93% in 2002.

Malting

The Group's malting business during the year achieved an increase in production to 188,000 tonnes (2001: 183,000 tonnes) and 140,000 tonnes (2001: 135,000 tonnes), respectively, at its Guangzhou plant and Ningbo plant. The respective revenue for Guangzhou plant and Ningbo plant amounted to HK$425,046,000 (2001: HK$439,465,000) and HK$338,280,000 (2001: HK$301,199,000).

In aggregate, turnover for the malting plants increased by 3.1% to HK$763,326,000 (2001: HK$740,664,000). This increase came despite continuous fierce market competition which led to a drop in average unit selling prices.

Tours/Travel

Although the business suffered greatly from a sharp price reduction in "Hong Kong Tour", effective cost control measures and interest savings helped the Group to mitigate its losses, attributable loss to the Group amounted to HK$58,569,000 (2001: a profit of HK$20,619,000).

LIQUIDITY, GEARING AND FINANCIAL RESOURCES

As at 31 December 2002, cash and bank balances of the Group increased by HK$183 million to HK$1,788 million (2001: HK$1,605 million), balances of which are mostly denominated in Hong Kong dollars (HK$534 million) and Renminbi (HK$1,118 million). The Group also had financial borrowings amounting to HK$18,325 million (2001: HK$19,390 million). Of the Group's total financial borrowings, HK$1,016 million was repayable within one year while the remaining balances of HK$4,812 million and HK$12,497 million are repayable before or in 2007, and after 2007, respectively.

As at 31 December 2002, the Group's total available credit facilities amounted to HK$21,263 million, of which HK$18,370 million have been utilised (2001: HK$21,033 million and HK$19,390 million, respectively). The unutilised banking facilities amounted to HK$2,893 million (2001: HK$1,643 million).

Management Discussion and Analysis (continued)

LIQUIDITY, GEARING AND FINANCIAL RESOURCES (continued)

The gearing for the Group at the balance sheet date was 2.02 times, while last year's was 2.22 times. The improvement mostly reflected the reduction in the level of the Group's financial borrowings due to early prepayments in 2002, together with an increase in net asset value of the Group.

The existing cash resources and available credit facilities of the Group, together with steady cash flows generated from its operations, are sufficient to meet its payment obligations and business requirements.

PLEDGE OF ASSETS

At 31 December 2002, certain of the Group's fixed assets, investment properties and bank deposits, with a total net book value of HK$725,157,000 (2001: HK$1,560,761,000) were pledged to secure general banking facilities granted to the Group.

In addition to the above, a property under development in Mainland China held under a long term lease with a carrying amount of HK$64,000,000 as at 31 December 2002 was held by the court in Mainland China as security for the Group's legal proceeding against the recovery from a debtor of the Group.

CAPITAL EXPENDITURE

The Group's total capital expenditure for fixed assets was HK$109 million in 2002, a decrease of HK$26 million from HK$135 million in 2001. The Group's 2002 capital expenditure related principally to the upgrading of certain facilities of the Water Project and the additions of plant and machinery for the power plant.

EXPOSURE TO FLUCTUATIONS IN EXCHANGE AND INTEREST RATES AND RELATED HEDGES

Currency Hedges

As at 31 December 2002, total foreign currency borrowings amounted to HK$3,330 million, of which HK$1,923 million were United States dollars, HK$16 million were Euros and HK$1,391 million were Renminbi (2001: HK$7,522 million, of which HK$6,550 million were United States dollars, HK$21 million were Euros and HK$951 million were Renminbi).

As at 31 December 2001, certain of the Group's foreign currency borrowings which were denominated in United States dollars and Euros were hedged by currency swap agreements. Such borrowings were no longer hedged by any currency swap agreements at the balance sheet date because all of them are scheduled to be fully repaid in May 2003.

Management Discussion and Analysis (continued)

EXPOSURE TO FLUCTUATIONS IN EXCHANGE AND INTEREST RATES AND RELATED HEDGES (continued)

Interest Rate Hedges

As at 31 December 2002, the Group's total floating rate borrowings amounted to HK$17,012 million (2001: HK$5,740 million), of which HK$3,500 million (2001: Nil) were hedged by a fixed rate swap agreement. Subsequent to the balance sheet date, an additional HK$2,500 million of floating rate debts were hedged by additional swap agreements.

CONTINGENT LIABILITIES

(a) In March 2001, Yue Sheng Finance Limited ("Yue Sheng"), a wholly owned subsidiary of the Company, commenced legal proceeding in Mainland China to recover two outstanding loans aggregating of HK$40,000,000 together with interest thereon from the two Chinese parties who were the guarantors of those loans. The hearing of the case has already taken place but the PRC Court has not yet delivered judgment.

After trying without success to dispute the jurisdiction of the PRC Court in the aforesaid proceedings, the two guarantors and the borrower of those two loans commenced legal proceedings in Hong Kong against Yue Sheng and a former subsidiary of the Group in July 2001 seeking, inter alia, a declaration that the plaintiffs were under no legal obligation to repay the two loans and compensation. The case is still in progress.

As a result of the mediation of the PRC Court, the parties to the PRC proceedings have agreed upon a settlement. As part of the settlement, the parties are to seek to bring the Hong Kong proceedings to an end. The PRC Court will also formalise the settlement once agreement has been reached among the parties to the Hong Kong proceedings for the final disposal of that case. The negotiation regarding the Hong Kong proceedings is still in progress.

Based on legal advice, the Directors are of the view that the claim brought against Yue Sheng is without merit and no provision for the claims of the guarantors and the borrower was considered necessary as at 31 December 2002.

Management Discussion and Analysis (continued)

CONTINGENT LIABILITIES (continued)

(b) In 2002, legal proceedings were brought against Guangdong (H.K.) Tours Company Limited ("GD Tours"), a wholly-owned subsidiary of the Company, claiming for damages in respect of traffic accidents in Mainland China involving members of a tour group organized by GD Tours. The proceedings are still in progress and the case has now been set down for trial on the issue of liability during the period from 24 November 2003 to 5 December 2003.

During the year and subsequent to the balance sheet date, GD Tours received certain claims in respect of another traffic accident in Mainland China involving members of a tour group organized by GD Tours. However, up to the date of this report, no legal proceedings have been commenced in respect of those claims.

Based on legal advice, the Directors are of the opinion that it is premature to estimate the outcome and hence, no provision has been made in the financial statements on account of the claims.

In any event, according to legal advice, GD Tours is not at fault. It has therefore already denied liability and will continue to vigorously contest all such claims.

(c) In September 2002, GD Tannery submitted a claim to China International Economic and Trade Arbitration Commission (the "Arbitration Commission") in Shenzhen, Mainland China against a PRC joint venture partner of a subsidiary of GD Tannery at Qingdao seeking, inter alia, termination of the joint venture agreement and compensation of losses and damages of approximately RMB24,000,000. However, the PRC joint venture partner also applied to the Arbitration Commission in Beijing against GD Tannery claiming for loss of fixed return under the joint venture agreement in question and damages in an aggregate of RMB15,000,000. The two arbitration proceedings are still in progress as at the date of this report.

In the opinion of the directors of GD Tannery, based on legal advice, it is premature to conclude the likely outcome of the two arbitration proceedings, accordingly, no provision has been made in the financial statements as at 31 December 2002.

Management Discussion and Analysis (continued)

CONTINGENT LIABILITIES (continued)

(d) Following the change in senior management of GD Tannery in June 2002, it was discovered that certain former executives (the "Former Executives") of Nanhai Tannery & Leather Products Co. Ltd. ("Nanhai Tannery") (one of whom was also a former director of GD Tannery) had been involved in certain irregularities. Nanhai Tannery is a wholly owned subsidiary of GD Tannery established in Nanhai, Mainland China.

Upon discovery of the irregularities, an internal audit team of the Company and its immediate holding company, working with the new management of GD Tannery, conducted a preliminary investigation of the irregularities. The investigation revealed that the Former Executives apparently operated a business in parallel to the operations of Nanhai Tannery (the "Parallel Operation") for their own personal gain.

The incident was reported by GD Tannery to the relevant PRC authorities who have detained the Former Executives and seized documents related to the Parallel Operation for investigation. GD Tannery also instructed its auditors and the PRC lawyers to carry out special investigations with a view to ascertaining the effects of the Parallel Operation on the business of Nanhai Tannery and to advise the management of GD Tannery on possible recourse against the Former Executives.

Based on the findings of the special investigations and having regard to the professional advice received, the directors of GD Tannery are of the opinion that the Parallel Operation should not be incorporated in the financial statements of GD Tannery (and hence, the Group) and that the Parallel Operation appears to have involved various irregularities in its transactions under the applicable PRC law and regulations.

As the investigation of the PRC authorities are still ongoing, it is not possible to ascertain with any degree of reasonable certainty the consequential actions that may be taken by the PRC authorities for the aforesaid irregularities and the existence or otherwise of any penalties and claims. As of the date of this report, no action has been taken against the GD Tannery Group and there have been no indications that any adverse actions against it are pending. Accordingly, based on currently available information, no provision has been made in the financial statements for such contingencies

GD Tours and GD Tannery are among the non-core businesses sold to GDH Limited after the balance sheet date which sale has since been completed.

Management Discussion and Analysis (continued)

EMPLOYEE AND REMUNERATION POLICY

As at 31 December 2002, the Group had a total of 6,580 employees. Among the employees, 5,994 were employed by subsidiaries in Mainland China and 586 were employed by the head office and subsidiaries in Hong Kong. Out of the total number, 1,015 were managerial employees of the head office and its subsidiaries. The Group recruits and promotes individuals based on merit and their development potential for the positions offered. Performance of staff is reviewed at least annually and employees' compensation is performance driven. The Group's remuneration and benefits policies are based on the business performance of the relevant employee's company. Year-end bonuses will be granted to those employees with outstanding performance. People are the Company's key assets and key to success. The Group encourages employees to participate in external training programmes to develop themselves on a continuous basis. For existing employees' career development, the Group provides opportunities through on-job training by regular job rotation, so as to improve staff quality to meet future challenges and gain a competitive edge. The Group advocates a corporate culture which seeks to excel in terms of financial performance and economic benefit and to effectively deploy its human resources strictly on merit. It also aims to continuously streamline its organisational structure to result in further cost reductions. The Group manages and develops its staff through an effective performance appraisal system with an incentive/penalty scheme to enhance staff motivation in order to achieve corporate goals.

The Group adopted a new share option scheme in May 2002. The purpose of the new share option scheme is to provide incentives to participants to contribute to the success of the Group and to enable it to recruit and retain good quality employees for the long term.

Management Discussion and Analysis (continued)

SIGNIFICANT TRANSACTIONS

The Group has continued to aggressively pursue its business and asset restructurings. Significant transactions during the year include the following:

Group's Restructured Bank Debts

(i) *Bank debts under the Company's group restructuring agreements signed in December 2000 ("restructured bank debts").*

As at the balance sheet date, the then outstanding "restructured bank debts" of the Company and certain "standalone" companies, in aggregate, amounted to HK$2.24 billion (2001: HK$3.79 billion). These debts had been successfully reduced by HK$1.55 billion in 2002, which on an accumulated basis, represented 67% of the original "restructured bank debts". In relation to such "restructured bank debts", interest expense dropped by approximately HK$85,000,000 (2001: approximately HK$132,000,000) due to the lower United States and Hong Kong interest rates during the year. Additional interest savings of approximately HK$127,000,000 (2001: approximately HK$58,000,000) resulted from the repayment or refinancing of those "restructured bank debts".

In 2002, the Company further reduced its own "restructured bank debts" by HK$1.18 billion (2001: HK$1.3 billion). Its outstanding amount as at the balance sheet date amounted to HK$2.04 billion and all of the repayments scheduled to be made by June 2005 were completed by December 2002.

Most of the "standalone" companies under their own debt restructuring scheme also made early repayments in the year 2002. In total these companies repaid during the year HK$369 million of their "restructured bank debts" of which HK$345 million was well ahead of the scheduled repayments. As at 31 December 2002, the "restructured bank debts" owed by such "standalone" companies were reduced to HK$203 million.

Following the completion of the Assets Disposal on 31 March 2003, the entire cash proceeds received, approximately HK$1.03 billion, will be applied towards the repayment of the Company's outstanding "restructured bank debts". The "restructured bank debts" of the Company and the "standalone" companies are expected to be fully repaid in 2003.

Management Discussion and Analysis (continued)

SIGNIFICANT TRANSACTIONS (continued)

(ii) *Debts under the GH Holdings Group*

As part of the acquisition of the Water Project in December 2000, substantial debts (including but not limited to Tranche A and B Credits and Tranche C Notes) amounting in aggregate to approximately HK$14.8 billion, were brought into the Group. Improved performance of the water supply business and successful cost savings exercises enabled the GH Holdings Group to further reduce in the year 2002 the Tranche A Credits by HK$507 million (2001: HK$359 million). These prepayments were well ahead of the Tranche A's scheduled repayments due in 2002 of HK$136 million, and led to interest savings for the year of HK$27 million (2001: HK$9.7 million).

The Group successfully arranged on 20 December 2002 (the "Refinancing Date") a refinancing of a substantial portion of the debts associated with the Water Project. The new facilities enabled the GH Holdings Group to refinance at lower costs, amongst other things, all of the Tranche A Credits, all of the Tranche C Notes and 75.88% of the Tranche B Credits (a further 1.5% of the Tranche B Credits were redeemed at par subsequent to the balance sheet date). This refinancing is expected to help the Group to substantially reduce its future financing costs. Interest costs were reduced by approximately HK$13 million for the 11-day period from the Refinancing Date to the balance sheet date.