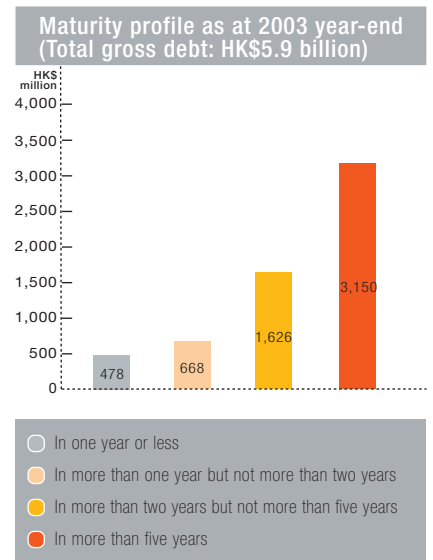
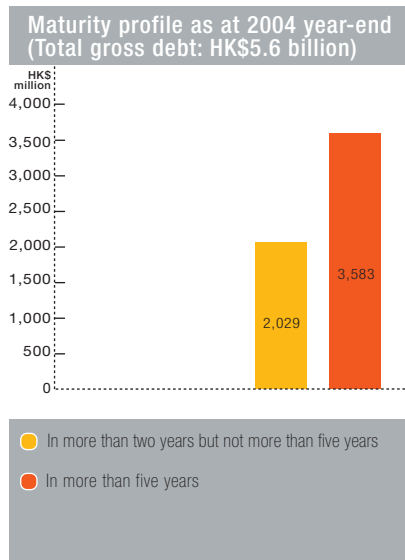
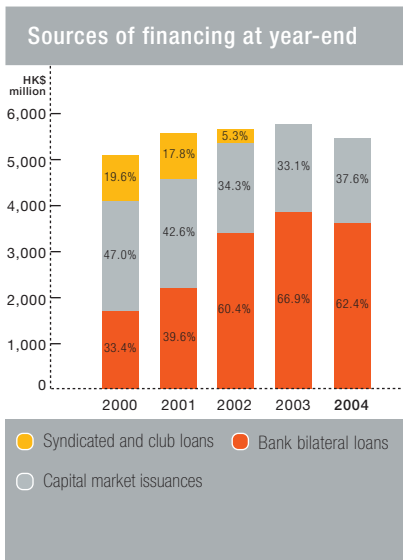


Financial Prudence and Managing Risks

Financing Policy, Internal Controls and Risk Management

We adhered to a policy of financial prudence throughout the review year and achieved:

- low net gearing ratio at 20.8%
- high net interest coverage ratio at 7.3 times
- average debt maturity stretched further to 5.5 years
- debt level reduced from HK\$5.9 billion to HK\$5.6 billion
- 50.7% of outstanding debts are fixed rate debts to further reduce adverse impact of any rise in interest rates
- investment-grade credit rating
 - Baa1 (Moody's)
 - BBB (Standard and Poor's)



FINANCING POLICY

We adhere to a policy of financial prudence. Our objectives are to:

- maintain a strong balance sheet by actively managing debt level and cash flow
- secure diversified funding sources from both banks and capital markets
- minimise refinancing and liquidity risks by attaining healthy debt repayment capacity, maturity profile, availability of banking facilities with minimum collateral on debt
- manage the exposures arisen from adverse market movements in interest rates and foreign exchange through appropriate hedging strategies
- monitor counter-party risks by imposing proper counter-party limits and reduce financial investment risk by holding quality marketable securities

The Treasury policy manual lays down the acceptable range of operational parameters and gives guidance on the above areas in order to achieve the objective of financial prudence.

Treasury has an overall objective of optimisation of borrowing costs: that is, to minimise the finance costs subject to the constraints of the operational parameters. The cost of financing was 2.54% for 2004.

As at 31 December 2004, the total outstanding borrowings of the Group amounted to HK\$5.6 billion, a decrease of 5.2% from HK\$5.9 billion in 2003. All these borrowings are on unsecured and committed basis.

The Group always takes a prudent approach in managing its loan portfolio. On the individual loan level, the Group strives to lower the borrowing margin as far as possible; but on the portfolio level, the more important objectives are to ensure sufficient available facilities, diversify the funding sources and maintain a suitable average tenor relative to the overall duration of the use of the funds. The Group also established long-term relationships with a number of local and overseas banks. At present, 15 local and overseas banks have provided bilateral banking facilities to the Group and such bank borrowings accounted for 62.4% of the Group's total borrowings while the remaining 37.6% outstanding debts were sourced from the capital market.

In November 2004, HK\$400 million floating rate notes were due for redemption. In order to maintain a comfortable balance on debts from the capital market, the Group issued a total of three new floating rate notes, amounting to HK\$550 million, from the Medium Term Note (MTN) Programme established in 2001. These issues marked the lowest point in the funding cost amongst the Group's existing loans and committed facilities.

In February 2005, the Group launched a 15-year zero-coupon notes issuance. The notes, which have the longest tenor in the Group's debt portfolio, were issued at a discount with a notional amount of HK\$430 million. The Group has a call option on the notes on the 10th anniversary date of the issue date. This note issuance, another drawdown from the MTN Programme, signified market confidence in the Group's credit by accepting an exceptionally long tenor for a Hong Kong Dollar issuance and no requirement of interest payment before the final maturity (or call) date of the notes.

All these capital market issuances reaffirm the Group's capability in tapping the capital market for various types of debt instruments and the Group's prudent financing strategy which focuses not only on lowering the funding costs but also reducing the financing risks.

Liquidity and Cash Balance

The Group does not underestimate the importance of sufficient liquidity. The Group's major sources of liquidity are from the strong recurring cash flows of the business and the committed banking facilities. The total undrawn committed facilities of HK\$2.3 billion as at 31 December 2004 essentially allows the Group to obtain the same level of liquidity as holding the equivalent amount of cash.

Another step that the Group has taken to lower the liquidity risk due to the lack of funds for repayment of maturing debts is to maintain an evenly spread maturity profile and reduce the concentration of debts maturing in the near term.

As at 31 December 2004, 63.8% of the outstanding debts would only be due after five years. Furthermore, there will not be any outstanding debt maturing within the next two years. The average maturity of the debt portfolio was about 5.5 years.

With such a maturity profile in place, the Group stands in a favourable position to commit on longer capital expenditure requirements if opportunity arises without concern on the refinancing risk.

Total debt at end of 2004 was HK\$5.6 billion, HK\$0.3 billion below the level in 2003. The source and application drivers leading to the lower debt are analysed below:

	2004 HK\$ million	2003 HK\$ million	Change HK\$ million
Operating activities			
Cash generated from operations	808	799	9
Tax paid	(64)	(135)	71
	744	664	80
Investing activities			
Net receipts from (payments to) overseas projects	117	(109)	226
Additions to investment properties	(104)	(418)	314
Additions to plant and equipment	(4)	(2)	(2)
Proceeds from securities disposals	26	116	(90)
Dividends and interests received	27	24	3
	62	(389)	451
Financing activities			
Dividends paid	(347)	(348)	1
Finance costs	(161)	(180)	19
Net (decrease) increase in borrowings	(311)	216	(527)
Others	20	29	(9)
	(799)	(283)	(516)
Net increase (decrease) in cash balances	7	(8)	15

Operating activities in 2004 brought a moderately higher cashflow than 2003, at HK\$808 million, of which HK\$64 million was applied to pay for the taxation due during the year.

Overseas joint venture projects repaid HK\$117 million in 2004, contrary to a net outflow in 2003. Additions to investment properties were much lower in 2004 at HK\$104 million, alleviating the need to dispose our blue-chip listed securities, the Group's liquidity buffer, to the same extent as in 2003. Proceeds from listed securities disposal amounted to HK\$26 million in 2004.

Net cash generated from 2004 operating and investing activities were HK\$744 million and HK\$62 million respectively. Allowing for dividend payments of HK\$347 million and finance costs of HK\$161 million, the remaining cash was applied to reduce the debt borrowing by HK\$311 million.



Interest Rate Exposure

Interest expenses account for a significant proportion of the Group's total expenses. Therefore, the Group monitors the interest rate exposures closely. Depending on our medium-term projections on the interest rates, appropriate hedging strategy would be adopted to manage the exposure.

The Group's cost of financing in 2004 was 2.54%. In anticipation of higher interest rates in the next few years, the Group has further reduced the floating rate debts to 49.3% in 2004 from 60.1% in 2003. This move was to further reduce the adverse impacts of any rise in interest rates in the near future. The remaining 50.7% fixed rate debts are largely fixed between two to three years.

Foreign Exchange Exposure

The Group aims to have minimal mismatches in currency and does not speculate in currency movements. With the exception of the US\$200 million 10-year notes, which have been hedged by appropriate hedging instruments, all of the Group's other borrowings were denominated in Hong Kong dollars. Other foreign exchange exposure relates to the investments of the overseas projects in Singapore and Shanghai. These foreign exchange exposure amounted to the equivalent of HK\$901 million or 3.0% of the total assets.

Use of Derivatives

The Group uses derivatives extensively to manage the interest rate and foreign exchange exposures. To avoid the Group being exposed to losses arising from the use of derivatives, the potential impacts of their use are evaluated thoroughly before executing the transactions. The Group's policy also prohibits the use of derivatives for purposes other than hedging.

Before entering into any hedging transaction, the Group will ensure that the counterparty possesses strong investment-grade ratings so that the transaction will not expose the Group to undue credit risk. As part of our risk management, a limit on maximum risk-adjusted credit exposure is assigned to each counterparty. The level of the limit is basically in line with the credit quality of the counterparty.

Credit Ratings

Moody's and Standard and Poor's have given the Group the credit ratings of Baa1 and BBB respectively. Furthermore, on 6 April 2004, Moody's changed the outlook of the Group's Baa1 rating from negative to stable, reflecting Moody's view on the Group's stronger cash flow and financial profile in light of the upturn in Hong Kong's retail market and stability in the office sector.

With these sound investment-grade ratings, the Group can readily access the local as well as international capital markets to raise funds from different types of investors.

Key Financial Ratios Net Interest Coverage

As at 31 December 2004, the net interest coverage ratio (defined as profit from operations before depreciation less dividend and interest income, divided by net interest expenses less dividend income) was 7.3 times (2003: 6.5 times), the highest in the past five years. This strong performance was mainly due to the favourable debt level, low interest rates and the active management of interest rate exposure.

Net Gearing

The year-end 2004 net gearing (defined as gross debt less cash and cash equivalents and marketable securities at year-end market value, divided by shareholders' funds) was 20.8% (2003: 27.0%). A lower net gearing was achieved as cash generated from operations and investment activities was used to pay down the debt, while revaluation gain on investment properties and securities uplifted the shareholders' funds.

INTERNAL CONTROLS

Overall Responsibility

The Board has overall responsibility for the system of internal controls and for reviewing its effectiveness.

A sound system of internal controls is designed to manage rather than eliminate risk of failure to achieve business objectives and to provide reasonable but not absolute assurance against material misstatement or loss. The concept of reasonable assurance recognises that the cost of a control procedure should not exceed the expected benefits.

Control Structure

Whilst the Board maintains full control and direction over the appropriate strategic, financial, organisational and compliance issues, it has delegated to management the implementation of the systems of internal controls within an established framework.

Management has a clear responsibility to provide the whole Board with all the information that is relevant to discharge the Board's responsibilities.

Control Environment, Monitor and Review

Management has put in place an organisational structure with formally defined lines of responsibility and delegation of authority. The Group's operating procedures include a comprehensive system for reporting information to management and the Board. Budgets prepared by individual business and support units based on

business objectives and operating environment are reviewed and endorsed by both management and the Board.

Forecasts are revised on a quarterly basis and compared against budget and prior forecasts. When presenting budgets and forecasts, potential significant business risks were identified, evaluated and reported. Variances against budget and latest forecasts are presented with reference to key performance drivers, to facilitate monitoring and measurement against corporate objectives. Business sector reports and key operating statistics, ratios and trends are also presented.

This top-down management control environment is supplemented by transaction processing controls. The importance of control is communicated to staff members to foster the control environment and awareness within the Group. Staff policy is set out to ensure competent personnel in key managerial and supervisory positions with appropriate knowledge and experience to effectively administer management policies and procedures.

Review of Effectiveness, Internal and External Audit

The Managing Director and the Chief Financial Officer undertake to report to the Audit Committee any significant control failings or weaknesses together with details of corrective action. On a half yearly basis, the Audit Committee and management



meet with the external auditors, Deloitte Touche Tohmatsu who will report their findings on internal controls and relevant financial reporting matters.

Management believes that effective internal controls is a continuous process of self-refinement and communication. A high degree of management involvement is adopted alongside a detailed and regular reporting environment. Root cause analysis is performed on failures reported.

Management currently takes the view that there is no immediate need to set up an Internal Audit function within the Group in light of current systems of internal controls and risk management. This will be reviewed from time to time. Management may engage external consultants to review selected areas of the control systems so as to obtain comfort on the operational and effectiveness of the internal control.

An international accounting firm was engaged in early 2004 to perform a process review on the Group's treasury and payment cycle and the results were satisfactory. Another review is being undertaken and an international accounting firm was appointed to examine the expenses processing cycle of the Group, with the objective of evaluating the operational effectiveness of the controls in the authorisation and approval of selected expenditure streams.

RISK MANAGEMENT

Management and manager of each business and support units, together with leaders of major projects, are responsible for identifying, evaluating and managing the significant risks that may cause business disruption or discontinuation. Appropriate policy and procedures are developed depending on materiality, probability of occurrence and impact if occurring. These include, but are not limited to:

1. Treasury policy manual on liquidity, interests and foreign exchange exposures;
2. Defined procedure for legal and compliance updates;
3. Established system of call tree for emergency on enterprise level and building services interruption;
4. Preventive maintenance programme to address building safety, regulations and environmental issues;
5. Comprehensive insurance coverage and regular review by a professional external broker; and
6. Defined authorisation as well as payment review and approval systems.

Way Forward

In addition, management plans to conduct a comprehensive review during 2005, with the following objectives:

1. Review all written policies and procedures with a view to formalise and to ensure clearly defined limits of delegated authority, and to provide a collaborative framework for management to deal with areas of significant risks;
2. Review all reports to management and directors to ensure a reasonable basis of detecting material misstatement or loss; and
3. Formalise an enterprise risk management framework. A comprehensive control self-assessment exercise should be conducted annually by each major project, business and support area to identify risks that will cause material disruption to our business, or in extreme cases when business continuity may be affected. The probability of those risks occurring, the impact if they do occur and the effectiveness of the controls to mitigate those risks to the desired level should be assessed.