

Chairman's Statement and Management Discussion and Analysis

I am pleased to report the activities of South China Industries Limited (the "Company") and its subsidiaries (collectively, the "Group") for the year ended 31 December 2006.

BUSINESS REVIEW

The Group recorded turnover of HK\$4.1 billion and profit attributable to the equity holders of the Company of HK\$312.4 million for the year ended 31 December 2006, representing an increase of 2% in turnover and a 56% increase in profit as compared to 2005.

Trading and Manufacturing

The segment recorded a 8.8% drop in turnover to HK\$2.1 billion and a profit of HK\$45.2 million in 2006, a decrease of 49.9% as compared to 2005.

Our diversified industrial operations in the People's Republic of China (the "PRC") faced similar harsh macroeconomic factors, namely increased worker wages, appreciation of the Renminbi, and rising raw material prices. Profit performance suffered relatively minor setbacks, with the major impact on the profit performance from the consolidation of the loss attributable to the footwear manufacturing operation of Nority International Group Limited ("Nority").

2006 was a year of corporate restructuring for our manufacturing segment with two major accomplishments: the privatization of Wah Shing International Holdings Limited, previously listed on the Singapore Exchange, and the acquisition of an additional interest in Nority. By grouping our various manufacturing units under one umbrella, we plan to streamline our operations in the long-term.

Property Investment and Development

Our property portfolio reported a rental profit of HK\$13.0 million and a revaluation gain of HK\$35.4 million.

During the year, we disposed of certain Hong Kong properties at aggregate cash proceeds of HK\$39.2 million and recorded a gain on disposal of HK\$5.3 million.

This year, our Group expanded our property interests in the PRC by increasing our controlling stake in a joint venture that holds a sizeable site area within the central retail district in Nanjing ("the Nanjing retail site"), the provincial capital city of Jiangsu. We now hold 87% interest of the Nanjing retail site, which involves retail floor area in excess of 50,000 square metres and is held primarily for rental purposes.

Our Hong Kong rental portfolio performed satisfactorily.

Travel Business

Hong Kong Four Seas Tours Limited ("Fourseas") recorded a 17.1% increase in turnover to HK\$1.9 billion and almost doubled operating profit to HK\$25.4 million in the year 2006. Fourseas benefited from a strong increase in passenger volume in the market and further strengthened its position in the ticketing wholesale market.

Information Technology

For our IT segment, the turnover decreased from HK\$82.4 million in 2005 to HK\$72.1 million in 2006 and operating loss increased from HK\$49,000 in 2005 to HK\$793,000 in 2006. The increased loss was largely due to increase in administrative expenses.

Chairman's Statement and Management Discussion and Analysis

Agriculture

The agricultural business units reported a loss of HK\$5.2 million in this year as compared with a loss of HK\$5.5 million in 2005 before gain or loss on fair value of biological assets. We benefited from some cost savings made in our Guangzhou lychee farm operations, but the business unit continues to be in its investment period due to our expanding winter dates project in Hebei.

Liquidity and Financial Resources

As at 31 December 2006, the Group had a current ratio of 1.03 and a gearing ratio of 9.0% (31 December 2005: 1.14 and 3.4% respectively). The gearing ratio is computed on comparing the Group's total long-term bank borrowings of HK\$128.5 million to the Group's equity of HK\$1,435.2 million. The Group's operations and investments continue to be financed by internal resources and bank borrowings.

During the year, the Group raised some purpose-specific bank borrowings for the privatisation of Wah Shing and the acquisition of an additional interest in a property joint venture in Nanjing. The Group's non-current assets rose substantially but net current assets (current assets less current liabilities) reduced as a result. The increased non-current assets are mostly income generating assets and therefore will benefit the Group in terms of its coming revenue, profit and cash flows. The reduced net current assets is only a temporary situation, and 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 2006, the Group had no significant exposure to fluctuations in foreign exchange rates and any related hedges.

INVESTMENTS

For the year ended 31 December 2006, available-for-sale investment and equity investments at fair value through profit or loss increased by HK\$8.0 million and HK\$49.5 million, respectively, after accounting for the increase in fair value of HK\$5.2 million and decrease in fair value of HK\$1.4 million for available-for-sale investments and equity investments at fair value through profit or loss, respectively.

MATERIAL ACQUISITIONS AND DISPOSALS

During the year ended 31 December 2006, the Group acquired an additional 31.8% equity interests of Wah Shing and an additional 52.8% equity interests of Nority at successive considerations of HK\$78.4 million and HK\$67.3 million, respectively. Wah Shing and Nority were then wholly owned and 95.4% owned by the Group, respectively.

During the year ended 31 December 2006, the Group acquired 87% equity interests of 南京微分電機有限公司 at a consideration of RMB41.7 million.

Save as disclosed above, there were no material acquisitions and disposals during the year.

CAPITAL STRUCTURE

The Group had no debt securities or other capital instruments as at 31 December 2006 and up to the date of this Annual Report.

Chairman's Statement and Management Discussion and Analysis

PLEDGES OF ASSETS AND CONTINGENT LIABILITIES

As at 31 December 2006, a significant portion of the borrowings was for normal trading purposes with the level of borrowings depending on the level of trading activities and for purchases of incoming generating non-current assets. Certain of the property, plant and equipment and investment properties of the Group secured the banking facilities.

Details of the Group's contingent liabilities and pledge of assets are set out in notes 43 and 44 to the financial statements respectively.

EMPLOYEES

As at 31 December 2006, the total number of employees of the Group was approximately 24,100. Employees' cost (including directors' emoluments) amounted to approximately HK\$520.7 million for the year.

In addition to salary, other fringe benefits such as medical subsidies, provident fund and subsidized 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.

PROSPECTS

Trading and Manufacturing

Our toys operation is faced with a tough operating environment for the near future, as there is no short-term solution for the adverse trends in currency, material prices, and wage rates. Nevertheless, our management believes that if we re-focus our efforts on efficiency and continue to broaden our customer base, in the long run we will stay ahead of competitors.

Our shoes operation was again awarded "International Supplier of the Year 2006" by Wal-Mart, a major customer of the footwear manufacturing operation. This is the fourth consecutive year we received this award. The operation is on track to deliver record turnover for 2007 as our previous enlargements and improvements to our factory base are being reflected in increased output.

Property Investment and Development

Subsequent to the increase in stake in the joint venture that owns the Nanjing retail site, a prime retail site in Yunan North Road, Gulou District, the main shopping district of Nanjing city, we are putting in greater efforts to tap its full development potential and to upgrade its current rental mix. We expect to see improving rental income from the joint venture in the coming years.

We are now in the process of increasing our controlling stake in a few other joint ventures that own sizable and valuable land bank in Nanjing that possess high potential for commercial or residential development. We anticipate concluding the acquisitions in 2007.

In early 2007, the Group transferred a 51% equity interest in the property development project of a prime retail shopping complex in Shenyang to a related company, South China Land Limited ("SCL", formerly known as Capital Publications Limited), which is listed on the GEM Board. The project is located in "Zhong Jie (中街)", the central commercial district of Shenyang city with a site area of approximately 25,000 square meters and will give us gross retail rental floor area of approximately 120,000 square meters. The Group in return received a non-interest bearing convertible note in the principal amount of HK\$408 million due in 2012 carrying a right to subscribe for SCL shares at HK\$0.075 per share before maturity. Upon full conversion of the convertible note, the Group may hold up to 75% of SCL, subject to the minimum public float requirement of the Stock Exchange.

Chairman's Statement and Management Discussion and Analysis

In addition to holding the Shenyang property development project, SCL has recently entered two property projects in the Mainland China. The first project, in which SCL will have a 70% interest, involves 400,000 square metres of site area in the commercial centre of the coastal economic development region of Tianjin-Bohai (天津渤海臨港經濟技術開發區). There is a contractual agreement with the aforementioned development region whereby SCL is responsible for the re-location and redevelopment of the commercial district. The second project, in which SCL will have a 49% interest, involves 20 square kilometers of site area in the Huanghua Port Development Zone. This is a joint development project with 滄州港口投資開發有限公司 to reclaim and redevelop land adjacent to the Huanghua Port for residential and industrial use.

In August 2006, the State Council passed the National Plan for Coastal Port Layout, the highest-level national port plan of the PRC. Of the five large-scale ports, Bohai Sea Area is to be developed into a large modern port group, consisting of Liaoning, Tianjin-Hebei (Cangzhou), and Shandong Coastal Ports, to service the social and economic development of Beijing, Tianjin, the north coastal areas and inland areas of the PRC. The facilities of Tianjin-Hebei coastal port will include coal shipping ports, large-scale transfer, warehousing and transportation for large quantity bulk cargo, including oil, natural gases, iron ore and foods, and facilities for passenger transportation and commercial car transfer.

Given the Group's long term presence and investment in the Tianjin-Tanggu (天津—塘沽) region over the last 15 years, the senior management of the Group has built very extensive knowledge and understanding of the recent development in the Tianjin-Bohai (天津—渤海) region. As a result, the Group is well positioned to participate in the rapid development of the region.

It is the strategy of the Group to fully and extensively engage in development and restructuring of land parcels as well as development and construction of industrial, commercial and residential properties in the region to service the expected rapid growth of the Tianjin-Hebei Coastal Port and Cangzhou Bohai New Zone.

Travel Business

Fourseas seeks to build upon the success of last year to further increase its market share. During the first quarter of 2007, we set up a project team to investigate and negotiate potential joint venture deals in the PRC. Progress so far is very promising, and management believes we can make good use of Fourseas' outbound market share to develop new revenue models.

We will continue to look for expansion possibilities within Mainland China either in the form of joint venture with a local partner, or chartered flights or local tourism related projects. Management believes that Fourseas' outbound market share will assist in developing new revenue models.

Information Technology

The information technology operation will further expand in the provision of services and software development. Management will streamline operations and aim to be profitable.

Agriculture

As of first quarter 2007, we have added acreage in Chongqing for our agricultural arm for the purposes of forestry and fruit tree plantation. We are still looking to expand acreage in Jiangsu and Hebei as rental cost is still relatively low in the region, and on top of our recent Chongqing expansion we are also considering other Northern provinces of the PRC. On the business side, apart from developing the forestry plantation in Chongqing, management is looking into agricultural wholesale markets as a new revenue source and has already negotiated with the government in Hebei for suitable land.

Chairman's Statement and Management Discussion and Analysis

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 services.

Ng Hung Sang
Chairman

Hong Kong, 17 April 2007