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. The Group's effective interest in this Dongshen Water Supply Project is 82.03%. The design annual capacity of water supply is 2.423 billion cubic meters.

During the year, although Guangdong has been facing its worst drought in 15 years, the water supply for the Dongshen Water Supply Project has not been adversely affected. On the contrary, because of the dry weather, there has been an increase in the reliance on the Dongshen Water Supply Project to meet the water supply demands of Hong Kong, Shenzhen and Dongguan. The total water sales amounted to 1.99 billion cubic meters, an increase of 14.37% over last year. The water sales to these three areas during the year were respectively 820 million cubic meters (an increase of 1.23%), 567 million cubic meters (an increase of 21.57%) and 603 million cubic meters (an increase of 28.07%).

In addition, following the completion of the Phase IV Renovation Project, there has been an increase in the water tariffs for Shenzhen and Dongguan.

The increase in water supply and revenue in 2004 was however more than offset by increases in electricity costs, depreciation charges on the Phase IV Renovation Project and a full year hedging cost. As a result, the profit contribution to the Group from the water distribution business for 2004 was only HK$647,474,000 (2003: HK$829,483,000), 21.94% lower than last year. However, earnings before interest, tax, depreciation and amortisation ("EBITDA") for our water distribution business during the year amounted to HK$2,591,478,000 (2003: HK$2,462,897,000), 5.22% higher than last year.

Electric Power Generation

Shaoguan Power Plant D ("Shaoguan PPD")

The Group's effective interest in Shaoguan PPD is 45.9% (a 51% owned subsidiary of the Company holds a 90% interest in the project joint venture company). Shaoguan PPD has 3 power units which have a total annual power generating capacity of 2,628 million kwh. However one of the old power units with an annual power generating capacity of 438 million kwh has been closed down since September this year in accordance with the policy of the PRC government for the closing down of small power units. Accordingly in 2004, sales of electricity dropped to 1,605 million kwh (2003: 1,922 million kwh). Revenue for the year was likewise only HK$534,250,000 (2003: HK$623,786,000), a decrease of 14.35%. Despite a slight increase in tariffs, the high cost of coal eroded the gross profit. In addition to the power unit which has already been closed down, there is another small power unit with an annual power generating capacity of 438 million Kwh that has also to be closed down in 2005. During the year, Shaoguan PPD has made impairment provision of HK$64,512,000 in relation to those two old power units. The loss before tax for the year was HK$22,124,000 (2003: a profit before tax of HK$155,040,000). Excluding the financial effects of the impairment provisions, the before-tax profit was HK$42,388,000 (2003: HK$155,040,000), a 72.66% decrease as compared to last year. A loss before tax of HK$10,155,000 (2003: a profit before tax of HK$71,163,000) was absorbed to the Group's results for the year.

Review of Operating Results (continued)

Electric Power Generation (continued)

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

Yue Jiang Power Plant is a 25% associate held by Shaoguan PPD. Yue Jiang Power Plant has an annual power generating capacity of 2,628 million kwh. In 2004, sales of electricity amounted to 1,641 million kwh (2003: 1,545 million kwh), an increase of 6.21%. The higher sales of electricity as compared with 2003 was mainly because, unlike 2003, there was no need to suspend the operation of the power plant for several months for special repair and maintenance work to be carried out to the power generation system. Yue Jiang Power Plant recorded an increase of 8.72% in revenue during the year (2004: HK$600,262,000; 2003: HK$552,126,000). This was the result of both the increase in kwh sold and the increase in tariffs. The Group's share of the profit before tax from this associate was HK$11,729,000 (2003: HK$14,669,000).

Meixian Power Plant

The Group's effective interest in Meixian Power Plant is 12.25% (a 49% associate of the Company, Guangdong Power International Limited ("GD Power Investment"), holds a 25% interest in the project joint venture company). Its total annual power generating capacity increased to 3,373 million kwh after a new power unit came into operation in October this year. Sales of electricity by Meixian Power Plant amounted to 1,867 million kwh (2003: 1,525 million kwh), an increase of 22.43%. Sales revenue for the year reached HK$638,093,000 (2003: HK$509,333,000), an increase of 25.28%. The profit before taxation was HK$198,342,000 (2003: HK$195,104,000), a slight increase of 1.66%. During the year, GD Power Investment received dividend income of HK$50,118,000 (2003: HK$39,137,000) from the power plant investment.

Toll Roads and Bridges

In 2004, an aggregate before-tax profit of HK$72,522,000 (2003: HK$124,233,000) was generated by the Group's two 51% jointly-controlled entities (the "JCEs" or "JCE") which hold interest in the "2 Roads and 2 Bridges" project. Both Humen Bridge and Shantou Haiwan Bridge recorded growth in traffic flow and performed well during the year while Qinglian Highway and Guangzhou-Shantou Highway (Huizhou section) suffered a drop in traffic flow primarily due to the opening of competing new highways. The significant decrease in profit was mainly due to a provision of HK$90,049,000 for diminution in value of investment in Guangzhou-Shantou Highway (Huizhou section) during the year, with the Group's share of such provision amounting to HK$45,925,000. Excluding the financial effect of the provision, the aggregate before-tax profit of the JCEs was HK$162,571,000, an 31% increase as compared to last year.

Humen Bridge

The Group's JCE holds a 30% interest in this project. Humen Bridge recorded a growth of 12.5% in traffic flow. The average daily traffic for 2004 increased to 39,171 vehicle trips (2003: 34,829 vehicle trips). Revenue for the year reached HK$577,395,000 (2003: HK$473,719,000), an increase of 21.9%. The profit before tax for the year was HK$294,351,000 (2003: HK$175,129,000), an increase of 68%, which was more than the percentage increase in traffic flow. This was mainly because the average vehicle tariff has increased following the adjustment to the classification of vehicles using the bridge.

Review of Operating Results (continued)

Toll Roads and Bridges (continued)

Shantou Haiwan Bridge

The Group's JCE holds a 30% interest in this project. Shantou Haiwan Bridge recorded a growth of 6.9% in traffic flow. The average daily traffic for 2004 increased to 14,170 vehicle trips (2003: 13,251 vehicle trips). Revenue for the year reached HK$153,183,000 (2003: HK$134,145,000), an increase of 14.2%, which was mainly driven by the increase in traffic flow. The profit before tax for the year reached HK$101,468,000 (2003: HK$85,636,000), an increase of 18%.

Guangzhou-Shantou Highway (Huizhou Section)

The Group's JCE holds a 51% interest in this project. Due to the opening of the Guangzhou-Huizhou Expressway in December 2003, the Guangzhou-Shantou Highway (Huizhou Section) suffered a 34.5% drop in traffic flow. The average daily traffic for 2004 was 18,793 vehicle trips (2003: 28,734 vehicle trips). Revenue for the year was HK$68,834,000 (2003: HK$126,935,000), a decrease of 46%. The profit before tax for the year was HK$11,875,000 (2003: HK$57,791,000), a decrease of 79%.

Qinglian Highway

The Group's JCE holds a 14.18% interest in this project. Due to the opening of the Jingzhu North and South Highways, the traffic flow of Qinglian Highway for the year dropped by 19%. The average daily traffic was 19,743 vehicle trips (2003: 24,448 vehicle trips). Revenue for the year was HK$131,108,000 (2003:HK$177,087,000), a decrease of 26%. The loss for the year was HK$157,462,000 (2003: HK$97,331,000).

The JCE has entered into a sale and purchase agreement with an independent third party in January 2005 to dispose of its entire interest in Qinglian Highway. Accordingly, a write-back provision of HK$24,800,000 was credited to the Group's results in the year.

Yingkeng Highway

The Group's effective interest in this project is 70%. Yingkeng Highway recorded an increase of 8% in traffic flow in 2004, with an average daily traffic for the year of 4,464 vehicle trips (2003: 4,135 vehicle trips). Revenue for the year was HK$9,868,000 (2003:HK$8,880,000), an increase of 11%. An impairment provision of HK$23,993,000 was made in the year to reflect the fair value of this toll road project, taking into account also the adjustment to the joint-venture period. The profit before tax (before the impairment) for the year was HK$1,322,000 (2003: HK$2,544,000), a decrease of 48% which was mainly due to the acceleration of the depreciation charge of the toll road for the year.

Review of Operating Results (continued)

Toll Roads and Bridges (continued)

Panyu Bridge

Panyu Bridge has been a 20% associate of the Group since the acquisition. Panyu Bridges recorded an increase of 18% in traffic flow. The average daily traffic in 2004 was 64,993 vehicle trips (2003: 54,960 vehicle trips). Revenue for the year reached HK$167,736,000 (2003: HK$113,178,000), an increase of 48% which was mainly driven by the increase in traffic flow and the increase in average vehicle tariffs after the adjustment to the classification of the vehicles using the bridge. The profit before tax for the year reached HK$74,128,000 (2003: HK$31,401,000), an increase of 136%. The post acquisition profit attributable to the Group in 2004 amounted to HK$2,715,000.

Two Pak Kong Bridges

The Group's effective interest in this project is 24.5%, which interest is classified as other investment. The actions taken by the local government has created problems in operating the Two Pak Kong Bridges in Qingyuan as toll bridges and collecting toll revenue from those bridges since 1 October 2004. The local government however intends to buy out the interest of the foreign parties, including the Group, in the project. The local government also offers to compensate the foreign parties for their losses. The parties are accordingly still in the course of seeking to resolve the matter through negotiation.

Property Investment

Mainland China

Guangzhou Teemall Plaza

Guangzhou Teemall Plaza, the most popular shopping mall which is located in the premier area of Guangzhou, has a total gross floor area of approximately 160,000 square metres. The Plaza continued to enjoy high occupancy rate of approximately 99% (same as last year) and increasing rental and management income (an increase of 8.3%). Relocation of rental spaces among existing tenants, additional rental areas of approximately 900m^2, awarding advertising space leases through open tender, and the entry of brand-name tenants such as Mannings, Kentucky Fried Chicken and Cafe de Coral are all factors helping to bring about the increase in both total revenue and profit before taxation. Total rental and management income of the Plaza for the year increased by 8.3% to HK$293,690,000 (2003: HK$271,204,000). The profit before taxation for the year increased by HK$26,879,000 to HK$259,372,000 (2003: HK$232,493,000).

At the balance sheet date, the Group holds an effective equity interest of 68.58% in the Plaza.

Property Investment (continued)

Hong Kong

Guangdong Investment Tower

The average occupancy rate at the Guangdong Investment Tower for 2004 was 87.29% (2003: 82.67%), 4.62 percentage points better than last year. However, the total rental income for the year of HK$18,127,000 (2003: HK$20,352,000) was down 10.93%, due to a drop in average rent rate upon the renewal of tenancies.

Hotel Operations and Management

As at 31 December 2004, our hotel management team managed 13 hotels (2003: 9 hotels), of which 2 are in Hong Kong, 1 in Macau and 10 in Mainland China (located in Shenzhen, Zhuhai, Dongguan, Qingdao, Jilin, Shanghai and Beijing). 4 of the hotels were owned by the Group (2 in Hong Kong, 1 in Shenzhen and 1 in Zhuhai).

The outbreak of SARS last year adversely impacted upon the hotel group's second quarter results. SARS had since come under control. There was also an influx of Mainland visitors as a result of the new 'free travel' policy to visit Hong Kong. The average occupancy rate for the year as a whole was therefore markedly higher as compared to 2003 (2004: 84.5%; 2003: 61%). In addition, after the completion of interior renovation work, all the four hotels owned by Group became able to increase their average room rates by 17.4%. As a result, our hotel business increased its turnover for 2004 by 37.9% to HK$218,989,000 (2003: HK$158,778,000) and its profit before tax (before the hotel property revaluation effect) by 205.5% to HK$56,840,000 (2003: HK$18,603,000).

Department Stores

廣東天河城百貨有限公司 (Guangdong Teemall Department Stores Ltd.) operates as a large department store with a total business area of approximately 32,200 square metres and selling a wide ranges of products. It is ranked, in terms of sales, as one of the major department stores in Guangzhou. This year, the Teemall Department Stores enjoyed record high turnover of HK$905,052,000 (2003: HK$773,511,000), an increase of 17.01%. Factors such as the holding of different trade fairs and festival shows throughout the year, additional floor area of approximately 5,300 square meters being made available for the department stores operation, and the launching of the new sport outlets and trendy fashion corners all helped to increase the customer traffic and turnover of the Teemall Department Stores. Due to the intense competition of the retail business, the profit before taxation of the department stores operation for the year was only HK$61,429,000 (2003: HK$60,091,000), a slight increase of 2.23%

廣東吉之島天貿百貨有限公司 (Guangdong Jusco Teem Stores Co., Ltd.), an associate of the Group, is jointly managed by GD Teem, the Group's 68.58%-owned subsidiary, and JUSCO Japan. It has achieved a satisfactory growth in business since its establishment in 1996.

At the balance sheet date, the Group holds an effective equity interest of 80.52% and 24% in the Teemall Department Stores and JUSCO respectively.

Liquidity, Gearing and Financial Resources

As at 31 December 2004, the cash and bank balances of the Group increased by HK$285 million to HK$1,668 million (31 December 2003: HK$1,383 million), of which 29% were in Hong Kong dollars, 55% in Renminbi and 16% in US dollars.

As at 31 December 2004, the level of the Group's financial borrowing decreased by HK$1,679 million. The decrease was mainly due to (1) the full redemption of the straight bonds of HK$497 million issued to GDH Limited, (2) the repayment of interest-bearing debts of approximately HK$1,065 million (of which HK$375 million equivalent related to the bank borrowings in Mainland China) and the settlement of non-interest bearing Hong Kong government loan of HK$118 million.

As at 31 December 2004, the Group had financial borrowings amounting to HK$16,810 million (31 December 2003: HK$18,489 million), including a non-interest bearing Hong Kong government loan of HK$2,127.6 million. Of the Group's total financial borrowings, HK$160 million was repayable within one year while the remaining balance of HK$3,666 million and HK$12,984 million are repayable within two to five years and beyond five years from the balance sheet date, respectively.

Save for the bank debts incurred in our water distribution business, the Group maintained nil credit facilities as at 31 December 2004 (31 December 2003: nil).

The gearing for the Group as at 31 December 2004 was 1.71 times (31 December 2003: 2.11 times). The improvement mostly reflected the reduction in the level of the Group's financial borrowings, together with an increase in the net asset value of the Group. The Group is in a healthy debt servicing position as the EBITDA/ finance cost ratio is 3.94 times (2003: 5.11 times).

The existing cash resources, together with steady cash flows generated from the Group's operations, are sufficient to meet the Group's payment obligations and business requirements.

Pledge of Assets

As at 31 December 2004, none of the Group's fixed assets, investment properties and bank deposits was pledged to secure general banking facilities granted to the Group (31 December 2003: nil).

Capital Expenditure

The Group's capital expenditure in 2004 amounted to HK$115 million principally related to the additions of plant and machinery for the power plant at our electric power generating facilities, renovation works for our hotels and the construction in progress of the East Tower at Guangzhou Teemall Plaza.

Exposure to Fluctuations in Exchange and Interest Rates and Related Hedges

As at 31 December 2004, total Renminbi borrowings amounted to HK$1,422 million (31 December 2003: HK$1,796 million).

As at 31 December 2004, the Group's total floating rate borrowings amounted to HK$12,954 million (31 December 2003: HK$14,017 million). For the purpose of interest rate risk management, the Group entered certain fixed or re-indexing interest rate swap agreements with a total contract amount of HK$11,700 million (31 December 2003: HK$11,100 million) and with a remaining life ranging from 3-8 years.

Recently Issued Accounting Standards

The Hong Kong Institute of Certified Public Accountants has issued a number of new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards, which are effective for accounting periods beginning on or after 1 January 2005. The Group has not early adopted these new HKFRSs in the financial statements for the year ended 31 December 2004. The Group has already commenced an assessment of the impact of these new HKFRSs but is not yet in a position to state whether these new HKFRSs would have a significant impact on its results of operations and financial position.

Employee and Remuneration Policy

As at 31 December 2004, the Group had a total of 3,623 employees. Among the employees, 3,391 were employed by subsidiaries in Mainland China and 232 were employed by the head office and subsidiaries in Hong Kong. Out of the total number, 480 were managerial employees of the head office and its subsidiaries. Total remuneration paid for the year under review was approximately HK$225,237,000 (2003: HK$233,724,000).

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.