# Management Discussion & Analysis

## 1. OPERATIONS REVIEW

Performance of the Group's hotels continue to be affected by the economic slowdown in the United States of America ("USA"), Europe and most regional economies and the political uncertainties and security problems in some of the countries in the region. Despite this, overall yield increased marginally by 3%. This is mainly attributable to the relatively favourable performance of the Group's hotels in Mainland China.

Overall performance of the Group's investment properties showed improvement due to increase in yields of commercial and office space in Mainland China. However, yields of serviced apartments both within and outside Mainland China declined mainly due to the emergence of competitive supply.

**Revenue**

*For the year ended 31 December*

| | Combined Revenue by Trade | | | | |
|---|---|---|---|---|---|
| | **2002** | | 2001 | | % |
| | ***US$ million*** | *%* | *US$ million* | *%* | *Change* |
| **Hotel Operation** | **775.9** | 79% | 769.9 | 80% | 1% |
| **Hotel Management** | **9.2** | 1% | 8.8 | 1% | 4% |
| **Property Rentals** | **191.0** | 20% | 184.6 | 19% | 3% |
| **Total** | **976.1** | 100% | 963.3 | 100% | 1% |

*Shangri-La's Rasa Sentosa Resort, Singapore – Exterior*

# Management Discussion & Analysis

**Breakdown of Turnover**
*For the year ended 31 December*

| | SUBSIDIARIES | | | ASSOCIATED COMPANIES | | |
|---|---|---|---|---|---|---|
| | **2002** | 2001 | % | **2002** | 2001 | % |
| | ***US$ million*** | *US$ million* | *Change* | ***US$ million*** | *US$ million* | *Change* |
| **Hotel Operation** | | | | | | |
| The People's Republic of China | | | | | | |
| *Hong Kong* | **137.5** | 141.0 | (2%) | **–** | – | N/A |
| *Mainland China* | **170.7** | 164.0 | 4% | **155.2** | 162.4 | (5%) |
| Singapore | **79.7** | 81.6 | (2%) | **19.2** | 21.4 | (11%) |
| The Philippines | **72.5** | 74.6 | (3%) | **–** | – | N/A |
| Malaysia | **58.5** | 62.8 | (7%) | **4.6** | – | NM |
| Thailand | **33.6** | 31.8 | 6% | **–** | – | N/A |
| Fiji | **18.9** | 13.8 | 37% | **–** | – | N/A |
| Indonesia | **–** | – | N/A | **20.6** | 11.5 | 78% |
| Myanmar | **4.9** | 5.0 | (1%) | **–** | – | N/A |
| | **576.3** | 574.6 | 0% | **199.6** | 195.3 | 2% |
| **Hotel Management** | **9.2** | 8.8 | 4% | **–** | – | N/A |
| Hotels Sub-total: | **585.5** | 583.4 | 0% | **199.6** | 195.3 | 2% |
| **Property Rentals** | | | | | | |
| The People's Republic of China | | | | | | |
| *Mainland China* | **4.4** | 4.1 | 6% | **164.6** | 158.0 | 4% |
| Singapore | **6.6** | 7.8 | (15%) | **8.0** | 7.5 | 7% |
| Malaysia | **3.5** | 3.8 | (9%) | **3.4** | 2.9 | 16% |
| Thailand | **0.5** | 0.5 | 7% | **–** | – | N/A |
| Properties Sub-total: | **15.0** | 16.2 | (8%) | **176.0** | 168.4 | 5% |
| **Total** | **600.5** | 599.6 | 0% | **375.6** | 363.7 | 3% |

*Note:* Revenue of the hotel management group is stated after elimination of revenue earned from fellow subsidiaries.

N/A Not Applicable
NM Not Meaningful

**(a) Combined Revenue**

*Hotel Operation*

***The People's Republic of China ("PRC")***

Hong Kong

Combined revenues of the two hotels in Hong Kong marginally decreased by 2% in 2002 despite a 5% increase in weighted average room yields ("RevPAR") due to on-going major renovations at the Kowloon Shangri-La which commenced in July 2002. This renovation, which is being phased to minimise disruption of business and restrict loss of revenues, is expected to be completed by 31 December 2003.

Mainland China

Consolidated revenues of the hotels increased by 4%. On a combined basis, however, hotels recorded a 11% increase in the weighted average RevPAR. The China World Hotel, Beijing commenced major renovations of its rooms and other facilities in January 2002 and these are expected to be completed by May 2003. Among all, the Pudong Shangri-La, Shanghai, the Shangri-La Hotel, Qingdao and the Shangri-La Hotel, Wuhan registered an increase in RevPAR by 20%, 19% and 16%, respectively. The other major hotels located in the principal cities of Beijing and Shanghai also recorded double-digit increases in RevPAR. However, emerging competition led to a sharp decline in yields in Shenyang by 26% while yields in Xian declined by 5% due to a slackening of demand in the early part of the year. Overall, the Mainland China market provided a positive momentum to the Group.

***Singapore***

Consolidated revenues of the hotels in Singapore recorded a decline of 2% in 2002 largely due to a decline in weighted average RevPAR by 9%. The Traders Hotel, Singapore is currently undergoing a soft-refurbishment of its guestrooms which is expected to be completed by April 2004. The Shangri-La Hotel, Singapore has commenced a major refurbishment programme at its Valley Wing on 1 March 2003 and this is expected to be completed by 31 October 2003.

***The Philippines***

The continuing weakness in the value of the Peso and security concerns have curtailed business and leisure traffic into the Philippines. Combined revenues of the three hotels declined by 3% in 2002 while weighted average RevPAR declined by 7%. The Makati Shangri-La, Manila completed renovation of its guestrooms in October 2002 while Shangri-La's Mactan Island Resort, Cebu commenced renovation of its guestrooms in January 2003. This is expected to be completed by November 2003.

# Management Discussion & Analysis

### *Malaysia*

Business at the Group's resort hotels was adversely affected after the tragic events on 11 September 2001 in the USA and the on-going global and regional economic problems. Shangri-La's Rasa Sayang Resort, Penang, Shangri-La's Tanjung Aru Resort, Kota Kinabalu ("TAH") and Shangri-La's Rasa Ria Resort, Sabah each recorded a decline in RevPAR in excess of 10%. Overall, combined revenues declined by 7% in 2002 in line with a 6% decline in weighted average RevPAR. On-going major renovations at the Shangri-La Hotel, Kuala Lumpur are expected to be completed in mid 2003. Meanwhile, TAH has commenced a refurbishment of its guestrooms in the Tanjung Wing which is expected to be completed by November 2003.

*Pudong Shangri-La, Shanghai – Lobby*

### *Thailand*

With the completion of the first stage of the major renovations to guestrooms at the Shangri-La Hotel, Bangkok, RevPAR increased by 15% and revenues increased by 6%. Guestroom renovations are expected to be completed by September 2003.

### *Fiji*

Combined revenues of the two hotels increased by 37% in line with a 43% increase in the weighted average RevPAR. It is expected that the performance of these two hotels will continue to strengthen.

### *Indonesia*

The Shangri-La Hotel, Jakarta continues to suffer on account of the political and economic problems facing Indonesia after the hotel's re-opening in March 2001. The hotel recorded a 78% increase in revenues in 2002 albeit from a low base, with an occupancy rate of 36% compared to 21% in 2001.

### *Myanmar*

The political situation continues to inhibit the performance of the Traders Hotel in Yangon. RevPAR declined by 8% in 2002.

*Note:* The RevPAR of hotels under renovation has been computed by excluding the number of rooms under renovation.

# Management Discussion & Analysis

*Hotel Management*

Revenues of SLIM International Limited, the hotel management arm of the Group, before consolidation adjustments, registered a marginal increase of 2% and the operating profits before consolidation adjustments increased by 4% in 2002.

*Investment Properties*

The Group's principal investment properties are located in Mainland China and owned by associated companies. The overall yields of serviced apartments in Shanghai registered a decline of 4% while those in Beijing recorded a decline ranging from 7% to 21%. This is attributable to the emergence of competitive supply. However, weighted average occupancies for commercial and office space in these two cities were above 90%. Yields of commercial space registered increases ranging from 9% at the Phase II of the China World Trade Center to 43% at the Shanghai Kerry Centre. Yields of office space in these two properties also registered an increase of 4% and 15%, respectively.

The yields of the office space at the Phase I development of the China World Trade Center increased by 13%. The serviced apartments in the Century Tower, Dalian also recorded a 11% increase in yields.

In Singapore, the yields of the serviced apartments declined by 12% on account of continuing slow-down in the local economy. However, yields of the commercial and office space have registered an increase of 9% and 10%, respectively. The commercial space was fully occupied throughout the year while the office space recorded an average occupancy of 92%.

The yields of serviced apartments and commercial space in Malaysia registered an increase of 1% and 16%, respectively, though the yield of the office space declined by 10%.

The yields of the commercial and office space in Bangkok increased by 2% and 14%, respectively.

# Management Discussion & Analysis

**(b) Consolidated Profits**

Consolidated profits attributable to shareholders increased to US$93.1 million from US$58.8 million. An analysis of the operating results and non-operating items is set out below:

**Consolidated Profit Attributable to Shareholders**
*For the year ended 31 December*

| | **2002 US$ million** | 2001 US$ million | % Change |
|---|---|---|---|
| ***Company & Subsidiaries*** | | | |
| **Hotel Operation** | | | |
| The People's Republic of China | | | |
| *Hong Kong* | **27.4** | 29.7 | (8%) |
| *Mainland China* | **36.5** | 28.8 | 27% |
| Singapore | **25.7** | 18.9 | 36% |
| The Philippines | **11.1** | 14.1 | (21%) |
| Malaysia | **1.1** | 2.5 | (56%) |
| Thailand | **6.8** | 7.3 | (7%) |
| Fiji | **2.4** | 1.4 | 71% |
| Myanmar | **(3.0)** | (2.3) | (31%) |
| | **108.0** | 100.4 | 8% |
| **Property Rentals** | | | |
| Mainland China | **1.5** | 1.2 | 23% |
| Singapore | **1.7** | 2.3 | (26%) |
| Malaysia | **0.3** | 0.6 | (51%) |
| Thailand | **0.1** | 0.1 | (7%) |
| | **3.6** | 4.2 | (15%) |
| **Hotel Management** | **6.0** | 5.7 | 7% |
| ***Associated Companies*** | | | |
| **Hotel Operation** | | | |
| Mainland China | **5.2** | 14.7 | (64%) |
| Singapore | **1.3** | 0.9 | 43% |
| Malaysia | **0.2** | – | NM |
| Indonesia | **0.7** | (1.2) | NM |
| | **7.4** | 14.4 | (48%) |
| **Property Rental** | | | |
| Mainland China | **24.1** | 23.8 | 1% |
| Singapore | **0.4** | 0.3 | 43% |
| Malaysia | **0.4** | 0.3 | 21% |
| | **24.9** | 24.4 | 2% |
| **Operating Profit After Tax** | **149.9** | 149.1 | 1% |
| Less: | | | |
| – Corporate expenses net | **(6.4)** | (6.9) | 7% |
| – Net interest expenses on corporate borrowings | **(34.9)** | (52.2) | 33% |
| **Profit before Non-Operating Items** | **108.6** | 90.0 | 21% |
| **Non-Operating Items:** | | | |
| – Deficit on valuation of hotel and investment properties | **(12.5)** | (18.5) | 32% |
| – Net realised and unrealised losses on other investments and provision for long-term investments | **(5.4)** | (23.4) | 77% |
| – Provision for impairment losses on project under development | **(13.3)** | (6.0) | (121%) |
| – Amortisation of negative goodwill | **16.5** | 16.7 | (1%) |
| – Loss on disposal of 0.75% interest in a subsidiary | **(0.8)** | – | NM |
| **Profit attributable to shareholders of the Group** | **93.1** | 58.8 | 58% |

*Notes:*

1. Interest expenses of operating units' bank borrowings are included in operating results.

2. All balances stated are net of share of minority interests.

3. Profit of the hotel management group is stated before elimination of revenue earned from fellow subsidiaries and operating results of the subsidiaries are stated before elimination of management fees charged by the hotel management group.

4. a) Profits from subsidiaries involved in hotel operations in Mainland China increased by 27% due to impressive performance by hotels in Pudong, Wuhan, Qingdao and Dalian.

   b) The increase in profits from the Singapore hotel subsidiaries arose on account of an over provision for depreciation in earlier accounting years relating to the Tower Wing renovations at the Shangri-La Hotel, Singapore. This was determined upon receipt of final certificates from the quantity surveyors.

   c) The Thailand subsidiary's reduction in profits is due to a write off of the residual book value of fixed assets discarded upon renovations at the Shangri-La Hotel, Bangkok.

   d) Profits from associated companies involved in hotel operations in Mainland China declined mainly due to major renovations at the China World Hotel, Beijing.

NM: Not Meaningful

## 2. LIQUIDITY AND FINANCIAL CONDITIONS

Taking advantage of the liquidity in the banking system, the Group executed the following unsecured bilateral Hong Kong dollars loan agreements with individual banks during the year:

| **Date** | **Loan Amount** *(HK$ million)* | **Maturity Date** |
|---|---|---|
| 11 February 2002 | 500 | February 2007 |
| 19 February 2002 | 300 | February 2007 |
| 19 February 2002 | 300 | February 2009 |

On 15 March 2002, the Group also executed a new five-year unsecured loan agreement with a consortium of banks in an amount of HK$3,000 million. The all-inclusive cost of this and the above bilateral loans with identical maturities described earlier, ranged between 53 to 55 basis points over HIBOR. With these facilities in place, the Group prepaid by June 2002, the outstanding loan balance under a US$500 million loan agreement which was due for final repayment in August 2002.

These new loans have therefore pushed out loan maturities, benefited the Group in terms of interest arbitrage, hedged currency risk by having a higher component of debt denominated in Hong Kong dollars and provided funding capacity for the Group's development efforts. The Group has adequate lines of credit available to fund its development programme for the forseeable future.

At the end of April 2002, the Group cancelled a total of US$200 million undrawn facilities under an existing US$600 million loan agreement which carried a higher interest rate.

The Group has satisfactorily complied with all covenants under its loan agreements.

# Management Discussion & Analysis

As at 31 December 2002, the Group's net borrowings (net of cash and bank balances of US$127.3 million) stood at US$1,013.7 million (2001: US$1,022.4 million), shareholders' equity was US$2,892.2 million (2001: US$2,880.7 million) and the net borrowings to shareholders' equity ratio was 35.0% (2001: 35.5%). Bank loan and banking facility of a subsidiary amounting to US$12.4 million were secured by charges over all the fixed assets and other assets of the subsidiary with net book values of US$60.4 million. A US$5.1 million bank loan of a subsidiary was secured by charges over other investments owned by it with a net book value of US$8.6 million. With these exceptions, the assets of the Company and its subsidiaries are unencumbered.

The analysis of loans outstanding as at 31 December 2002 is as follows:

| | Maturities of Bank Loans, Overdrafts and Other Borrowings Contracted as at 31 December 2002 | | | | |
|---|---|---|---|---|---|
| | | | Repayment | | |
| *(US$ million)* | **Within 1 year** | **In the 2nd year** | **In the 3rd to 5th year** | **After 5 years** | **Total** |
| **Unsecured** | | | | | |
| Corporate bank loans | – | – | 874.7 | 38.5 | 913.2 |
| Project bank loans and overdrafts | 112.6 | 21.1 | 58.7 | 0.6 | 193.0 |
| Floating rate notes | – | 17.3 | – | – | 17.3 |
| | 112.6 | 38.4 | 933.4 | 39.1 | 1,123.5 |
| **Secured** | | | | | |
| Project bank loans and overdrafts | 17.5 | – | – | – | 17.5 |
| **Total Borrowings** | 130.1 | 38.4 | 933.4 | 39.1 | 1,141.0 |
| **Undrawn but Committed facilities** | | | | | |
| Bank loans and overdrafts | 127.2 | 2.9 | 249.7 | – | 379.8 |

*Shangri-La Hotel, Kuala Lumpur – Guestroom*

## Management Discussion & Analysis

The currency-mix of the borrowings and cash and bank balances as at 31 December 2002 is as follows:

| *(US$ million)* | **Borrowings** | **Cash and Bank Balances** |
|---|---|---|
| In Hong Kong dollars | 914.8 | 8.0 |
| In Singapore dollars | 144.0 | 3.4 |
| In Malaysian Ringgit | 41.4 | 1.1 |
| In Renminbi | 29.0 | 18.2 |
| In US dollars | 9.9 | 72.7 |
| In Thai Baht | – | 13.2 |
| In Philippine Pesos | 1.9 | 2.8 |
| In Fiji dollars | – | 7.6 |
| In other currencies | – | 0.3 |
| | 1,141.0 | 127.3 |

The loans in United States dollars, Hong Kong dollars, Singapore dollars, Malaysian Ringgit and Philippine Pesos are at variable rates of interest at spreads over SIBOR, HIBOR, Swap Rate/Money Market Rate (for Singapore), Cost of Funds (for Malaysia) and Rate of Treasury Bills (for Philippines), respectively. The loans in Renminbi are at rates specified by The People's Bank of China from time to time.

As at 31 December 2002, of the Group's cash and bank balances, US$79.9 million (2001: US$55.6 million) were kept in Mainland China, Malaysia, Thailand, the Philippines and Myanmar. The remittance of funds out of these countries is subject to rules and regulations of foreign exchange control promulgated by the governments of the respective countries.

The Group executed guarantees in favour of banks for securing banking facilities to certain associated companies. The utilised amount of such facilities covered by the Group's guarantees for these associated companies as at 31 December 2002 amounted to US$44.8 million (2001: US$47.4 million).

# Management Discussion & Analysis

## 3. TREASURY POLICIES

The treasury policies followed by the Group aim to:

**(a) Minimise interest risk**

This is accomplished in the loan re-financing and loan negotiation process, and in ensuring that surplus funds from operations are made available to the corporate treasury to reduce the debt exposure. The Group has also sought to hedge its medium term interest rate risk by entering into HIBOR interest rate swap contracts. As at 31 December 2002, the Group had executed three-year contracts for an aggregate principal amount of HK$4,916 million and four-year contracts for an aggregate principal amount of HK$500 million at fixed interest rates ranging between 3.735% to 5.74% per annum. The interest cover continues through December 2006.

**(b) Minimise currency risk**

The Group has an economic hedge in terms of currency risk to the extent that a substantial portion of its hotels' room revenues in Mainland China, the Philippines, Thailand and Indonesia and investment property revenues in Mainland China are priced in United States dollars. Moreover, these and the other hotel revenues in these countries (except Thailand and the Philippines where exchange controls apply) are immediately converted into United States dollars upon realisation, to the maximum extent possible. The hotels and properties in Hong Kong, Singapore and Malaysia derive their revenue in local currencies.

The Group attempts to align the currencies of its loan portfolio with the currency mix of the Group's investments and revenues in various countries. Except in countries where exchange controls apply, revenues are immediately converted into United States dollars upon realisation, to the maximum extent possible. During the year, the Group re-financed a US$500 million loan by obtaining Hong Kong dollars loans. The Group has also obtained loans in Renminbi to finance the extension project of the Pudong Shangri-La, Shanghai and will continue to look for additional sources of funding in Renminbi to match the currency of its assets in Mainland China.

The Group has not felt it appropriate to substantially hedge against currency risks through forward exchange contracts on a consideration of the currency risks involved and the cost of obtaining such cover.

## 4. FIXED ASSET VALUATIONS

### (a) Fixed Assets Values* – by Geographical Area

| | **2002** **US$ million** | % | 2001 US$ million | % |
|---|---|---|---|---|
| The People's Republic of China | | | | |
| *Hong Kong* | **694** | 15% | 718 | 16% |
| *Mainland China* | **1,961** | 43% | 1,972 | 44% |
| Singapore | **680** | 15% | 649 | 14% |
| The Philippines | **522** | 11% | 537 | 12% |
| Malaysia | **412** | 9% | 381 | 8% |
| Thailand | **147** | 3% | 127 | 3% |
| Fiji | **64** | 2% | 64 | 1% |
| Indonesia | **31** | 1% | 31 | 1% |
| Myanmar | **37** | 1% | 38 | 1% |
| Corporate | **–** | 0% | 1 | 0% |
| Total | **4,548** | 100% | 4,518 | 100% |

* Including total fixed assets value owned by subsidiaries and the effective interest share of fixed assets value owned by associated companies.

*Makati Shangri-La, Manila – Lobby*

# Management Discussion & Analysis

**(b) Independent Valuation of Properties**

Hotel and investment properties are stated at professional valuations carried out by the following independent firms of professional valuers:

| | | |
|---|---|---|
| CB Richard Ellis Limited, DTZ Debenham Tie Leung Limited and Chesterton Petty Limited | : | For properties in Mainland China |
| CB Richard Ellis Limited | : | For properties in Hong Kong, the Philippines, Indonesia, Myanmar, Fiji and Thailand |
| CB Richard Ellis (Pte) Ltd., Colliers International Consultancy & Valuation (Singapore) Pte Ltd and DTZ Debenham Tie Leung (SEA) Pte Limited | : | For properties in Singapore |
| W.M. Malik & Kamaruzaman and CH Williams Talhar & Wong Sdn Bhd | : | For properties in Malaysia |

*Shangri-La Hotel, Dalian – Lobby*

According to Group practice, with the exception of properties held on leases of which the unexpired term is 20 years or less, independent valuations are obtained on a rotation basis for some of the hotels in its hotel property portfolio each year with the intention that all hotels in its portfolio are independently valued once every three years. Investment properties in its portfolio are independently revalued at every year end. The valuations made in the current year resulted in the reserves decreasing by US$62.3 million as at 31 December 2002 and a net charge to the current year's results of US$12.5 million after minority interests. The valuation reserves have also decreased by US$0.2 million on those properties held by a subsidiary of which 0.75% interest was disposed in 2002. In addition, the Group has made a provision of US$13.3 million for impairment losses on properties under development.

## 5. OTHER INVESTMENTS

The Group continued to gradually dispose its investment portfolio in marketable securities. In 2002, this disposal for US$13.4 million recorded net realised gains of US$1.1 million (both before and after adjustments of minority interests). Net unrealised losses of US$6.8 million (US$6.5 million after minority interests) and dividend income from other investments of US$1.8 million (US$1.6 million after minority interests) were recorded in 2002.

As at 31 December 2002, the market value of the Group's investment portfolio was US$37.5 million. The investment portfolio included 13,195,055 ordinary shares in the Company ("such SA shares") with a market value of US$8.6 million held by a wholly owned subsidiary of Shangri-La Hotel Public Company Limited, Thailand ("SHPCL"), one of the principal subsidiaries of the Group which is listed on the Stock Exchange of Thailand. Such SA shares were held by this subsidiary before the Company acquired a controlling interest in it in late 1999. The Company has undertaken, subject to market conditions, to use its reasonable endeavours to procure SHPCL to dispose all such SA shares to parties independent of the Kuok Group.

## 6. ACQUISITIONS AND DISPOSAL

(a) On 25 January 2002, Shangri-La Hotels (Malaysia) Berhad, Malaysia ("SHMB"), one of the principal subsidiaries of the Group which is listed on the Kuala Lumpur Stock Exchange, completed the acquisition of a further 33,750,000 fully paid ordinary shares of RM1 each representing 25% equity interest in Pantai Dalit Beach Resort Sdn. Bhd. ("PDBR") which owns Shangri-La's Rasa Ria Resort and Dalit Bay Golf & Country Club in Sabah, Malaysia from PPB Group Berhad (a company within the Kuok Group) for a cash consideration of RM28.7 million (equivalent to US$7.5 million). As a result, SHMB's effective equity interest in PDBR has increased from 50% to 75%. The Group's effective equity interest in PDBR has increased from 52.34% to 65.78% considering that Shangri-La Hotel Limited, Singapore ("SHL"), which holds 25% equity interest in PDBR, became a wholly owned subsidiary of the Group on 5 March 2002 (item (b) below) and the Group's disposal of 0.75% equity interest in SHMB on 8 April 2002 (item (f) below).

The fair value of the net identifiable assets relating to the 25% share of PDBR at the date of acquisition was US$8.4 million. The Group's share of the resulting negative goodwill of US$0.5 million is being amortised on a straight line basis over 15 years.

# Management Discussion & Analysis

(b) On 4 March 2002, the High Court of Singapore confirmed the Proposed Capital Scheme approved at the extraordinary general meeting of SHL held on 2 February 2002 to reduce the issued and paid up capital of SHL by cancelling 1,476,887 issued and fully paid ordinary shares of S$1 each, being 0.89% equity interest, in the capital of SHL held by all the minority shareholders. Upon filing of the order of the High Court with the Registry of Companies of Singapore on 5 March 2002, SHL became a wholly owned subsidiary of the Group. SHL is one of the principal subsidiaries of the Group and is engaged in investment holding, hotel ownership and operation, and leasing of residential and serviced apartments. The total consideration paid by SHL to the minority shareholders for all the cancelled shares was S$5.6 million (equivalent to US$3.1 million). The resulting negative goodwill of US$2.3 million is being amortised on a straight line basis over 15 years.

(c) On 11 March 2002, a wholly owned subsidiary of the Group invested US$8.3 million, being 51% of the total registered capital, in Zhongshan Shangri-La Hotel Co., Ltd. pursuant to a joint venture agreement for the development of a hotel project in Zhongshan, Guangdong Province, Mainland China.

(d) On 17 July 2002, a wholly owned subsidiary of SHL completed the acquisition of an aggregate of 33,200,000 fully paid ordinary shares of RM1 each representing 40% equity interest in Tanjong Aru Hotel Sdn. Bhd. which owns Shangri-La's Tanjung Aru Resort, Kota Kinabalu, for a total cash consideration of RM61.4 million (equivalent to US$16.2 million) from Kuok Brothers Sdn. Bhd. and PPB Group Berhad, companies within the Kuok Group. The fair value of the net identifiable assets relating to this 40% equity interest at the date of acquisition was US$17.9 million. The resulting negative goodwill of US$1.7 million is being amortised on a straight line basis over 15 years.

(e) On 22 November 2002, a wholly owned subsidiary of SHL completed the acquisition of the remaining 12,000,000 fully paid ordinary shares of S$1 each representing 40% equity interest in Sentosa Beach Resort Pte Ltd ("SEN") from its minority shareholder, Mr Prajogo Pangestu, for a total cash consideration of S$14.2 million (equivalent to US$8.2 million). The fair value of the net identifiable assets relating to the 40% share of SEN at the date of acquisition was US$10.1 million. The Group's share of the resulting negative goodwill of US$1.9 million is being amortised on a straight line basis over 15 years.

These acquisitions, which are expected to be accretive to earnings, conform to the Group's objective to maximise the ownership of hotel assets within the Group.

(f) On 8 April 2002, the Group disposed 3,300,000 SHMB shares, being 0.75% equity interest in the capital of SHMB, for a cash consideration of RM3.3 million (equivalent to US$0.9 million). As a result, the Group's effective interest in SHMB has reduced from 55.12% to 54.37%. The Group recorded a loss on disposal of US$0.8 million which was charged to profit and loss account. This includes the share of unamortised negative goodwill derecognised of US$0.7 million attributable to this 0.75% equity interest. The attributable share of hotel properties revaluation reserve of US$0.2 million was transferred to retained profits.

## 7. MANAGEMENT STRATEGIES

### General

The Group's strategic focus has been to build on its brand strength in Mainland China. It currently owns and/or operates 17 hotels in Mainland China. The fundamentals of the Mainland Chinese economy remain very strong with GDP growth of around 8% per annum, very high annual inflows of Foreign Direct Investment, international arrivals growing by 8% per annum and domestic travel growing by 10% per annum. Increasingly, manufacturing capacities are being relocated into the country because of comparative cost advantages, availability of skill sets and strong economic fundamentals. The country's accession to the World Trade Organisation, its success in being awarded the staging of the 2008 Olympic games and the 2010 World Expo will provide further impetus to its economic growth. Concurrently, the per capita GDP growth, increasing disposable incomes and aspirational needs of its citizens is underpinning a growing demand for luxury hotel accommodation.

The Group remains optimistic about the future potential for hotel business in Mainland China and to this end continues to actively pursue investment and management contract opportunities. The Group also believes that its growing brand dominance in the country will, over time, benefit its hotels elsewhere in Asia as increasing numbers of Mainland Chinese travel overseas.

The performance of the Group's hotels outside Mainland China is predicated on the recovery of the regional economies and the global economy which has been characterised by recessionary trends, security concerns and more recently, the escalating political crisis in the Middle East. The negative sentiment triggered by these developments have dampened business and leisure travel to and within the region. However, with limited if any, addition to hotel supply in the competitive set anticipated in most locations within the region, the Group's hotels should benefit from the operational leverage inherent in this business when these economies turn around.

*China World Hotel, Beijing – Guestroom*

# Management Discussion & Analysis

**Renovation Programs**

Major projects completed by end of 2002 included:

(i) Renovation of guestrooms at the Makati Shangri-La, Manila.

(ii) Renovation of lobby, public areas and guestrooms at the Shangri-La Hotel, Bangkok.

Major renovations on-going include:

(i) Renovation of lobby, public areas, food and beverage facilities and guestrooms at the Shangri-La Hotel, Kuala Lumpur which are expected to be completed by mid 2003.

(ii) Renovation of guestrooms and public areas at the China World Hotel, Beijing, the Kowloon Shangri-La, Hong Kong and the Shangri-La Golden Flower Hotel, Xian. These projects are expected to be progressively completed by December 2003.

(iii) Renovation of guestrooms at the Traders Hotel, Singapore, Shangri-La's Tanjung Aru Resort, Kota Kinabalu and Shangri-La's Mactan Island Resort, Cebu. These renovations are expected to be progressively completed by April 2004.

Major improvements and renovations commissioned in 2003 include the fit-out of an additional 80 guestrooms at the Shangri-La Hotel, Qingdao and extensive renovations to the Valley Wing of the Shangri-La Hotel, Singapore.

The Group is committed to maintaining its hotels in excellent condition to retain their competitive advantage. It will constantly assess the need to renovate or upgrade the hotels' facilities and introduce new concepts. The Group has decided to build state-of-the-art SPA facilities in some of its hotels and resorts.

All renovations are being scheduled to minimise inconvenience to hotel guests and restrict loss of revenue. The Group also believes that the renovated and upgraded products should be available for sale to coincide with the anticipated turn-around in business conditions in the region. Estimated expenditure of US$111.3 million on renovation projects of subsidiaries currently on-going and to be commissioned in 2003 will be mainly financed by operating cash flows of the individual hotel, supplemented by locally contracted short term bank loans, where appropriate.

**New Projects**

Construction work on the Shangri-La Hotel, Fuzhou, ("SLFZ"), the Shangri-La Hotel, Zhongshan ("SLZN"), and the extension of the Pudong Shangri-La, Shanghai ("SLPU") is on-going. As at 31 December 2002, the Group has already invested US$36.5 million in these projects and SLPU has obtained bank loans in Renminbi equivalent of US$25.4 million to finance its extension project. The future incremental costs to complete these projects, net of funding from minority shareholders, are estimated at US$164.3 million and will be mainly financed by locally contracted project loans and the operating surplus of SLPU. SLZN is expected to open for business by year end 2003 while SLFZ and the extension of SLPU will be ready for business in 2005. The Group is currently finalising the master development plan for the project in Jingan Nanli, Shanghai.

The Group continues to evaluate investment opportunities in the PRC and to this end has entered into agreements to acquire land in Xian and in Chengdu for US$3.2 million and US$8.3 million, respectively, for future development of hotel projects. A total amount of US$6.5 million has been paid by way of deposits as at 31 December 2002 and the balance of US$5.0 million will be paid in installments in 2003. The Group has also injected US$4.2 million equity to a newly formed wholly owned subsidiary in Mainland China for a hotel project in Futian, Shenzhen.

Upon completion of the above projects and future developments contemplated as mentioned earlier, the number of operating hotels in which the Group has an equity interest will increase from 36 as at 31 December 2002 to 42 and the corresponding room inventory will increase from 18,807 to 22,358.

The subsidiary of China World Trade Center Ltd ("CWTC") which is listed on the Stock Exchange of Shanghai has received approval from the State Development Planning Commission of the government of the PRC for the development of Phase III of the China World Trade Center complex in Beijing. This development will be done in phases commencing 2003. The first phase is expected to be completed in mid 2007. The proposed development envisages a gross floor area of 541,000 square metres in a 300 metre tall mega tower which will be a landmark in the city. Components of the development include a luxury hotel, offices, retail spaces and underground parking. The total cost of the development is estimated at US$800 million which will be financed through internally and externally sourced funds. CWTC is an associated company of the Group and it is expected that there will be no demand on the Group's cash resources arising from this project.

**Management Contracts**

In 2002, the Group signed six new hotel management contracts. Of these, the Shangri-La Hotel, Putrajaya in Kuala Lumpur commenced operations on 4 February 2003. Shangri-La's Sunny Bay Resort, Sanya, the Traders Hotel, Kunshan, the Traders Fudu Hotel, Changzhou (all located in Mainland China) and the Shangri-La resort in Maldives are under construction and expected to open for business in 2005. The Traders Hotel, Shijiazhuang near Beijing is expected to be completed in mid 2004.

Construction work at the Shangri-La Hotel, Dubai which includes some serviced apartments and the Traders Hotel, Dubai is progressing satisfactorily. It is expected that these hotels will open for business in June 2003 and December 2003, respectively. The Shangri-La Hotel, Zhengzhou will also open for business in December 2003. Construction work at the hotel project in Muscat is expected to be completed in 2005.

Upon completion of all the above projects, the number of hotels under management in which the Group does not have any equity interest will increase from 3 as at 31 December 2002 to 13 and the corresponding room inventory will increase from 962 to 4,677 rooms.

The Group continues to receive and examine several proposals for management of hotels in the Asia-Pacific Region and the Middle East. The Group believes that these contracts will significantly underpin the brand strength and improve returns to shareholders.

**Technology**

Several of the Group's hotels now offer high speed broad band internet access in guestrooms, business centres and function rooms. Reservations through the Group's interactive web-site (www.shangri-la.com) increased by 90% in terms of roomnight volumes in 2002. The Group has initiated an upgrade of its current hotel reservation system to a state-of-the-art central reservation and information system which will be supplemented by strategically located voice reservation centres (call centres) serviced by toll free phone numbers. This project involves an investment of US$3 million and is expected to be completed by October 2003. This investment will make it easier for customers to book the Group's hotel rooms, aid management to optimise yield management opportunities and strengthen customer relationships across the hotel group.

The Group also successfully implemented a state-of-the-art e-planning software to facilitate compilation of business plans and updating of financial forecasts each month by its hotels. This is greatly expected to aid the planning and control process.

**Personnel**

As at 31 December 2002, the Company and its subsidiaries had approximately 16,300 employees. Salaries of employees are maintained at competitive levels under which bonuses are based on an evaluation of efforts and the financial performance of the business units with reference to goals set. Other benefits include provident fund, insurance and medical cover, housing and share option schemes. The Group has extensive training programmes to improve service skills of its line staff and professional skills of other employees. Its in-house training programmes emphasise service attitudes, organisational values and job enrichment. In-house training is supplemented by retaining outside professional training agencies.

**Share Option Scheme**

At the Special General Meeting of the Company held on 24 May 2002, the shareholders of the Company approved the adoption of a new share option scheme (the "New Option Scheme") and the termination of the operation of the executive share option scheme adopted by the shareholders of the Company on 16 December 1997 (the "Executive Option Scheme") (such that no further options shall thereafter be offered under the Executive Option Scheme but in all other respects the provisions of the Executive Option Scheme shall remain in full force and effect).

On 29 May 2002, pursuant to the terms of the New Option Scheme, the Directors have granted options on 17,140,000 shares to eligible persons at an exercise price of HK$6.81 per share. The exercise of these new options is governed by a two-year vesting scale.

According to the terms of the Executive Option Scheme and the New Option Scheme, options on 6,610,000 shares and 270,000 shares respectively, have so far lapsed. Following the change in the capital structure of the Company arising from the various repurchases of the Company's own shares and the issue of the scrip dividend shares on 19 November 2002, adjustments have been made to the number of outstanding option shares granted under the Executive Option Scheme on 30 December 2002. The number of the outstanding option shares were adjusted downward for a total of 815,454 option shares.

As of this date, the options outstanding aggregate to 25,134,546 shares and 16,870,000 shares under the Executive Option Scheme and the New Option Scheme, respectively. No option has been exercised so far.