

MANAGEMENT'S DISCUSSION AND ANALYSIS

FINANCIAL FOCUS

Return on Equity — Hsin Chong Construction Group Ltd. and its subsidiaries (together, "Hsin Chong") pays close attention to return on equity for both current businesses and new investment opportunities. Hsin Chong appreciates just being more profitable than other companies of the same industry may not be good enough for some investors. As a manager of public shareholders' capital, Hsin Chong aims to generate risk-adjusted returns on capital that are systematically acceptable to investors taking into account that construction is a cyclical industry. Historically, Hsin Chong's return on equity has ranged from 6.5% to 29.6% (except 1999 which reported a loss on equity of 6.0% due to the sizeable provisions for properties under development). Current year's return on equity (before final dividend) is 3.6% due to significant losses incurred in the foundation segment. Such figure is unacceptably low comparing with Hsin Chong's track record and target of 15%. Looking forward and taking into account the competitive environment, Hsin Chong has set a minimum target of 12% in the forthcoming year.

Capital Structure — Hsin Chong historically adheres to a policy of conservative capital management. We believe a strong balance sheet affords more opportunities upon an industry upturn, inspires greater confidence amongst its clients, bankers, sub-contractors, suppliers and employees. Furthermore, since progress payments in the construction business inherently create high operating leverage, an overlay of high financial leverage over any extended period would not be prudent.

Executive Remuneration — Remuneration for executive directors and senior management of Hsin Chong is tied in a meaningful way to profitability. The Board believes such incentive remuneration best motivates its staff, aligns management's interests with shareholders' and minimises fixed salary expenses.

ELEMENTS OF EXECUTIVE COMPENSATION

The compensation package for executive officers of Hsin Chong consists of the following basic elements.

Base Salary — The base salaries of executive officers of Hsin Chong are set on an individual basis and are designed to enhance Hsin Chong's ability to attract and retain highly qualified key executives. Salaries bear a direct relationship to the executive's level of responsibility and reflect his/her individual talents and skills.

Annual Bonus — The annual bonus paid to executive officers is a critical element of compensation designed to reward the achievement of corporate goals, as well as individual productivity and performance. Amount of bonus is based upon performance of Hsin Chong during the year and upon the value to Hsin Chong and its shareholders of significant corporate accomplishments during the year, as well as upon the contribution of the individual executive to such performance and accomplishments.

Share Options — Share option awards provide the most significant element of long-term compensation from middle management staff to senior executives. Share options provide compensation in a manner that is intrinsically related to long-term corporate performance and stockholder's value, since the value of share options is determined solely by Hsin Chong's share price over the term of the option. Share option awards are discretionary determined by a variety of factors, including the level of responsibility and performance of the executive and his/her ability to affect share value.

Retirement Plans — Hsin Chong has designed a retirement benefit program to provide executives and employees with retirement compensation and at the same time promotes staff stability. Under the program, the employee contributes 5% of his/her basic monthly salary which is matched by Hsin Chong's contribution of 5–10%,

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depending only on the length of service. The retirement benefit programme, first established in 1973 is fully-funded and has received appreciative remarks from both working and retired staff.

Hsin Chong has established Hsin Chong Group Mandatory Provident Fund Scheme in December 2000 to conform with the requirements as stipulated in the Mandatory Provident Fund Schemes Ordinance.

FINANCIAL POSITION

Hsin Chong maintains its policy of conservative capital management with balance sheet ratios and coverage ratios remaining at prudent levels. Debt-to-capitalization ratio (before final dividend) is 24% at the balance sheet date (2000: 25%). Interest cover is at 2.8x (2000: 3.4x) with debt to cashflow cover of 2.3x (2000: 0.9x). Total bank borrowing amounted to HK\$242.6 million (2000: HK\$265.4 million), of which, 94% (2000: 20%) falls due after one year. During the year under review, Hsin Chong successfully negotiated several term loans to refinance term loans due this fiscal year and to increase Hsin Chong's liquidity. The applicable interest rates for Hsin Chong's borrowing, which are largely at a spread to HIBOR, averaged 8.6%. Up to 30th June, 2001, total credit facilities available to Hsin Chong amounted to HK\$605.0 million with an undrawn balance of HK\$395.0 million. Land and buildings with a net book value of HK\$212.7 million (2000: HK\$220.7 million) have been pledged to secure a related mortgage loan. In respect of Guangzhou Wen Chang Square first phase development in which Hsin Chong has an effective interest of 42%, negotiation for a project bank loan of RMB100 million for financing the construction cost is in progress. Hsin Chong's other financing requirements for the coming year are expected to be met by available cash as at balance sheet date, cash generated by operations and bank credit facilities.

As of 31st March, 2001, net working capital (before payment of final dividend) amounted to HK\$378.3 million (2000: HK\$134.0 million). Cash balances and short term

investments are 4.2% higher at HK\$794.3 million compared with last year end (HK\$762.2 million) with 91% (2000: 97%) as cash and cash equivalents. The Finance Committee has set out criteria on the credit ratings of financial institutions and the limits on counterparty exposures for placing fixed deposits. Actual exposures to each bank are closely monitored so as not to exceed the pre-set limit except otherwise approved. In this way, counterparty exposures to banks with deposits placed are expected to be adequately managed.

With Hsin Chong's borrowings and cash balances primarily denominated in Hong Kong and US dollars, Hsin Chong has no significant exposure to foreign currency fluctuations. In addition, Hsin Chong adopts hedging policies for mitigating interest rate risk and exchange rate risk associated with respective assets or liabilities, rights or obligations. Such policies ensure effective cost controls on construction cost as early as at the tendering stage and controllable borrowing cost for operation and investment needs.

OFF BALANCE SHEET FINANCIAL INSTRUMENTS

Interest rate risk and exchange rate risk are risks to earnings or capital arising from movement of respective rates. The former mainly arises from bank borrowings by Hsin Chong and the latter comprises exposure due to currency needs from normal business operation for material procurements and services requirements. Hsin Chong has established policies and procedures to the assessment, booking and monitoring of all such off balance sheet financial instruments under limits approved by the Finance Committee. Such policies and procedures have been reviewed by the internal audit personnel and reported to the Audit Committee in June 1999. The controls and procedures governing such activities were overall considered adequate for their intended purposes.

Gain or loss arising from relevant hedging transactions will be booked against profit and loss associated with underlying assets or liabilities. For example, any differential interest

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receipts and payments, arising from interest rate swap agreements are accrued so as to match the net income or cost of such agreement with the related finance expenses from the underlying borrowings.

In light of the current interest rate trend as affected by the slack US economy, to date, only 23.8% (2000: 99.6%) of Hsin Chong's long-term borrowing have been hedged by interest swap agreements. The Finance Committee pays close attention to financial markets and monitors market condition changes.

OPERATIONAL REVIEW ON CONTRACTS

Over the past twelve months, HK\$1,751.7 million new contracts were received by the building construction and civil engineering arms. The new awards included two Housing Authority's projects in Tseung Kwan O Area 73A Phase 4 and Kwai Shing East Estate Phase 7 with an aggregate value of HK\$916.8 million, a residential development at Tuen Mun Area 4C TMTL 384 of Housing

Society of HK\$550.2 million together with two civil works, namely, the construction of sewage treatment plant at the Cyberport Development, Telegraph Bay and the road and associated engineering works for Hung Shui Kiu North Phase I, totalling HK\$243.8 million. Reduced nominated subcontractors works, fluctuation and contingency sum adjustments eventually led to a net increment of HK\$950.4 million in the division. Contracts totalling HK\$2,597.0 million were completed. Major completions covered Tung Chung Area 30 Phase 2, Tin Shui Wai Area 102 Phase 6, Sau Mau Ping Estate Phase 8, Kwai Fong Estate Phase 6 and Wang Tau Hom Estate Phase 14, all being contracts received from the Housing Authority with a total contract sum of HK\$2,517.8 million. The foundation operations received new contracts amounting to HK\$78.2 million with HK\$90.7 million in completion. Overall, consolidated orders on hand amounted to HK\$5,586.5 million, a 22.9% decrease over the preceding period.

The breakdown in outstanding contracts of Hsin Chong's construction subsidiaries is as follows:

	31/3/2000	Contracts Received	Contracts Completed	31/3/2001
	HK\$ Million	HK\$ Million	HK\$ Million	HK\$ Million
Building Construction and Civil Engineering	6,998.2	950.4	(2,597.0)	5,351.6
Foundations	247.4	78.2	(90.7)	234.9
Total	7,245.6	1,028.6	(2,687.7)	5,586.5

The split of outstanding contracts at the balance sheet date is as follows:

	Amount	%
	HK\$ Million	
Government	2,720.9	48.7
Housing Authority	2,348.2	42.0
Public, charitable or non-profit institutions	26.8	0.5
Private developers	490.6	8.8
Total	5,586.5	100.0

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Operating profit after finance costs for building construction and civil engineering increased by HK\$30.2 million to HK\$110.1 million. The improvement is mainly due to contribution from the HK\$6.5 billion contracts awarded in the fiscal year 1998/99 that were largely completed in the year with profit substantially recognised.

Foundation operations sustained further losses of HK\$73.9 million this year (2000: HK\$46.9 million) with reduced turnover of 27.5% to HK\$130.7 million after its delisting from the Housing Authority in 1999. As noted in our last annual report, though Hsin Chong has taken proactive steps to restructure management and processes in the foundation business, the competitive nature of the industry and the ever increasing expectations and demands of our customers, from



Tin Shui Wai Area 101, Phase I

An Artist’s Impression of Disciplined Services Quarters, Lee On Road, Kowloon



both public and private sectors, have resulted in significant cost overruns. Prolonged negotiations for claims settlement with clients have also led Hsin Chong to prudently make additional provisions. Looking forward, foundation operations will remain difficult.

BUILDING CONSTRUCTION AND CIVIL ENGINEERING

Total turnover increased by 9.9% to HK\$2,950.5 million while outstanding orders decreased by 23.5% to HK\$5,351.6 million for 2000/2001. Profit margins improved to 3.7% in this year from 3.0% of last year.

Major contracts received during the year include:

Contract	Location	Type	Amount
HK\$ Million			
Tseung Kwan O Area 73A Phase 4	Tseung Kwan O	Residential	729.6
Tuen Mun Area 4C TMTL 384	Tuen Mun	Residential	550.2
Kwai Shing East Estate Phase 7	Kwai Shing	Residential	187.2
Sewage Treatment Plant, Cyberport	Telegraph Bay	Civil Work	178.4
Road and associated engineering works for Hung Shui Kiu North Phase I	Hung Shui Kiu	Civil Work	65.4

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Major contracts completed during the year include:

Contract	Location	Type	Amount
HK\$ Million			
Tung Chung Area 30 Phase 2	Tung Chung	Residential	905.1
Tin Shui Wai Area 102 Phase 6	Tin Shui Wai	Residential	614.4
Redevelopment of Sau Mau Ping Estate Phase 8	Sau Mau Ping	Residential	409.8
Redevelopment of Kwai Fong Estate Phase 6	Kwai Fong	Residential	308.1
Redevelopment of Wang Tau Hom Estate Phase 14	Wang Tau Hom	Residential	280.4

FOUNDATIONS

With thin volume of workload on hand, turnover for the year decreased by 27.5% from last year to HK\$130.7 million. Contracts on hand narrowed to HK\$234.9 million. During the year, HK\$78.2 million new contracts were received against HK\$90.7 million completion. Consequently, order book decreased by HK\$12.5 million.

Major completions included bored pile works for a residential project at So Kwun Wat, Tuen Mun (HK\$27.0 million) and non-bored pile works for Student Hostels for The Hong Kong Polytechnic University at KIL 11117 (HK\$38.5 million) and Shatin Racecourse Redevelopment — Central Complex Phase 2 and 3 (HK\$13.5 million).



Sau Mau Ping Estate, Phase 8

ASSOCIATES

With an order book of HK\$629.2 million (2000: HK\$282.2 million), Hsin Chong Aster, Hsin Chong's 50% owned electrical and mechanical installation associate, returned to profitability year despite continuing severe market conditions. Contracts received amounted to HK\$423.9 million with HK\$76.9 million in completion, resulting in a 123.0% increase in order book. Major order secured include electrical and mechanical works for Cyberport Development at Telegraph Bay of HK\$315.4 million, Student Hostels Phase I Development for City University of Hong Kong of HK\$33.0 million as well as a primary school in Area 27 and a primary school and a secondary school in Area 101, Tin Shui Wai of HK\$29.3 million.

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The breakdown in outstanding contracts of Hsin Chong's construction associates is as follows:

	31/3/2000	Contracts Received	Contracts Completed	31/3/2001
	HK\$ Million	HK\$ Million	HK\$ Million	HK\$ Million
Hsin Chong Aster	282.2	423.9	(76.9)	629.2

Note: The amounts shown above are gross and do not reflect Hsin Chong's net attributable share.

CONSTRUCTION RELATED PROPERTY DEVELOPMENTS

Lung Mun Oasis, Tuen Mun, Hong Kong

At the report date, 271 carparking spaces remain unsold. These carparking spaces are currently let out either temporary or on an hourly basis for rental income. Hsin Chong has a 85% interest in the development.

No. 3 Lockhart Road (formerly AON Insurance Tower), Wanchai, Hong Kong

The development is a 26-storey office building. Hsin Chong has a 20-year freely-assignable master lease for the 10th-26th floors, comprising approximately 77,000 square feet which is substantially let. Hsin Chong's cost thereof is amortised on a straight-line basis over 20 years. The residual lease term is around 13 years.

Century Harbour Hotel, Sai Wan, Hong Kong

The property is a 3-star hotel with 276 rooms (including 12 suites). Hsin Chong has an effective interest of 22.5% in the investment at a carrying value of HK\$47.1 million (2000: HK\$51.0 million). With a re-focus on clientele towards the higher end, average room rates have been increased which resulted in lower occupancy rate at 67%. However, the overall performance of the hotel is satisfactory.

Hsin Chong Center, Kwun Tong, Hong Kong

The property has been used as headquarter of Hsin Chong since April 1999 with some office space taken up by certain related companies on medium term lease.

18A La Salle Road, Kowloon Tong, Hong Kong

The development, in which Hsin Chong holds a 25% interest, was completed during the year. It comprises six luxury residential houses (named as Jade House, Ruby House, Sapphire House, Emerald House, Amber House and Pearl House) with gross floor area ranging from 5,544 square feet to 6,518 square feet each. Subsequent to the year end, the show house (Ruby House) with gross floor area of 6,516 square feet was sold for HK\$46.8 million. The renovation work of new show house (Jade House) with distinctive interior design was completed in mid May 2001.



18A La Salle Road, Kowloon Tong

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Guangzhou Wen Chang Square, Guangzhou City, PRC

The project, comprising a total site area of 18,215 square metres (approximately 196,000 square feet) which is bound on the East by Wen Chang Road North, on the South by Yao Hua Jie North, Guangzhou City, PRC, is intended to be developed into residential units and shops in phases. Phase I comprises a total floor area of approximately 39,159 square metres for sale with 81 carparking spaces at an estimated cost of approximately HK\$333.3 million. Negotiation with the PRC municipal government on the premium for the land use right was finalised on 29th December, 2000.

Hsin Chong has a 70% interest in the Foreign Joint Venturer which in turn holds a 60% interest in the project with the balance held by Guangzhou Development District Real Estate Corporation.

To date, Hsin Chong's investment amounts to HK\$129.5 million (2000: HK\$111.9 million). In light of the slight market oversupply in Guangzhou City, a HK\$26.8 million provision for impairment in value of the development was made in this year, making up an accumulated provision of HK\$59.5 million at the end of the year.

Taifeng Industrial Park, Tianjin, PRC

Hsin Chong has a 95% interest in the intended development of 'standard ready for use' light industry factory buildings in Tianjin Economic Development Zone, Tianjin, PRC. The project's development cost is carried at HK\$23.7 million (2000: HK\$23.6 million). Development plans have been put on hold due to unattractive market conditions. As of today, a provision of HK\$17.0 million has been made for the impairment in value of the property interest.

SuCasa Service Apartments, Kuala Lumpur, Malaysia

SuCasa is a 180-room service apartments development with dining, recreational and parking facilities which commenced operations in 1993. Hsin Chong has an attributable 10% interest in SuCasa, carried at a cost of HK\$11.6 million after

a HK\$4.3 million return on reduction of capital during the year. Results reflected better industry conditions, though the contribution is insignificant to Hsin Chong.

Budi Ikhtiar, Kuala Lumpur, Malaysia

Hsin Chong has an attributable interest of 20% in the site, which is a joint venture with the Mandarin Oriental Hotel Group. At present, development plans have been put on hold. Total costs remain unchanged at HK\$10.7 million, which is lower than current market value.

MAJOR CONTRACTS AND PROJECTS SUBSEQUENT TO YEAR END

Consolidated

Subsequent to the year end, Hsin Chong was awarded HK\$1,537.9 million construction contracts, including IL 8969 Cyberport Development at Telegraph Bay, Pokfulam, Hong Kong — Contract C3/C4 and a proposed Alteration and Addition Works at No. 3 Dai Kwai Street, Tai Po Industrial Estate from the private sector as well as the construction and foundation works for Shek Lei Estate Phase 12 from the Housing Authority. The foundation subsidiary, on the other hand, received one new contract for foundation works at 377 Prince Edward Road, Kowloon of HK\$12.0 million. Major

An Artist's Impression of Cyberport Development at Telegraph Bay, Pokfulam, Hong Kong



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completion included a residential development at Tin Shui Wai Area 101 Phase I of the Housing Authority with a contract value of HK\$600.1 million. Overall, these bring total outstanding contracts from HK\$5,586.5 million at year end to HK\$6,505.6 million as of 30th June, 2001.

Associates

Hsin Chong Aster received an electrical and mechanical installation contract for Senior Citizen Residence at Tseung Kwan O Area 44 of HK\$19.2 million from the Hong Kong Housing Society.

SALE AND PURCHASE OF SHARES

During the financial year, the Company's repurchase program resulted in a total repurchases and cancellations of 25,478,256 shares at an average price of HK\$0.51 per share. Apart from this, there was no redemption, purchase, sale or cancellation of shares in the Company made by the Company or any of its subsidiaries during the financial year ended 31st March, 2001.

Changes in number of shares in issue are as follows:

Date	Number of Shares	Notes
1st April, 2000	660,677,296	Shares in issue
3rd July, 2000	945,698	Shares issued under Employee Share Subscription Scheme at HK\$0.46 each
3rd January, 2001	1,054,089	Shares issued under Employee Share Subscription Scheme at HK\$0.43 each
April 2000 – March 2001	(25,478,256)	Shares repurchased and cancelled under the Repurchase Mandate at prices ranging from HK\$0.45 to HK\$0.57 per share
31st March, 2001	<u>637,198,827</u>	Shares in issue