

## MANAGEMENT DISCUSSION AND ANALYSIS

### Review of Results and Operation

During the first half of 2005, the tourism industry in Hong Kong and Mainland China continued to sustain strong growth and the Group's core travel business developed considerably further compared with the same period last year. The revenue of the Group's travel agencies in Hong Kong and overseas continued to grow and the 15 wholly-owned and joint venture travel agencies in Mainland China entered the harvesting stage. Excellent achievements were made in areas such as consolidation of internal resources, joint development of MICE markets and addition of sales outlets. At the same time, the Group concluded the ticketing agency arrangement with Hong Kong Disneyland and devised the joint promotion plan of Hong Kong Disneyland related travel products between the Group's travel agencies in Hong Kong and Mainland China. Operating profits of complementary services to core travel business such as hotel, passenger transportation and art performance for the period increased significantly compared with the same period last year whereas the revenue and profit of the theme parks during the period remained stable compared with the same period last year. The construction work of Zhuhai Ocean Spring Resort progressed smoothly and it will commence operation by the end of this year as scheduled. The online Centralized Platform is expected to come to the market in December this year. The launch of these two projects will make positive contributions in strengthening the competitiveness of the Group's core travel business and enhancing earning power.

For the six months ended 30 June 2005, the consolidated revenue of the Group was HK\$2,574 million, an increase of 26.2% from the same period last year. Due to the continuous rise in coal and oil prices in Mainland China, the profit of Weihe Power Plant decreased significantly and affected the consolidated net profit of the Group. During the period, the consolidated net profit of the Group was HK\$345 million, an increase of 6.8% from HK\$323 million as restated in accordance with the new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards for the same period last year. The earnings per share for the period was HK7.32 cents, a decrease of 4.1% from the same period last year. The shareholders' equity of the Group as at 30 June 2005 reached HK\$9,366 million, an increase of 14.8% from the end of last year. The net interest bearing debt to equity ratio at the end of the period was -10.1%.

## MANAGEMENT DISCUSSION AND ANALYSIS *(continued)*

### Tour Operation and Leisure Business

The Tour Operation and Leisure Business of the Group comprise of travel agency business, China Travel Net, three theme parks and a golf club in Shenzhen. During the first half of the year, the revenue was HK\$1,110 million, an increase of 14% from the same period last year.

China Travel Service (Hong Kong) Limited ("CTSHK") actively developed new businesses and established a conference travel division which handled large conferences such as the "2005 China Investment Forum" and "International Computer Exchange Conference" and served more international premier customers. In addition, CTSHK launched a membership program "Friends of CTSHK" to enhance customer loyalty and cooperated with Mainland travel agencies to prepare for launching tour and ticketing businesses after the opening of Hong Kong Disneyland. The Group made achievements in the expansion of Mainland travel agency network. Shanghai China Travel International Limited established joint venture travel agencies in Suzhou and Hangzhou and China Travel International (Xinjiang) Limited also actively established network in its peripheral region. During the first half of the year, the revenue of the Mainland travel agency network increased by 25.8% compared with the same period last year. During the period, the number of website visitors and number of members of China Travel Net increased by 29.41% and 13% respectively compared with the same period last year. According to professional market research report, China Travel Net was one of the mostly visited travel website in Hong Kong.

The well-planned Centralized Platform purchased property in Shenzhen to use as the operational headquarter office, machine room and call center. Preparation work such as restructuring of internal resources, procurement of hardware and software systems, recruitment of human resources, design of workflow regarding booking of hotel rooms and air tickets, etc. progressed smoothly and the Centralized Platform is expected to commence operation by the end of this year.

During the first half of the year, the revenue of Window of the World, Splendid China and China Folk Culture Villages was HK\$183 million, an increase of 1% from the same period last year and the total number of visitors received was 1.75 million, an increase of 3% from the same period last year. Window of the World carried out the planning and organization work for the Chinese New Year and the Labor Day Holiday well, launched the "Beer Festival" in summer and brought in large dance groups from Ukraine and Ireland. At the same time, Window of the World carried out the revamp work of attractions and the construction work of a new hotel next to the park. Splendid China launched several programs such as the "Temple Torch Festival", "1st Chinese Kung Fu Festival" and "10th Water Splashing Festival" in summer, etc. and strengthened marketing and promotional efforts.

## MANAGEMENT DISCUSSION AND ANALYSIS *(continued)*

### Tour Operation and Leisure Business *(continued)*

"Legend of Kung Fu" and "Goddess", mega stage shows produced by China Heaven Creation International Performance Art Co., Ltd. ("China Heaven"), were included in the 2005 and 2006 Guidance Directory for Export of National Commercial Performances and Exhibition of Cultural Products published by the Ministry of Culture of the PRC. "Legend of Kung Fu" launched its premiere 5-month tour to the United States and Canada in August this year and "Goddess" was also invited to launch its premiere 12-month tour to the United States in September this year. The favorable development of China Heaven will make contributions to the Group.

Tycoon Golf Club in Shenzhen managed to overcome the negative effects of rainy weather in the first half of the year and the number of golfers and golfing-related revenue increased by 11.3% and 30.5% respectively compared with the same period last year. Tycoon Golf Club introduced the new one-year membership to promote sales and the total revenue for the period increased by 19.5% compared with the same period last year. The new wing of the Club, which is a small hotel, will commence operation in the second half of the year and will further enhance membership sales.

The construction work of Zhuhai Ocean Spring Resort progressed smoothly and the interior decorating work on the hotels, private club, hotspring centre, health and fitness center, fisherman's wharf and staff quarter was in progress. The pre-opening work was planned in details and the sales strategy to focus on target markets including Hong Kong, Macau, Taiwan, Pearl River Delta, Beijing and Shanghai was adopted. Pre-opening promotional work was being carried out and well-received by the market.

### Hotel Operation

Benefiting from the Individual Visit Scheme and the increase in business guests, the revenue and operating profit of the Group's five hotels in the first half of the year increased by 8.3% and 46.2% respectively compared with the same period last year. During the period, the average occupancy rate of the Group's four hotels in Hong Kong decreased slightly to 87% whereas the average room rate increased by 14.1% compared with the same period last year. The average occupancy rate and average room rate of Hotel Grandeur Macau during the period remained stable compared with the same period last year.

## MANAGEMENT DISCUSSION AND ANALYSIS *(continued)*

### Passenger Transportation and Freight Forwarding

Regarding the passenger transportation operation, the number of passengers carried by China Travel Tours Transportation Services Hong Kong Limited ("CT Tours") during the first half of the year reached 1.72 million, an increase of 18.58% from the same period last year. Revenue for the period reached HK\$112 million, an increase of 14.8% from the same period last year and the profit for the period increased by 15.8% compared with the same period last year. During the period, CT Tours broke several historical records. Currently CT Tours operates more than 40 bus routes which cover most of the Pearl River Delta region and its profitability ranks highly among the 50 best passenger road transportation enterprises in Mainland China. Recently, CT Tours won the through bus franchise between Hong Kong International Airport and Mainland China through open tender again and will continue to provide luxurious through bus service to Guangzhou and Shenzhen, etc. to travelers. Affected by the drastic rise in oil price, the profit of the Group's joint venture company Shun Tak-China Travel Shipping Investments Limited for the period decreased by 2.6% compared with the same period last year.

In respect of the freight forwarding operation, the revenue and profit after tax for the first half of the year increased by 45.9% and 50.7% compared with the same period last year. CTS International Transportation Company Limited ("CTS International") with its base in Yangtze River Delta leveraged on its competitive advantages in networking and human resources and continued to grow rapidly. Its revenue and profit after tax for the period increased by 50% and 25% respectively compared with the same period last year. In the 2004 Ranking of the 100 Best China International Freight Forwarders jointly organized by International Business Daily and China International Freight Forwarders Association, CTS International ranked among the top ten in terms of freight forwarding, air-freight and sea-freight businesses.

### Infrastructure

Due to the drastic rise in coal and oil prices, the profit of Shaanxi Weihe Power Co., Ltd. for the first half of the year decreased significantly from the same period last year. During the period, the profit from the power generation operation decreased by HK\$60.43 million to HK\$114 million, a decrease of 34.7% from the same period last year.

## MANAGEMENT DISCUSSION AND ANALYSIS *(continued)*

### Prospects

In the second half of the year, various factors will affect the results of the Group considerably. The adoption of the new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards will increase the depreciation expense of hotel properties, thus limiting room for upward hotel revaluation. In addition, further pre-operating costs such as development costs and promotional costs will be expended towards the commencement of business of Zhuhai Ocean Spring Resort and Centralized Platform by the end of the year. Furthermore, the result of the non-core power generation operation in the second half of the year will continue to drop. Affected by these factors, the profit for this year will decrease considerably compared with 2004.

On a more positive note, the Group's core businesses will benefit from the development of tourism industry in Hong Kong and Mainland China. The steady growth in the Chinese economy will spur leisure and especially business travel activities. The opening of Hong Kong Disneyland and the implementation of measures by the Hong Kong SAR Government to actively promote tourism industry will bring a new wave of visitors to Hong Kong and Macau. The Group will seize the opportunity to expand the travel agency network, strengthen the consolidation of resources, and leverage on competitive advantages in networking and branding to further develop the Group's travel business. The major developments Zhuhai Ocean Spring Resort and Centralized Platform, which capture the demands for leisure holiday travel and online booking of hotel rooms and air tickets, possess great prospects. Towards the end of this year, the two major travel projects will commence operation. Besides strengthening the core competitiveness of the Group's core travel businesses significantly, they will provide new sources of earnings growth to the Group. The Directors and Management will strive to increase revenue sources and control costs, and to prepare well for the launch of Zhuhai Ocean Spring Resort and Centralized Platform, thus laying down a solid foundation for the future development of the Group. The Directors believe the Group's core businesses will have encouraging growth in 2006.

### Employee Relations

As at 30 June 2005, the Group has 7,287 employees of whom 2,555 are based in Hong Kong, 225 are based in overseas countries and 4,507 are based in Mainland China, and the related employee costs for the current six-month period totalled HK\$331 million (six months ended 30 June 2004: HK\$283 million).

## MANAGEMENT DISCUSSION AND ANALYSIS *(continued)*

### Employee Relations *(continued)*

The employees are remunerated based on their work performance, professional experiences and prevailing industry practices. The remuneration policy and package of the Group's employees are periodically reviewed by the management. Apart from medical coverage, provident funds, retirement plans and long service awards, discretionary bonuses and share options are awarded to certain employees according to the assessment of individual performance. In addition, training and development programmes are provided on an on-going basis throughout the Group. Sporting and recreational activities were arranged during the period for employees on a Group-wide basis. Group employees also participated in community-orientated events.

### Liquidity, Financial Resources and Capital Structure

The Group maintained a strong financial position for the period. As at 30 June 2005, the Group had total assets of HK\$12,832 million (31 December 2004: HK\$11,521 million), total liabilities of HK\$3,094 million (31 December 2004: HK\$2,973 million) and the equity attributable to equity holders of the parent was HK\$9,366 million (31 December 2004: HK\$8,162 million), amongst which cash and bank balances amounted to HK\$2,463 million (31 December 2004: HK\$1,786 million) whereas interest-bearing bank debts and convertible bonds amounted to HK\$1,505 million (31 December 2004: HK\$712 million) and Nil (31 December 2004: HK\$749 million) respectively. The net interest-bearing debt to equity ratio was -10.1% (31 December 2004: -4.0% as restated). During the period under review, net cash generated from operating activities amounted to approximately HK\$445 million (six months ended 30 June 2004: HK\$192 million).

As at 30 June 2005, the Group had loan facilities, which were subject to, inter alia, a specific performance obligation on the controlling shareholder of the Company, CTS Holdings, during the tenure of such loan facilities. The specific performance obligation is that CTS Holdings shall maintain a holding of not less than 51% of the total issued share capital of the Company throughout the tenure of the loan facilities granted to the Group. A breach of the obligation will constitute an event of default. As a result of such breach, the loan facilities may become due and repayable on demand by the relevant tenders according to the respective terms and conditions thereof. The details of the loan facilities are as follows:

#### Amount outstanding as at 30 June 2005

HK\$1,500 million

#### Final maturity of the loan facilities

30 October 2007

Interest is charged on the outstanding balance at 0.5% per annum over the Hong Kong Interbank Offered Rate for the applicable loan period. The loans are secured by the corporate guarantee given by the Company.

## **MANAGEMENT DISCUSSION AND ANALYSIS** *(continued)*

### **Liquidity, Financial Resources and Capital Structure** *(continued)*

The total capital expenditure on property, plant and equipment during the period amounted to HK\$96 million (2004: HK\$82 million). These capital expenditures were funded mainly by internal resources.

There had been no material change in exposure to fluctuation in exchanges rates since the most recent published annual report, and there was no material charge on group assets as at 30 June 2005, whereas contingent liabilities had increased from HK\$4.41 million as at 31 December 2004 to HK\$8.85 million at the end of the period.

During the period, 111,615,191 bonus warrants were exercised for 111,615,191 shares of HK\$0.10 each at the subscription price of HK\$1.508 per share and US\$101,810,000 of convertible bonds were converted into 431,547,127 shares of HK\$0.10 each at the conversion price of HK\$1.84 per share. Accordingly, the number of issued share capital of the Company increased from 4,467,658,548 shares to 5,010,820,866 shares as at 30 June 2005.