

MANAGEMENT'S DISCUSSION AND ANALYSIS

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Introduction

The Company name was changed from Lucky Development Co., Ltd. to LG Construction Co., Ltd. on February 24, 1995, and LG Engineering Co., Ltd. was merged with the Company on August 1, 1999, prompting the corporate name to be changed again to LG Engineering & Construction Corp. LG E&C performs diverse engineering and construction activities in such areas as office buildings, civil works, apartment complexes and industrial plants. Ongoing management innovation and steady operational growth has made the company one of the new leaders in the Korean construction industry since the nation's foreign exchange crisis in 1997.

Operational Results

New Orders

The Korean construction market, led by the housing construction sector, showed strong growth in 2002 over the previous year. The Company saw a year-on-year increase in new orders for housing projects while orders received for civil engineering and non-residential projects were down from the previous year. Total orders were over ₩3.63 trillion in 2002, a drop of 1.7% from the ₩3.69 trillion recorded in 2001.

Housing projects contributed the most to the increase in private sector contracts. However, the Company is now seeking to enhance portfolio stability by expanding the volume of orders for civil engineering projects from the public sector. New orders outpaced sales revenue in 2002, and the order backlog was over ₩7.27 trillion at year's end, up 7.0% from a year earlier.

The Housing Division did not acquire any new in-house apartment construction projects in 2002. However, the Division did receive government approval to reconstruct several large-scale apartment complexes under contract with property owners in southern Seoul. The Division has aggressively sought additional projects with property owners and received almost ₩1.53 trillion in new orders during 2002, a hefty 77.1% increase year on year. The order backlog for housing projects was over ₩2.3 trillion at the end of 2002.

In addition, the Housing Division has ₩4.5 trillion in provisional orders. This term refers to projects (redevelopment of private residential sites into new apartment complexes or reconstruction of existing apartment complexes) for which the Company has been chosen as contractor but government approval is yet to be given. "Pending contracts" are transferred to the "new orders" category only after receipt of government approval.

The Plant Division received ₩881.3 billion in new orders during 2002, a 2.2% year-on-year increase, while the order backlog at year's end was over ₩1.44 trillion, up 26.3% from the previous year. Overseas orders, which were mainly in the Middle East, totaled ₩609.2 billion, down 6.9% year on year. The decline overseas was compensated by a 31% rise in domestic orders, which reached ₩272.1 billion.

The Civil Engineering Division received ₩417.3 billion in new orders during 2002, a 59.8% year on year drop. During the fourth quarter, however, the Division won three out of the four turnkey projects on which it bid as well as one PFI project. Value-added projects such as these have improved profitability for the Civil Engineering Division, which had more than ₩2.42 trillion in order backlog at the end of 2002.

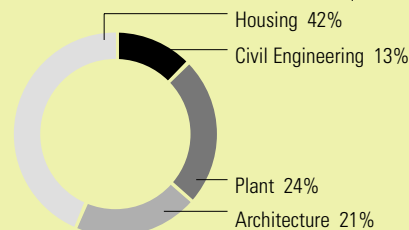
The Architecture Division continues to raise its competitiveness amid fierce competition and has secured a stable supply based on new orders from other LG affiliates. New orders amounted to ₩750.1 billion in 2002, down 5.6% year on year, and the order backlog stood at more than ₩1.08 trillion at year's end.

Sales Revenues

Revenues are recognized by using the percentage-of-completion method, measured principally by the percentage of costs incurred to date to the total estimated contract costs. Sales revenues for the Plant, Civil Engineering and Architecture Divisions were down slightly in 2002 from the previous year. However, a large order balance for the Housing Division raised total company sales revenues sufficiently to surpass ₩3.17 trillion in 2002, up 0.7% from the previous year.

The Housing Division did not supply any new in-house apartments in 2002, and in-house apartment sales dropped from the previous year. However, the Division has been contracted to build several large-scale apartment complexes, with units being sold from 1999. Total sales revenue was

NEW ORDERS BY DIVISION

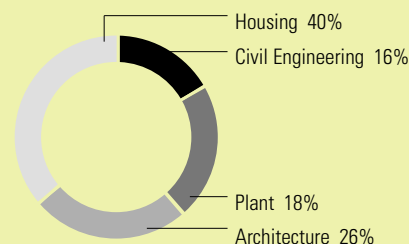


NEW ORDERS

(Unit: billions of Won)



SALES BY DIVISION



boosted 11.7% year on year to almost ₩1.26 trillion.

The Plant Division completed a massive overseas refinery expansion project in early 2002, but since then the commencement of some major new projects has been delayed. Sales revenue from overseas suffered a steep decline as a result. Domestic sales were higher year on year, but total revenue fell 7.6% to ₩582.9 billion.

The Civil Engineering Division experienced a major increase in new orders in the fourth quarter of 2001, boosting the order backlog sharply. By nature, most civil works projects require a long time to complete, and the early project stages are particularly slow. As a result, 2002 sales revenue was down 4.8% to ₩514.4 billion.

The Architecture Division enjoyed 31.1% year-on-year sales growth in 2001 to total ₩856.2 billion. While projects have proceeded smoothly since then, sales in 2002 were down slightly to ₩819.7 billion.

Gross Margin

The costs of construction materials and labor rose across the board in Korea during 2002. Despite this development, highly profitable projects engaged in by the Civil Engineering and Housing Divisions elevated overall gross margin. Cost of sales, which came to 87.2% in 2001, dropped 2.1 percentage points to 85.1% in 2002, raising the gross margin 16.7% to ₩472.5 billion.

The Housing Division has been building large apartment complexes in both the Yongin and Seoul areas. Some of the most profitable projects among these are now reaching their conclusion, driving up sales revenues. As a result, the gross margin has improved significantly from 13.8% in 2001 to 17.2% in 2002. As the Plant Division generates revenue from overseas, the gross margin has dropped from 7.9% in 2001 to 6.7% in 2002. The lower figure is due to the marginal profitability of overseas projects awarded to LG Engineering Co., Ltd. when it was a separate entity, and many of these projects are nearing completion.

The gross margin for the Civil Engineering Division rose from 15.5% in 2001 to 22.6% in 2002. The upsurge in profitability is due to a much greater proportion of PFI projects in the sales mix.

Slow recovery of the private sector caused the Architecture Division to suffer a drop in profitability, with gross margin falling from 13.5% in 2001 to 12.3% in 2002.

Selling & Administrative Expenses

Selling and administrative expenses, which contracted 2.6% in 2001 despite a 16.4% rise in sales revenue, surged 30.9% (₩46.3 billion) to ₩196.4 billion during 2002. This increase reflects spending on mid-/long term strategies to boost competitiveness and profitability rather than on a one-time purchase of supplies.

The Company has adopted a conservative posture and has remained committed to bolstering asset soundness. Bad debt expenses amounted to ₩24.3 billion in 2000, dipped to ₩14.6 billion the following year and then rebounded to ₩32.6 billion in 2002.

A massive campaign, complete with TV commercials, accompanied the launch of the new "Xi" apartment brand, driving up advertising expenses from ₩6.4 billion in 2001 to ₩15.8 billion in 2002. In the second half of the year, moreover, the Company aggressively pursued new government turnkey projects, an effort that drove up R&D outlays and commission expenses.

Non-operating Income & Expenses

As interest expenses continued to fall in 2002, the Company strove to bolster the soundness of inventories, investment securities and other tangible assets. Interest expenses, a salient part of non-operating expenses, have dropped sharply, from ₩54.3 billion in 2000 to ₩30 billion in 2001 and down to ₩14.7 billion in 2002. In addition, financing expenses incurred when purchasing or fabricating and constructing inventories and other tangible assets are treated as asset-related until the asset acquisition is complete. According to this method, capitalized financing expenses have declined from ₩42.2 billion in 2000 to ₩28.4 billion in 2001 and ₩19.6 billion in 2002.

Losses on valuation of inventories, which were not reported through 2000, amounted to ₩14 billion in 2001 and rose to ₩18 billion in 2002. The Company considers inventories to be an acquisition cost, but when the net realizable value of inventories is deemed to fall below acquisition cost, the net realizable value is posted on the balance sheet, and the difference is reflected as a loss on valuation of inventories.

The equity accounting method is applied when evaluating investment securities in which the Company holds least 20% of the total equity. The Company owns the largest share of Han Moo Development Co., which posted successive losses until 2001 but went into the black in 2002. The profitability of Han Moo Development is expected to improve steadily in the future.

The equity method was employed with the PFI firms Chonan-Nonsan Highway Co. and Seoul Highway Co. until 2001. However, Corporate Accounting Principles Interpretation 42-59 states the equity method is excluded when 20% or more of the equity is held but the investor can clearly be shown to not exert significant influence over the investee. For this reason, the equity accounting method was no longer applied the investment securities for the above two firms from 2002. The resulting changes in the equity method loss valuations for 2000 and 2001 required a revision in the ordinary income and net income figures. Discontinuation of the equity method for PFI companies reduced the equity method evaluation losses for 2001 by ₩13.7 billion, thereby raising net income for the year by ₩9.5 billion. The Daejeon Sports Plaza, a tangible asset held by the Company, saw a significant reduction in market value as compared with book value. This drop was shown as a devaluation loss of ₩12.6 billion.

Extraordinary Income and Losses

A debit of ₩14.1 billion in foreign currency translation at overseas operations was amortized as an extraordinary loss in 2002. Independent accounting records are maintained in the local currency at overseas branch offices and construction sites. Assets and liabilities from these records are entered on the corporate balance sheet in Won values converted according to local exchange rates prevailing on the last day of the fiscal year, while the average exchange rate for the entire fiscal year is applied for converting income and expenses into Won. The resulting gains or losses are offset against each other and the net amounts are recorded as an overseas business debit or credit and presented as an addition to or deduction from shareholders' equity. The overseas business translation debits or credits are offset against subsequent overseas business translation debits or credits until they are recognized as gains or losses at the time when the respective foreign branch is closed or the overseas project is completed.

Financial Position

Cash Flows

Cash Generated by Operations

Business operations, which generated a cash flow of ₩300.5 billion in 2000 and ₩306.4 billion in 2001, provided ₩325 billion in 2002, a 6.1% (₩18.6 billion) increase over the previous year. Operating income rose 8.3% year on year while inventories were cut sharply, allowing a stable cash flow to be produced from business activities. Uncompleted buildings represent a large portion of inventories. This category is not generated by contracted projects but by apartment construction on land owned by the Company. The Housing Division did not start any new apartment projects on Company-owned land in 2002, and projects begun in 2001 or earlier are mostly complete. As a result, the uncompleted buildings amount fell to ₩199.8 billion.

Trade accounts and notes receivable showed an increase, but the nature of the construction industry causes them to fluctuate widely depending on project stage. Therefore, collection of trade accounts and notes receivable is not a problem, and the rate of increase for this category is expected to slow in 2003.

Turning to operational liabilities, trade accounts and notes payable increased during 2002, while advances received declined. Thus, the two categories offset one another. In addition, the opening of condominiums and ski slopes at the Gangchon Resort in 2002 caused membership guarantee deposits received to rise by ₩61.1 billion.

Cash Used in Investments

The Company's investment activities in 2002 centered mainly on acquiring securities for PFI projects and building the Gangchon Resort. Funds invested by the company totaled ₩107.1 billion in 2000, fell to ₩29.7 billion in 2001 and then rose to ₩129.5 billion in 2002. Construction companies and other investors establish a joint company for each PFI project, and funds are raised through participants' equity investments, borrowings and government grants. Once the infrastructure (such as a road, railway, harbor, water treatment plant, or power plant) is built, the PFI company usually operates it for 20-30 years, collecting revenue to pay back the investors in proportion to their equity share. The investors may also sell their equity to raise cash. LG E&C's investments in PFI projects totaled ₩80 billion in 2000 and dipped to ₩15.7 billion the following year. Such investments in 2002 reached ₩48.1 billion, with most of the funds being put into Seoul Beltway Corp, the project company for the Seoul Beltway project. The Company plans to invest in additional PFI projects in 2003.

CASH FLOWS FROM OPERATIONS

(Unit: billions of Won)



Debt

Total borrowings were ₩615 billion at the end of 2000 and fell to ₩516.1 billion a year later. The figure dropped an additional ₩170.5 billion to ₩345.6 billion at the end of 2002, indicating a very stable financial structure when compared with sales revenue and total shareholders' equity.

Of the total debt, 9.1% (₩31.4 billion) is made up of short-term borrowings, which includes overdrafts for overseas projects and trade-related borrowings such as construction financing from the Korea Export-Import Bank and usance L/Cs. Long-term debt consists of ₩15.9 billion in loans from Korea Housing Guarantee Co. and ₩298.3 billion in debentures, all of which have fixed interest rates. The Company holds no floating rate notes. Of the long-term debt, ₩119.6 billion matures in 2003 and ₩178.7 billion in 2004.

Equity

Common stock stood at 51,000,000 shares as of December 31, 2002, and no preferred stocks or equity linked securities such as convertible bonds or bonds with warrant were issued.

Chairman Huh Chang-soo and his family members acquired 10.74% of LG Chem Investment (LGC), 8.56% of LG Electronics Investment (LGEI) and 4.81% of LG Cable shares during 2002. Their combined equity holdings totaled 24.11% (12,297,210 shares) at the end of 2002.

Treasury stocks equivalent to 2.26% (1,152,560 shares) of the total issued shares were held by the Company as of December 31, 2002. The Company bought back 241,309 shares as treasury stocks, which are given to employees as performance incentives, in 2001 and an additional 341,344 shares in 2002. Of the treasury stocks purchased, employees received 191,430 shares in 2001 and 307,930 shares in 2002. The Company plans to continue this stock buyback and distribution program in the future.

Dividends

The dividend per share was ₩600 in 2000, increased to ₩800 in 2001 and on to ₩1,000 in 2002, raising the payout ratio from 24.7% to 25.0% and then 31.0% over the three years. Until the end of 2001, accrued dividends—the amount of dividends scheduled to be paid—were treated as a liability and deducted from retained earnings. Starting in 2002, however, accrued dividends are reflected as such at the close of the fiscal year and not deducted from retained earnings until the statement of retained earnings receives final approval at the General Shareholders' Meeting.

Risk Management

Ongoing efforts are made to maintain a balanced and stable business portfolio for each division and market, thereby minimizing the risk of performance fluctuation amid changing economic circumstances. The Company will continue to improve the stability, predictability and effectiveness of project execution in the future.

Foreign Exchange Risk

Foreign exchange risk is minimal. Overseas projects represent only a small portion of sales revenue, and many of the materials used in these projects are purchased locally, limiting foreign exchange exposure. Exchange rate fluctuations, too, have little effect on income.

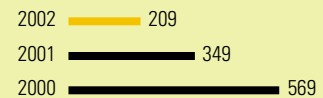
The Company received US\$179 million for overseas projects in 2002 while paying out US\$139 million, leaving a surplus of US\$40 million. However, a US\$29 million shortfall results when the balance of loans and other financing is taken into account. Foreign exchange exposure may increase slightly in 2003 because of large-scale projects overseas.

The Company's foreign exchange policy with regard to overseas projects is to match cash received with cash paid out to minimize foreign exchange exposure. To cover any mismatch or surplus US Dollar payment, however, the Company maintains foreign currency accounts and borrowings as needed. The Company has US\$120 million lines of forward exchange transactions which is used as a derivative hedging instrument between US Dollars received and payments made in other currencies such as Euros or Yen. In 2003, the Company will acquire foreign exchange risk insurance from Korea Export Insurance Corp. to hedge against risk from exchange rate fluctuation, starting from the tender participation stage. Foreign exchange risk management activities will be strengthened as a result.

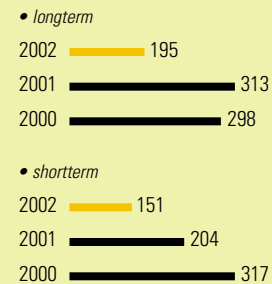
Liquidity Risk

LG E&C's funding strategy seeks to spread out the maturities of borrowings to minimize funding pressure from loan repayment. As of December 31, 2002, loans due within twelve months comprised 43% of the total

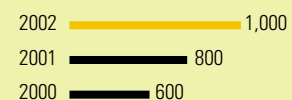
NET BORROWINGS (Unit: billions of Won)



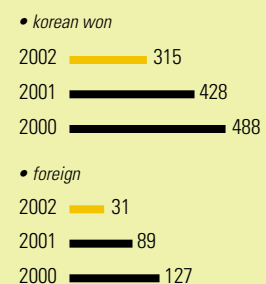
DEBT BY MATURITY (Unit: billions of Won)



DIVIDEND PER SHARE (Unit: Won)



DEBT BY CURRENCY (Unit: billions of Won)



of outstanding loans. Therefore, the Company's loan repayment obligations are relatively small in 2003, and the Company plans to maintain this stable loan maturity structure in the coming year.

Importantly, the Company has a variety of lines of credit to ensure smooth cash management and operations. The Company has ₩72 billion lines of bank overdrafts and ₩1.33 trillion lines of commercial paper to keep Won currency sufficiently liquid. And LG E&C enjoys the best credit ratings of any listed Korean Construction firm. In addition, the Company maintains US\$38.8 million lines of foreign currency overdrafts, US\$208.1 lines to support letters of credit, and US\$319.7 million lines of bank guarantees (performance bonds, etc.) to provide support for various commercial provisions in overseas engineering and construction contracts.

A positive cash flow is maintained as possible for each overseas project to minimize the possibility of non-performing trade receivables. The Company provides major project clients with a project finance structure that allows direct payment from the bank for costs incurred during the project. Korea Export Insurance Corp. insures all overseas projects and short-/long-term exports to cover any possible losses.

Restructuring

No More Overseas Civil Engineering and Building Projects; Plant Projects Now the Focus

Overseas construction firms have grown on the basis of low-cost labor in their local markets, and LG E&C has struggled to compete for overseas civil engineering and building projects on the basis of cost alone. However, the Company will aggressively pursue overseas plant projects, which require project management capabilities covering engineering, procurement and construction as well as technology and financing competencies. The majority of these plant projects will be in the Middle East, where the Company has had long experience, and the focus will be on oil refineries, petrochemical plants and gas processing facilities.

Consolidated Energy and Environmental Operations

The Civil Engineering and Plant Divisions each had units for constructing environmental protection and energy facilities in the past. Now, however, these operations have been consolidated in the Plant Division for greater efficiency.

Improved Pre-project and Post-project Assessment

A new Project Management Team has been formed to carry out feasibility studies before the Company decides to participate in a tender. The new team is separate from the existing Budget Assessment Team, which is responsible for implementing systematic and effective cost control measures and risk management activities once a contract has been received. The new unit improves the Company's project assessment capabilities.

The Plant Division, which engages in many large-scale projects, operates F/S team separately, solely responsible for creating project estimations and budgets, minimizing the risks either before or after tender participation.

Reinforcing the Marketing Organization

Each Division will strive to win more public sector contracts to diversify and stabilize the business portfolio. As part of this effort, marketing support task forces have been established for the Civil Engineering, Architecture and Plant Divisions. In addition, the marketing teams in the Civil Engineering and Architecture Divisions have been strengthened to more aggressively turnkey projects, which provide high margins.

The Housing Division, which already enjoys industry-leading competitiveness, has added four marketing teams to its existing sales organization to secure more orders. The sales staff has been augmented as well. The Division aims to expand its involvement in apartment redevelopment projects in northern Seoul and, if possible, build new apartments on Company-owned land in 2003.

New Personnel Evaluation System and HRD Team

The personnel evaluation system has been revised to put greater emphasis on team effort, thereby raising overall organizational effectiveness. In addition, the Human Resources Development Team has been newly formed to promote internal harmony and improve the personnel training effort.

Ex-Const Activities

"Ex-Const," a phrase derived from "excellent construction," refers to business innovation activities designed to pinpoint and solve chronic problems in day-to-day operations as well as to secure core competencies for the mid-/long term. Each year new cost-cutting measures, construction methods and process innovations are introduced; moreover, individual as well as organizational problem-solving capabilities are constantly improved. The result is a more-competitive workforce that can help make the Company stand apart from its rivals.

In 2002, modular installation of thermal power plant boilers was introduced to shorten project completion time and cut costs while improving work quality and safety. Each year the individual divisions work on selected themes (a total of 87 in 2002), and significant results have been achieved. Ex-Const activities will also be employed in the future to accomplish key tasks identified in the Company's mid-/long-term strategies and vision for 2010.

e-Business

The construction industry has been slow to recognize the value of IT. By nature, however, construction operations are scattered out in many locations, and the use of online systems raises competitiveness by providing ready access to knowledge and tightening controls.

LG E&C was among the first Korean construction firms to realize how online capabilities can provide a core competitive advantage and has pursued this goal since the mid-1990s. An IT master plan formulated in 1997 served as the blueprint for building an integrated construction system in 1999. Subsystems were installed to cover marketing, design, construction, sales, finance, personnel, and general affairs. These various subsystems were integrated into the Project Management System (PMS), which is now being integrated into a knowledge management system for sharing data among the Head Office and all the construction sites and branches around the world in real time.

LG E&C was also one of Korea's first construction firms to install the PMS, which is now used with every project to provide scientific and systematic project management. The PMS is also connected with schedule and cost controls for enhanced productivity. Precise profit and loss data as well as schedule status can be accessed in real time, providing a platform for highly effective risk management. The PMS was upgraded and integrated with the Plant Division's Project Management & Information System (PMIS) in 2002.

The Company also developed eWorks 21, which expands access to all interested parties, including clients, project supervisors, contractors, subcontractors, partners and vendors. The eWorks 21 system has improved both the speed and transparency of communication while minimizing the possibility of error. The result has been lower costs and higher customer satisfaction. Details on each project along with related documents and communications are stored in a database, which serves as the foundation for a highly effective knowledge management system.

MASIC, an automated architectural design system, has also been built to reduce errors and enhance productivity. MASIC is linked with the procurement and project management systems to incorporate cost and schedule controls from the design stage and is connected to eWorks21 for even greater efficiency.

All the new systems are now Web-based, and all employees have ready access anytime and anyplace through an Enterprise Information Portal (EIP). Additional systems will be developed in 2003 and existing systems will be utilized as much as possible to raise the competitive advantage provided by information technology.

New Vision and Mid-/Long-term Strategies

The Korean construction market has recently shown steady recovery from the sharp downturn experienced in the wake of the 1997 financial crisis. However, the high growth rates of the past can no longer be expected, and competition within the industry is intensifying. Companies that have unbalanced portfolios and rely only on simple construction activities will have growth and stability problems over the mid-/long term.

To effectively cope with the changing reality, the Company teamed up with the LG Economic Research Institute for four months, starting in September 2002, to craft a new vision and mid-/long-term strategies for LG E&C. The vision calls for the Company to be ranked first in the Korean market and earn 5% of ordinary margin in overseas markets by 2010. Corporate mid-/long-term strategies have also been devised and key tasks identified to realize this ambitious vision. Detailed action plans will be established for each division during the first half of 2003, and these plans will be aggressively pursued in the coming months.

PMS
eWorks 21
MASIC
EIP