Management Discussion & Analysis

(I) REVIEW OF 2003 RESULTS AND SEGMENTAL PERFORMANCE

REVIEW OF 2003 RESULTS

Profit attributable to Shareholders

The Group reported a profit attributable to shareholders of HK$3,043 million for the year of 2003, an increase of HK$784 million or 35% against HK$2,259 million achieved in 2002. Earnings per share were HK$1.24, compared to HK$0.92 recorded in the previous year.

A lower aggregate attributable impairment provision for properties and investments was provided in 2003 than that for 2002 by HK$641 million. Also included in the profit for 2003 are a deemed profit of HK$312 million arising from the distribution of i-CABLE shares as part of the Company's interim dividend for the year and a write-down of fixed assets in the sum of HK$85 million.

Excluding the above-mentioned non-recurring items in both years, the Group's net profit would be HK$3,122 million in 2003, a mere decrease of HK$84 million or 3% compared to HK$3,206 million for 2002. The decline was chiefly attributable to the decrease in operating profit of the Group's hotel business by HK$118 million consequent to the outbreak of SARS in mid-March 2003, a drop in office rental contribution of HK$85 million under an oversupply situation prevailing in the Grade A office market, an additional tax charge of HK$223 million primarily in respect of current year's taxation and deferred tax liabilities for a rise of 1.5% in Profits Tax rate and increase in profit shared by minority interests of HK$91 million. The increase of HK$198 million in share of operating profits from associates, and savings of HK$275 million in borrowings cost mitigated the decline in profit for the year under review.

Group's Turnover

The Group's turnover for the year was HK$11,253 million, an overall insignificant decrease of HK$80 million or 1% against HK$11,333 million earned in 2002. The decrease in turnover was chiefly attributable to the reduction in hotel revenue of HK$83 million as a consequence of SARS and office rental income of HK$105 million, despite revenue growths totaling HK$161 million reported by Communications, Media and Entertainment and the logistics segment.

Group Operating Profit

Group operating profit before borrowing costs for the year 2003 amounted to HK$5,050 million, decreased by HK$291 million or 5% from HK$5,341 million in 2002. This was primarily owing to unfavourable results of hotel operations and reduction in rental contribution from office area as explained above.

SEGMENT PERFORMANCE

Property Investment

For 2003, the Property Investment segment reported a revenue of HK$4,275 million representing a reduction of HK$167 million or 4%. Operating profit showed a decrease of HK$224 million or 7% to HK$2,901 million. Additional operating and promotional expenditure totaling HK$16 million were incurred during and after the SARS period in respect of the core property assets of the Group.

Wharf Estates Limited

Harbour City

Harbour City, a core property investment asset of Wharf Estates Limited, generated a lower turnover to HK$2,732 million for 2003, as a result of a reduction in revenue from hotel businesses, office area and apartments. With the local tourist industry adversely affected by the spread of SARS in the second quarter of the year, the hotel operations recorded a decrease in sales of 13% to HK$533 million in 2003. Following stabilization of the SARS impact, the operating environment improved with the restoration of average room occupancy rate to the normal 80% plus level. Average hotel room occupancy for the whole year of 2003, however, reduced to around 67% as opposed to 86% achieved last year. Office area rental had been under pressure given the oversupply situation of Grade A office. The apartments also reported a decrease in revenue due to decline in both occupancy rate and rental rate in an intense competitive environment. Retails area recorded slightly lower contribution mainly because of rental loss in certain parts of Ocean Terminal, which had been reserved during part of 2003 for renovation and planned refurbishment programmes.

Times Square

Times Square, another core investment property asset of Wharf Estates Limited, generated in 2003 total revenue of HK$841 million, which was lower than the previous year's level by 6%. A lower office occupancy level in early part of 2003 was recorded, following the exit of an anchor tenant, which negatively impacted the revenue contribution from its office area. Revenue from retails area continued the rising trend of the previous year, resulting in improvement in both the occupancy rate and rental rate.

Plaza Hollywood

Plaza Hollywood, under Wharf Estates Limited, reported lower revenue of HK$238 million for 2003 further to the declines both in the occupancy rate and rental rate. The unfavourable results were partly due to its proximity to some SARS affected areas in Kowloon East.

The aggregate property value of Harbour City, Times Square and Plaza Hollywood owned under Wharf Estates Limited was HK$50,139 million, based on the revaluation as at December 31, 2003 conducted by independent valuers. This portfolio generated total revenue and operating profit of HK$3,811 million and HK$2,683 million respectively for 2003 against HK$4,034 million and HK$2,965 million respectively reported in 2002.

Wharf Estates Development Limited

Owning various residential, office and industrial investment properties located in Hong Kong including the peak properties, Wharf Estates Development Limited reported improvement both in aggregate revenue and operating profit in 2003. The better results were achieved with the support of an aggressive leasing strategy.

Wharf Estates China Limited

With its two major investment properties in Mainland China, namely, Beijing Capital Times Square and Shanghai Times Square, Wharf Estates China Limited recorded satisfactory growth both in aggregate revenue and operating profit in 2003, reflecting the resilience of these property assets and the high economic growth of China Mainland.

Communications, Media and Entertainment ("CME")

Benefited from the continuous increases in subscribers to Pay TV, Broadband Internet multimedia and telecommunication services, the CME segment reported growth of HK$143 million or 4% to HK$3,578 million in aggregate revenue; and growth of HK$3 million or 1% to HK$432 million in operating profit in 2003. Albeit with increased subscribers, the Broadband services reported unfavorable results principally due to the erosion in its ARPU resulting from keen price competition.

i-CABLE

Pay TV

Subscribers for Pay TV grew by 8% to reach 656,000 at the end of 2003, in spite of the absence of FIFA World Cup the year before. Accompanied by a significant year-on-year savings on programming cost and strong airtime sales performance in the second half of 2003, Pay TV turnover increased by HK$23 million or 1% to HK$1,734 million and operating profit rose by HK$112 million or 34% to HK$444 million for 2003.

Internet and multimedia

Internet and multimedia revenue decreased by HK$41 million or 9% to HK$409 million for 2003, in spite of a growth of Broadband subscribers by 14% to reach 258,000. The operating results recorded a loss of HK$85 million against profit of HK$9 million in 2002. The unfavourable results were primarily due to substantial decline of ARPU from HK$180 year-on-year to HK$129 following the adoption of an aggressive pricing strategy to maintain subscriber growth momentum under the highly competitive environment.

As compared to 2002, the consolidated results of Pay TV and Internet and multimedia businesses revealed a decrease in the group revenue of i-CABLE by HK$18 million or 1% to HK$2,143 million but an increase in its operating profit before unallocated corporate expenses by HK$18 million or 5% to HK$359 million due to significant programming cost savings as a result of stringent cost control and the non-recurring World Cup related costs incurred in 2002. Added by the benefit of the decline in finance cost and the non-recurrence of the impairment loss on investment recorded in 2002, the net profit attributable to shareholders of i-CABLE thus rose by HK$103 million or 88% to HK$220 million.

Wharf T&T

Against a backdrop of the competitive environment that has put pressure on nearly every aspect of the telecommunication business including but not limited to ARPU, operating cost, churn rate and sales force resources, Wharf T&T managed to increase its telecommunication revenue by 11% to HK$1,235 million compared to the results of 2002. During 2003, its installed base of fixed lines grew by 28% to reach 433,000 lines with a market share of 11%. The company's revenue from fixed-line telephony services rose by 16% to HK$982 million and IDD revenue rose by 7% to HK$253 million. The revenue ratio between fixed line and IDD was improved to nearly 4:1 to reflect the continuing shift to fixed line focus in its business model. The operating profit was, however, virtually unchanged at HK$54 million mainly due to higher depreciation charge, which neutralised the increase in EBITDA.

Logistics

The total revenue of Logistics segment, mainly contributed by Modern Terminals Limited ("Modern Terminals"), a 55.3%-owned subsidiary, was HK$3,221 million, an increase of HK$18 million or 1% as compared with HK$3,203 million in 2002. The operating profit, however, slightly decreased by HK$11 million or 1% to HK$1,827 million.

Modern Terminals

The revenue of Modern Terminals increased in 2003 as a result of a growth in throughput handled, mainly driven by strong feeder and transshipment volume. Operating profit of Modern Terminals also improved satisfactorily despite the keen competitive environment of the terminal industry in South China.

The decrease in profit contribution from other logistics activities, resulted mainly from SARS impact, was largely offset by the increase in profit contribution of Modern Terminals.

Property development

In addition to their property investments, Wharf Estates Development Limited and Wharf Estates China Limited conducted during the year some property sales activities in Hong Kong and China respectively but recorded a small aggregate loss. The Sorrento and Bellagio residential projects undertaken through associates progressed their respective developments according to schedule and their sales results, not being accounted for as the Group's turnover, were successful as mentioned hereunder having regard to the volatile market conditions.

Depreciation and amortisation

Depreciation and amortisation charge for the year 2003 totalled HK$1,292 million (including the amortisation of goodwill HK$50 million), an increase of HK$84 million or 7% over 2002. The rise resulted from the combined effect of a net increase in depreciation of i-CABLE and Wharf T&T, which incurred further capital investments to cater for subscriber growth and service enhancement. Amortisation of goodwill increased by HK$28 million in 2003 as its estimated useful lives had been shortened to better reflect the period during which the related asset will generate economic benefits for the Group.

Borrowing costs

Due to a persistently low interest rate environment as well as a declining Group's net debt level, net borrowing costs as charged decreased by HK$275 million or 36% to HK$480 million for 2003 from HK$755 million incurred in the previous year. The charge was after capitalization to related assets of HK$54 million for the year compared to HK$94 million in the previous year. The Group's average borrowing cost was 2.66% p.a., a reduction from 3.59% p.a. in 2002.

Net other charges

The net other charge recognized in 2003 comprised the deemed profit of HK$312 million arising from a distribution of 244.7 million i-CABLE shares by the Company as part of 2003 interim dividend, net impairment provision of HK$276 million for properties under development, impairment provision of HK$58 million for investments and write off of fixed assets of HK$85 million; all before deduction of minority interest. The deemed profit on distribution of the i-CABLE shares represents the difference between the total value of HK$508 million, calculated on basis of the closing price of i-CABLE share on August 19, 2003, and the net book value of the distributed shares.

The charges in 2002 mainly included net provisions of HK$285 million for impairment in value of various properties under development and HK$149 million for impairment in value of investments.

Share of profits less losses of associates

The share of profits of associates for the year was HK$292 million compared to loss of HK$495 million in 2002. The share of profit for the year under review mainly came from attributed profit on sale of Sorrento residential units benefited from the rebounding residential market, particularly in the second half of 2003. The attributed losses for last year mainly resulted from the Group's share of the aggregate provisions of HK$589 million made by the associates for the impairment in value of two property development projects, namely, Sorrento and Bellagio, 40% and 33-1/3% respectively owned by the Group.

Profit before taxation

The profit before taxation, which include the non-recurring items and provisions as stated above, increased by HK$1,098 million or 30% to HK$4,755 million for 2003 from HK$3,657 million against previous year.

Taxation

The taxation charge for 2003 was HK$952 million, a jump of HK$223 million from HK$729 million recorded in the previous year. The significant increase primarily resulted from the rise in the Hong Kong Profits Tax rate to 17.5% (2002: 16%), which affected not only the current tax charge but also the deferred tax liabilities. The latter item had, *inter alia*, been enlarged upon the adoption of the new accounting standard SSAP 12 "Income taxes" in the current financial year.

Minority interests

Minority interests were HK$760 million compared to HK$669 million in 2002. The increase arose mainly from better results achieved by two non-wholly owned subsidiaries, namely, Harbour Centre Development Limited and i-CABLE.

Included in the Group's profit attributable to the shareholders is profit of HK$1,051 million (2002: HK$883 million) contributed aggregately from three major non-wholly owned subsidiaries, namely, the 55.3%-owned Modern Terminals, 67.1%-owned i-CABLE and 66.8%-owned Harbour Centre Development Limited. Total dividends received from these subsidiaries amounted to HK$891 million for the year 2003 (2002: HK$853 million).

(II) LIQUIDITY AND FINANCIAL RESOURCES

Shareholders' funds

The Group's consolidated net asset value was HK$51,628 million or HK$21.09 per share at December 31, 2003, grew from the restated value of HK$47,734 million or HK$19.50 per share at December 31, 2002, respectively. The improvement partly reflected the net appreciation in the Group's investment and hotel property portfolios, which were revalued by independent valuers at December 31, 2003. A transfer of a net revaluation surplus of HK$2,201 million was made to the Group's revaluation reserves account for the year.

Shareholders' funds at December 31, 2002 was restated downwards by HK$979 million as a prior year adjustment by providing an additional net deferred tax liabilities to comply with the new requirements of SSAP 12 "Income taxes" (revised) retrospectively with effective from January 1, 2003.

Supplemental Information

To better reflect the underlying net asset value of the Group, the following objective-base adjustments are given below:

	Per share
Book net asset value at December 31, 2003	HK$21.09
Add adjustments for:-	
Modern Terminals	
– based on the previous average transaction prices	2.12
i-CABLE	
– based on market value at December 31, 2003 (@HK$1.99 p.s.)	0.64
Adjusted net asset value per share at December 31, 2003	HK$23.85

Net cash generated from the Group's operating activities

For the year under review, net cash generated from the Group's operating activities increased to HK$5.4 billion from HK$4.7 billion in 2002. This was partly due to the proceeds of HK$0.5 billion from disposal of certain listed debt securities in 2003. Net cash inflow of HK$1.1 billion was recorded for investing activities which comprised net repayments of advances mainly from the associates undertaking the property developments of Bellagio and Sorrento of HK$1.7 billion, the uplift of pledged and long term deposits of HK$0.8 billion and proceeds of HK$0.3 billion from sale of long term listed investments net of purchase of fixed assets for HK$1.7 billion.

Capital expenditure

The capital expenditure, including programming library, incurred by the Group's core businesses during the year and related capital commitments at the year-end date are analysed as follows:

		Capital Commitments as at December 31, 2003	
Business Unit/Company	**Capital expenditure in 2003 HK$ Million**	**Authorised and contracted for HK$ Million**	**Authorised but not contracted for HK$ Million**
Property investments/others	216	213	1,061
Wharf T&T	512	74	79
i-CABLE	507	137	180
Modern Terminals	441	675	99
	1,676	1,099	1,419
At December 31, 2002	2,174	1,700	1,606

The capital expenditure of Wharf T&T and i-CABLE mainly related to network equipment while that of the Logistics was substantially for construction of Container Terminal 9.

In addition to the above, the Group had planned expenditures at the end of 2003 of approximately HK$2.5 billion (2002: HK$1.1 billion) mainly related to the properties under development for sale in China Mainland.

Major property projects undertaken by associates

Sale of the Sorrento and Bellagio projects undertaken by associates, 40%-owned and 33-1/3% owned by the Group, respectively, reported good progress. For the year under review, 673 units of Sorrento and 332 units of Bellagio were sold. At December 31, 2003, accumulated sales of Sorrento Phase I and Phase II units reached 1,251 units or 98% and 728 units or 85% respectively. The sale of Bellagio accumulated to 1,585 units or 93% of the 1,704 Phases I and II units.

At December 31, 2003, the cash deposits in Sorrento's stakeholders account amounted to HK$0.5 billion, which would be sufficient to fully cover its outstanding construction cost for completion of the whole project. Following the completion of the Phases I and II units, the cash deposits in Bellagio's stakeholders' account at March 31, 2003, amounting to HK$1.2 billion were distributed to the shareholders of the project company in proportion to their equity interests in April 2003. Construction works for Bellagio Phases III and IV are underway in accordance with schedule and the estimated cost for completion of these Phases was approximately HK$1 billion. The two project companies did not have any bank borrowings at December 31, 2003.

Gearing ratios

As at December 31, 2003, the ratio of net debts to total assets decreased to 21.4%, while the ratio of net debts to shareholders' equity decreased to 32.9%, compared to 25.9% and 42.9% at December 31, 2002, respectively. The Group's net debts decreased substantially from HK$20.5 billion at December 31, 2002 to HK$17.0 billion at December 31, 2003, which was made up of HK$18.7 billion in debts less HK$1.7 billion in deposits and cash. Included in the Group's debts were loans of HK$1,300 million borrowed by a non-wholly owned subsidiary, Modern Terminals (2002: HK$941 million borrowed by Modern Terminals and HK$386 million borrowed by i-CABLE). These loans are without recourse to the Company and other subsidiaries of the Group.

Availability of committed and uncommitted facilities

High liquidity continued to sustain in the banking market during 2003. Taking advantage of the circumstances, the Group had arranged loan facilities on favourable terms in an aggregate amount of HK$6.3 billion for refinancing purpose. The asset-backed notes totalling HK$4.5 billion were prepaid in May 2003, with substantial reduction in interest margins achieved. To diversify the funding source, the Group has set up a medium term note programme, which allows the Group from time to time to issue for an aggregate amount of notes the outstanding of which will not at any time exceed US$1,000 million.

The Group's available loan facilities and debt securities amounted to HK$26.3 billion. Debts totaling HK$18.7 billion were outstanding at December 31, 2003, against the available facilities as analysed below:

	31/12/2003			
Debt Maturity	**Available Facility HK$ Billion**	**Total Debt HK$ Billion**		**Undrawn Facility HK$ Billion**
Company and wholly owned subsidiaries				
Committed facilities				
Repayable within 1 year	5.1	5.0	27%	0.1
Repayable between 1 to 2 years	1.6	1.6	9%	–
Repayable between 2 to 3 years	4.6	4.6	24%	–
Repayable between 3 to 4 years	6.9	2.9	16%	4.0
Repayable between 4 to 5 years	2.0	1.6	8%	0.4
	20.2	15.7	84%	4.5
Uncommitted facilities	2.1	1.3	7%	0.8
	22.3	17.0	91%	5.3
Non wholly-owned subsidiaries				
Committed and uncommitted				
Modern Terminals Limited	2.9	1.3	7%	1.6
i-CABLE Communications Limited	0.5	–	–	0.5
Others	0.6	0.4	2%	0.2
	26.3	18.7	100%	7.6
Secured	0.5	0.4	2%	0.1
Unsecured	25.8	18.3	98%	7.5
Total	26.3	18.7	100%	7.6

Subsequent to the year end, banking and other facilities in an aggregate amount of HK$5,934 million, with maturity ranging from 3 to 7 years, have been secured to refinance the facilities of HK$6,900 million including those expiring in the year ending December 31, 2004, which further reduce average borrowing margins and lengthen the Group's maturity portfolio.

As at December 31, 2003, notes of HK$880 million have been issued under the above-mentioned US$1,000 million medium term note programme, of which only the amount issued had been included in the amount of the above available facility.

As at December 31, 2003, the banking facilities of the Group were secured by mortgages over certain investment properties with an aggregate carrying value of HK$3,732 million (2002: HK$17,923 million).

An analysis of the Group's total debts by currency at December 31, 2003 is shown as below:

	HK$ Billion
Hong Kong dollar	14.0
United States dollar (swapped into Hong Kong dollars)	4.6
Renminbi	0.1
	18.7

The Group's debts are primarily denominated in Hong Kong and US dollars and the US dollars loans have almost fully been effectively swapped into Hong Kong dollar loans by forward exchange contracts.

The use of financial derivative products is strictly controlled. The majority of the derivative products entered into by the Group were used for management of the Group's interest rate exposures.

The Group maintained a reasonable level of surplus cash, which was denominated principally in Hong Kong and US dollars, to facilitate the Group's business and investment activities. As at December 31, 2003, the Group also maintained a portfolio of long-term investments, primarily in blue-chip securities, with a market value of HK$1.3 billion.

(III) EMPLOYEES

The Group has approximately 10,102 employees. Employees are remunerated according to nature of the job and market trend, with a built-in merit component incorporated in the annual increment to reward and motivate individual performance. Total staff costs for the year 2003 amounted to HK$1,999 million, compared to HK$1,983 million of 2002.