

Management Discussion and Analysis

FINANCIAL REVIEW

The Group's turnover for the year ended 31 March 2005 (the "Year") amounted to HK\$225,003,000 (2004: HK\$89,422,000), representing a rise of 151.62% as compared with last year. Loss attributable to shareholders was HK\$69,193,000 (2004: HK\$26,300,000). Since a significant number of the Group's city development and investment projects, and environmental protection and water treatment projects in China were still under construction, no revenue had been recorded from them yet. In the past year, the Changsha city development project was completed and the sewage plant in Qinhuangdao City, Hebei Province started service, generating revenue for the Group. Expected to be completed in late 2005, the "Wang Guo Commercial Plaza" located in Phase One of "Interchina Mall" in Changsha also commenced pre-sale. It will bring to the Group profitable returns.



As at 31 March 2005, total assets and net assets of the Group valued at HK\$1,673,599,000 (31 March 2004: restated HK\$1,614,957,000) and HK\$706,686,000 (31 March 2004: HK\$761,422,000), representing an increase of 3.63% and a decrease of 7.19% respectively against those of the previous year.



As at 31 March 2005, the Group's cash on hand, deposits in bank (including segregated and trust account) and deposits in other financial institutions totaled approximately HK\$64,361,000 (31 March 2004: HK\$58,494,000), representing an increase of 10.03% against the balance as at 31 March 2004. Approximately 41.81% of the deposits was denominated in Hong Kong dollars while the remainder in Renminbi. The Group's net current liabilities amounted to HK\$134,638,000 (31 March 2004: restated net current assets of HK\$5,231,000). The Group's outstanding bank and other borrowings were HK\$562,869,000 (31 March 2004: HK\$599,485,000) which mainly comprised bank and other borrowings of approximately HK\$315,293,000 repayable within a year, and HK\$247,576,000 of bank and other borrowings repayable after more than one year. The gearing ratio (total borrowings/total assets) was 36.06%.



As at 31 March 2005, approximately 24.97% of the Group's bank and other borrowings were denominated in Hong Kong dollars while the rest in Renminbi. The Group's bank and other borrowings were arranged on both floating and fixed rate basis of which approximately 81.35% were secured by the Group's investment property, property, plant and equipment and properties under development for sale.

Since the Group's business is primarily based in China and Hong Kong, and during the Year, there were no significant fluctuations in the exchange rate of Renminbi against Hong Kong dollar, the Group was not exposed to material risk in foreign exchange fluctuations, requiring no corresponding hedging provision. The Group had not used any financial instrument for hedging purposes and any instrument for hedging against foreign currency investment.

BUSINESS REVIEW AND PROSPECT

Environmental Protection and Water Treatment Operation

The development of the Group's water treatment and environmental protection projects was encouraging. All of the Group's construction projects went smoothly during the Year. Construction of the plant and installation of the sewage treatment facility located in Haigang District, Qinghuangdao City, Hebei Province was completed in September 2004. It commenced operation in December last year. For the Year, it



generated HK\$6,966,000 in turnover for the Group's environmental protection and water treatment business. The plant currently processes on average 100,000 tonnes of sewage per day, and the production capacity will be gradually enhanced to 120,000 tonnes per day in the future.

The strategic alliance between Interchina Water Treatment Limited and North China Municipal Engineering Design & Research Institute (中國市政工程華北設計研究院) enabled the Group to enjoy the benefits of cost integration over the Qinghuangdao Sewage Treatment Plant project, which was clearly demonstrated from its infrastructure and operation. Besides building the first BOT sewage treatment facility in the Hebei Province, the work of the alliance also helped foster planning and construction of sewage treatment plants in the cities of the Hebei Province. This highly productive operation mode created a solid foundation for the development of the Group's sewage treatment business in Hebei Province.

The Qinghuangdao Sewage Treatment project of the Group also adopted a comprehensive production and monitoring system that promises reliable and impeccable quality control. And, this sophisticated testing facility can serve as the research and development and operational training center of Interchina Aihua (Tianjin) Municipal & Environmental Engineering Company Limited, providing the Group strong technical support in the future.



Meanwhile, the Group was granted the right for a period of 22 years by the Ma'anshan Municipal Government to invest, construct and operate a sewage treatment plant and redevelop an existing sewage treatment plant in May 2004. The total daily sewage processing capacity of the plants will be 60,000 tonnes. In addition, in May 2004, the Group entered an agreement with the Changli Municipal Government in Hebei

Province to establish a sewage treatment plant that can handle 40,000 tonnes of sewage per day. Both projects are in their early and preparatory stages.

For the Group's water supply project in Hanzhong City, Shaanxi Province, the PRC, the Group is formulating the details of operations with the Hanzhong Municipal Government. It is scheduled to start operations by the end of 2005.

The Group is negotiating with the Xianyang Municipal Government in Shaanxi Province, the PRC regarding the future operations of the water supply project in Xianyang City.

Apart from accelerating its water treatment and environmental protection projects, including the Sewage Treatment Plants in Ma'anshan City and Changli City and Water Supply Plants in Hanzhong City and Xianyang City, the Group has been actively seeking potential and quality merger and acquisition opportunities to further consolidate its development foundation and boost operational scale.

In early May 2005, the Group entered into an cooperation agreement with the People's Government of Zhuozhou, Hebei Province, the PRC, which granted the Group the exclusive right to finance, design, construct, own, manage, maintain and operate two sewage treatment plants (each processing 40,000 tonnes of sewage per day) in Zhuozhou City, Hebei Province for 25 years.



The Group also entered into a legally binding memorandum with another Independent Third Party in mid April 2005 in relation to the acquisition of the entire equity interest in Shanghai You Lian Enterprise (Holdings) Limited (“You Lian Enterprise”). You Lian Enterprise runs Asia’s largest sewage treatment plant – Zuyuan First Sewage Treatment Plant – in Pudong New Area, Shanghai. The plant, a major sewage



treatment facility in Shanghai, has a daily sewage treatment capacity of 1,700,000 tonnes, which is the highest in Asia. Upon the completion of the acquisition, the plant will generate annual income no less than RMB110,000,000 for the Group. The Group’s daily sewage processing capacity by then will reach more than 2,000,000 tonnes and thus will be a paramount force in China’s environmental protection and water treatment industry. The Group will make use of You Lian Enterprise as a platform for water treatment investment and financing to facilitate the construction of quality infrastructure, and establish a solid foundation for it to explore other potential areas for development.

City Development and Investment Operation

Riding on its years of experience investing in and building infrastructures, the Group’s city development projects yielded returns during the Year. It completed the construction of Changsha New Sports City and its related stadium and facilities had been in service, generating an income of HK\$179,132,000 and a profit of HK\$9,321,000 to the Group respectively. By participating in this project, the Group will increase its premium, high growth value land reserve at fixed price for the future property development operation in the PRC.



Nevertheless, the Wang Guo Commercial Plaza, located in the Interchina Mall (Phase One), a mega-scale luxurious residential and commercial complex in Changsha, received overwhelming response since its sale started in August 2004. As at the reporting date, over 700 shop premises were sold and over HK\$200 million was liquefied. Other hotel equities are now under construction. The construction of Wang Guo Commercial

Plaza of Interchina Mall (Phase One) is expected to be completed in late 2005 with the certificate of compliance to be granted shortly. The pre-sale permit of two hotel equities in Phase One of the project was obtained. Open sale began in April 2005 and more than 35% of the flats were already sold. The Group will offer more flats later in response to the market demand.

With sales scaling new heights, the Changsha Interchina Mall not only established prominence as a property brand name in China, but also provided an example to follow for urban construction industry in China. In early February 2005, at RMB235,000,000, the Group bought four plots of land of total area 378.53 hectares in the New Industrial Park of the Xian Hi-tech Industrial Zone (高新技術產業開發區新型工業園) in Shaanxi Province. The Group will plan to establish another Interchina Mall in Xian adopting the proven operational and development mode of the Changsha project, and subsequently also introduce it to other provincial cities or municipalities, developing a chain operation.

In September 2004, the Group sold the land situated at R-06, in Changsha New Sports City. The 49,571 square metres lot was sold at the consideration of RMB69,526,000. The land transfer is being processed and the income from this sale will be recognised in the next fiscal year.



Apart from Changsha City and Xian City, in November 2004, the Group entered an agreement with the Economic Development Management Committee (漢中經濟開發區管理委員會) of Hanzhong City, Shaanxi Province to develop supplementary infrastructure for the city's Commercial Administrative Tourist Region (Northern Region). The project will cover 4.3 square kilometers of land. According to the agreement, the Group will undertake the construction of various infrastructures including roads, lighting and electric supply, water supply network and land flattening. The Group is also allowed to undertake development projects in other aspects such as real estate development, and has priority in obtaining permits for land use.

Property and Other Investment Operation

During the Year, the Group's rental income amounted to HK\$22,953,000 (2004: HK\$30,187,000), representing an decrease of 23.96% compared with the corresponding period last year. With competition in the leasing market in Shanghai continued to intensify, the Group recorded lower rental returns from its leased property in Shanghai compared with last year. In Hong Kong, the Group sold the office building at 18-22 Cheung Lok Street, Yaumatei, Kowloon in August 2004 at a consideration of HK\$127,180,000, resulting in a profit of HK\$1,180,000.



The Group entered a conditional purchase agreement with Shanghai Qiangsheng Group Co. Ltd in October 2003 to acquire 39,772,732 issued shares of the latter at RMB178,977,294. However, the agreement was terminated automatically by its first anniversary when approval for purchase was not granted by the authority concerned. The termination of the agreement will not have any material adverse effect to the Group. Details of the termination were given in the announcement dated 28 October 2004. The Group will look into other business opportunities with Shanghai Qiangsheng Group.



In late April 2005, the Group disposed 60% controlling interest in Money Capture Investments Limited, amounting to approximately HK\$137,000,000 (will be accounted for in the next fiscal year). The move evidenced the Group's determination in focusing on its core business lines of developing environmental protection and water treatment, and city development and investment.

Securities and Financial Operation

The Group's securities and future operation generated an income of HK\$13,529,000 (2004: HK\$59,235,000), constituting commission and interest income from margin clients. Having strengthened internal control over the borrowings to margin clients during the Year, especially in reducing the proportion of borrowings for non-index constituents stock, income generated by the securities and future operation lowered by 77.16% compared with the same period last year.



Corporate Visions

The hottest issues that China has to address today are the building of an efficient national water supply network and city development, and the former in particular takes key investment. Prompted by the robust growth of the national economy in recent years and backed by local governments' policies to nurture market economy, city development in China has been burgeoning. The general objective is to, through boosting efficiency, speed up rebuilding of cities, improve living conditions for the urban dwellers, strengthen urban management, enhance urban management standard as well as the living standards of the urban population.

Seeing abundant potential opportunities in city development, the Group has been actively negotiating with municipal governments in China, on water treatment and urban development works.

In the aspect of environmental protection and water treatment, the Group's negotiation with municipal governments touched on issues including cooperation details in relation to water supply and sewage treatment. Mid-size projects with daily processing capacity of between 50,000 and 100,000 tonnes will be the Group's priority, and the Group expected that these projects will eventually provide a scalable foundation of its development in the next three years. For the Zuyuan First Sewage Treatment Plant which can treat up to 1,700,000 tonnes of sewage per day, the management believes that building more water supply and water treatment infrastructure can help to expand the scale of the plant's water treatment and environmental protection operations and to bring short-to-mid term returns.



In the aspect of city development, the Group will use Changsha as critical reference in expanding its city development investment in other cities and municipalities. The Group is negotiating with municipal governments concerning the development of urban infrastructure and other possible property investments with the aim of boosting its land reserve.

Looking ahead, riding on its strong capital base, sound technologies and business vision, the Group will strive to bring fruitful returns to its shareholders.

LIQUIDITY AND FINANCIAL RESOURCES

During the Year, the Group's financial resources comprised mainly cash income generated by its business operations as well as bank and other borrowings. With the best interest of shareholders in mind and at minimum financial cost, the Group will make financial arrangements (including capital investment) to facilitate its current and future business development plans.

Of the net amount of HK\$126,400,000 from selling property received by the Group in August 2004, HK\$80,941,000 was used to repay bank loans and the rest was applied as the Group's operational capital.



CONTINGENT LIABILITIES

During the Year, with reference to the repurchase and loan agreements it signed with a bank in April 2003, the Group bought back 31 units of properties from the purchaser. As a result, the corporate guarantee to a bank for its mortgage loans was released. As at 31 March 2005, the Group had no contingent liabilities (31 March 2004: HK\$100,000,000) to the purchaser of the Group's property.

The Group provides a guarantee of RMB5,000,000 to Ma'anshan Government, PRC, for the commitment to invest in Ma'anshan, details as per announcement dated 21 May 2004.

During the Year, a bank guarantee of HK\$5,000,000 of HKFE Clearing Corporation Limited has been terminated and released.



PLEDGE OF GROUP'S ASSETS

As at 31 March 2005, the Group's assets were pledged as security for liabilities, comprising investment property with a book value of HK\$394,325,000 (31 March 2004: HK\$455,511,000) and property, plant and equipment with book value of HK\$687,086,000 (31 March 2004: restated HK\$518,535,000) and property under development for sale with a book value of HK\$86,903,000 (31 March 2004: Nil).

EMPLOYMENT AND REMUNERATION POLICY



As at 31 March 2005, the Group had a total of 388 employees in the PRC and Hong Kong. Staff costs for the Year amounted to HK\$31,577,000 (2004: HK\$31,846,000). To maintain the Group's competitiveness, salary adjustments and award of bonus for staff are subject to the performance of individual staff members. Apart from offering a retirement benefit scheme and a share options scheme for its staff, the Group also provides staff with various training and development programs.