MANAGEMENT DISCUSSION AND ANALYSIS

INTRODUCTION

The Board of Directors of the Company presents the first annual results of the Group for the year ended 31 March 2003 following the listing of the Company's shares on the Stock Exchange of Hong Kong Limited on 28 August 2002.

By way of the Scheme of Arrangement (the "Scheme") which became effective on 26 August 2002, the shareholders of Dransfield Holdings Limited ("Dransfield") received the shares of the Company, credited as fully-paid up and ranking pari passu with all the shares of the Company then in issue, on the basis of one share of the Company for every one share of Dransfield. Dransfield then became the wholly owned subsidiary of the Company and its listing status on The Stock Exchange of Hong Kong Limited was withdrawn on 27 August 2002. The shares of the Company were listed on the main board of The Stock Exchange of Hong Kong Limited on 28 August 2002.

BUSINESS REVIEW

We are in the process of discontinuing operations that are either loss-making and with negative cash flow or are non-core business operations to the Company's future business plans, being the legacy of residual businesses from Dransfield. Whilst we are arranging for these disposals, we continue to manage our costs through streamlining operations and headcount.

Performance of operating divisions

Bonded warehouse

The 100%-owned bonded warehouse located at Futian, China, contributed a substantial increase to the Group's revenue during the year. With improved efficiency and a recognized reputation, it has gained several new multi-national corporate clients.

Home appliances sales

This operation is comparatively small scale. The contribution is not significant and the business will be disposed of.

Food & beverage

As disclosed in the 2002 annual report of Dransfield, in April 2002, the Group disposed of the Redruth brewery operation in the UK and the disposal showed a gain of HK$9 million for the year.

The vending machines business has operated at a loss, though not significant, and was sold after the year end to an independent third party on 4 July 2003, with net cash inflow to the Group.

The Management has therefore now successfully disposed of all the food and beverage operations of the Group.

Shenyang & Yixing

These two operations turned into self-sustaining units. With a change of management and stringent cost control in the past year, these two operations have improved their revenues and cash flow significantly and have become self-sustaining.

Significant investments and acquisitions

Shanxi Transportation Industry Company ("STIC")

The Company entered into a joint venture agreement on 20 January 2003 with STIC, a company incorporated in the People's Republic of China, and DiChain Holdings Limited ("DiChain Holdings") for the intelligent transportation platform development and operation, based on the technologies of Geographical Information Systems, Global Positioning Systems and Wireless ("GPS"). The Company undertook to subscribe RMB1.3 million, representing 13% of the total registered capital of the joint venture.

DF China Technology Inc ("DFCT")

At 31 March 2003, the company owned 19.76% in DFCT, a Nasdaq listed corporation. On 11 June 2003, after the year end by conversion of the debts which DFCT owed to the Group, the Group increased its shareholdings to 30% of the issued share capital of DFCT. The completed equity for debt conversion shows a gain on write-back of the substantial provision made on the debts in the previous year. Management is in the process of realizing part of the existing holdings, to take advantage of the increased share price, given the prevailing market boom for technology stocks listed in the USA.

Business development

We have been negotiating with various partners on a number of projects relative to the core business of the company. GPS, a worldwide radio-navigation system provided by a constellation of 24-satellites and their ground stations and the linking of GPS with a software platform which provides for a transportation and logistics system, is one of the key growth areas and core business of the company going forward. Management believes that GPS represents significant potential for future profitability. By way of background, the State policy of the People's Republic of China (the "PRC") will require all vehicles transporting dangerous goods, such as chemicals and petroleum, to install GPS monitoring equipment. Furthermore, the PRC will also require all inter-provincial buses to install GPS navigation systems. As these policies become statutory requirements, it will boost demand for GPS systems products and will be positive for GPS services providers such as our company is now positioned to provide, and a large user base will create economies of scale and ensure increased and stable recurrent income streams.

Management Discussion and Analysis

RESULTS

Profit for the year

The new Management successfully turned the Group results from an operating loss of HK$104 million for fiscal 2002 to an operating profit of HK$10 million for fiscal 2003. Similarly the earnings attributable to shareholders, were turned from a net loss of HK$129 million in fiscal 2002 to a net profit of HK$13 million in the current year.

Return on average Capital Employed for the year was 5% as compared to a Loss on Capital Employed of 83% for fiscal 2002. Return on average Equity for the year is 17% as compared to a Loss on Equity of 115% for fiscal 2002. Since new management only took over the businesses in August 2002, both ratios for the year were adversely affected by the poor performance prior to the takeover.

Operating revenue

Dransfield disposed of the UK brewery production business in April 2002 and two other investment properties during fiscal 2002. After adjusting for the income derived from such assets sold, adjusted consolidated operating revenues for fiscal 2002 amounted to HK$33 million. In fiscal 2003, operating revenues rose 10% to HK$36 million.

By segment, operating revenues for the Edible oil operation increased 47% to HK$22 million (2002: $15 million) whilst the Logistics operation increased 75% to HK$7 million (2002: HK$2 million). After taking over Dransfield in August 2002, the management better utilised the resources of these two businesses and a significant increase in revenue was recorded. The utilisation level of the Futian bonded warehouse rose from only 15% in fiscal 2002 to over 40% in fiscal 2003. In view of this significant improvement, which is further improving in fiscal 2004, an independent appraiser revalued the assets showing increase in value by HK$27 million, and therefore these two segments reported operating gains.

The electronic household appliances distribution recorded, an operating gain in fiscal 2003 compared to an operating loss in fiscal 2002.

Expenses

Operating expenses (selling and administrative expenses)

After deducting the operating expenses of the disposed businesses as previously mentioned, the adjusted consolidated operating expenses for fiscal 2002 amounted to HK$29 million. After excluding the adjustment of expenses relative to prior years, operating expenses for fiscal 2003 amounted to HK$29 million. The management will continue to closely control costs of core businesses.

Finance expenses

In fiscal 2003, interest on bank borrowings was reduced by 61% to HK$4 million (2002: HK$11 million) due to the repayment of bank borrowings from funds injected from the new shareholders. The Group also arranged for bank re-financing to repay all remaining old loans. Because of the strong reputation of the China Merchants Group and sound business potential of the newly reorganized Company, the Group was able to obtain new bank loans at much lower interest rates and on favourable terms, including no repayment of a substantial part of the principal within the initial two-year period which helped alleviate any short-term cash flow pressure.

Other expenses

In fiscal 2002, Dransfield reported a significant loss on asset value impairment and on disposal of assets and including an unrealized loss on investments in DFCT which totaled HK$92 million. As most of the non-core assets have been disposed of, no material loss attributable to the remaining assets was reported in fiscal 2003. On the contrary, major assets recorded significant revaluation gains due to improved performance.

Dividend

The Directors do not recommend the payment of a dividend for the year (2002: Nil).

FINANCIAL POSITION

Assets

Total assets of the Group at the close of fiscal 2003 amounted to HK$213 million (2002: HK$197 million), an increase of 8%, or HK$16 million. The increase was mainly due to the increase of bank balances by HK$29 million to HK$36 million. This increase was partially offset by the settlement of the amount due from minority shareholders and the elimination of high inventories of the disposed brewery plant in UK. As a consequence of the disposal there were lower provisions for bad debts and obsolete stocks for the year.

Liabilities

Total liabilities of the Group amounted to HK$100 million (2002: HK$140 million), a reduction of 29%, or HK$40 million in the year. Total current liabilities reduced significantly by HK$83 million to HK$50 million (2002: HK$133 million) due to the disposal of the UK brewery production business; settlement of trade and other creditors; and re-financing of bank borrowings maturing over one year. Short and long-term debts rose by HK$3 million to HK$77 million (2002: HK$74 million) for working capital; repaying old bank loans; and financing future acquisitions.

The quick ratio of 1.2 times (2002: 0.3 times) – being current assets minus stock over current liabilities – shows that the Group's liquidity position is healthy. Debt to Equity capital for the year is 41% as compared to 57% at the close of fiscal 2002.

MANAGEMENT DISCUSSION AND ANALYSIS

LIQUIDITY AND FINANCIAL RESOURCES

On completion of the Scheme, proceeds of approximately HK$54 million were raised as the subscription to the issued share capital of the Company from the Subscribers, out of which approximately HK$26 million was applied to repay part of the bank loans with the Bank of East Asia, Ltd and the remainder was applied as general working capital for the Group. The cash flow of the Group has been substantially improved as a result of the subscription on completion of the Scheme.

Other than the subscription monies, the Group generally finances its operations from internally generated cash flows and bank facilities granted by its principal bankers in the PRC.

Cash flows

Cash and cash equivalents at the end of the year amounted to HK$36 million (2002: HK$7 million), an increase of HK$29 million over the previous year.

Net cash used in operating activities amounted to HK$28 million (2002: generated HK$13 million), mainly used for settlement of debts owed by Dransfield and financing the poor performing businesses prior to the take-over by the new management in August 2002. Management has since taken measures to minimize cash outflows from the existing operations. By eliminating loss-making operations and acquiring profitable business ventures, the Management expects that net cash inflows will be generated from operating activities in the coming years.

Cash outflows in the operating activities and repayment of the old bank loan of HK$52 million were financed by repayment of loans from a minority shareholder; the new bank loans of HK$56 million; capital injection by the new shareholders; and funds raised, from the exercise of share options of Dransfield before the takeover. As a result, net cash generated from investing and financing activities was HK$7 million (2002: generated HK$45 million) and HK$51 million (2002: used HK$65 million) respectively.

CONTINGENT LIABILITY

The Group had no material contingent liabilities at 31 March 2003.

EMPLOYEES

At 31 March 2003, the group had a total 96 employees, 73 of whom were employed in the Chinese mainland and 23 were employed in Hong Kong. The Group provides competitive remuneration packages to employees commensurate with the level and market trend of pay in the business sector in which the Group operates, including insurance and medical cover, mandatory provident fund schemes and share option schemes. Other employee benefits include meal and traveling allowances and discretionary bonuses.

NEW SHARE OPTION SCHEME

The share option scheme of Dransfield was cancelled on 26 August 2002 upon completion of the Scheme.

The Company adopted a new share option scheme on 21 June 2002, which enables the Company to grant share options to eligible persons as an incentive or reward for their contribution to the Group. The terms of the new share option scheme fully comply with the provisions of Chapter 17 of the Listing Rules. No share options had been granted under the new option scheme during the year under review.

DIRECTORS

With effect from 26 March 2003, Mr. Gordon Chen Gang resigned as an Executive Director of the Company. Mr. Zhu Xiaojun and Mr. Zheng Yingsheng were appointed as Executive Directors of the Company on 27 March 2003.

STRATEGIES AND PROSPECTS

Looking ahead, we plan to restructure our existing businesses and further control our costs so as to maximize operational efficiency cost effectively and to roll out GPS services in the PRC, which is estimated to be growing into an RMB10 billion market, for proprietary GPS products and backbone enterprises. In light of the fast expanding logistics industry in the PRC, we will seek to further improve the utilization of our Futian bonded warehouse. We will also look for possible cooperation, mergers and acquisitions in the Mainland when appropriate opportunities arise. With the continued commitment of the management and our staff, the Board of Directors is confident that the Company is on the way to improving returns for our shareholders.