

Chairman's Statement and Management Discussion and Analysis

I am pleased to report the activities of South China Holdings Limited (the "Company") and its subsidiaries (together the "Group") for the year ended 31 December 2002.

BUSINESS REVIEW

For the year ended 31 December 2002, turnover of the Group was HK\$2.0 billion and loss attributable to shareholders amounted to HK\$187.0 million. The continuing unfavourable business environment was persistently affecting the Group's operations in the year 2002. As compared to the previous year, turnover decreased by 6%, while the loss reduced nominally, but this time included a significant portion of non-cash losses of net amount around HK\$148.4 million arising from provisions for various investments.

As of 31 December 2002, the Group made aggregate provisions of HK\$94.2 million on the Group's property portfolio including HK\$75.0 million related to the property project held under an associate and reported as loss on interests in associates during the year.

The Group's two major streams of businesses performed very differently during the year. The brokerage and securities trading businesses were hard hit by the diminishing daily stock turnover and equity values in the severe downturn of the local stock market. It was the major loss contributor of the Group in the year 2002. The trading and manufacturing businesses, on the other hand, successfully returned to profit as a result of stringent control of overheads and optimising production efficiency. Travel related business also attained profitability on strengthening of its marketing efforts. The media and publication businesses made satisfactory improvements in results due to committed efforts to streamline operations and cutting costs.

Two major corporate restructuring transactions were done in 2002 in attempts to consolidate the Group's businesses and more importantly further reduce the operating costs to maintain our competitiveness. The first was the financial restructuring of South China Information and Technology Limited (now known as "Guorun Holdings Limited") ("SCIT"), previously a listed subsidiary of South China Industries Limited ("SCI"), completed a financial restructuring on 28 June 2002. The second was the transfer of SCI's direct interest in Wah Shing Electronics Company Limited ("WSE") to Wah Shing International Holdings Limited ("Wah Shing"), a major subsidiary of SCI listed in Singapore, on 3 June 2002. This was done to group WSE, a toy-related electronics manufacturing company under our key toy-manufacturing group, Wah Shing. The Group realised respective gains of HK\$91.2 million and HK\$9.0 million from the two transactions.

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Brokerage and Financial Services

Owing to the contraction of the stock market, the turnover of South China Brokerage Company Limited ("SCB") dropped approximately 20%. Commission income from brokerage and interest income from share margin financing fell substantially. Security trading activities during the year suffered losses and provisions were made on the investment portfolio due to the decrease in market values at the year-end. Certain long term investments were disposed at a loss reducing the likelihood of further impairment in value. However, sales volume and commission income from online trading increased promisingly.

In response to the keen competition in brokerage business and the changing market demand from traditional to online trading, SCB closed some of its local branches in order to further cut down operating costs.

The corporate finance team performed well and fees income increased sharply with various assignments on new listings, takeovers and general advisory work. Personal loan business maintained profitable contribution to our brokerage and financial services group despite high delinquency ratio.

SCB reported net loss of HK\$225.7 million for the year 2002.

Trading and Manufacturing

Wah Shing recorded satisfactory profit albeit in difficult economic conditions. Turnover of Wah Shing increased by 8% comparing to the prior year. Gross profit margin and net profit improved due to its continuous efforts in corporate restructuring, streamlining and relocating of existing operations, changing product mix and stringent overhead control.

Revenue from WSE dropped because of the loss of business resulting from the corporate failure of a major customer and the shrinkage in demand of high-end electronic toys as a result of weaker consumer spending.

Other smaller scale trading and manufacturing businesses had encouraging results in the last year. Successful marketing efforts and the support of major customers led to the tremendous growth of turnover of leather shoes and garment operations.

Nority International Group Limited ("Nority"), a listed associate of SCI engaging in the manufacture of athletic footwear, found the year under review a difficult year for its operations. Its customers was much cautious in placing their orders given the global economic downturn and this caused the decrease in both turnover and operating results of the year by 22% and 51% respectively. The net profit for the year 2002 was HK\$7.7 million.

The aggregate contribution from trading and manufacturing operations returned from a loss of HK\$101.8 million in 2001 to profit of HK\$14.8 million in 2002, before accounting for Nority's results.

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Information and Technology and Related Business

Compared to 2001, turnover from the information and technology ("IT") related businesses declined by 23% from HK\$109.0 million to HK\$83.8 million. However, the loss from IT operations narrowed down from HK\$7.4 million in 2001 to HK\$1.9 million in 2002 as a result of restructuring of business operations throughout 2002.

Property Investment and Development

After the acquisition of the entire property portfolio from the disposed subsidiary SCIT in mid-2002, rental revenue and operating profit before provisions rose to HK\$17.1 million and HK\$12.1 million respectively which accounted for the respective increases of 1.1 times and 2.5 times over the corresponding period. The occupancy rate of the investment properties improved despite the average rent per square foot dropped as a whole.

The 30% owned property project, "The Centrium" in Central had leased out about 60% of its total rentable area by the end of 2002. Another 20% owned property development project, a residential and commercial complex in Shanghai was put on sale and well received in 2002 due to the active property market environment in there. Completion of these sales will be in 2003.

Travel and Related Services

The travel industry worldwide generally recovered in 2002 from the September 11 incident in the US. However, the operating environment remained harsh with intense price competition. The travel and related services operated mainly through Hong Kong Four Seas Tours Limited ("Four Seas Travel"), a company with a solid history in the travel industry for over 30 years benefited from the devoted efforts of its sales team and reported the increase in both turnover and profit in 2002.

Media and Publications

The publications business, South China Media Group, benefited from cost saving made at the end of the year 2001 and early 2002. Despite very difficult market conditions, the publications business saw improvements at the operational level. Both editorial and business teams of the magazines were strengthened. Mature titles continued to bring profit to the Group and vigilant measures were taken to maintain a cost-effective structure.

Other Investments in the PRC

The agricultural business of lychee and longan trees plantation in Guangdong was severely affected by the drastic decline in retail price by two-thirds in 2002. The hairy crab rearing farm in Nanjing, wholly owned under SCI, was still at a preliminary development stage and its sale of the first batch of crabs in late 2002 produced only a minimal return. The two agricultural projects have implemented very stringent cost measures to ensure the average cost is low enough to survive against the fierce market competitions.

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LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2002, the Group has a current ratio of 1.10 and a gearing ratio (long-term bank borrowings of approximately HK\$104.4 million to equity of approximately HK\$634.6 million) of 16.5%. A significant portion of the short term borrowings was for normal trading purposes with the level of borrowings depending on the level of trading activities. The fixed assets and the development and investment properties of the Group mostly secured the long term banking facilities. The Group's operations and investments continue to be financed by internal resources and bank borrowings.

EXPOSURE TO FLUCTUATIONS IN EXCHANGE RATES AND RELATED HEDGES

As at 31 December 2002, the Group had no significant exposure to fluctuations in exchange rates and any related hedges.

CAPITAL STRUCTURE

On 23 July 2002, the Company issued 364,680,275 bonus warrants (the "Warrants") to its shareholders on the basis of one Warrant for every five ordinary shares in the share capital of the Company at the subscription price of HK\$0.42 per Warrant. Upon full exercise of the Warrants, the gross proceeds will be approximately HK\$153 million and 364,680,275 new shares will fall to be issued (the "New Shares"), representing approximately 20% of the Company's existing issued share capital of 1,823,401,376 shares, and approximately 17% of the Company's issued share capital of 2,188,081,651 shares as enlarged by the issue of the New Shares. As at the date of this report, there was no exercise of any conversion rights attaching to the Warrants.

Apart from the above, the Group had no debt securities or other capital instruments as at 31 December 2002 and up to the date of this report.

MATERIAL ACQUISITIONS AND DISPOSALS OF SUBSIDIARIES AND ASSOCIATES

SCIT, previously a listed subsidiary of SCI, completed the Financial Restructuring on 28 June 2002. The effects of the Financial Restructuring on the Group were the acquisition of the entire property portfolio of SCIT together with the related mortgages, 49% of its travel related business and a number of its subsidiaries engaged in information and technology related business in the PRC (the "Acquisition") and the dilution of SCI's equity interest in SCIT to 7.17% (the "Deemed Disposal"). SCI paid an aggregate consideration of HK\$239 million to SCIT for the Acquisition of which HK\$238 million was used to set off its outstanding loans due to SCI and the remaining HK\$1 million was paid in cash. Simultaneously, SCI received HK\$65 million in cash from SCIT out of the Deemed Disposal as partial repayment of the balance of its outstanding loans due to SCI. Also, SCI subsequently disposed of part of the remaining interest in SCIT (the "Disposal"). As a result of the Deemed Disposal and the Disposal, the Group in total realised a gain amounting to HK\$91.2 million.

SCI entered into an agreement to sell its direct interest in WSE to Wah Shing at a consideration of HK\$56.0 million on 3 June 2002. Consequently SCI's effective interest in WSE was diluted from 59.0% to 35.9%. The Group realised a deemed gain of approximately HK\$9.0 million.

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CHARGES ON ASSETS

As at 31 December 2002, the details of charges on assets of the Group are set out in note 45 to the financial statements.

CONTINGENT LIABILITIES

As at 31 December 2002, the details of the Group's contingent liabilities are set out in note 44 to the financial statements.

EMPLOYEES

As at 31 December 2002, the total number of employees of the Group was approximately 22,000 (31 December 2001: approximately 21,000). Employees' cost (including directors' emoluments) amounted to approximately HK\$491 million for the year (2001: HK\$547 million).

The Group considers its employees as its most valuable asset. In addition to salary, other fringe benefits such as medical subsidies, provident fund and subsidised training programmes are offered to all employees of the Group. Performance of the employees is normally reviewed on an annual basis with adjustment compatible to the market. Individual employees may also receive a discretionary bonus at the end of each year based on performance. The Company adopted a new employee share option scheme on 31 May 2002.

PROSPECTS

Brokerage and Financial Services

The abolition of the minimum commission rate in April 2003 is expected to have a significant impact on the commission revenue of SCB. In order to justify a reasonable commission rate, SCB will continue to improve its quality of service to customers. More resources will be put on exploring and developing new products, such as equity linked instruments and other financial planning services, which will be added to the online trading platform. The corporate finance team will actively pursue opportunities in the primary securities market and advisory services. The personal loan operation will continue to control cost, monitor the delinquency ratio and seek funding from different sources for its business development.

The outbreak of atypical pneumonia has further dampened the already fragile consumer spending confidence. SCB is now speeding up efforts on minimizing running costs including closing non-profit contributing local branches and further reducing administrative expenses to combat the adversities.

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Trading and Manufacturing

Wah Shing group will strive to upgrade its product engineering, machinery and equipment for production as well as computer applications in order to capture large volume orders and promotional items. Efforts will be made to source raw materials in the PRC to counteract the recent rise in plastic price driven by the fear of war in the Middle East. Additional sewing capacity has been set up in western part of Guangdong to leverage the relatively lower labour wages in the area that is anticipated to begin operation in the middle of 2003. Dedicated attention will be given on monitoring the credit risks against any possible corporate failure of the overseas customers.

The leather shoes and garment trading and manufacturing businesses are to certain extent also affected by the frightening news of atypical pneumonia in late March this year. Some of the overseas new customers have already deferred their trips to visit our operations in Hong Kong and the PRC until later this year depending on the health condition. We expect these operations will sustain a steadily profit though their growth may not be as good as the last year.

Nority believes the consumer market of Mainland China is full of potential and opportunities. It has already invested in Dingshanhu Town, Kunshan City, Jiangsu Province, where it is taking its first step to commence construction of a production plant. Continuing efforts will be made to reduce costs and exploring new markets to cope with the adverse influence of the economic downturn on its operations.

Information and Technology and Related Business

The progress varies substantially among the joint ventures engaging in the IT business in the PRC. We intend to scale down all unprofitable joint ventures and to concentrate resources on those profitable ones. One of the joint ventures in Chongqing concluded a system development project with the local tax authority at the end of 2002. We are exploring the possibility to market the system, which is applicable to the tax bureaus across the whole country.

Property Investment and Development

The property letting market for commercial and industrial properties is expected to stay stagnant or weak in 2003. Rental income from the Group's investment properties should remain around the same level in this year. More flexible terms will be offered to attract and retain tenants. Poor occupancy properties will be renovated to increase marketability. The Group will benefit from the profitable sales of the recently completed Shanghai property development project in the year 2003.

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Travel and Related Services

Four Seas Travel generated reasonable profit early in the year, but the situation has rapidly changed since then. The tourist industry, particularly the routes related to the mainland, is now greatly affected by the outbreak of atypical pneumonia in Hong Kong and China. Revenue from our travel and related services is likely to decline in the first half of 2003. Immediate actions have been taken in mitigating the impacts in order to survive the difficult period to come. Staff policy and general operating costs are immediately revised to be more variable and responsive to cater for any sudden changes. We believe that with the strong foundation laid down by Four Seas Travel in the past years as one of the top consolidators in the air-ticketing industry, it will be one of the quickest among its competitors to get back on track when the market rebounds.

Notwithstanding the spread of the disease, the Group will continue to keep an eye on the PRC travel market in the long run. A first established office in Guangzhou has obtained its license to operate in April this year.

Media and Publications

Advertising revenue is expected to be hit hard in the first half of 2003 with a slow start at the first quarter and again the outbreak of atypical pneumonia in March 2003 which has adversely affected the retail business and consumer spending. The advertisers have taken swift action to reduce budgets. South China Media Group will continue to improve the magazines and at the same time keep tight cost control to get through these very difficult times until the economy recovers at the domestic and global level.

Other Investments in the PRC

Both the agricultural projects of fruit plantation and fish rearing in the PRC had undergone series of reviewing and restructuring exercises in respects of administration, human resources, production and marketing channels. All the efforts made in the year 2002 are anticipated to reflect in the coming years in the form of increased efficiency and reduced costs.

Overview

The present economic and business environment are clouded by the war in the Middle East and the sudden outbreak of the atypical pneumonia rendering the outlook very uncertain in the short term. With the active measures we are taking, we are cautiously optimistic about the eventual improvement in the Group's overall performance; in particular the trading and manufacturing sector as we believe the overseas markets will begin to stabilize after the Gulf war later this year.

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APPRECIATION

On behalf of the Board, I wish to express my gratitude to our customers and shareholders for their continued support and all our staff members for their hard work and dedicated service.

On behalf of the Board
Ng Hung Sang, Robert
Chairman

Hong Kong Special Administrative Region of
the People's Republic of China
25 April 2003