

Chairman's Statement and Management Discussion and Analysis

I am pleased to report the activities of South China Holdings Limited (the "Company") and its subsidiaries (together the "Group") for the year ended 31 December 2004.

BUSINESS REVIEW

Building on the recovery of local and global economies, the Group was able to achieve another good year of result in 2004. The Group recorded turnover HK\$3.8 billion and profit attributable to shareholders of HK\$124.2 million for the year ended 31 December 2004, representing increases of 11% and 33% in turnover and profit respectively over the last year.

South China Brokerage Company Limited ("SCB") benefited from the high daily trading volume and high market capitalisation in the local stock market in 2004 and recorded double-digit growth in both turnover and net profit. The toy manufacturing business under South China Industries Limited ("SCI") was however affected by the substantial rise in raw material costs, in particular plastic, driven up by the surging oil prices. This directly reduced the Group's overall gross profit margin and indirectly raised our distribution costs. Administrative expenses were further reduced by our continuing efforts in bringing down costs at the operating level which helped to offset some of the adverse impacts from rising direct costs. Our travel business attained impressive growth with a profit increase to almost double the previous year. The rebound of prices of investment properties and gain on securities trading also contributed to the overall improvement in result.

As at 31 December 2004, the Group reported an unrealized gain of HK\$11.4 million on holdings of trading securities and a surplus on revaluation of our investment property portfolio of HK\$77.5 million. In addition, there was a write-back of allowance for advances to a principal associate of HK\$57.9 million due to the significant appreciation in the underlying property value of our 30% owned Grade-A commercial building, "The Centrium" in Central, as compared to a write-back of HK\$41.1 million in 2003.

During the year, the Group acquired additional equity interest in a subsidiary, Wah Shing International Holdings Limited ("Wah Shing"), and recognized a discount on acquisition of HK\$15.7 million.

Trading and Manufacturing

The Group's toy OEM business carried out through Wah Shing Toys Company Limited ("WST") and Wah Shing Electronics Company Limited ("WSE") under Wah Shing performed differently in the last year. WST's result was far below expectation and reported a drop of 78% from HK\$58 million to HK\$13 million due to a substantial decrease in sales and significant increase in write-down of inventories. WST also faced the surging raw material prices and labour costs in the Mainland. The continuing fierce market competition made it difficult for WST to pass on the increased material costs to customers.

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WSE was able to turn around its result from a loss of HK\$7.9 million in 2003 to a profit of HK\$9.3 million principally attributable to the significant increase in demand for electronic toys resulting in a sharp jump in turnover by 1.2 times over 2003.

The performance of the footwear operation under Wah Shing was satisfactory. In March 2004, it won Wal-Mart's "International Supplier of the Year 2003" award in recognition of its outstanding quality and logistics. Sales orders from Wal-Mart surged in 2004. Its turnover in 2004 increased by 32% over 2003 and it reported a profit of HK\$6.3 million.

The other leather products and garment operations made a positive contribution, though insignificant, to the Group during the year. The aggregated operating profit from the trading and manufacturing segment was HK\$30.7 million for the year 2004.

The Group's associate Nority International Group Limited ("Nority") which engages in the manufacture and export of athletic-style leisure footwear, reported a net loss of HK\$29.5 million for the year 2004.

Securities and Financial Services

The average daily stock market turnover leaped from HK\$10.3 billion in 2003 to HK\$15.9 billion in 2004. Our income from securities and futures broking increased by 19% to HK\$74.0 million for the year 2004 as compared with 2003. In August 2004, the trading of Hang Seng Index Futures contracts was newly launched on the existing online trading platform. Both the trading volume and the number of clients for online securities trading continued to grow. The result from the broking operation turned from loss of HK\$11.9 million in 2003 to a profit of HK\$6.2 million in 2004.

The size of the loan and advances portfolio for margin financing and personal loans dropped slightly by 7% to HK\$179.7 million. In line with this decline, the overall income from this operation dropped moderately to HK\$30.3 million. However, the provision for bad and doubtful debts was substantially reduced by 49% to HK\$7.4 million in 2004 due to our tight credit monitoring measures to control the quality of our loan portfolio.

Our corporate advisory division was not profitable amid the intense competition in obtaining corporate advisory business. However, it did well to reduce the operating loss from HK\$9.8 million in 2003 to HK\$1.6 million in 2004.

For the year under review, SCB's turnover and profit attributable to shareholders increased by 12% to HK\$132.0 million and by 1.1 times to HK\$68.6 million respectively. The gains on holdings of trading and non-trading securities helped to contribute to the satisfactory results in addition to its improvement in operating activities.

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Travel and Related Services

Hong Kong Four Seas Tours Limited ("Fourseas"), our travel business division sustained its impressive growth for another year in 2004. It achieved a 36% increase in turnover to HK\$1.5 billion and a 96% increase in operating profit to HK\$17.7 million. During the year, Fourseas established consolidated agent status for more major airlines in Hong Kong so as to increase its competitive advantage in the wholesale ticketing business. During the year, student travel packages and corporate sales business with higher profit margin grew steadily. At the same time, more marketing and services product developments were made to strengthen and broaden the client base.

Property Investment and Development

The property market improved considerably throughout the year. Our property arm recorded a 33% increase in gross rental income and a net operating profit of HK\$9.4 million and an unrealised gain on revaluation of HK\$77.5 million, as a result of increased rental revenues from higher property occupancy rates, a reviving commercial sector and better renewal terms during the year. The most significant appreciation in property value was recorded as a write-back of allowance for advances to an associate in respect of the 30% owned Grade-A commercial building, "The Centrium" in Central. Over 97% of the gross floor area was leased out at the end of 2004, generating very satisfactory revenue.

Media and Publications

The media group overall made progress in terms of the market position and market penetration of our magazines, and considerable investment was made into the launch and nurturing of young and new titles. During the second half of last year, the media business launched two new magazines, namely "Friday Weekly", a weekly trends and style magazine targeted at the youth market and "Capital Femme", a women's lifestyle and finance monthly magazine. Individual mature magazines experienced significant growth in advertising revenues, with extensions of titles launched, to further strengthen the brand names of these titles, and to provide a wider base for growth in advertising and circulation revenues in the future. By the end of 2004, the media group had launched pilot testing titles in Beijing to prepare for the establishment of our publishing titles in the PRC market.

Information and Technology

The Group revitalised its IT business in 2004. The turnover of the IT business soared by 72% to HK\$64.2 million with a reduced loss of HK\$0.3 million when compared to a loss of HK\$4.5 million incurred in the previous year. In 2004, the Group consolidated its business platform and increased its interest in certain profitable PRC IT joint ventures with perceived good potential for growth in the foreseeable future.

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Agricultural Business

The agricultural business reported a loss of HK\$4.8 million for the year 2004 as compared with a loss HK\$8.2 million for the year 2003. Operations continue to focus on product diversification and cost control methods at our Guangzhou fruit plantation and Nanjing fish rearing projects, while our Hebei province fruit plantation project continues to expand in acreage as we enter into our second year of investment.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2004, the Group had a current ratio of 1.17 and a gearing ratio of 8.6% (31 December 2003: 1.16 and 13.5% respectively). The gearing ratio is computed on comparing the Group's total long-term bank borrowings of HK\$75.2 million to the Group's shareholders' fund of HK\$872.4 million. The Group's operations and investments continue to be financed by internal resources and bank borrowings. The Directors believe that the Group has sufficient banking facilities and working capital for its operations.

EXPOSURE TO FLUCTUATIONS IN EXCHANGE RATES AND RELATED HEDGES

As at 31 December 2004, the Group had no significant exposure to fluctuations in foreign exchange rates and any related hedges.

INVESTMENTS

For the year ended 31 December 2004, the Group reduced and increased its non-trading and trading securities portfolios by HK\$25.2 million and HK\$3.5 million respectively, after accounting for the increase in fair values of HK\$3.2 million and HK\$11.4 million for non-trading and trading securities respectively by the end of the year.

CAPITAL STRUCTURE

Subsequent to the balance sheet date, on 22 February 2005, SCB, a subsidiary of the Company, placed 970,000,000 warrants of HK\$0.026 each (the "Warrants") to independent investors. The Warrants entitle the holders to subscribe in cash for ordinary shares of HK\$0.025 each in SCB at a subscription price of HK\$0.1012 per share (subject to adjustment) and are exercisable on or before 2 March 2006. The net proceeds under the warrant placing of approximately HK\$25 million will be used as working capital of the Group.

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Save as disclosed above, the Group had no other debt securities or capital instruments as at 31 December 2004 and up to the date of this report.

MATERIAL ACQUISITIONS AND DISPOSALS

During the year ended 31 December 2004, the Group acquired a further approximately 9% equity interests of Wah Shing for successive considerations of HK\$22 million.

On 31 March 2004, the Group acquired the remaining 51% equity interest in information and technology business from Geely Automobile Holdings Limited (formerly known as Guorun Holdings Limited) ("Geely") for an aggregate consideration of HK\$5.5 million of which HK\$0.5 million was satisfied in cash and the remaining HK\$5 million was satisfied by a set-off against an equivalent amount owed from Geely to the Group.

PLEDGES OF ASSETS, CONTINGENT LIABILITIES

As at 31 December 2004, a significant portion of the short-term borrowings was for normal trading purposes with the level of borrowings depending on the level of trading activities. The property, plant and equipment and the development and investment properties of the Group mostly secured the long term banking facilities.

Details of the Group's contingent liabilities and pledge of assets are set out in notes 42 and 43 to the financial statements respectively.

EMPLOYEES

As at 31 December 2004, the total number of employees of the Group was approximately 27,600. Employees' cost (including directors' emoluments) amounted to approximately HK\$531.2 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 employees may also receive a discretionary bonus at the end of each year based on performance. The Company adopted an employee share option scheme which came into effect on 18 June 2002.

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PROSPECTS

Trading and Manufacturing

Industry-wide challenges such as the uptrends in raw material prices and labour costs in the Mainland, the electricity and worker shortage in Southern China, the possible revaluation of Renminbi and the more stringent product and workplace safety requirements continue to affect our toy manufacturing business. The mounting price reduction pressure from overseas customers and competition from other toy makers in the Mainland and the market demand for more products with a wider variety of novel designs are all putting pressure on our gross profit margins. The outlook for WST and Nority remains dim.

Better than expected, our footwear operation was consecutively selected as a Wal-Mart "International Supplier of the Year 2004". Leveraging on the award recognition received from Wal-Mart, our footwear operation is considering the expansion of production capacity to cope with the increase in sales.

Securities and Financial Services

The online trading platform is enabling us to expand our customer base especially outside the territory and there are significant benefits to be obtained in terms of cost, efficiency and effectiveness by more extensive reliance on the online trading platform. The new trading platform of Hang Seng Index Futures contracts was well accepted and we are positive about its future. Following Hang Seng Index Futures contracts, a wide array of global commodity futures contracts will soon go onto the online trading platform.

Travel and Related Services

Fourseas will continue to focus on the development of corporate and retail sales in 2005. A new office has been rented for the expansion of the working team for corporate customers. A new retail branch was opened in early February this year to capture more retail customers in a highly populated residential area. A more balanced customer mix will be achieved in the coming years.

In February 2005, Fourseas was appointed as the General Sales Agent in Hong Kong & Macau for China Regal Cruises on the Yangtze New Three Gorges. We believe this will make a further positive contribution to the Group. Experienced business development staff are being recruited to cope with our different new markets and products.

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Property Investment and Development

The recent result of government land auctions signifies an upward trend in the property market. Vacancy levels for all types of property continue to fall, which is favourable for our portfolio of office and commercial property. Property rentals inevitably move upward in line with increases in property value. We expect that our rental properties and in particular those in the central commercial districts will continue to contribute to the Group in the coming year.

Looking forward to a rising property market, we shall re-tune our property portfolio to divest non-core assets and seek opportunities in Hong Kong and China.

Media and Publications

We expect our media business to continue to grow, in terms of advertising and circulation incomes as advertising spending is expected to soar with a stronger economy and sentiment. Titles with strong bases as a result of the previous investments are expected to see significant growth, and borderline titles to make positive contribution this year. The Group will focus on creating strong brands in its titles, and further enhancing the magazines' presence in the market through brand extensions and multi-dimensional promotional activities.

The Group will consider launching new titles in the market should the opportunity arise, as well as expanding further into the PRC publishing industry.

Information and Technology

The business development of individual IT joint ventures continues to improve.

Agricultural Business

We will continue to cut down on costs, while minimizing market and weather risks through size and diversification. Expanding our acreage remains our top priority.

Overview

We expect the Hong Kong economy will continue to improve in view of the closer relationship with the Mainland China, the opening of Disneyland in September 2005 and the relaxed travel and currency restriction for Mainland individuals.

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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 service.

On behalf of the Board

Ng Hung Sang, Robert

Chairman

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

21 April 2005