

MANAGEMENT DISCUSSION AND ANALYSIS

Capital Reorganisation, Creditors' Scheme, Restructuring Proposal, Open Offer and New Controlling Shareholder

On 27 April, the Capital Reorganisation and the Creditors' Scheme became effective and the Open Offer became unconditional and that all conditions precedent to the Restructuring Proposal have been fulfilled and the Restructuring Proposal was completed. Mr. Tam Jin Rong became the new controlling shareholder of China Nan Feng Group Limited (the "Company") with beneficial interest in 51.7% of the share capital of the Company.

Business Review

Results of First Half of Fiscal 2004

For the six months ended 30 June 2004 (the "Period"), the Company and its subsidiaries (collectively known as the "Group") generated a turnover of HK\$13.0 million.

The Group generated a profit attributable to shareholders of HK\$145.9 million (2003: loss of HK\$72.2 million), which mainly includes gain of approximately HK\$100.3 million arising from debts discharged under the Creditors' Scheme. It also includes gain of approximately HK\$50.2 million arising from deconsolidation of Prosperity Construction and Decoration Limited ("PCDL"), a wholly-owned subsidiary of the Company, upon receiving a winding-up Court order during the Period.

Construction Contractor

Despite the recovery of the overall economy in Hong Kong during this Period and the strong rebound of the property sector, the construction industry in Hong Kong did not stage a meaningful recovery and continued to be one of the sectors which lagged behind the general economic recovery in Hong Kong. In view of the continuing difficult operating environment and the high costs of maintaining a full construction management team in Hong Kong, the Group decided to substantially scaled down its loss making Hong Kong construction division since the second half of last year and focused its efforts in the more promising construction market in Guangdong Province, the People's Republic of China (the "PRC"). The turnover of the construction division as a whole recorded an increase of 3% from approximately HK\$12.6 million in the corresponding period in last year to HK\$13.0 million in this Period. The turnover in the PRC amounted to approximately HK\$13.0 million for the Period, an increase of 75% over the corresponding period in last year.

Construction contract costs mainly represent direct materials and subcontracting costs for construction projects. It increased by 5% from approximately HK\$10.7 million in the corresponding period in last year to HK\$11.3 million in this Period, roughly in line with the increase in turnover.

In the coming period, we would increase our resources to grasp and develop the growing and more profitable construction and property related businesses in the PRC.

System Integration and IT Training

Intwell Technology (S) Private Limited (“Intwell”), of which the Group has a 50% beneficial interest (2003: 50%), was principally engaged in the development, production and sale of computer hardware and software, integration of computer software and provision of training and after sales services in Singapore. The business of Intwell was hard hit by substantial cutback of the education budget by the Ministry of Education in Singapore. In view of this, the Director decided to fully provide for the premium on consolidation since the second half of last year.

Operating Expenses

General and administrative expenses, which included staff costs, professional fees, consultancy fees and general administrative expenses decreased by 74% from approximately HK\$20.3 million in the corresponding period in last year to HK\$5.3 million in this Period due to the decrease in professional fees and consultancy fees upon the settlement of numerous litigations and the completion of the Restructuring Proposal. In addition, the Directors also implemented strict cost control on the operating expenses during the Period.

A Subsidiary under winding-up Court order

On 9 June 2004, the High Court of Hong Kong issued a winding-up order to PCDL, a subsidiary of the Company. PCDL had a substantial capital deficiency and had an insignificant scale of operation. The winding-up of PCDL did not have material financial and operational impacts to the Group.

Liquidity and Financial Resources

Support for Subsidiaries with Capital Deficiencies

As at 30 June 2004, many subsidiaries of the Company were in capital deficiency. Only subsidiaries with future prospect would receive continuing financial support from the Company.

Creditors' Scheme

On 19 February 2004, the majority of the Scheme Creditors approved the Creditors' Scheme under which all indebtedness owed by the Company to the Scheme Creditors on the Scheme Record Date were released, discharged and fully settled.

The Creditors' Scheme was sanctioned by the High Court of Hong Kong and the Supreme Court of Bermuda on 16 and 19 March 2004, respectively. The total indebtedness admitted by the Scheme Administrator under the Creditors' Scheme was discharged in full and final settlement by way of a combination of the cash payment of an aggregate amount of HK\$12 million from the proceeds of the Open Offer and an issuance of 180,000,000 Creditors Shares at HK\$0.1 per Creditors Shares to the Scheme Creditors, resulted in a gain amounted to approximately HK\$100.3 million.

Gearing Ratio

The Group's consolidated interest bearing debts less bank and cash balances amounted to HK\$3.1 million (2003: HK\$58.1 million) in contrast to the shareholders' equity of HK\$7.3 million (2003: capital deficiency of HK\$177.6 million), resulting in a gearing ratio of 42.1% at 30 June 2004. As the shareholder's equity of the Group was a deficiency of HK\$177.6 million at 31 December 2003, calculation of gearing ratio as at 31 December 2003 was inappropriate.

Finance Cost

Interests on the Group's borrowings were based on the normal commercial interest rates for redeemable debentures, loan notes and the shareholder's loan.

Exchange Rate Risk Exposure

Most of the Group's transactions were in Hong Kong Dollars and Renminbi. As the exchange rate of Renminbi against Hong Kong Dollar was relatively stable during the Period, we were not exposed to any significant exchange risk in this Period.

Contingent Liabilities

As at 30 June 2004, the Group did not have any material contingent liabilities.

Future Prospects

The new controlling shareholder, Mr. Tam Jin Rong, is the founder of the Guangdong Southpeak Group in the PRC. The businesses of the Guangdong Southpeak Group include property development, construction, supermarket, transportation and manufacturing industries. The Directors decided only to focus on business areas where they have expertise and had substantially scaled down or terminated the financial support for unprofitable businesses in the Hong Kong and overseas. The Directors will continue to develop the construction and property related sectors in the PRC, in particular the Guangdong Province where the Board have extensive business networks and local expertise.

The Board would also look for other opportunities in both Hong Kong and the PRC for investments which would generate positive cashflows and profits to the Company.

Employee

As of 30 June 2004, the Group has approximately 70 employees (2003: 20 employees) in Hong Kong, the PRC and Singapore.