

Chairman's Statement

RESTRUCTURING PROPOSAL (CAPITAL REORGANISATION, CREDITORS' SCHEME, SHARE CONSOLIDATION, CHANGE IN BOARD LOT SIZE, OPEN OFFER) AND NEW CONTROLLING SHAREHOLDER

On 27 April 2004, the Capital Reorganisation and the Creditors' Scheme became effective and the Open Offer became unconditional and that all conditions precedent to the Restructuring Proposal have been fulfilled and the Restructuring Proposal was completed. Mr. Tam Jin Rong ("Mr. Tam") became the new controlling shareholder of the Company with beneficial interest in 51.7% of the issued share capital of the Company. Mr. Tam was subsequently re-designated as the Chairman of the Company on 29 September 2004. Mr. Tam's shareholding was subsequently reduced to 48.1% upon a placement and top up subscription completed on 13 December 2004 and further reduced to 36.5% upon a placement completed on 31 March 2005.

BUSINESS REVIEW

Results

For the year ended 31 December 2004, China Nan Feng Group Limited (the "Company") and its subsidiaries (the "Group") recorded a turnover of HK\$36.8 million (2003: HK\$14.1 million), an increase of 161%. The Group generated a gross profit of HK\$2.6 million (2003: loss of HK\$3.3 million).

The Group generated a profit attributable to shareholders of HK\$161.8 million (2003: loss of HK\$262.3 million), which mainly includes gain of approximately HK\$100.3 million arising from debts discharged under the Creditors' Scheme. It also includes a gain of approximately HK\$50.2 million arising from deconsolidation of Prosperity Construction and Decoration Limited ("PCDL"), a wholly-owned subsidiary of the Company, upon receiving a winding-up Court order and gain of HK\$23.0 million arising from the disposal of subsidiaries which the Board resolved not to provide additional financial resources to those businesses.

Dividend

No interim dividend was declared and paid during the year (2003: Nil). The Board of Directors does not recommend the payment of a final dividend for the year (2003: Nil).

Construction Contractor

Despite the recovery of the overall economy in Hong Kong during this year and the strong rebound of the property sector, the construction industry in Hong Kong did not stage a meaningful recovery and continued to be one of the sectors which lagged behind the general economic recovery in Hong Kong. In view of the continuing difficult operating environment and the high costs of maintaining a full construction management team in Hong Kong, the Group decided to substantially scaled down its loss making Hong Kong construction division since the second half of last year and focused its efforts in the more promising construction market in Guangdong Province, the People's Republic of China (the "PRC"). The turnover of the construction division as a whole recorded an increase of 161% from approximately HK\$14.1 million last year to HK\$36.8 million in this year. The entire turnover of HK\$36.8 million this year was generated in the PRC, an increase of 207% over that of HK\$12.0 million last year.

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Construction contract costs mainly represent direct materials and subcontracting costs for construction projects. It increased by 111% from approximately HK\$16.2 million last year to HK\$34.2 million this year, slightly less than the increase in turnover.

We would continue to increase our resources to grasp and develop the growing and more profitable construction and property related businesses in the PRC.

Operating Expenses

General and administrative expenses, which included staff cost, professional fees, consultancy fees and general administrative expenses decreased by 63% from approximately HK\$32 million last year to HK\$12 million this year due to the decrease in professional fees and consultancy fees upon the settlement of numerous litigations and the completion of the Restructuring Proposal. In addition, the Directors also implemented strict cost control on the operating expenses during the year.

A SUBSIDIARY UNDER WINDING-UP COURT ORDER

On 9 June 2004, the High Court of Hong Kong issued a winding-up order to PCDL, a subsidiary of the Company. PCDL had a substantial capital deficiency and had an insignificant scale of operation. This resulted in a gain of HK\$50 million.

LIQUIDITY AND FINANCIAL RESOURCES

Creditors' Scheme

On 19 February 2004, the majority of the Scheme Creditors approved the Creditors' Scheme under which all indebtedness owed by the Company to the Scheme Creditors on the Scheme Record Date were released, discharged and fully settled.

The Creditors' Scheme was sanctioned by the High Court of Hong Kong and the Supreme Court of Bermuda on 16 and 19 March 2004, respectively. The total indebtedness admitted by the Scheme Administrator under the Creditors' Scheme was discharged in full and final settlement by way of a combination of the cash payment of an aggregate amount of HK\$12 million from the proceeds of the Open Offer and an issuance of 180,000,000 Creditors Shares at HK\$0.10 per Creditors Shares to the Scheme Creditors, resulted in a gain amounted to approximately HK\$100.3 million.

Placement of Shares

On 29 November 2004, the Company announced a placement of 60,000,000 existing shares and a top up subscription of the same amount of new shares at HK\$0.08 per share raising HK\$4.55 million (net of expenses) for general working capital purposes. This represents 7.55% of the then existing issued share capital of the Company.

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Support for Subsidiaries with Capital Deficiencies

During the year there were many subsidiaries of the Company in capital deficiency situation. The Board decided only subsidiaries with future prospect would receive continuing financial support from the Company.

Gearing Ratio

The Group's consolidated interest bearing debts less bank and cash balances amounted to HK\$5.6 million (2003: HK\$58.0 million) in contrast to the shareholders' equity of HK\$5.6 million (2003: capital deficiency of HK\$177.6 million), resulting in a gearing ratio of 98% at 31 December 2004. As the shareholders' equity of the Group was a deficiency of HK\$177.6 million at 31 December 2003, calculation of gearing ratio as at 31 December 2003 was inappropriate.

Finance Cost

Interests on the Group's borrowings were based on the normal commercial interest rates for bank mortgage and the shareholders' loan.

EXCHANGE RATE RISK EXPOSURE

Most of the Group's transactions were in Hong Kong Dollars and Renminbi. As the exchange rate of Renminbi against Hong Kong Dollar was relatively stable during the year, we were not exposed to any significant exchange risk in this year.

CONTINGENT LIABILITIES

As at 31 December 2004, the Group did not have any material contingent liabilities.

FUTURE PROSPECTS

The new controlling shareholder and Chairman, Mr. Tam Jin Rong, is the founder of the Southpeak Group in Dongguan, Guangdong Province, the PRC. The businesses of the Southpeak Group include property development, construction, supermarket, transportation and manufacturing industries. The Directors decided only to focus on business areas where they have expertise and had substantially scaled down or terminated the financial support for unprofitable businesses in the Hong Kong and overseas. The Directors will continue to develop the construction and property related sectors in the PRC, in particular in the Guangdong Province where the Board have extensive business networks and local expertise.

The Board would also look for other opportunities in both Hong Kong and the PRC for investments which would generate positive cashflows and profits to the Company.

EMPLOYEE

As of 31 December 2004, the Group has approximately 82 employees (2003: 20 employees) in Hong Kong and the PRC.