

# Management Discussion and Analysis

## Review of Operating Results

A summary of the performance of the Group's major businesses during the year under review is as follows:

### Water Distribution

Profit contribution from the Dongshen Water Supply Project remained significant to the Group.

As mentioned in the interim report, the earlier than usual one-month suspension of water supply to Hong Kong in June 2003 has resulted in a full six-month water supply to Hong Kong in the second half of the year. In 2004, the one-month suspension of water supply to Hong Kong is scheduled to occur at the normal time in December.

The commencement of the operation of the phase IV renovation project in the second half of the year has significantly improved the quality of water supplied to Hong Kong.

In 2003, the management of the Dongshen water supply project successfully transformed itself from operating management style to a more market oriented management style. The change of management attitude has helped the Company to achieve substantial growth in water revenue from increased sales to Dongguan and Shenzhen, better tariff collection efforts and tariff increases. In addition, the growth of our service network has also helped to increase water revenue in these two cities.

Total volume of water supply to the Hong Kong, Shenzhen and Dongguan markets enjoyed very healthy growth, amounting to 1.74 billion cubic meters, an increase of 15.62% over 2002. This represents a growth of 1.25%, 3.8% and 79.78% for the three regions respectively.

Operating profit (before finance costs and tax) of our water distribution business remained stable in the year (2003: HK\$1,626,693,000 ; 2002: HK\$1,634,804,000).

The successful refinancing of the water project debts of approximately HK\$14.8 billion resulted in a significant savings in our finance costs, which dropped to HK\$585,960,000 from HK\$1,332,494,000 in the same period last year.

The profit contribution to the Group from the water distribution business was HK\$829,483,000 (2002: HK\$113,947,000).

## Management Discussion and Analysis

### Review of Operating Results (continued)

#### Electric Power Generation

##### *Shaoguan Power Plant D*

In 2002, sales of electricity by the Shaoguan Power Plant D (“Shaoguan PPD”) were adversely affected by a series of shutdowns that occurred after a major repair in July 2002, heavy rains during August and September, and a reduction in tariffs that became effective in July 2002.

In 2003, extensive efforts by management to secure increased sales of electricity (2003: 1,922 million kwh; 2002: 1,280 million kwh) and the ongoing shortage of electricity in China, enabled the plant to achieve strong results. In 2003, total sales of electricity amounted to HK\$623,786,000 (2002: HK\$464,370,000), an increase of 34.33%. Despite higher costs of coal and lower tariffs, better control of overheads and a full year of operation at the plant helped the plant to achieve a substantial increase of 232.74% in its profit before tax (2003: HK\$155,040,000; 2002: HK\$46,595,000).

##### *廣東省韶關粵江發電有限責任公司 (Guangdong Shaoguan Yue Jiang Power Supply Limited)*

The associated company of Shaoguan PPD, the Yue Jiang Power Plant, achieved no substantial change in revenue during the year (2003: HK\$552,126,000; 2002: HK\$554,793,000). This was the net results of a slight increase in kwh sold (2003: 1,545 million kwh; 2002: 1,542 million kwh) and a lower unit revenue per kwh sold due to lower tariffs. The Group's share of the sales revenue and operating profit before tax from this associated company was HK\$63,356,000 and HK\$14,669,000 (2002: HK\$63,662,000 and HK\$12,111,000) respectively.

##### *Meixian Power Plant B*

Sales of electricity by the power plant in Meixian, an investment held by the Group's associated company, amounted to 1,525 million kwh (2002: 1,396 million kwh), an increase of 9.24%. The lower sales of electricity due to wet seasons from April to June 2003 was more than offset by strong demand for power in the second half of the year. Sales revenue for the year reached HK\$509,333,000 (2002: HK\$514,163,000), a slight drop of 0.94% mainly due to a tariff reduction. Operating profit before tax was HK\$195,104,000 (2002: HK\$239,902,000), a drop of 18.67%.

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### Review of Operating Results (continued)

#### Toll Roads and Bridges

A before-tax profit of HK\$124,233,000 (2002: HK\$120,898,000) was generated by the Group's jointly-controlled entity ("JCE"), which holds interests in the "2 Roads and 2 Bridges" project. The 2.76% increase in JCE's profits was largely driven by a lower interest expense that arose from the early repayment of bank debt. In addition, the project enjoyed year over year growth in traffic. As at 31 December 2003, the balance of the bank loan was further reduced to US\$26,900,000 (2002: US\$59,800,000).

Humen Bridge recorded a growth of 15.02% in its traffic flow. The average daily traffic for 2003 increased to 34,829 vehicle trips (2002: 30,280 vehicle trips). Revenue for the year reached HK\$473,719,000 (2002: HK\$395,365,000), an increase of 19.82%. The Company's effective interest in this project is 15.3%.

Shantou Haiwan Bridge recorded a growth of 3.82% in its traffic flow. The average daily traffic for 2003 was 13,251 vehicle trips (2002: 12,764 vehicle trips). Revenue for the year reached HK\$134,145,000 (2002: HK\$123,156,000), an increase of 8.92%. The Company's effective interest in this project is 15.3%.

The Guangzhou-Shantou Highway (Huizhou Section) recorded a 6.25% growth in its traffic flow. The average daily traffic for 2003 was 28,734 vehicle trips (2002: 27,045 vehicle trips). Revenue for the year reached HK\$126,935,000 (2002: HK\$120,189,000), an increase of 5.61%. The Company's effective interest in this project is 26.01%.

Due to the commencement of Jingzhu North and South highways, the traffic flow of Qinglian Highway for 2003 drastically dropped by 23.16%. The average daily traffic dropped to 24,448 vehicle trips (2002: 31,815 vehicle trips). Revenue for the year was HK\$177,087,000 (2002: HK\$272,499,000), a decrease of 35.01%. The Company's effective interest in this project is 7.23%. As a result of the drop in traffic flow, a provision of HK\$60 million was made by the Group against this investment.

The performance of the two Pak Kong Bridges in Qingyuan remained stable, generating a steady cash return to the Group. The Company's effective interest in this project is 24.5%.

The average daily traffic of Yingkeng Highway remained stable (2003: 4,135 vehicle trips; 2002: 3,969 vehicle trips). The Company's effective interest in this project is 70%.

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### Property Investment

#### Mainland China

##### *Teem Plaza*

Teem Plaza in Guangzhou continued to enjoy high occupancy rates (99%) and increasing rental income in 2003. Despite the negative impact of SARS in the first half of the year, effective damage controls, the development of an additional 6,676 square meters of rental area and normal annual rental increases all helped Teem Plaza to enjoy another strong year. Rental income for the year reached HK\$271,204,000 (2002: HK\$263,100,000), an increase of 3.08%.

#### Hong Kong

##### *Guangdong Investment Tower*

The average occupancy rate at the Guangdong Investment Tower (the "GDI Tower") for 2003 was 82.67% (2002: 80%), a slight increase of 2.67%. Despite the fact that the local commercial rental market finally started to pick up in the last quarter of 2003, rental revenue for the year only amounted to HK\$20,352,000 (2002: HK\$24,040,000), a drop of 15.34%.

### Hotel Operations and Management

As at 31 December 2003, our hotel management team was managing nine hotels (2002: ten hotels) in Hong Kong, Macau and Mainland China, of which four were owned by the Group.

The hotel business during the first six months of 2003 was adversely affected by the impact of SARS. In the second quarter of 2003 alone, turnover was HK\$19.63 million (63.69%) lower than the same quarter of the previous year. The post-SARS recovery of the tourism business in Hong Kong, together with the influx of visitors from Mainland China taking advantage of the new "free travel" policy to visit Hong Kong, helped the hotel group to achieve better results in the second half of 2003.

Despite the rebound in the second half of year, full year figures for the hotel business were still disappointing compared to 2002. Average occupancy rate for 2003 was 61% compared to 88% in 2002. Average room rate was down by 2.7%. Total revenue for 2003 was HK\$158,778,000 (2002: HK\$220,066,000), a drop of 27.85%. Despite an effective control of overheads, the profit before tax (before the hotel property revaluation effect) from the hotel business was substantially decreased to HK\$18,603,000 (2002: HK\$46,848,000).

### Retail

廣東天貿南大百貨有限公司 (Guangdong Teem Nanda Department Stores Ltd.) ended the year with a record high turnover of HK\$773,511,000 (2002: HK\$736,032,000). The post-SARS promotional programmes in July and August successfully increased visitor traffic back to pre-SARS levels. Stronger sales of digital cameras, sportswear and gold and jewellery items were partly offset by a price war in electrical appliances.

## Management Discussion and Analysis

### Liquidity, Gearing and Financial Resources

As at 31 December 2003, the cash and bank balances of the Group fell by HK\$405 million to HK\$1,383 million (2002: HK\$1,788 million), mostly denominated in Hong Kong dollars (HK\$319.16 million), Renminbi (equivalent to HK\$907.88 million) and US dollars (equivalent to HK\$155.96 million). This is mainly due to the repayment and prepayment of all of the Group's remaining bank debts that were restructured in December 2000.

Despite the full repayment of the Group's remaining restructured bank debts in May 2003, the level of the Group's financial borrowings at the balance sheet date increased by HK\$164 million. The increase is mainly due to the net effects of (i) the issue of bonds amounting to HK\$994.64 million in December 2003 to GDH Limited in return for the cancellation of preference shares, (ii) the additions at our water distribution business of a non-interest bearing government loan and interest-bearing bank loans of HK\$2,364 million and HK\$684 million respectively, being part of the funding for the cost of the phase IV renovation project which commenced its operation in October 2003, and (iii) the repayment of financial debts for the year of approximately HK\$3,880 million. As at 31 December 2003, the Group had financial borrowings amounting to HK\$18,489 million (2002: HK\$18,325 million). Of the Group's total financial borrowings, HK\$356 million was repayable within one year while the remaining balances of HK\$4,281 million and HK\$13,852 million are repayable within two to five years and beyond five years from the balance sheet date, respectively.

Save for the refinancing bank debts incurred at our water distribution business, the Group maintained nil credit facilities as at the balance sheet date.

Though there was a slight increase in the Group's financial borrowings, the gearing for the Group as at 31 December 2003 remained stable (2003: 2.11 times; 2002: 2.15 times (restated)).

The existing cash resources and available credit facilities of the Group, together with steady cash flows generated from its operations, are sufficient to meet its payment obligation and business requirements.

### Pledge of Assets

At 31 December 2003, none of the Group's fixed assets, investment properties and bank deposits were pledged to secure general banking facilities granted to the Group (2002: HK\$725,157,000).

### Capital Expenditure

The Group's total capital expenditure for fixed assets was HK\$4,923,757,000 in 2003, an increase of HK\$4,814,659,000 compared to last year. The Group's capital expenditure (other than the capital expenditure related to subsidiaries that were disposed of in the current year) related principally to the commencement of the operation of the phase IV renovation project in 2003 at our water distribution business (RMB4.7 billion), the additions of plant and machinery for the power plant at our electric power generating facilities, and renovation works for our hotels.

## Management Discussion and Analysis

### Exposure to Fluctuations in Exchange and Interest Rates and Related Hedges

As at 31 December 2003, total Renminbi borrowings amounted to HK\$1,796 million (2002: our foreign currency borrowings were HK\$3,330 million, of which HK\$1,923 million were United States dollars, HK\$16 million were Euros and HK\$1,391 million were Renminbi)

As at 31 December 2003, the Group's total floating rate borrowings amounted to HK\$14,017 million (2002: HK\$17,012 million), of which HK\$9,100 million (2002: HK\$3,500 million) were hedged by fixed interest rate swap agreements with an average remaining life ranging from 4 to 9 years.

### Litigation

As at 31 December 2003, there were no material contingent liabilities in respect of outstanding litigation or legal proceedings that need to be disclosed.

### Number and Remuneration of Employees

As at 31 December 2003, the Group had a total of 3,644 employees. Among the employees, 3,418 were employed by subsidiaries in Mainland China and 226 were employed by the head office and subsidiaries in Hong Kong. Out of the total number, 665 were managerial employees of the head office and its subsidiaries. Total remuneration paid for the year under review was approximately HK\$233,724,000 (2002: HK\$373,607,000).

The Group recruits and promotes individuals based on merit and their development potential for the positions offered. Performance of staff is reviewed at least annually and employees' compensation is performance driven. The Group's remuneration and benefit policies are based on the business performance of the relevant employee's company. Year-end bonuses will be granted to those employees with outstanding performance. The Group adopts a share option scheme which aims to provide incentives to participants who contribute to the success of the Group and to enable it to recruit and retain good quality employees for the long term. People are the Company's key assets and key to success. The Group encourages employees to participate in external training programmes to develop themselves on a continuous basis. For existing employees' career development, the Group provides opportunities through on-the-job training by regular job rotation, so as to improve staff quality to meet future challenges and gain a competitive edge.

The Group advocates a corporate culture which seeks to excel in terms of financial performance and economic benefit and to effectively deploy its human resources strictly on merit. It also aims to continuously streamline its organisational structure to result in further cost reductions. The Group manages and develops its staff through an effective performance appraisal system with an incentive/penalty scheme to enhance staff motivation in order to achieve corporate goals.

## Management Discussion and Analysis

### Significant Transactions

The significant transactions incurred by the Group during the year include the following:

- (a) The closing of the approximately HK\$1.5 billion sale of substantially all of the Group's non-core businesses and the repayment of all of the Group's remaining bank debts that were originally restructured in December 2000.
- In February 2003, the Company entered into a conditional agreement (the "Disposal Agreement") with its immediate holding company, GDH Limited, under which the Company would sell to GDH Limited various assets including the Company's approximately 72% shareholding in Guangdong Brewery Holdings Limited and the Company's shareholding of approximately 71.56% in Guangdong Tannery Limited for a total consideration of approximately HK\$1,451,226,000. The transaction was completed in March 2003 pursuant to the Disposal Agreement and thereafter majority of the Company's remaining assets would be directly or indirectly engaged in the Group's core businesses.
  - The sale proceeds arising from the Disposal Agreement were used to finance part of the repayment in May 2003 of all of the Group's remaining bank debts under the restructuring scheme. Upon the full repayment of the bank restructuring debts, the Company has been fully released from any further obligations under, and successfully exited from, its debt restructuring completely.
- (b) In August 2003, the Company announced its intention to put forward (i) a proposal to reduce the Company's share premium account by approximately HK\$3,879,160,000, being an amount of the Company's accumulated losses as at 30 June 2003 and thereafter to apply the amount of the share premium account so reduced in eliminating the accumulated losses of the Company as at 30 June 2003 (the "Loss Elimination Reduction"); and (ii) a proposal involving the cancellation of the 3.25% redeemable cumulative convertible preference shares of par value of US\$1 each and paid up value of US\$1,000 each in the capital of the Company and their replacement with HK\$497,320,000 5.1% five-year straight bonds and HK\$497,320,000 2.0% five-year convertible bonds, both to be issued to GDH Limited (as the beneficial owner of all the preference shares in issue) or its nominee (the "Preference Share Cancellation"). The Loss Elimination Reduction and the Preference Share Cancellation were referred to collectively as the "Capital Reduction Proposal".

In December 2003, it was confirmed that the bonds were issued by GDI Finance (Cayman) 2003 Limited, a wholly-owned subsidiary of the Company, to GDH Limited, on 24 December 2003 pursuant to the Preference Share Cancellation. The aggregate principal amount of bonds issued is HK\$994,640,000. As at the date of the issue of the bonds, the redemption amount of the preference shares was US\$138,175,730 (approximately HK\$1,077,771,000). Therefore, the amount which GDH Limited would be waived under the Preference Share Cancellation is equivalent to approximately HK\$83,131,000.

## Management Discussion and Analysis

### Significant Transactions (continued)

On 24 December 2003, it was confirmed that a copy of the order of the High Court of Hong Kong confirming the Capital Reduction Proposal, and the minutes of the capital of the Company resulting from the Preference Share Cancellation, were registered with the Registrar of Companies in accordance with section 61 of the Companies Ordinance. Accordingly, the Capital Reduction Proposal became effective on 24 December 2003.

The effect of the Capital Reduction Proposal was to place the Company in a position to resume the payment of dividends out of any distributable profits that may be generated by the Company in the years subsequent to 2003.