BUSINESS REVIEW AND PROSPECTS

Harbour City

For the first six months of 2003, **Harbour City** generated HK$1.3 billion in total revenue.

Offices

Harbour City's office occupancy was maintained at 85 per cent taking into account also Tower 6, the last tower of Gateway II, in the overall calculation. While the oversupply situation on the Island side prompted by IFC remained to be the top issue in the Grade A office market, prime rentals across several major districts generally came down by about 10 to 20 per cent during the first six months of the year. However, asking rents for office space at **Harbour City** only experienced on average a single-digit decline due to the relatively stable supply of space within Tsimshatsui and nearby areas. Out of the expiring tenancies in first half 2003, retention rate was at about 80 per cent. More than 50 per cent of all renewals due in 2003 have so far been successfully concluded.

Hotels and Service Apartments

Due to the SARS outbreak, the consolidated occupancy for the three Marco Polo Hotels at **Harbour City** fell to 48 per cent, versus the 84 per cent recorded same time a year ago. Immediately after the outbreak in March, both business and leisure segments slowed down dramatically as reflected through the across-the-board decline in visitor arrivals. Room rates were under pressure. To cope with such unprecedented situation, several extraordinary cost-control measures as well as promotional activities have been adopted to help preserve both margin and market share.

The prevailing economic condition has made it extremely difficult for Gateway Apartments to sustain the previous outperformance against the market. Having continuously outperformed the industry average for a period of more than three years since its initial launch at the end of year 1999, Gateway Apartments' average occupancy gradually came down to the 70 per cent market norm during the first half of this year. Competition is expected to intensify further as more supplies come on to the market.

Retail

In spite of the SARS outbreak, **Harbour City**'s retail podium maintained its occupancy at around 96 to 97 per cent which showed remarkable resilience during the crisis. Special measures implemented to boost up **Harbour City**'s already outstanding hygiene standard to an even higher level have received tremendous support from all shoppers, tenants and the public. Rather than reacting passively by giving away concession or rental reduction to tenants, Group management responded proactively by investing promptly into the area of marketing and promotion. Backed by **Harbour City**'s ever rising standard of hygiene-control and exciting promotional activities, both business flow and confidence level have certainly been restored. Immediate business "disruptions" caused by SARS proved to be relatively short-lived, as evidenced by the speedy recovery of foot traffic within weeks during which average weekend foot traffic for the month of May and June showed a year-on-year growth of 26 and 21 per cent respectively.

Times Square

For the first six months of 2003, **Times Square** generated HK$415 million in total revenue.

Offices

After staying consistently at 92 per cent for two consecutive years, **Times Square**'s office occupancy declined to just under 84 per cent during the first half of 2003, as a result of one single tenant's decision to relocate to Tai Po. Apart from this particular incident, no other significant vacation of space is expected in the near to medium term. The retention rate for the expiring office tenancies in the first half was at around the normal 70 per cent level. Due to the SARS outbreak and the supply-demand imbalance, most office tenants have been trying to delay their leasing decision to the latest possible as the continued downward trend for rental rates remains the widely accepted view in the market. During the six-month period under review, office consolidation and lease restructuring were still the dominant activities observed in the Grade A office market in Hong Kong.

Retail

Being the landmark property of Causeway Bay, the **Times Square** shopping complex again demonstrated exceptional resilience during the SARS period. Due to Wharf management's timely and decisive actions, foot traffic quickly bounced back to pre-SARS level within weeks in absolute terms which was indeed about 10 per cent higher than the foot traffic number recorded the same time a year ago. Similar to the case of **Harbour City**, numerous innovative marketing programmes and extensive hygiene measures proved to be extremely successful and no rental reduction has been given to any tenant due to SARS. During the six-month period under review, retail occupancy was maintained at 97 per cent and all expiring tenancies had been either renewed or re-merchandised with more appealing retailers. While rental reversion stayed positive, more international brands and retail chains including L'Oreal Paris, Swiss Balance, Offermann, Fruits & Passion and Pedder Red continued to march into **Times Square**.

Modern Terminals

Notwithstanding the great deal of uncertainties brought by the implementation of the US Government's Container Security Initiative requirements, the Middle East military conflict and the SARS outbreak, **Modern Terminals** handled 1.93 million TEUs and recorded a year-on-year growth of 23 per cent in throughput volume during the first six months of 2003.

Modern Terminals' market share in Kwai Chung expanded to 33.2 per cent as compared to the 28.7 per cent achieved the same time a year ago. Even though the pricing differential between Kwai Chung and other Southern China ports has narrowed considerably, the average tariff achieved by **Modern Terminals** continued to be under pressure.

The delivery of the four berths to **Modern Terminals** at Container Terminal 9 in Hong Kong is about to begin in October 2003. Judging from the recent years' persistently strong growth recorded out of the Pearl River Delta's manufacturing activities and exports performance, **Modern Terminals** stands to benefit from its additional capacity in the next several years to come.

All ongoing projects are progressing smoothly and on schedule. Shekou Container Terminal 2 in Shenzhen, in which **Modern Terminals** holds a 20 per cent equity stake in it, is expected to become operational within the coming month.

CME

i-CABLE

Against the backdrop of an already lacklustre economy which suffered a further blow in the first half of 2003 as Hong Kong was hit by SARS, **i-CABLE** continued to register subscriber growth from both sides of the business including Pay TV and Broadband. However, such additional demand on the Broadband side was not large enough to offset the weakness in pricing due to the extremely cautious consumer sentiment. For the six-month period under review, **i-CABLE** reported an 8 per cent year-on-year decrease in turnover, partly because of the high base backed by World Cup in first half 2002, to HK$1,037 million. Due mainly to a higher depreciation charge and the increase in tax rate, a 7 per cent decline in net profit to HK$95 million was recorded, when compared with the same period a year ago. Thanks to effective cost-control and also in the absence of World Cup, **i-CABLE**'s EBITDA margin nevertheless expanded to 36 per cent from June 2002's 33 per cent and EBITDA also grew by 3 per cent to HK$378 million to surpass all previous periods.

Pay TV

Despite the weak economy and the absence of any mega programming impetus like the World Cup last year, the Pay TV division managed to report a steady 4 per cent year-on-year subscriber growth to 625,000 with the implementation of a variety of new marketing and programming initiatives. While approximately 50 per cent of **i-CABLE**'s Pay TV subscribers are now receiving digital television service, the digitisation technology adopted has been proven effective not only in curtailing piracy but also in network capacity expansion. During the six-month period under review, five new channels had been added to the Pay TV platform. More content and choices would always help to firstly increase the stickiness of the subscriber's habit in watching cable television and to secondly bring in additional revenue.

Apart from the basic monthly Pay TV subscription business, **i-CABLE** has also been actively looking for other new sources of revenue. Sports events on a "pay-per-event" basis was one of the newly experimented areas. Events introduced during the first half included World Cup Cricket, NCAA basketball finals and NHL playoff matches. Meanwhile, **i-CABLE** is exploiting the area of licensing its digital content to other service providers, including mobile phone operators as well as overseas television stations.

ARPU for first half 2003 was HK$219, compared to the HK$244, mainly driven by World Cup, achieved for first half 2002 and the HK$222 for second half 2002.

Internet and Multimedia

On the Broadband service front, proactive steps have been taken to improve service quality and customer retention efforts are beginning to bear fruit. During the period under review, total Broadband subscribers grew by 22,000 to reach 247,000.

However, due to **i-CABLE**'s aggressive pricing strategy in order to further penetrate the competitive market, the Broadband turnover actually showed a year-on-year decline of 21 per cent to HK$193 million and ARPU also fell to HK$125 before stabilising at such level. The drop in turnover caused a decline in EBITDA to HK$71 million. Coupled with a HK$22 million increase in depreciation associated with the expansion of the subscriber base, the Broadband division recorded a net operating loss of HK$48 million against a HK$31 million profit generated in the first six months of 2002.

Wharf T&T

The weak economy resulted in business closures and downsizing and the business sector of the telecommunications market headed for further contraction. Despite such difficult operating environment in the first half, **Wharf T&T** was able to increase market share within various product segments. The second half, however, is expected to be more challenging as the weak economic condition and more severe competition are likely going to prevail.

During the first six months of the year, the installed base of total fixed lines grew by about 39,000 lines to reach 378,000 which represented an overall market share of 10 per cent. While total net revenue increased by 8 per cent year-on-year to HK$615 million, a net profit of HK$19 million was reported versus the net profit of HK$3 million achieved in the first half of 2002. On the back of a 22 per cent higher EBITDA at HK$172 million, EBITDA margin also improved to 28 per cent from the previous year's 25 per cent.

On a sectoral basis, business and residential customers accounted for 76 and 24 per cent of total revenue respectively as at the end of June 2003, versus the 79 and 21 per cent split 12 months ago. While the size of the residential market was relatively less affected by the economic downturn, extra efforts have been deployed to further penetrate that particular segment.

Wharf Estates Development Limited

Sorrento

Sorrento is an MTRC joint-venture project above the Kowloon Station, equally owned by a five-member consortium comprising Wharf, Harbour Centre Development, Wheelock, New Asia Realty and Realty Development Corporation (now a wholly-owned subsidiary of New Asia Realty). Phase II units were launched in November 2002 for pre-sales. As at the end of June 2003, cumulative sales recorded for Phase I and Phase II reached 1,061 and 346 units respectively, realising sales proceeds of about HK$4.93 billion and HK$2.31 billion respectively.

Each of the five stakeholders has contributed financial capital and funding on a pro rata basis to the project company which holds Sorrento. The total area of the development is 2.5 million square feet, comprising 2,126 units in two phases. Phase I consisting of 1,272 units was completed in October 2002, one year ahead of the expected completion of Phase II which covers the remaining 854 units.

Bellagio

Bellagio, in Sham Tseng on the western shore of the New Territories overlooking the Tsing Ma Bridge, is a joint-venture development equally owned by Wharf, Wheelock and New Asia Realty. Both Phases I and II were launched in September 2002 for pre-sales. As at the end of June 2003, cumulative sales for Phases I and II reached 1,356 units, realising sales proceeds of about HK$3.11 billion.

The three stakeholders contributed financial capital and funding on a pro rata basis to the project company which holds Bellagio. With a total area of 3.1 million square feet, once completed it will provide altogether 3,354 units in four phases. Phase I and Phase II, consisting of 1,704 units in total, were completed in May and August 2002 respectively. Construction works for Phase III and IV which cover the remaining 1,650 units commenced recently in March 2003.

Group

The Group continued to enjoy low cost of borrowings during the first half of this financial year due to high liquidity in the market. Total borrowing costs for the six-month period under review amounted to HK$305 million, which was HK$78 million lower than the total borrowing costs recorded for the same period a year ago. Loan facilities totalling HK$3.0 billion have been refinanced with lower interest margins and more favourable terms. Incoming cash from successful pre-sales also helped to cancel or prepay all outstanding project loans. As at the end of June 2003, the Group's net debt amounted to HK$19.4 billion. If the portion of **Modern Terminals**' debts (non-recourse to parent) were to be excluded, the Group's net debt would stand at an even lower level of HK$18.1 billion.