

Management Discussion and Analysis

FINANCIAL REVIEW

The Group's turnover for the year ended 31 March 2004 ("the year") amounted to HK\$89,422,000 (2003: HK\$71,030,000), representing a rise of 25.89% as compared with last year. Loss attributable to shareholders was HK\$26,300,000 (2003: Profit of HK\$15,008,000). The loss was mainly attributable to the Group's environmental protection and water treatment and city development and investment projects in China, as which were still under construction, and no revenue has been generated yet.

As at 31 March 2004, the total assets and net assets of the Group were HK\$1,711,928,000 (31 March 2003: HK\$1,355,512,000) and HK\$761,422,000 (31 March 2003: HK\$ 787,721,000), representing a rise of 26.29% and a decrease of 3.34% respectively against that of 31 March 2003.

As at 31 March 2004, the Group's cash on hand and deposits held in banks and other financial institutions totaled approximately HK\$58,494,000 (31 March 2003: HK\$64,852,000), a drop of 9.8% compared with the balance as at 31 March 2003. Approximately 45.55% of the deposits was denominated in Hong Kong dollars while the remainder in Renminbi. The Group's net current liabilities



amounted to HK\$261,551,000 (31 March 2003: net current assets HK\$5,911,000). The Group's outstanding bank and other borrowings were HK\$599,485,000 (31 March 2003: HK\$258,166,000), which mainly comprised bank and other borrowings of approximately HK\$351,640,000 repayable within a year and HK\$247,845,000 of bank and other borrowings repayable after more than one year. The gearing ratio was 35.4% (total borrowings / total assets).

As at 31 March 2004, approximately 10.21% of the Group's bank and other borrowings were denominated in Hong Kong dollars while





the remaining in Renminbi. The Group's bank and other borrowings were arranged on a floating rate basis of which approximately 98.84% were secured by the Group's investment property and property, plant and equipment.

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, and there was no corresponding hedging provision. The Group had neither used any financial instrument for hedging purposes, nor used any instrument for hedging against foreign currency investment.

BUSINESS REVIEW

Environmental Protection and Water Treatment Operation

The Group's first water supply project in Hanzhong City, Shaanxi Province has

completed the infrastructure construction. The plant, with the daily output of 100,000 tonnes of water is currently undergoing trial runs and water quality tests. The facility is expected to start operations in late 2004.

The construction of the sewage treatment plant in Haigang District, Qinghuangdao City, Hebei Province, with its infrastructure completed, is in the final stage of installation of equipment, which is scheduled for completion in late 2004. It is expected that upon completion, it will have a daily sewage treatment capacity of 120,000 tonnes.

In April 2003, the Group entered a cooperation framework agreement with the Construction Office of the Anhui Provincial Government, which grants the Group exclusive priority in negotiating with the government on the development of water supply, sewage treatment and garbage treatment projects in all cities



within the province. Besides, in October 2003, the Group entered an agreement with the Xianyang Municipal Government which gave the Group 50 years' exclusive rights to investment, design, construction and operation of the Water Treatment Plant through a wholly-owned foreign enterprise. The plant with a daily supply capacity of 300,000 tonnes will be completed in mid 2006.

To boost the size of investment in water supplies and sewage treatment, the Group increased its investment and enhanced its shareholdings in Interchina Aihua (Tianjin) Municipal & Environmental Engineering Co., Ltd. (hereinafter referred to as "IAH") in August and December 2003. It currently holds 93% interest in IAH. The moves enhanced the Group's investment scale, consolidating and increasing its investment return for its expansion and operation of the city development and environmental protection infrastructure business in the PRC in the future.



City Development and Investment Operation

In March 2004, construction works of the Changsha New Sports City was near completion, and the sporting arenas and related facilities for the 5th City Sports Games in the Changsha New Sports City were completed and already in use. The construction of the project is now being audited and it is expected that the gains from the project will be reflected in the next year's results.

Complementary to the development of Changsha New Sports City, the Group invested in the development of "Interchina Mall", a mega-scale luxurious residential and commercial complex in Changsha. Interchina Mall is located in the Changsha New Sports City in the Yuhua District of Changsha City, about 5km from the city hub, to be developed in three phases, spans an area of 640 hectares. Adopting a low budget yet high quality and innovative





development approach, "Interchina Mall" Phase 1 occupies an area of 274 hectares, which comprises business area, hotels, as well as serviced apartments and offices. The construction of Interchina Mall Phase 1 has begun; with the pre-sale permit of the shopping arcade units has been approved, sales activities are going to commence in the near future, and it is expected to generate promising returns to the Group. The construction of Interchina Mall Phase 1 is expected to be completed in late 2005.

With the rapid development of Changsha City's economy, its demand for investment in municipal infrastructure is tremendous. The concept of Interchina Mall fits in perfectly with the city's urban planning. Through 長沙國中星城置業有限公司 (hereinafter referred to as "星城置業"), the Group develops the Interchina Mall investment project. To ensure better management, the Group acquired 30% interests of 星城置業 from the Changsha Municipal Land Development and

Construction Company Limited in November 2003. Upon the completion of the acquisition, 星城置業 has become a wholly-owned subsidiary of the Group.

Property and Other Investment Operation

During the year, the Group's rental income rose by 6.81% compared with last year to HK\$30,187,000 (2003: HK\$28,263,000). The increase was mainly the result of better rental returns from property acquired last year for lease in Shanghai, China. The Group also let out the office building at 18-22 Cheung Lok Street, Yaumatei, Kowloon (hereinafter referred as "that property"), in November 2003.

Since the management holds the opinion that disposal of that property would allow it to focus resources on investment in its environmental protection and water treatment and city development and investment operation, the Group sold that property at a consideration of





HK\$127,180,000 in May 2004. The transaction is expected to be completed by mid-August 2004.

As a long-term investment plan, the Group reached a conditional purchase agreement with Shanghai Qiangsheng Group Co. Ltd. in October 2003 to acquire 12.87% of its issued share capital of Shanghai Qiangsheng Holdings Co. Ltd. at a consideration of RMB178,977,294. The acquisition was approved at the Extraordinary General Meeting of the Group on 9 January 2004 and the relevant process for transfer of shares is carried out by the legal adviser appointed in China. The management believes that the acquisition will increase the Group's asset returns. Details of the aforementioned acquisition were already set out in the circular dated 18 December 2003.

Securities and Financial Operation

During the year, with the introduction of a series of economy boosting measures, Hong Kong reaching the Closer Economic

Partnership Agreement with Mainland China, and the relaxation of travel restrictions on mainland visitors to Hong Kong, the Hong Kong economy saw marked improvement. The revival of the residential property market also contributed to a better investment sentiment. As capital flow in, the stock market surged. The Group's securities and futures operation generated from margin clients a commission and interest income of HK\$59,235,000 (2003: HK\$42,767,000), representing a rise of 38.51% compared with last year.

LIQUIDITY AND FINANCIAL RESOURCES

The Group's financial resources constituted mainly of the cash income from its operations, and bank and other borrowings. During the year, the Group secured two



long-term bank loans totaling RMB140,000,000 for the development of existing water treatment projects. The Group also obtained a number of loans totaling RMB310,000,000 from various banks to fund its city development and investment operation, property investment operation and other potential investment projects. The Group will make suitable financial arrangements for the shareholders' best interest, necessary for the optimum development of existing and future business (including capital expenses) and to reduce financial costs.

As in March 2004, the Group reached a cancellation deed with note holders. The 3-year convertible loan note totalling HK\$40,600,000 was cancelled, while the note's payable has been settled by the Group's internal resources.

As in May 2004, the Group's net gain from disposal of that property was approximately HK\$126,400,000, of which approximately HK\$53,352,000 will be used to repay bank loans while the remainder will be used for the Group's operating fund.

CONTINGENT LIABILITIES

As at 31 March 2004, the Group had issued a guarantee to banks in respect of property buyers for bank mortgages amounting to HK\$100,000,000 (31 March 2003: HK\$100,000,000). To release the guarantee, the Group reached a repurchase and loan agreement with the concerned bank in April 2003 to repurchase 31 property units from property buyers at a consideration of HK\$34,499,000. The guarantee will be released after the aforementioned deal is completed. As at 31 March 2004, the Group had repurchased 10 property units. The Group have already bought back all the 31 property units on 7 June 2004.





As at 31 March 2004, an indemnity had been given by the Group in favor of a bank for issuing a guarantee of amount HK\$5,000,000 (31 March 2003: HK\$5,000,000) to HKFE Clearing Corporation Limited.

PLEDGE OF GROUP'S ASSETS

As at 31 March 2004, the Group's assets were pledged as security for liabilities, comprising investment property with a book value of HK\$455,511,000 (31 March 2003: HK\$88,000,000) and property, plant and equipment with a book value of HK\$615,505,000 (31 March 2003: HK\$239,528,000).

EMPLOYMENT AND REMUNERATION POLICY

As at 31 March 2004, the Group had a total of 340 employees in the PRC and Hong Kong. Staff costs for the year amounted to HK\$31,846,000 (2003: HK\$36,288,000). To maintain

competitiveness, the salary and bonus of employees are geared on their individual performance. Apart from establishing a retirement benefits scheme and a share options scheme for its employees, the Group also provides training and development programmes for its staff.

BUSINESS PROSPECTS AND CORPORATE VISIONS

For the environmental protection and water treatment operation, the Group is currently discussing with the Anhui Provincial Government the details of implementation of the development of water supply, sewage treatment and garbage treatment projects in all cities within the province pinpointing on medium sized projects with daily capacity of 50,000 to 100,000 tonnes. The agreement and discussion will provide a strong foundation for the Group's development in the next three years. At the same time, the Group was granted the right by the Ma'anshan Municipal Government in May 2004 to invest, construct and operate a sewage treatment plant and redevelop the existing sewage treatment plant for a period of 22 years. The total sewage processing capacity of the plants will be 60,000 tonnes.

Apart from the water supply, sewage treatment and garbage treatment projects in Anhui, the Group is also negotiating with other provinces for several projects of



water supply, sewage treatment projects and acquisition of shares of water companies. The Group's management believes that the enhanced investment scale in water supply and water treatment projects is expected to boost up short-term to mid-term profit growth for the Group.

Riding on China's robust economic growth, the Group expects lucrative investment opportunities arising from the large-scale urbanization projects in the near future. With regards to city development and investment business, the Group will build upon city development and investment of Changsha and replicate this model to other relevant cities, further exploring the Group's growth drivers. The Group is undergoing negotiation with other provinces in the PRC on the feasibility of large-scale local city development and investments projects and concrete results are pending upon final confirmation. The Group, however, has mapped out its business

strategies and intended to select Central and Western China as its strategic development area.

In long run, developing Western China is a long-term and difficult mission, the success of which cannot be achieved overnight. The management strongly believes that the conditions and practicalities of northwestern China should be objectively taken into account. Nevertheless, the management will take the shareholders and corporate interests as major concern, and formulate relevant strategic policies. Strategically speaking, "rejuvenating values, improving the environment, streamlining structures and creating a new system" is the Group's development strategies in the Western China Project. Additionally, the Group will take Interchina Mall as an example, strategically focusing on the development of tourism industry in Western China. Together with its competitive edge in the capital market, the Group will launch its city development operations in the region, and flourish the tourism and hospitality businesses.

The Group's integration and enhancement of these premium properties will create vast business opportunities and in turn benefit the local people.