



# Management Discussion and Analysis

The directors of the Company (the “Directors”) are pleased to present the annual results for the year ended 31st December 2003.

## RESULTS

During the year, despite having to face the adverse effects of undesirable events including the war in Iraq and Serious Acute Respiratory Syndrome, China maintained steady development with the 9.1% growth in GDP to a total of RMB11,670 billion. The GDP of the Yangtze River Delta, where the Group is located, accounted for almost 20% of China’s overall GDP, at RMB2,277.5 billion.

The overall fixed assets investment in China and Zhejiang Province amounted to approximately RMB5,511.8 billion and RMB494.683 billion, respectively in 2003, representing a year-on-year growth of 26.7% and 38.1%, respectively. The healthy and rapid growth in economy, investments and people’s income helped the Group’s three major businesses: the general contracting of construction works, the manufacture and sale of building materials, and real estates development all maintained a fast, healthy and steady growth.

For the year ended 31st December 2003, the Group recorded a turnover of RMB2,994.5 million, an increase of 30.3% over the previous year. Profit attributable to shareholders was RMB112.4 million (2002: RMB141.1 million). Earnings per share were RMB25.5 fens (2002: RMB40.2 fens).

The Group recorded pre-sale receipt in advance of approximately RMB300 million from the sales of Phase I of Guazhu Fengqing (瓜渚湖風情小區), a residential project developed by the Group’s subsidiary Zhejiang Baoye Real Estate Group Co., Ltd. in 2003, which will bring a net profit of around RMB70 million to the Group. Since the profit was not recognised in the accounts of 2003, profit attributable to shareholders decreased by 20.3%. However, such profit will be recognised in 2004.

At the board meeting held on 28th May 2004, the Directors declared a final dividend of RMB0.0635 per ordinary share for the year ended 31st December 2003. The proposed dividend is not reflected as a dividend payable in the accounts, but will be reflected as an appropriation of retained earnings for the year ending 31st December 2004.

## BUSINESS REVIEW

Based in the Zhejiang Province and the Yangtze River Delta, our main businesses are general contracting for construction works, manufacture and distribution of building materials and development and sale of properties in the PRC. During the year under review, the Group recorded stable development in its businesses.

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### CONSTRUCTION BUSINESS

The Group is principally engaged in general contracting for the urban public works, roads, bridges and marine channels, industrial and civil construction works, as well as other specialised construction projects, such as indoor and outdoor decoration works, electrical and mechanical equipment installation, fire services equipment installation, and the production and installation of different kinds of curtain walls.

The continual urbanisation of cities in China has allowed the country's construction industry to maintain consistent development. In 2002, the Ministry of Construction ("MOC") adjusted its grading system on the qualifications of construction enterprises and tightened the criteria on entrance into the industry. The Group holds a premium class certificate for general building construction contracting works, the highest qualifications awarded by the MOC in the PRC. The adjustment has brought out the edge of the Group and enhances its position to further expand its business.

During the year under review, the Group, with its competitive edges of quality, reputation and brandname, completed 233 construction projects with a total gross floor area of 1,778,000 sq.m., bringing in an income of RMB2,683.1 million, equivalent to 89.6% of the aggregate turnover of the Group. While the Group kept up its efforts in consolidating its business in Zhejiang and Shanghai, its markets were extended to Jiangsu, Anhui and Beijing. It is worth noting that the Group won bids of quality projects including the Shanghai Xijiao Shiji Hua Cheng (上海西郊世紀華城) with a contract sum of RMB600 million, the Suzhou Industrial Park Modern Building (蘇州工業園現代大廈) with a contract sum of RMB122.68 million and the Hefei CBD Plaza (合肥CBD廣場) with a contract sum of RMB126.34 million, during the year.

The projects completed included (by category):

- 36 urban works projects, such as Binjiang Avenue (濱江大道), Huxi Park (湖西公園), Changxin Western Ring Road Project (長興西環線工程), the Road network of Pujiang Industrial Park (浦江工業園區區間道路), Ferry Pier of Lishui and Kubei (麗水雲和庫北交通碼頭).
- 109 public utilities projects such as the Shaoxing Wenli Institute Library (紹興文理學院圖書館), Paojiang International Logistics Centre (袍江國際物流中心), Civil Affairs Welfare Office (民政局福利院), Shaoxing Grand Theatre (紹興大劇院), Wuyi People's Hospital (武義人民醫院).
- 59 residential projects such as the Shanghai Four-Season Spring House (上海四季春別墅), Bai Yulan Garden Phase III (白玉蘭花園三期) and Shanghai New Times Garden (上海新時代花園).
- 29 industrial projects such as the Hangzhou Huaye Technology Company Limited Standard Factory (杭州華業科技有限公司標準廠房), Yutai Industrial and Commercial Company Limited Factory (裕泰工貿有限公司廠房) and Ningbo Mrs. Fang Kitchen Utensils Factory (寧波方太廚具廠房).

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### CONSTRUCTION BUSINESS *(continued)*

The construction projects categorised by geographical location are as follows:

- 111 projects in the Shaoxing Region, such as Industrial and Commercial Department Office Building (工商局大樓), Shaoxing County Public Transport Company Office Building (紹興市公交公司辦公樓) and Kebei Avenue (柯北大道).
- 53 projects in other parts of Zhejiang Province, such as the Lishui Teachers' School Lecture Building (麗水師專教學樓), Wuyi People's Hospital (武義人民醫院), Hangzhou Baima Apartment (杭州白馬公寓), Fuyang Yongtai Office Building (富陽永泰辦公樓), Huangyanbin Binjiang Century Highrise Apartment (黃岩濱江世紀高層公寓) and Rui An – Cangnan Section of the Yong'an Expressway (甬安高速公路瑞安至蒼南段).
- 69 projects in the Shanghai Municipality and other parts of China, such as New Times Garden Phase III (新時代花園三期), Bai Yulan Garden Phase II (玉蘭花園二期), Four-Season Spring House (四季春別墅), Shangcai Factory Product Exhibition Centre (上柴廠產品展示中心), Hubei Yinfeng Textiles Company Limited (湖北銀豐紡織有限公司) and new students' hostel in Anhui University (安徽大學新校學生公寓).



Projects undertaken by the Group constantly gain industry recognition. During the year, 59 of the Group's projects received awards and the major awards received included:

Awards	Project
Silver Medal of the State Outstanding Construction Projects	– Shanghai Lianyang Garden
National Construction Decoration Award	– Huzhou County Electrical Power Allocation Centre
Zhejiang Province's Qianjiang Cup	– Shaoxing Wenli Institute Nanshan Company – Area A of Taizhou Telecom Allocation Management Office – Fuyang Yongtai Office Building – Shaoxing Agriculture Bank Keqiao Finance Centre – Shaoxing Province Administration Centre
Shanghai's Bai Yulan Cup	– Bai Yulan Garden Phase II G2, 3, 5 – Four-Season Spring House No. 6-12 – Aviation Electronic R&D Testing Building Phase II
Shanghai's Pujiang Cup	– New Times Garden Phase III Building No. 2-11 – Daan Garden Club House

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### CONSTRUCTION BUSINESS *(continued)*



The Group had 343 projects in progress as at 31st December 2003, including 71 municipal and infrastructure projects, 111 public utilities projects, 89 residential projects and 72 industrial projects, with a total contract sum of approximately RMB6,500 million. Among these, over 200 projects are expected to be completed in 2004.

### BUILDING MATERIALS BUSINESS

The Group is determined to develop quality semi-finished building materials that are cost-effective and in line with policy of energy conservation adopted in the PRC. These materials include ready-mixed concrete, concrete piles, concrete ducts, large roof sheathings, and fire-proof materials. While there was pressure to increase product prices as prices of raw materials, such as cement and steel increased, the demand for building materials grew as a result of huge investment on fixed assets in Zhejiang Province. Responding to these market forces accordingly, and through extending its sales channels, the Group's turnover from building materials business was RMB226.0 million (2002: RMB148.7 million), accounted for 7.5% (2002: 6.5%) of the Group's total turnover.

The Group's semi-finished building materials are proven to be very popular. The growth of sales for ready-mixed concrete was most significant. During the year, the sales and growth rate of various semi-finished building materials were as follows:

<b>Semi-finished building materials</b>	<b>Sales in 2003 (RMB'000)</b>	<b>Proportion in building materials sales</b>	<b>Growth (year on year)</b>
Ready-mixed concrete	163,141	72%	62%
Concrete piles	24,927	11%	35%
Concrete ducts	24,696	11%	26%
Large roof sheathings	5,291	2%	48%
Fire-proof materials	7,933	4%	25%

As the Group has innovated and improved its building materials in the past few years, production costs were reduced accordingly. The Group could sell building materials at relatively lower prices allowing it to capture a larger market share. Operating results (before taxation and finance costs) amounted to RMB43.1 million, representing an increase of 33.1% over the previous year.

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### BUILDING MATERIALS BUSINESS *(continued)*



To further improve its building materials business, and to tie in with the Government's "Building Materials Industrialisation Policy", the Group has started to develop a building materials industrial park – Baoye Residential Industry (Building Materials) Park (寶業住宅產業(建材)園區) ("Building Materials Park") in the Kexi Industrial Park (柯西工業園) in the Keqiao Economic Development Zone, Shaoxing County, Zhejiang Province in 2002. The total investment involved was RMB220 million, and as at 31st December 2003, RMB119 million has already been injected into the project, of which RMB85,054,000 was come from proceeds of H share issue. The Park consists of a research and development centre for building materials and several building material production lines, including:

Production Lines	Date of completion	Date of mass production	Annual production capacity
Curtain wall	November 2003	December 2003	400,000 sq.m.
Wooden door	November 2003	May 2004	75,000 sets
Steel structure	Under Construction	August 2004	70,000 tonnes

### REAL ESTATE BUSINESS

The Group has expanded its business in recent years to cover downstream real estate, and also extended the scope of geographic coverage from Zhejiang Province to other parts of Eastern China. The Group capitalised on its well-established brand of "Baoye" to drive its real estate sales. During the year, sales of real estate totalled RMB84 million, representing 2.9% of the Group's turnover. The Group has 3 projects under development of a total construction area of approximately 250 thousand sq.m., including Keqiao City Garden Phase III, in Shaoxing County, Zhejiang Province and Guazhu Fengqing and Yulan Grand Palace.

Due to the rising property prices, the selling prices of the Group's properties increased. The gross profit margin grew from 29% in the previous year to 41% during the year.

With the Shaoxing government introducing policies to build Greater Shaoxing and to integrate the county into the Yangtze River Delta, the property price in county has skyrocketed. Besides favorable government policies, the demand for housing and property prices hikes were fuelled also by the rising expectations on living standards of Shaoxing citizens whose per capita income ranked 3rd among cities and counties in the Yangtze River Delta, and the continuous urbanisation of the area, as a result of considerable number of relocating households and the growing number of peasants moving into cities. Helped by the above factors and its prominent brandname, the Group successfully instilled in customers the impression "Baoye builds good houses".



The Group also attaches great emphasis to land reserves. Earlier, we had acquired a considerable amount of quality land at quite low cost, and the current land reserves which mainly located at Hefei, Shaoxing and Shanghai, are sufficient for development in the coming five years.

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### PROSPECTS

The infrastructure and building materials business will definitely grow continuously with the accelerated urbanisation in China. Currently, the rate of urbanisation in the country has reached 40.9% and is expected to rise to about 44% in 2010. According to the plan spelt out in 《中國21世紀人口與發展》 (Population and Development of China in 21st Century), the population of China is to be kept under 1.4 billion in 2010 with urban population, expected to grow by 30% to 620 million. This means in the next 10 years there will be an increase of 160 million in urban population, resulting in a tremendous need for infrastructure. According to a survey conducted by an authoritative institution, for every percentage point increase in urbanisation in China, there will be:



- 2% growth in GDP.
- 16 million growth in urban population.
- If the average living space for every individual is 20 sq.m., the area needed to house the expanded urban population will be 320 million sq.m.. By the year 2010, the need for new housing will reach 3 billion sq.m..
- The need for 20 km of roads for every 100 sq.km. of urbanised land. The related construction of government buildings and hospitals etc. will be a stronger growth driver for the construction industry and real estate market than the demand for new housing.



Increased investment in residences and infrastructure will be translated into huge development potential for the construction sector, which is expected to outgrow the national economy by 3-5% and to become the pillar industry of the country. The income from construction business is anticipated to grow at a compound annual growth rate of 15% in the next five years. Growth in the output value of the construction industry in the Yangtze River Delta area, where Zhejiang Province is located, leads with the highest GDP and GDP per capita in the country, is expected to exceed 20%.

Located in Zhejiang Province, the sixth largest metropolitan area in the world, the Group is well positioned for the enormous opportunities arising from economic unification of the Yangtze River Delta and Eastern China. Urban development and redevelopment have also brought about new business opportunities for the Group. With the sustained development of the Chinese economy and the rise in people's standard of living, China's sustained urbanisation and fixed assets investments will continue to increase. China's entry into the World Trade Organisation, the 2008 Olympics in Beijing and the 2010 World Exposition in Shanghai will also generate infinite opportunities for the industry.

## Management Discussion and Analysis

### **PROSPECTS** *(continued)*

The accelerated urbanisation and geographical advantage of the Group's major market have provided Baoye with tremendous development opportunities. The Group will capitalise on its industry leading qualifications, its brandname and expertise, to effectively capture these opportunities.

The accelerated urbanisation has stimulated the demand for infrastructure, but at the same time has caused pollution in the cities. To curb pollution and meet rising expectations on the quality of living and on the construction sector, the Chinese government clearly states in its 《關於推進住宅產業現代化提高住宅質量的若干意見》 (Certain Options Concerning the Promotion of Industrialisation of Building Materials to Improve Housing Quality) the need for industrialisation and standardisation of the building materials industry and that the initial stages of the initiatives are to be completed by 2005. The paper also specifically called for the acceleration of the use of advanced construction technology and techniques and encouraged the use of steel structures and concrete bricks by the construction industry.

The Group's Building Materials Park is currently the largest and the only production base for the manufacture of building materials in Zhejiang Province. The Group has insisted on manufacturing building materials that are standardised, institutionalised and in compliance with the PRC's requirements on environmental protection for more efficient use, shorter construction time and reduced pollution and energy consumption of the building. With a thorough understanding of the expectations on the industry and its inherent competitiveness, the Group expects to play a leading role in the revolutionary transformation of the construction industry in China. It will also be a major beneficiary of the revolution.

Looking ahead, with superb know-how and valuable experience in the industry, the Group will be able to grasp every opportunity in the construction and real estate businesses and consolidate its leading industry position. We will strive to strictly control costs, enhance construction quality, and maintain our growth momentum. The Group will expand its income sources, laying a solid foundation for future development and for generating rewarding returns for our shareholders.

To further expand our business, the Group planned to acquire a 90% equity interest of a PRC company which is engaged in a major property development at Hangzhou, and to bid for a piece of land and two construction projects through Baoye Investment. The total investment in the four projects amounted to RMB177,000,000. It was paid by the Company's working capital. Preliminary negotiation of the acquisition of a PRC company has been completed and details of the formal agreements are being finalised. The piece of land concerned has been acquired and construction of the site has commenced. Bidding for the other construction projects will be opened soon. The Management believes the projects will be smoothly implemented and will bring profitable income to the Group in the coming years.



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### LIQUIDITY AND FINANCIAL RESOURCES

As at 31st December 2003, the Group's cash and cash equivalent balances amounted to RMB482.4 million, compared with RMB237 million as at 31st December 2002. As at 31st December 2003, the shareholders' fund of the Group amounted to RMB816.4 million, representing an increase of RMB358.9 million from RMB457.5 million as at 31st December 2002.

As at 31st December 2003, the Group had outstanding bank loans amounting to RMB543 million, representing an increase of RMB399 million from RMB144 million as at 31st December 2002. All of the outstanding bank loans was repayable within one year.

As at 31st December 2003, the gearing ratio of the Group was 65% (as at 31st December 2002: 62%) which was arrived at by dividing total liabilities by total assets.

### MATERIAL ACQUISITIONS AND DISPOSALS OF SUBSIDIARIES

Save for (i) the acquisition of Shaoxing Baogang Woodwork Co., Ltd.; (ii) the establishment of Shaoxing Baoye Construction Intelligent Technology Co., Ltd.; and (iii) the disposal of Fuzhou Baoyue Real Estate Development Company Limited, the Group did not undertake any significant acquisition or disposal of subsidiaries or associated companies during the year ended 31st December 2003. Details of these acquisition and disposal are set out in note 13 to the accounts.