MANAGEMENT DISCUSSION AND ANALYSIS

Lei Shing Hong
is principally engaged in five diversified businesses

AUTOMOBILE DIVISION

MACHINERY DIVISION

PROPERTY DIVISION

TRADING DIVISION

FINANCIAL SERVICES DIVISION

BUSINESS NETWORK

AUTOMOBILE DIVISION
- Mainland China
- Taiwan
- Korea
- Vietnam

MACHINERY DIVISION
- Mainland China
- Taiwan

PROPERTY DIVISION
- Mainland China

TRADING DIVISION
- Mainland China
- Singapore
- Hong Kong

FINANCIAL SERVICES DIVISION
- Mainland China
- Taiwan
- Hong Kong

moving forward

AUTOMOBILE DIVISION

The Group's Automobile Division operates dealerships for a portfolio of premium brands in Asia, including: Mercedes-Benz in Mainland China; Mercedes-Benz and Porsche in Korea; Mercedes-Benz, Chrysler, Jeep and Smart in Taiwan; and Mercedes-Benz in Vietnam.

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In 2006, our Automobile Division delivered a very strong performance as a result of: rapid economic growth in Mainland China; accelerating growth in Korea's imported vehicle market segment; a first-rate product line-up, with the new S-Class continuing to be well received since its launch in late 2005.

Mainland China

We have continued our strategy of developing the Group's sales and after-sales network in the Northern and Eastern regions of Mainland China. At the start of the year, our network comprised 39 outlets in North and East China. Our network coverage was expanded to 43 outlets by the end of 2006, with 8 more outlets planned for construction in 2007.

During the year, we successfully completed the transfer of our distribution activities for North and East China from our subsidiary companies to Mercedes-Benz (China) Limited, a company in which the Group holds a 49% equity stake and which operates as the national distributor for the Mercedes-Benz brand in Mainland China. In addition, we have established a new company, Lei Shing Hong Management (Shanghai) Co. Ltd., which will provide dealer management support to our existing dealers, as well as lead our network development.

The Chinese economy continued its fast pace of growth, with GDP increasing by over 10% in 2006 and another 9% growth projected for 2007. Reflecting the increased prosperity and spending power of the nation, total vehicle sales in Mainland China grew by 25% in 2006, bringing the volume to 7.2 million units for the year. Sales of Mercedes-Benz grew by 11% to 17,572 units for the year, of which 5,381 were the CKD E-Class model.

Our unit sales in Mainland China increased by 20% as compared with the last year, with a total of 10,669 new car sales reported for 2006. This upward trend was driven by a number of factors, including: the purchase of vehicles by consumers in the first quarter ahead of anticipated increases in consumption tax; positive response to the new S-Class launched in the fourth quarter of 2005; the successful introduction of the CKD E-Class into Mainland China; and ongoing strong sales of the M-Class, particularly in North China. Whilst we foresee that this growth rate may slow in 2007, we believe that tremendous long-term opportunities are presented by the automobile industry in Mainland China. We will continue to plan our investment activities to ensure that the Group is well placed to maximise the potential presented by this sector.

Turnover from Service operations increased by 45% over the previous year, enhancing profit contribution to the Group's Mainland portfolio. This increase reflects the growth in the vehicle parc and the positive impact of the new service facilities.

With regards to our commercial vehicles business, we have now established two dedicated dealerships in Xinjiang and Sichuan. In addition to handling Mercedes-Benz CBU trucks, this division also supports our passenger car dealerships in selling Mercedes-Benz vans, in particular the Viano model. The Chinese truck market is currently dominated by locally produced trucks. Over the medium term, we foresee an increase in imported heavy-duty trucks, boosted by the need for reliable long haul road transportation.

Taiwan

In 2006, the total passenger vehicle market in Taiwan declined by 32% as compared with 2005. This reflects the impact of the political uncertainty, tightening of credit lines, and rising fuel costs. The luxury segment, in which our business competes, was slightly down as premium purchasers were not as affected by these factors in the short term. However, should the market remain weak, a greater impact on premium models is expected in 2007. The economic growth rate for Taiwan was just above 4.4% in 2006, as compared with 4.0% in 2005 and 6.1% in 2004.

DaimlerChrysler Taiwan Limited ("DCT"), our associate company focused entirely on the sale of Mercedes-Benz and Smart brands since January 2006, achieved sales volume growth of almost 6%. This was mainly due to continued strong sales for the S-Class and the growing popularity of the M-Class, reflecting keen demand for these models that were launched in the second half of 2005. Even greater growth was achieved, in terms of sales value, as a result of enhanced product mix, with a higher proportion of S-Class and M-Class vehicles sold.

A major factor behind DCT's sales growth was the significant decline in grey market sales, down by almost 43% partly due to strengthening of the Euro, improved availability of key models through official dealers and stricter homologation rules for grey importers which affected the relative price competitiveness of grey market supply versus the official supply. The grey market represented 29.3% of Mercedes-Benz sales in 2006, as compared with 47.8% in 2005.

Our retail business, CMI, was a key driver in the improved sales of official Mercedes-Benz cars in 2006 and increased new car sales volume by 7%. Overall revenue was also enhanced through greater sales of the more expensive S-Class and M-Class models. The facelifted E-Class was the only new model to be launched in 2006.

CMI has continued its programme of upgrading facilities, with the grand opening of the new flagship Taichung facility held in February 2006. The Group is also currently renovating and upgrading the Taoyuan branch in North Taiwan and developing a new 3-S "Autohaus" in Kaohsiung, scheduled to be completed at the end of 2007.

The outlook for the Taiwan automobile market in 2007 is expected to be challenging. We anticipate that the overall market, including the imported premium segment, will remain soft. The small reduction in commodity tax on imported vehicles with engine sizes greater than 2.0L is not expected to provide much relief to importers in terms of sales as most brands passed on this benefit to customers in the form of discounts in the last quarter of 2006. However, the Group boasts a strong product line-up under the Mercedes-Benz brand and with the introduction of the CDI-diesel engine models and the facelifted E-Class in late 2006 and the all new C-Class in the third quarter of 2007, we expect to make gains in market share.

Korea

The imported car market in Korea grew from 30,901 units to 40,530 units, representing an increase of 31% over 2006. It now represents 4.2% of the total passenger vehicle market, versus 3.3% in 2005.

Through our associate company, Mercedes-Benz Korea Limited, official Mercedes-Benz sales achieved a 12.4% share of the imported vehicle market. The total sales of Mercedes-Benz in 2006 reached 5,026, a 25% increase as compared with 2005.

The Group's subsidiaries, Han Sung Motor Co Ltd ("Han Sung") and Busan Star Motor Co Ltd ("Busan Star"), contributed to 55.3% of the overall Mercedes-Benz retail sales in the Korean market. Han Sung and Busan Star operate 7 dealerships and achieved unit sales growth of 13.4% as compared with 2005. This increase reflects the strong sales of the new S-Class, launched in October 2005, and the popularity of the facelifted E-Class, launched in September 2006.

The relocation of the Incheon showroom and quick service centre was completed and officially opened in September 2006. The relocation of a showroom from Banpo to Seocho in Seoul and the move from the current Busan showroom to a new site in Busan will both be completed in 2007. The head office in Banpo will also be relocated to Seocho in late 2007 in conjunction with the showroom move.

The B-Class is due to be launched for the first time in the second quarter of 2007, taking Mercedes-Benz into a new segment, followed by the all new C-Class in the last quarter of 2007. Together with the launch of both of these models, plus the introduction of new diesel engines in existing models, a boost in sales is expected for the coming year.

Stuttgart Sports Car Limited, our exclusive Porsche importer and distributor, achieved unit sales growth of 54% in 2006 as the Cayman model was successfully launched and both the Cayenne and 911 models experienced strong growth. Long-term, we anticipate excellent prospects for the Porsche franchise in Korea and we are taking steps to expand our sales and service coverage. Land has been acquired for a new Porsche dealership in Busan and construction of the facility is expected to be completed by September 2007. A second sales outlet at the Seoul Automobile Gallery in the Yangjae area of Seoul successfully commenced sales of new and previously-owned Porsches in October 2006 and we are planning to establish additional Porsche dealerships in the coming years. These expansion initiatives, combined with Porsche's strong and expanding product range (that includes the new Panamera model line that will be introduced in 2009) and our ongoing sales and marketing programmes (such as Porsche Financing, Porsche Owners Club and Porsche Driving Schools among others), form part of our strategy to significantly grow the Porsche business in Korea, a market where imported cars, particularly in the luxury segment, are making significant share gains. For 2007, we are aiming to achieve sales growth of approximately 50% to over 300 new Porsche cars.

Vietnam

The total vehicle market grew by almost 40% in 2006 to 33,373 units. Of this total, the number of passenger cars decreased by 34% to 7,480 units. Vietnam is predominantly a commercial vehicle market and Mercedes-Benz Vietnam is a large seller of Sprinter Vans in the transportation vehicle segment.

Total registrations of Mercedes-Benz vehicles decreased by 28% to 1,202 units. The number of Mercedes-Benz passenger cars increased by 75% to 299 units, mainly driven by the supply of cars to the APEC forum in late 2006. The facelifted E-Class was launched towards the end of 2006 and the C-Class, the other passenger car model produced and sold in Vietnam, will be launched in the third quarter of 2007.

Good progress was achieved by our Vietnam Star business with unit sales growing by 50% to 549 units in 2006. The Autohaus in Ho Chi Minh City was open for the full year, as well as a showroom in the centre of Hanoi. An Autohaus in Hanoi was completed at the very end of 2006 and commenced operations in 2007. With two Autohaus in Vietnam, we expect strong growth in car sales and, in particular, the after-sales business in 2007.

MACHINERY DIVISION

The Group's Machinery Division continues to be the largest Caterpillar hydraulic excavator dealership in the world, distributing the full range of Caterpillar products and services in our assigned territories in Mainland China and Taiwan.

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Following Caterpillar's presentation of their Vision 2020 at its World Wide Dealer meeting in the United States last year, we have re-aligned our strategic development plans to achieve this overall vision and to fulfill Caterpillar's defined 2010 goals for Mainland China in particular.

Mainland China

Turnover for Lei Shing Hong Machinery Limited ("LSHM") increased by 22% over 2005, in line with continued expansion of the market and gains in market share. Machine sales increased by 27% and product support sales by 32%, while engine sales suffered from a downturn in Electric Power Generator (EPG) sales with slow growth in demand, in part due to ongoing improvements in power supply within Mainland China.

Machine sales benefited from the ongoing infrastructure development in Eastern China – despite supply constraints on certain Caterpillar models – and from our acquisition of distribution rights in Jiangsu Province for the domestic SEM wheel loaders, with the SEM factory in Shandong now being managed and partly owned by Caterpillar. The domestic wheel loader market is a low price, but high volume business, in which we expect to become more heavily involved as Caterpillar acquires majority ownership of SEM, develops the product and allows further distribution by their main dealers.

Used equipment machine sales also increased during the year with the opening of LSHM's new dedicated used equipment rebuild facility in Yangzhou. With this facility, we are establishing a new benchmark for quality used Caterpillar equipment in Mainland China.

The engine market improved significantly in the marine and petroleum sectors, despite the decline in standby EPG demand and supply constraints on the larger 3500 and 3600 series engines. Our marine engine group is in the process of re-organisation to maximise growth in our Caterpillar marine engine business.

Our power systems division officially commenced marketing the Perkins line of industrial engines in November, with volume orders received from various OEM customers for delivery throughout 2007.

Product support sales continued to benefit from the increased machine and engine populations in the territory. The continued development of our Provincial and Branch product support network has allowed us to capitalise on this increasing opportunity.

With our continued emphasis on staff training and development, 6 Sigma process improvement, our alignment with Caterpillar's objectives and our Provincial facility expansion, we are confident of continued growth of our business in 2007 and beyond.

Taiwan

Capital Machinery Limited ("CML") grew revenue by 7% in 2006 as compared with 2005, despite the lack of growth in the industry. Although total sales growth was modest and limited by supply constraints for certain products, significant market share gains were made, especially in the machine, marine engine and product support segments of the business. This growth validates our strategy of upgrading and expanding our facilities and focusing on further improvements in customer service and support. During 2006, the facility in Tayuan was upgraded and renovated. In addition, the newly acquired facility in Taichung was fully renovated and is now in full operation. Other facility projects currently in progress include the addition of a new service workshop building in Taichung and the construction of a new facility in Kaohsiung. These capital investments will improve our sales coverage and customer service throughout Taiwan and help set us apart from competition.

Comprehensive product, technical and management training programmes are being implemented to upgrade skill levels, management talent and staff professionalism. The 6 Sigma process improvement programme was expanded during 2006 and this will be a continued focus to reduce costs, improve efficiency and better utilise our resources.

We remain optimistic about the economic prospects and business opportunities in Taiwan in the future. Customers are recognising that the improvements in CML's ability to offer integrated solutions better support their own business operations. We expect continued challenges associated with Caterpillar's long delivery times and price increases, these can only assist competitive efforts to regain market share that we have won during the past couple of years and it is expected that the business will experience a slowing rate of growth in line with the overall industry. On the upside, an increase in construction projects has occurred in anticipation of increasing tourism and business investment in Taiwan from Mainland China. This bodes well for the future growth and expansion of our business in Taiwan.

PROPERTY DIVISION

The Group's Property Division is engaged in the development of quality property projects, both commercial and residential, in the major cities of Mainland China.

The Group's Property Division is engaged in the development of quality property projects, both commercial and residential, in the major cities of Mainland China. Our key property projects include: "Starcrest", a residential and commercial development in Wangjing New City, Chaoyang District, Beijing; "LSH Plaza", a major commercial development also in Wangjing New City, Chaoyang District, Beijing; and "Lei Shing International Plaza", which is now substantially sold, located on Yan An Xi Road in Shanghai.

Sales of 98% of the residential units of Yan An Xi Road were recognised during 2006, with the office and retail towers sold in 2005.

Phase I of "Starcrest" development is 85% sold and most of the remaining units let out. Sales and purchase agreements are in hand for 98% of the residential units within Phase II and with the certificates already obtained, the sales will be recognised in 2007. Work is in progress on the school which forms part of Phase II and it is anticipated that construction will be completed and handed over in the first half, in time for commencement of the new school year in the third quarter of 2007.

Phase III of "Starcrest" is made up of 341 residential units, as well as retail and car park space with a total gross floor area of 119,992sq. m. Work is in progress on the foundation of the residential block, scheduled to be completed shortly. The commencement of the super structure works are expected to begin in the second quarter of 2007. Drawings have been completed for the commercial building and the construction permit is expected to be obtained shortly.

The topping out of "LSH Plaza" has now been achieved and interior work is well underway, with completion of the total project anticipated by early 2008. The Group plans to retain this development as we see good rental potential for this prestigious commercial development in Beijing. We will occupy a portion of the building as our Mainland China Head Office, incorporating a flagship Mercedes-Benz showroom. Discussions have commenced with a number of multinationals with regards to the external leasing of the rest of the office space.

We continue to consider opportunities for expanding our land bank and have participated in a number of auctions, although no major purchases were made during the year under review.

New measures to cool down the overheated property market were introduced by the Chinese Government. These new measures are aimed at ensuring an efficient use of land without overdevelopment of high-end luxury properties. While the measures have been effective in stabilising prices in the luxury segment, the impact on other segments in the residential and commercial markets has not been significant.

The strong economy, the ongoing need to upgrade housing stock, and increasing urbanisation is expected to result in continued demand for middle and low end residential property. The demand for commercial property is also anticipated to remain strong, with increasing foreign direct investment inflow and expansion of both multi-nationals and local Chinese companies.

Whilst the above factors are considered as positive it must be noted that Chinese Government policies to cool the market can have a significant impact on property prices.

TRADING DIVISION

The Group's Trading Division specialises in commodity-based products, watch components and fertiliser trading. Our operations are based in Hong Kong, Singapore and more recently, in Mainland China.

The Group's Trading Division specialises in commodity-based products, watch components and fertiliser trading. Our operations are based in Hong Kong, Singapore and more recently, in Mainland China. Watch components are traded within Hong Kong and fertilisers and chemicals are sourced from Mainland China, Taiwan and Canada with sales mainly into Malaysia. In addition to this external business, the Division also continues to handle the importing of trucks and other smaller commercial vehicles from Germany into Mainland China on behalf of the Group's commercial vehicle automobile business. The importing of passenger cars into Mainland China, which was a major part of the Trading Divisions sales in prior years, was discontinued as passenger car distribution was transferred from the Group's subsidiaries to Mercedes-Benz (China) Limited, a subsidiary of the DaimlerChrysler Group in which the Group holds a significant equity stake.

In 2006, total external sales were down by 18% year-on-year, with sharp declines in all the product groups as predicted. Watch component sales dropped, reflecting a slackening of demand for low-end finished watches from overseas. Fertiliser and chemical sales also declined sharply year-on-year. This was in part due to most fertiliser importers carrying high inventory into 2006. This was further exacerbated by very weak demand and tight shipping space.

We anticipate growth in the fertiliser business with importers beginning to place new orders following a spate of good news on the price of crude palm oil. In addition, we anticipate contribution from our Shanghai office due to its access to more fertiliser supplies at competitive prices from the Mainland China market.

The first quarter has been slower than anticipated with a number of adverse external factors affecting volumes; these included port congestion in Mainland China and availability of shipping space.

FINANCIAL SERVICES DIVISION

The Group's Financial Services Division is engaged in portfolio management, share trading and services, securities brokerage and money lending.

The Group's Financial Services Division is engaged in portfolio management, share trading and services, securities brokerage and money lending. During 2006 the division benefited from a number of positive factors including a robust global economy, a strong performance by worldwide markets on the back of ample liquidity inflow; the strength of Asian currencies against the US dollar, and particularly the strength of the Renminbi; and the general belief that US interest rates had peaked in 2006.

The performance of our securities brokerage business also benefited from increased trading volumes in the Hong Kong market due to the large number of IPOs during the year, coupled with rising share prices. Our proprietary share trading business was boosted by the overall improved market conditions, particularly in Hong Kong and other Asian markets where we are active.

The Group's insurance business also benefited from the expanding opportunities being generated in Mainland China where our automobile, machinery and property businesses continue to grow. Increased commission revenue was generated by the new showrooms and offices established on behalf of our Automobile Division in Mainland China. Property insurance commissions are expected to grow further with the ongoing expansion of our property business and the loan business from Lei Shing Hong Credit Limited.

The loan portfolio of our credit business doubled from 30 June 2006 to 31 December 2006, rising from HK$200 million to almost HK$400 million as a result of the key appointments made in the middle of the year and the general expansion of our credit operations. New business generated in the area of loans to support small and medium sized enterprises remains our primary focus. Efforts to leverage within our Financial Services Division through the cross-selling of services will continue to be a major goal for the coming year.

The outlook for 2007 for the Credit Division is positive, with ongoing growth in the loan book planned. We expect to see continued growth in our insurance brokerage business, albeit from a small base. The outlook for the proprietary equity trading business is more difficult to predict and our forecasts for the security brokerage business assume lower average daily turnover on the market and a reduction in IPO activity compared to the exceptionally strong 2006 levels.