

Management Discussion and Analysis

operational review

Infrastructure

- ● ● Despite the Central Government's measures to cool down the overheated economy, NWSI maintained stable growth in AOP in FY2004, mainly benefited from surging electricity generation, increased demand for treated water and growth in high quality logistics service.

ENERGY

WATER TREATMENT
AND WASTE MANAGEMENT

ROADS AND BRIDGES



Zhujiang Power was named

First Class

Fired Power Plants



Management Discussion and Analysis

Despite measures by the Central Government in the first half of 2004 to curb excessive investment and cool down the overheated economy, NWSI still managed to maintain stable growth in its profitability in FY2004. The Energy segment benefited from surging electricity generation and consumption caused by economic growth, especially in Guangdong Province. The improved performance of the Water Treatment and Waste Management segment resulted from increased demand for treated water in Mainland China. Likewise, the road and expressway projects benefited from the growth in high quality logistics services in Mainland China.



Zhujiang Power Station

AOP Contribution by Segment			
For the year ended 30 June	2004 HK\$m	As restated 2003 HK\$m	Change % Fav./Unfav.)
Energy	463.1	396.7	17
Water Treatment and Waste Management	52.1	26.1	99
Roads and Bridges	291.0	346.3	(16)
Total	806.2	769.1	5

Energy

The AOP of the Energy segment increased by HK\$66.4 million to HK\$463.1 million, up 17% from FY2003.

Overall electricity sales of Zhujiang Power Phases I and II increased by 16%. This was mainly due to the rapid growth of local heavy industrial activities which typically demand generous electricity supply. The significant increase in the AOP of Zhujiang Power Phase I was

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Macau Power Plant

attributable to the increase in electricity sales. It also reflected the enhanced operating profit that resulted from the extension of the power plant's estimated useful life which in turn reduced the depreciation charge for the year. The performance of Macau Power was satisfactory with a 7% increase in electricity sales. However, the contribution from this business decreased when compared to FY2003 as last year's results were supported by a gain on disposal in

May 2003 of an effective interest of 1.35% in Macau Power to China Power International Holding Limited.

During FY2004, the Group consolidated its energy portfolio by disposing of certain under-performing projects. In June 2004, the Group disposed of its 60% interest in Shunde

Desheng Power Plant for a consideration of approximately HK\$660.0 million. Subsequent to the year end (August 2004), it also entered into a conditional sale and purchase agreement with a Mainland Chinese party in respect of the disposal of Sichuan Qianwei Power Plant for a consideration of RMB48.0 million.

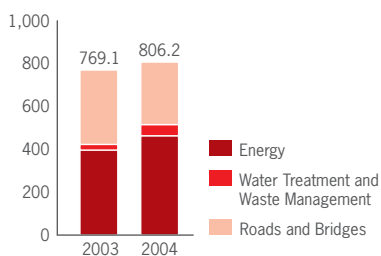
Water Treatment and Waste Management

The AOP of the Water Treatment and Waste Management segment increased by 99% to HK\$52.1 million in FY2004. The increase was attributable to the improved performance of certain projects in Mainland China, especially a full-year contribution from a project in Chongqing that commenced operations in November 2002. Furthermore, the increase in AOP was also attributable to a net reduction in provision for under-performing projects.

The Macao Water Supply Company Limited was once again the highest profit contributor to the Water

AOP Contribution by Segment

HK\$m



The Macao Water Supply Company Limited

Management Discussion and Analysis



Guangzhou City Northern Ring Road

Treatment segment. The average daily water sales volume increased by 5% over FY2003.

During the year, the Group, through its 50% owned jointly controlled entity, contracted new investments in the water sector in Hainan Province and Tianjin Municipality in Mainland China. The water plant in Sanya City, Hainan Province commenced operation in January 2004 while the project in Tanggu District,

Tianjin Municipality is expected to start operation later this year.

Roads and Bridges

During FY2004, the Roads and Bridges segment strengthened its operations by divesting several under-performing projects - including the Tianjin Yonghe Bridge, the Zhaoqing Roadways Network and the Wuhan Bridges project – and

exploring new investment opportunities with solid returns.

The AOP of the Roads and Bridges segment was HK\$291.0 million for FY2004, a decrease of 16% compared to FY2003. The decrease in AOP was mainly due to certain one-off gains recognized in FY2003.

The increase in toll income of Guangzhou City Northern Ring Road by 19% mainly resulted from the change in classification of toll rates/ vehicle types that took effect in August 2003 under the Guangdong Province joint toll collection scheme. Average daily traffic flow increased slightly by 5% in FY2004 while toll income increased by HK\$76.8 million. However, the favourable effect was partly offset by the one-off withholding tax refund of HK\$8.4 million recognized in FY2003. The combined effect led to an overall increase in AOP of 44%.

Average daily traffic flow of Sections I and II of Beijing-Zhuhai Expressway (Guangzhou-Zhuhai Section) increased by 18% and 19% respectively. However, the overall AOP decreased by HK\$34.8 million due to the recognition of a one-off net interest income to the Group of approximately HK\$36.0 million, which was previously deferred, as a result of the restructuring of the project's investment vehicle during FY2003. Another reason for the decrease in AOP is that no interest income from the joint venture to the Group was recognized in FY2004 as the joint

infrastructure

venture had fully repaid shareholder loans in February 2003.

The AOP of Shenzhen-Huizhou Roadway and Expressway decreased by HK\$7.4 million. Combined average daily traffic flow dropped by 2% in FY2004. The decrease in AOP was mainly attributable to increased repairs and maintenance expenditure.

Average daily traffic flow of Hui-Ao Roadway increased by 2%. However, a significant decrease in AOP contribution from Hui-Ao Roadway was noted in FY2004. During FY2003, the joint venture partner agreed to reduce the interest rate on shareholder loans from 10% to 2% effective retrospectively. This created a substantial interest credit in FY2003.

In November 2003, the Group announced the disposal of the Zhaoqing Roadways Network for a consideration of approximately HK\$1.168 billion. These disposals were all completed by March 2004 and the results from these projects were only recognized up to February 2004. Accordingly, AOP dropped slightly when compared to FY2003.

The performance of the Guangxi Roadways Network was satisfactory. Average daily traffic flow and toll income, on a combined basis, increased by 7% and 5% respectively.

Tangjin Expressway (Tianjin North Section) in Tianjin recorded an increase in toll income of 43% or HK\$76.4 million. Average daily traffic flow increased by 14% in FY2004 due to the opening of Tangjin Expressway

South Section in mid-November 2003. However, the favourable effect on AOP resulting from increased toll income was offset by repair and maintenance costs. Accordingly, the AOP of Tangjin Expressway (Tianjin North Section) increased only by HK\$6.1 million.

The average daily traffic flow of Shanxi Roadways, on a combined basis, decreased by 3% when compared to FY2003. Traffic on the Taiyuan to Changzhi Roadway (Changzhi Section) and Roadway No. 309 (Changzhi Section) was seriously affected by rarely occurred flooding problem with combined toll income dropped by 14%.

In Hong Kong, the AOP of Tate's Cairn Tunnel saw a slight decrease of 3% and the average daily traffic flow remained fairly constant in FY2004.

The AOP contribution from the Bridges segment was not significant. Negotiations of the detailed terms in respect of the compensation from the Wuhan City Government following the



The Macao Water Supply Company Limited

cessation of toll collection at the Wuhan Bridges project is still in progress and partial consideration has been received according to the agreed schedule.

Business Outlook

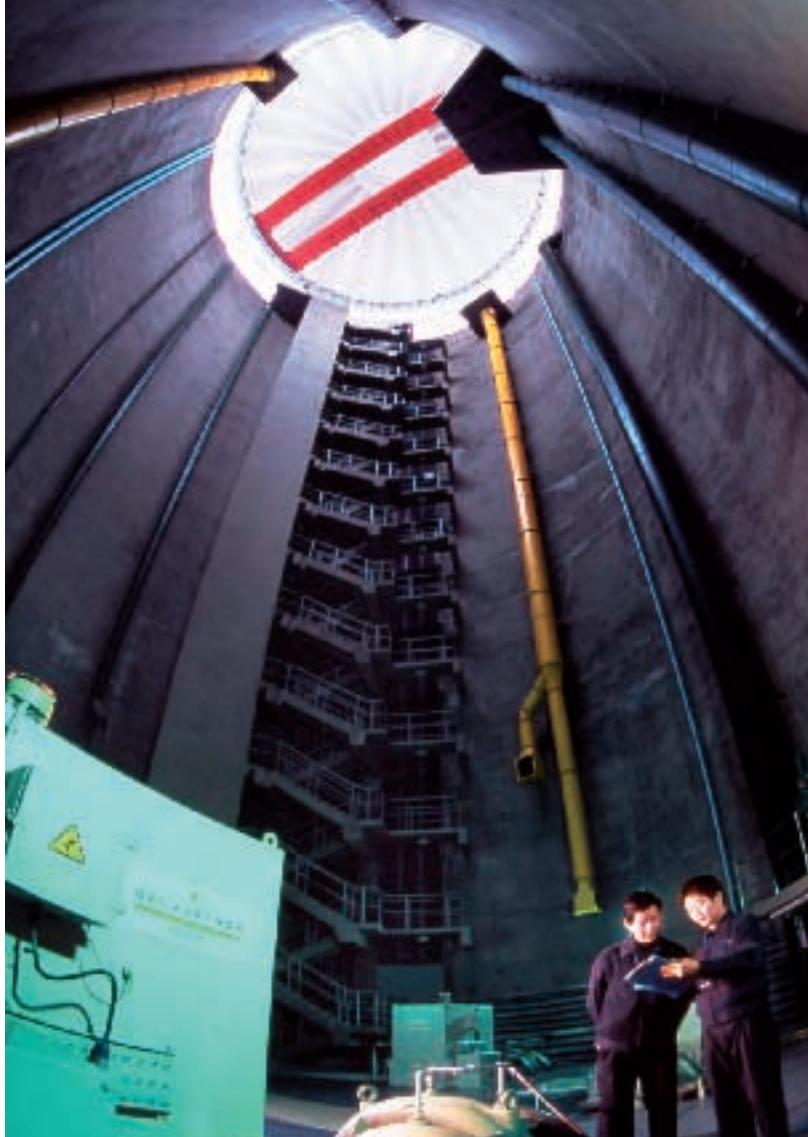
Energy

Despite measures aimed at curbing excessive investment, national electricity demand and consumption in Mainland China continued to surge in the first half of 2004 by 18.5% and 16% respectively. Demand for



Tate's Cairn Tunnel

Management Discussion and Analysis



Chongqing Water Plant

electricity in Guangdong Province is still rising. In the first half of 2004, electricity generated in Guangdong Province increased by 18% and GDP grew by 15% over the first half of 2003. GDP of secondary industries recorded growth of 19% while heavy industries reported growth of 25% in real terms.

Growth continued in the second quarter of 2004. Guangdong Province's electricity consumption rose by 21% over the second quarter of 2003. Due to a lack of rainfall in the Western Provinces, west-to-east electricity supply remained at the same level while hydro electricity supply in Guangdong Province

dropped by 16%. Meanwhile, supply from the Three Gorges commenced in March 2004 and supplied some 3% of Guangdong Province's electricity demand at the end of FY2004. In addition to newly installed capacity in Guangdong Province, total supply capacity will be increased by at least 8% by the end of 2004. Taking all these factors into consideration, sales prospects in Guangdong Province are still promising.

Although the National Development and Reform Commission announced two on-grid tariff increases and an increase in average end-user tariffs in 2004, the continuing increase in the price of coal is still hindering the profitability of both power producers and operators. Power producers unable to lock in coal supply at a fixed price have been especially affected. The tariff increases are expected to suppress overheated economic activity and to fund transmission network development, easing the pressure on financing future development costs in this segment. However, new environmental regulations imposed in July 2003 by the Central Government will increase investment and operation costs, negatively impacting the profitability of the Energy segment.

Looking ahead, Macau Power will benefit from the completion of new casinos in Macau. In the context of all markets, the steady growth in investment projects will ensure a steady increase in electricity consumption and so underpin demand for the Group's services.

infrastructure

Water Treatment and Waste Management

On 19 March 2004, the Ministry of Construction issued a set of guidelines/directives effective 1 May 2004 concerning provision of concessions for urban public utilities covering water, waste water, public transport and waste management. These guidelines stipulate that all future projects of this kind will only be awarded through open tender. Consequently, competition for new projects will increase significantly. Nevertheless, the AOP contribution from this segment is likely to grow as new projects come on stream.

Roads and Bridges

Sustainable development of Mainland China's economy, coupled with increased consumer purchasing power and private car ownership, will see an increase in the number of

vehicles on the nation's roads. In addition, the Central Government plans to build an expressway network with a total length of 82,000km. These factors create ample investment opportunities for investors. Counter-measures against over-loaded trucks by different authorities in Mainland China since June 2004 will also benefit highway investors by ensuring a longer useful life for highways owing to less onerous wear and tear, and by increasing traffic flow as each truck carries no more than its designated volume of goods.

Despite these favourable conditions, challenges still remain. Central Government policy measures in Mainland China to cool down the overheated economy, together with an expected rise in interest rates, will exert pressure on the financing costs of road and bridge projects. Furthermore, a sustained increase in



Guangzhou City Northern Ring Road

the price of oil may inhibit the growth of private car ownership.

The Group's development strategy is to focus on expressway projects located in cities and provinces with high growth potential, although rigorous competition from both local and foreign investors is expected. In early September 2004, the Group strengthened its Roads and Bridges segment by acquiring 15% effective interest in Beijing – Zhuhai Expressway (Guangzhou – Zhuhai Northern Section) which locates in Guangdong Province.



Tate's Cairn Tunnel