SEGMENT REVIEW

The Marco Polo Hongkong Hotel ("MPHK Hotel") recorded steady occupancy and double-digit growth in average room rate during 2005. Total revenue and operating profit of the Hotel Segment in 2005 grew by 11 per cent and 9 per cent to HK$370.9 million and HK$117.0 million respectively.

Average occupancy at MPHK Hotel was maintained at 87 per cent during 2005, compared with 88 per cent in 2004. Despite the slight decline in occupancy, MPHK Hotel recorded a 19 per cent growth in average room rate. The outlook for Hong Kong's hotel industry remains positive in the wake of strong economic fundamentals and growth in tourist arrivals.

Property Segment revenue and operating profit increased by 14 per cent and 12 per cent to reach HK$94.3 million and HK$83.0 million respectively. The increase was attributable to increased rental from MPHK Hotel's retail space, which was enlarged following the completion of the second phase retail space extension in October 2005, and rental contribution from retail units at Star House, Tsimshatsui, which were acquired for a cash consideration of HK$309.2 million in November 2005.

During 2005, the office and retail areas of MPHK Hotel were respectively 100% and 91% occupied, while the newly acquired Star House units were 99% occupied at the end of 2005. Lane Crawford remains the anchor tenant at MPHK Hotel's retail area, which blends well with the patronage of the hotel.

The Group's investment property, comprising the office and retail areas in MPHK Hotel and the Star House units, were revalued by an independent valuer at 31st December, 2005 which gave rise to a net revaluation surplus (after deferred tax) of HK$223.7 million. This surplus has been included as part of the profit for the year under review in accordance with the new Hong Kong accounting standards.

On property development, superstructure work for the 60 Victoria Road development at Kennedy Town is in progress and is scheduled for completion in August 2006. Pre-selling of the residential units was launched in October 2005 and has met with favourable market response. As at the end of 2005, cumulative pre-sales had reached 21 per cent of the 73 units, realising approximately HK$70 million in proceeds. In accordance with current accounting standards, these sales will only be recognised in the profit and loss account on completion of the development.

For the Sorrento development (Kowloon Station Package II), in which the Group has a 20 per cent interest, cumulative sales of Phase II reached 851 units (99 per cent sold) at the end of 2005.

FINANCIAL REVIEW

(I) Review of 2005 Results

In preparing the Accounts for the year under review, the Group has adopted the new and revised Hong Kong Financial Reporting Standards ("HKFRSs"), including all Hong Kong Accounting Standards ("HKASs") and relevant Interpretations ("HKAS-INTs" and "HK-INTs"), which took effect on 1st January, 2005. The resultant significant changes in accounting treatment and presentation are detailed in Note 8 to the Accounts.

Profit Attributable to Shareholders

The Group's profit attributable to shareholders for the year amounted to HK$517.1 million, representing an increase of HK$145.4 million or 39.1 per cent from the HK$371.7 million in 2004 (as restated). Earnings per share were HK$1.64 (2004 restated: HK$1.18).

In compliance with the new HKFRSs, the Group's investment properties were revalued as at 31st December, 2005 resulting in a net surplus after deferred tax of HK$223.7 million being recorded in the profit and loss account for the year under review. Excluding this surplus, profit for the year would have been HK$293.4 million, an increase of 17.8 per cent over 2004. The improvement is mainly due to the increase in the Group's operating profit by HK$58.6 million, offset partially by the decrease in contribution from associates by HK$32.0 million (primarily due to the reduction in sales of Sorrento units held by an associate).

Turnover

The Group's turnover for the year under review was HK$526.8 million, an increase by 18.4 per cent from the HK$445.0 million achieved in 2004. Against the backdrop of the improving economic conditions in Hong Kong and fuelled by the favourable performance of The Marco Polo Hongkong Hotel and its retail space, the Group's hotel revenue and property investment income increased by 11 per cent and 14 per cent to HK$370.9 million and HK$94.0 million, respectively. The growth was also aided by higher interest income generated from the Group's surplus cash as a result of interest rate hikes during the year.

Operating Profit

The Group's operating profit for 2005 amounted to HK$259.3 million, representing an increase of HK$58.6 million or 29 per cent from the HK$200.7 million in 2004 (as restated) as all segments of the Group reported revenue increases.

Performance of the Group's business segments is covered in detail under the Segment Review Section.

Other Items

Included in the Group's profit is a surplus of HK$271.1 million (2004: HK$148.7 million) on revaluation of the Group's investment properties and other net income of HK$42.6 million (2004: HK$20.9 million). Other net income included deferred interest income of HK$3.9 million (2004: HK$20.9 million), which was earned from a loan advanced to an associate undertaking the Sorrento project and recognised on the basis of the sales progress of the project, and a write-back of provision for impairment totalling HK$40.7 million for the Victoria Road development project based on prevailing market conditions.

Share of Profits of Associates

Share of profits of associates in 2005 was HK$24.4 million, compared to HK$56.4 million in 2004. This was caused by the reduction in attributable profit by HK$33.1 million from the Sorrento project as less residential units were sold during the year under review. As over 99 per cent of the units of Sorrento had been sold by the end of 2005, further profit contributions from this project will be insignificant in the coming years.

Taxation

The taxation charge for the year was HK$80.3 million, compared to HK$55.0 million in the last year. Included in the current year's taxation charge was a deferred tax provision of HK$47.4 million (2004: HK$26.0 million) in relation to investment property revaluations in accordance with the HKAS 12 "Income taxes" and HKAS-INT 21 "Income taxes – recovery of revalued non-depreciable assets".

(II) Liquidity and Financial Resources

As of 31st December, 2005, the Group's shareholders' equity was HK$4,101.0 million or HK$13.02 per share based on the currently adopted HKFRSs.

In compliance with the new and revised HKFRSs, which are effective from 1st January 2005 and have been adopted retrospectively as detailed in the notes to the Accounts, the Group's shareholders' equity as at 31st December, 2004 has been restated to HK$3,505.6 million or HK$11.13 per share from HK$5,462.7 million or HK$17.34 per share respectively, a decrease of HK$1,957.1 million or HK$6.21 per share. The reduction mainly represents the reversal of the revaluation reserve for the Group's hotel property of HK$1,813.0 million on restating it at cost (less depreciation) instead of at valuation as previously adopted, and the provision for deferred tax of HK$144.1 million on investment property revaluations, both in compliance with the new HKFRSs. Details of these adjustments are presented in Note 8 to the Accounts.

As at 31st December, 2005, the Group had a net cash balance of HK$1,519.6 million, HK$217.9 million lower than at 31st December, 2004. The decrease was mainly due to the acquisition of the Star House units in November 2005. Our cash surplus was mostly placed as bank deposits. In addition, the Group maintained a portfolio of investments primarily consisting of blue chip securities, with a market value aggregating HK$922.8 million as at 31st December, 2005 (2004: HK$820.4 million). The performance of the portfolio was in line with the general stock markets.

As at 31st December, 2005, the Group had no significant exposure to foreign exchange rate fluctuations.

(III) Human Resources

The Group has approximately 452 employees working at the Group's hotel. Employees are remunerated according to the nature of the job and market trends, with a built-in merit component incorporated in the annual increment to reward and motivate individual performance. Total staff costs for year ended 31st December, 2005 amounted to HK$92.9 million (2004: HK$84.2 million).