

CHAIRMAN'S STATEMENT AND REVIEW OF OPERATIONS AND RESULTS

RESULTS

The Group's unaudited consolidated turnover for the period amounted to HK\$742 million, representing an increase of 20% as compared to last period's HK\$620 million. The Group's gross profit margin for the period was 39%, compared to gross profit margin of 38% for the last period. The Group's operating profit for the period was HK\$155 million (For 2001, it was HK\$142 million) representing an operating margin of 21% (For 2001, it was 23%). The Group's profit attributable to shareholders and basic earnings per share for the period was HK\$70.6 million and HK3.94 cents respectively (For 2001, they were HK\$65.2 million and HK\$4.32 cents respectively), which represent an increase of 8% and an decrease of 9% respectively compared to last period. The decrease in earnings per share despite the increase in profits was mainly because of the issue of 1.11 billion new shares during the period.

INTERIM DIVIDEND

The Group plans to continue expanding its business via organic growth and acquisitions and would need to conserve cash resources for such purpose. Hence, the Directors do not recommend the payment of dividend for the six months ended 30th June, 2002 and there was no dividend paid for the six months period ended 30th June, 2001.

BUSINESS REVIEW

The four businesses of the Group are (i) Compressor Business, (ii) Semiconductor Business, (iii) Information Technology Business and (iv) Office Furniture Business.

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Compressor Business

The Group's Compressor Business with Sanyo Electric Co. Ltd of Japan, a minority partner, is one of the top four suppliers of residential air-conditioner compressor in mainland China with a market share of about 10%.



During the period ended 30th June, 2002, the residential air-conditioner market in mainland China has experienced severe price competition. This was mainly brought about by the proliferation of numerous brands of low end residential air-conditioners marketed and produced by numerous small residential air-conditioner assemblers. The relatively high margin of residential air-conditioners compares to other home appliances and the low cost entry barrier of assembling, as oppose to manufacturing, attracted new low end entrants. It is envisaged that residential air-conditioner market will consolidate in the near future and most of these opportunistic new entrants will vanish. There is thus price pressure on the upstream air-conditioner compressor manufacturers but not as severe as that in the end product air-conditioner market. This is because the top 5 air-conditioner manufacturers in mainland China supply some 70% of the total market. Moreover, its high barriers of entry such as investment costs and technology have deterred new entrants. Nevertheless, prices of air-conditioner compressor has dropped by some 10%.

Despite the above mentioned market condition and price reduction for the period ended 30th June, 2002, turnover amounted to HK\$541 million. This represents an increase of 23% over the HK\$438 million for the period ended 30th June, 2001. Sales volume reached 1,397,000 units compared to 971,000 units in previous corresponding period. The Compressor Business has continued to make a significant contribution to the Group's operating profit with good margin. Despite the price reduction, both gross and operating margins are maintained because of continual successful material localisation program and tight cost controls. An operating profit (before goodwill amortisation) of HK\$167 million (For 2001, it was HK\$133 million) was achieved during the period.

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As the air-conditioner market in mainland China enters its slow season, couple with the high inventory level of the entire residential air-conditioner industry, the Group's Compressor Business for the second half year of 2002 is expected to slow down significantly relative to the first half of 2002. The situation is not expected to improve in the short term until the consolidation of the end product residential air-conditioner market is over.

The annual production capacity of the Compressor Business has increased by 600,000 units to 2,800,000 units as a result of Phase IV expansion of C-R20F series rotary compressor production capacity during the period. Once the consolidation of the residential air-conditioner market completes, the Group is well poised to capture the huge potential demand for the residential air-conditioner in both new and replacement markets in mainland China, which will continue to be brought about by (i) growing affluence among the population, (ii) low penetration of residential air-conditioners which is about 30% in the cities, and (iii) replacement needs of air-conditioners after 7 to 8 years' usage.

On 16th April, 2002, each of the China Resources (Shenyang) Sanyo Compressor Co., Ltd., and Shenyang Shengrun Sanyo Compressor Co. Ltd. of the Compressor Business has entered into a Licence Agreement with its Japanese joint-venture partner, Sanyo Electric Co. Ltd. in which the latter licensed certain of its trademark for use by the Compressor Business for a renewable term of 5 years. This further enhances the Compressor Business's co-operation with its Japanese joint-venture partner, which brings long term benefits to the Compressor Business.

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Semiconductor Business

The Group's Semiconductor Business includes, among others, (a) the production facilities, with an annual capacity of 360,000 4-inch wafers, for design, fabrication, packaging and testing of 4-inch wafers for consumer integrated circuits ("IC") used in telecommunication devices and consumer electronic products such as toys and watches and (b) a leading fabless design house in mainland China.

Turnover of the consumer IC's produced by the Semiconductor Business amounted to HK\$118 million for the period compared to HK\$85 million in corresponding period in 2001, an increase of 39%. The increase was due to the contribution from the recently acquired fabless design house, Wuxi China Resources Semico Company Limited ("Semico"). The gross profit margin achieved by the Semiconductor Business was at a respectable 32% (For 2001, it was 30%) owing to tight cost control measures and relative low depreciation of 4-inch wafer production line. The Semiconductor Business achieved an operating profit (before goodwill amortisation) of HK\$13 million for the period ended 30th June, 2002.

At present, the domestic semiconductor industry satisfies only a small portion of the total demand in mainland China. This represents an excellent potential market for the expansion of the Group's Semiconductor Business. Since the consumer IC's produced by Group's Semiconductor Business belong to the low and mid end market segment, they are relatively immune to volatile price fluctuations found in high end IC market segment and contribute to the Semiconductor Business's stable gross profit margin.

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With the trend of vertical specialization in the semiconductor industry, apart from dedicated foundries, dedicated packaging and testing service providers, fabless IC design houses have blossomed in recent years. In February 2002, the Company has acquired a 55% equity interest in Semico, an equity joint-venture company incorporated in mainland China. Semico is a leading fabless IC design house engaging in the design, testing and sale of IC products and chips. Semico's products are principally used in the fields of consumer electronics appliances and telecommunication devices including, among others, calculators, display module of fixed line telephones, black and white Super-twisted-nematic-LCD, remote controls and voice synchronizers. The acquisition represents a good investment opportunity with relatively low capital investment.

Semico's current business focus on consumer and telecommunication ICs is in line with the Group's strategy on semiconductor business. Semico's strong market presence, rich product portfolio and about 150 experienced engineers and technicians together with the existing design team of the Group will provide a solid platform for the Group to further enhance its designing capabilities. Semico's established marketing channels in mainland China and rich product portfolio will help the Group strengthen its foundation for further penetration into the mainland China semiconductor market.

On 29th August, 2002, the Company, through one of its wholly owned subsidiaries, Semico Microelectronics (BVI) Limited, entered into a conditional agreement with the minority shareholder, the China Huajing Electronics Group Corporation ("China Huajing Group") of Semico, to acquire an additional 45% equity interest in Semico for a consideration of RMB13,083,750 (equivalent to approximately HK\$12,343,000) with the result that Semico will become the Company's wholly owned subsidiary upon completion, which is expected to be before 29th November, 2002. China Huajing Group is one of the largest domestic semiconductor enterprises in mainland China, principally engaged in the businesses of designing, fabrication, packaging, testing and sale of IC's and discrete devices. Currently, the Company is in active pursuit of acquiring a controlling interest in China Huajing Group. No definitive agreement has been in place between the parties in respect of the timetable, consideration and method of payment in connection with the proposed acquisition of China Huajing Group.

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Information Technology ("IT") Business

The Group's IT Business was carried out through Resources Link Network Limited ("Resolink"), a wholly owned subsidiary of the Company. The range of services and products provided by Resolink include, inter alia, business consulting services, enterprise applications, infrastructure services, value-added IT product distribution services, retail solutions and content management.



The major customer of Resolink is China Resources (Holdings) Company Limited and its subsidiaries. This provides Resolink with a solid customer base and steady income. Turnover for the IT Business amounted to HK\$21 million for the period ended 30th June, 2002 with an operating profit (before goodwill amortisation) of HK\$107,000 (For 2001, they were HK\$21 million and HK\$1.86 million respectively). The contribution from the IT Business is not expected to be significant for the foreseeable future.

Office Furniture Business

The Group's Office Furniture Business is one of the leading quality office furniture manufacturers and suppliers in mainland China. Its brand name is widely known and well-received in mainland China. At present, the Office Furniture Business has over 20 regional distribution channels across mainland China including 8 branches in major cities.



Turnover for the period ended 30th June, 2002 amounted to HK\$62 million with an operating profit of HK\$834,000 (For 2001, they were HK\$76 million and HK\$4.9 million respectively). Current period's competitive market has eroded the revenue and operating profits of the Office Furniture Business. The contribution from the Office Furniture Business is not expected to be significant for the foreseeable future.

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PROSPECTS

The Group will continue to expand in particular, its Compressor Business and Semiconductor Business, by organic growth, external acquisitions and by exploring the forming of strategic partnerships with both overseas and Chinese enterprises.

For the Compressor Business, the Group is confident of its long term potential despite the short term aberration of competitive pricing situation in the end product residential air-conditioner market. By increasing its annual production capacity from the current 2.8 million units to 3.1 million units of compressor upon the completion of Phase IV expansion in 2003, the Group's Compressor Business will strive to enlarge its market share in mainland China to capture the huge potential demand for residential air-conditioners in the longer term once consolidation in the residential air-conditioner market is completed. The Group would also enhance its product research and development through co-operation with its existing joint-venture Japanese partner, with the ultimate aim to enhance its product portfolio and keeping up with the latest cooling technology to increase competitiveness. As one of the top four air-conditioner compressor manufacturers supplying some 10% of the residential air-conditioner compressor market, the Group envisages the Compressor Business to grow steadily and eventually become the Group's cash cow to provide cash flow and funds to invest in other high growth industry such as semiconductor.

As to the Semiconductor Business, the Group will continue to benefit from the rapidly increasing demand in mainland China for consumer IC's. With the acquisition of Semico, the Group has increased its consumer IC's product portfolio and enhanced its capability on IC design. These further strengthen the foundation of the Semiconductor Business for further penetration into the mainland China semiconductor market. The successful acquisition of China Huajing Group, if materialize, will provide the Group with the manufacturing platform to catapult the Group into a leading semiconductor manufacturer in mainland China. The Group aims to become a market leader in the low to mid end semiconductor market segment in the near future and foresees the revenue contribution from its Semiconductor Business to account for a significant share of the Group's total revenue within the next few years.

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FINANCIAL REVIEW***Placement of existing shares and subscription of new shares and conversion of convertible bonds ("the Placement, Subscription and Conversion")***

On 9th May, 2002, China Resources (Holdings) Company Limited ("CRH"), the controlling shareholder of the Company, placed 290,000,000 existing shares of the Company to independent placees and subscribed from the Company 170,000,000 new shares of the Company at HK\$0.94 per share. On the same date, the Company has received a notice of conversion from CRH to convert all convertible bonds it held into shares of the Company at HK\$0.9108 per share. The convertible bonds were issued by the Company to CRH on 1st February 2001 with 2% coupon rate and maturity date being the 3rd anniversary of the date of issue. The total principal and interests to be converted are HK\$855,868,569, with HK\$4,153,569 being the interests from 1st February, 2002 to 30th April, 2002. The placement of existing shares and subscription of new shares were completed on 14th May and 23rd May, 2002 respectively whilst conversion was completed on 15th May, 2002. As a result, the Company has received net cash proceed of HK\$156 million, issued share capital increased from HK\$151 million to HK\$262 million and debt reduced by HK\$852 million. The public float and market capitalization of the Company have also been substantially increased.

Cash Flow

The Group has positive cash inflow of HK\$229 million during the period ended 30th June, 2002 with main sources of inflow from operating activities of HK\$86 million, decrease in pledged bank deposits used to finance the Group's working capital of HK\$86 million, net proceeds from the Placement and the Subscription and Conversion of HK\$156 million. The cash inflow was used mainly in the Phase IV expansion of the Compressor Business amounting to HK\$107 million and the net effect, taking into account other minor cash flow items, was the increase in cash balance to HK\$487 million as at 30th June, 2002.

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Liquidity and Financial Resources

The Placement, Subscription and Conversion have fundamentally improved the Group's financial and liquidity position. Free cash on hand as at 30th June, 2002 amounted to HK\$487 million which represents an increase of HK\$229 million since 31st December 2001. It is the intention of the Company to use the proceeds from the Placement, Subscription and Conversion to finance future expansion of its Semiconductor Business. No significant amount has been spent as at 30th June, 2002.

As at 30th June, 2002, total interest bearing debt decreased significantly by 82% from HK\$1,030 million as at 31st December, 2001 to HK\$187 million. The Group was in net cash position as compared to having a gearing ratio (calculated as net debt (including CB) to shareholders' fund and minority interests) of 102% as at year ended 31st December, 2001. The current ratio (ratio of current assets to current liabilities) was at a healthy level of 2.4 times. Among the outstanding bank borrowings of HK\$187 million, HK\$38 million was repayable in year 2005 with the rest repayable within the next twelve months. The Group's bank deposits and notes receivables of HK\$32 million and HK\$52 million respectively were pledged to secure general banking facilities granted to subsidiaries of the Company. Apart from this, the Group has no other committed borrowing facilities.

The funding requirement of the Phase IV expansion of the Compressor Business will be financed by internally generated funds of the Group as well as bank borrowings.

For day-to-day liquidity management and maintaining flexibility in funding, the Group has access to sufficient uncommitted short-term facilities provided by its bankers.

Financial Management and Treasury Policy

The financial risk management of the Group is the responsibility of the Group's treasury function at the head office in Hong Kong. The objective of the Group's treasury policies is to manage its exposure to fluctuation in foreign currency exchange rates and interest rates on specific transactions. It is the Group's policy not to engage in speculative activities.

Most of the Group's assets and liabilities are denominated in Hong Kong dollars and Renminbi with some payables for machinery and parts denominated in Japanese Yen. The Group does not expect significant exposure to foreign exchange fluctuation in this regard.

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Capital Structure

The Placement, Subscription and Conversion has fundamentally improved the capital structure of the Group. As at 30th June, 2002 the shareholders' fund of the Group was HK\$1,486 million, representing an increase of HK\$1,083 million or 269% compared to 31st December, 2001. The Group was in net cash position as at 30th June, 2002.

To prepare for possible distribution of dividends in the future, the Company has announced on 25th April, 2002, it would undergo reduction of share premium amount of the Company by HK\$534 million and application of contributed surplus account of the Company by the amount of HK\$56 million to offset its accumulated losses of HK\$590 million. The proposals have been approved in the shareholders' meeting held on 27th May, 2002 and become effective on 28th May, 2002. At as 30th June, 2002 the Company's retained earnings amounted to HK\$13 million and would be able to declare and pay dividends to its shareholders if so desired.

Significant Investments, Acquisitions and Disposals

The Group has successfully completed the acquisition of 55% interest in Semico in April 2002 with cash consideration of RMB29 million. The contribution of Semico to the Group's turnover and operating profit during the period was HK\$38 million and HK\$4 million respectively.

The Phase IV expansion of Compressor Business is proceeding as scheduled. The cumulative spending to date was HK\$128 million compared to total budgeted amount of HK\$438 million. One of the two production lines of the Phase IV expansion was completed and began production in April 2002.

Going Concern

On the basis of current financial projections and facilities available, the Group has adequate financial resources to continue its operation for the foreseeable future. For this reason, the going concern basis continues to be adopted in preparing the financial statements.

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Reward for Employees

As at 30th June, 2002, the Group employs approximately 3,800 employees in Hong Kong and mainland China. The Group's success is linked to the quality of its staff. It has always been the Group's policy to attract valuable human resources and retain suitably qualified personnel. Staff bonus and incentive are awarded basing on individual performance and share options are granted by the Board of Directors to certain employees as the Board considers appropriate. With the establishment of the Compensation and Remuneration Committee which is entrusted with the function to maximize human resources with appropriate staff retention and incentive policies, the Group believes that it could attract and retain quality staff and continue to count on them for the Group's continuing success.