Managing Director's Report

Financial Review

Financial Review

(I) RESULTS REVIEW

In preparing the financial statements for the year ended December 31, 2005, 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 January 1, 2005. Applicable prior year adjustments have also been made to 2004's financial statements. The resulting effects of the changes in accounting treatment and presentation are detailed in note 11 to the financial statements.

Profit Attributable to Shareholders

For the year ended December 31, 2005, the Group recorded a profit attributable to Shareholders of HK$13,888 million, an increase of HK$1,211 million or 10% over HK$12,677 million in 2004. Earnings per share were HK$5.67, compared to HK$5.18 recorded in the previous year.

In accordance with the new HKFRSs, the Group revalued its investment properties as at December 31, 2005 and accounted for a net attributable surplus to Shareholders of HK$9,389 million, representing revaluation surplus of HK$11,513 million less related deferred tax and minority interest of HK$2,124 million, in its profit and loss account for 2005. The comparative net surplus of HK$8,937 million has also been restated in 2004's results. Excluding the net revaluation surplus, the Group's net profit would have been HK$4,499 million, an increase of HK$759 million or 20% over the HK$3,740 million in 2004.

The profit growth before the revaluation surplus was driven mainly by the solid performance of the Group's Property Investment segment, which resumed to attain accretive office rental reversion and sustained its continued growth in retail rental income. This also reflects the overall steady growth in the operating profits of its Logistics segment and the Communications, Media and Entertainment ("CME") segment during the year under review. However, this strong operating performance was offset in part by the increase in the Group's borrowing cost caused mainly by a series of interest rate hikes in 2005 and the absence of attributable provision write-back in respect of Bellagio project, which amounted to HK$442 million in 2004.

Turnover

The Group's turnover for the year grew by HK$590 million or 5% to HK$12,543 million, versus HK$11,953 million achieved in 2004. The growth was primarily underpinned by the increase in revenue by HK$428 million or 9% from the Property Investment segment, which delivered strong business momentum and recorded encouraging revenue growth across its property portfolios covering high quality retail and office spaces as well as hotels, serviced apartments and residential units. Property investment in China also bore fruit with encouraging revenue growth of 31%.

The Logistics segment also reported steady revenue growth of HK$187 million or 6% to HK$3,534 million over 2004, mainly reflecting the continuous rising in containers throughput handled by Modern Terminals.

CME, supported by continuous expansion among its Pay TV, Broadband and telecom subscriber bases, also grew its total revenue healthily by HK$114 million or 3% to HK$3,937 million, notwithstanding intense competition in the market.

Operating Profit

The Group's operating profit in 2005 was HK$6,003 million, HK$746 million or 14% higher than the HK$5,257 million in 2004, which was attributable to the favourable results delivered by all its core business segments, in particular the overall operating profit of the Property Investment, which grew by 11% to HK$3,465 million. The Logistics and CME segments also reported operating profit growth by 5% and 7% to HK$1,935 million and HK$486 million respectively. However, within the CME segment, Pay TV operating profit dropped by 28% to HK$337 million primarily due to decrease in ARPU and increase in operating and marketing cost. Pay TV's adverse operating results were substantially mitigated by Internet and Multimedia's record operating profit of HK$78 million versus its loss of HK$44 million incurred in 2004. The Group's operating profit in 2005 also benefited from increase in investment and other profit by HK$273 million over 2004.

Performance of the Group's business segments is discussed in detail under the Business Review section.

Other Items

Included in the Group's profit is a revaluation surplus of HK$11,513 million (2004: HK$10,911 million restated as a prior year adjustment) on revaluation of the Group's investment properties in accordance with the new accounting standard as mentioned above. The total value of the Group's investment properties was HK$78,224 million as revalued by an independent valuer at December 31, 2005, representing a full-year net appreciation of 17% amidst the continuous strong rebound in the property values particularly in the first half of 2005 though followed by a slower pace of increase in the second half of 2005.

There was also a net write-back of HK$47 million from the previous provisions for the Group's various properties, based on prevailing market conditions, versus the net other charges of HK$190 million recognised in 2004, which included Wharf T&T's write-down of HK$298 million for impairment of its fixed assets and a write-back of HK$108 million in respect of the Group's various properties.

Borrowing Costs

Net borrowing costs as charged against the results increased by HK$323 million to HK$562 million in 2005 from HK$239 million in 2004. This was primarily due to the continuous interest rate hikes in 2005 as well as the moderate increase in the Group's borrowings caused mainly by the expanding port investment activities undertaken by Modern Terminals. The charge was net of capitalisation of HK$8 million (2004: HK$25 million) for the Group's related assets. The Group's average effective borrowing rate in 2005 was 3.56% p.a., compared to 1.56% p.a. in 2004.

Share of Profits less Losses of Associates and Jointly Controlled Entities

The share of profits less losses of associates was HK$425 million, a decrease of HK$311 million against the profit of HK$736 million in 2004. Included in 2004 results was an attributable property write-back of HK$442 million in respect of the Bellagio development. Excluding this write-back in 2004 for comparison purpose, associates' profits would have increased by HK$131 million or 45% due mainly to higher profit contribution from the sale of Bellagio residential units in 2005.

The attributable losses of HK$13 million (2004: HK$2 million) from jointly controlled entities was mainly related to port investments undertaken by Modern Terminals.

Taxation

The taxation charge was HK$2,583 million, HK$342 million or 12% lower than the HK$2,925 million recorded in 2004. Included in the tax charge is a deferred taxation of HK$2,045 million (2004: HK$1,984 million) provided against the surplus arising from the revaluation of investment properties in 2005 in accordance with the new accounting standard. Excluding this deferred item, the remaining tax charge would have been HK$403 million lower than 2004, which was mainly due to the inclusion of a net deferred tax credit of HK$305 million recognised by i-CABLE mainly for its tax losses that are expected to be utilised in the coming years.

Minority Interests

Minority interests increased by HK$71 million to HK$942 million from HK$871 million in 2004, due mainly to better net profits achieved by the non wholly-owned subsidiaries, namely, Harbour Centre Development Limited, Modern Terminals and i-CABLE. The increase was in part offset by the decrease in minority interests on the Group's increasing its holding interest in Modern Terminals and i-CABLE to 67.6% and 73.6%, respectively, during the year under review.

Included in the Group's profit attributable to shareholders is a profit of HK$1,674 million (2004: HK$1,178 million) contributed aggregately from three major non wholly-owned subsidiaries, namely, the 67.6%-owned Modern Terminals, 73.6%-owned i-CABLE and 66.8%-owned Harbour Centre Development Limited.

Consolidated Net Profit Summary

The combined effect of the operating performance of the Group and the net impact on adoption of the new accounting standards for accounting the surplus on revaluation of investment properties and related deferred taxation has boosted the Group's net profit attributable to Shareholders to HK$13,888 million (2004: HK$12,677 million). The analysis below sets out the impact of the new accounting standard for investment properties and to better reflect the Group's underlying performance and results with the comparability to 2004:

	2005	2004
	HK$ Million	*HK$ Million*
Profit attributable to Shareholders as reported in the financial statements	**13,888**	12,677
Adjustments		
Investment property revaluation surplus	**(11,513)**	(10,911)
Deferred tax on above surplus	**2,045**	1,984
Minority interests	**79**	(10)
Profit attributable to Shareholders before the impact on adoption of HKAS 40	**4,499**	3,740

There were other new accounting changes in 2005 with minor net impact on the Group's results and the details of which have been included in note 11 to the financial statements.

(II) LIQUIDITY AND FINANCIAL RESOURCES

Shareholders' Equity

As at December 31, 2005, the Group's net asset value was HK$65,313 million or HK$26.68 per share, compared to the restated amount of HK$54,949 million or HK$22.46 per share at December 31, 2004, respectively. The increase of HK$10,364 million was primarily due to the attributable appreciation in value by HK$9,389 million (net of deferred tax) in the Group's investment properties portfolio based on a revaluation by an independent valuer.

In compliance with the new and revised HKFRSs, the Group's equity attributable to Shareholders as at January 1, 2005 was restated to HK$54,949 million from the HK$65,168 million previously reported and the Group's net asset value attributable to Shareholders hence dropped by HK$4.17 to HK$22.46 per share from HK$26.63. The reduction resulted mainly from the provision for deferred tax of HK$7,380 million on investment properties revaluation surplus, reversal of revaluation reserve of HK$2,629 million by restating the hotel properties at cost and provision for accumulated depreciation for hotel properties of HK$221 million. Details of these adjustments are given in note 11 to the financial statements.

The Group's total equity, including minority interests, was HK$68,429 million as at December 31, 2005, representing an increase of 17% over the HK$58,624 million as at December 31, 2004.

Supplemental Information on Net Asset Value ("NAV")

To better reflect the underlying NAV attributable to Shareholders, the following adjustments are made to the book NAV prepared based on the HKFRSs:

	NAV to Shareholders	
	Total	Per share
	HK$ Million	*HK$*
Book NAV (based on HKFRSs) at December 31, 2005	65,313	26.68
Adjustments for:–		
Modern Terminals (67.6%)		
– based on the latest transaction price	8,296	3.39
i-CABLE (73.6%)		
– based on market price at December 31, 2005 (@HK$1.90 p.s.)	1,167	0.48
Hotel properties		
– based on the valuation conducted by an independent valuer	3,360	1.37
Deferred tax for surplus on revaluation of investment properties in Hong Kong*	9,338	3.82
Adjusted underlying NAV at December 31, 2005	87,474	35.74

* As there is no capital gains tax in Hong Kong, total deferred tax liability in the amount of HK$9.34 billion (equivalent to HK$3.82 per share) as provided and included in the consolidated balance sheet would not be payable if the above-mentioned investment properties were to be sold at the revalued amounts under the current tax regime. Accordingly, such deferred tax as provided under HKAS 40 and HKAS-INT 21 has been excluded for the above calculation in order to provide a better understanding of the net asset value attributable to Shareholders.

Net Cash Generated from the Group's Operating Activities

For the year under review, the Group's net cash inflow generated from operating activities was HK$5.0 billion, representing a decrease of HK$0.7 billion from HK$5.7 billion in 2004. The reduction was primarily caused by increase in expenditures on trading properties under development not ready for sale in 2005 and increase in interest payment. Fortunately, this reduction was substantially offset by strong steady operating cash inflow of the Group's Property Investment, Logistics and CME business segments. Net cash of HK$4.7 billion used in investing activities was mainly spent for capital expenditure and investments in certain subsidiaries, including the considerations of HK$0.3 billion and HK$2.4 billion paid for acquisitions of additional 6.5% interest in i-CABLE and 12.3% in Modern Terminals.

Capital Expenditure

The capital expenditure incurred by the Group's core businesses during the year and related capital commitments at December 31, 2005 are analysed as follows:

		Capital Commitments as at December 31, 2005	
Business Unit/Company	Capital Expenditure for 2005 *HK$ Million*	Authorised and Contracted for *HK$ Million*	Authorised but not Contracted for *HK$ Million*
Property Investments/others			
China	48	47	1,007
Harbour City	274	186	14
Other properties/others	457	67	–
	779	300	1,021
Wharf T&T	305	46	95
	1,084	346	1,116
Modern Terminals (67.6%-owned)	394	783	1,864
i-CABLE (73.6%-owned)	282	14	119
	1,760	1,143	3,099
At December 31, 2004	1,368	1,236	1,413

The capital expenditure incurred by the Property Investment segment was mainly related to certain refurbishment and renovation works for enhancing the quality and value of the Group's investment properties. For i-CABLE and Wharf T&T, the capital expenditures were incurred mainly for network upgrade and expansion, as well as procurement of TV production facilities, while that of Modern Terminals was substantially incurred for the construction of the new Container Terminal 9, which is now in full operation, and procurement of various terminal equipments. i-CABLE and Modern Terminals, 73.6%- and 67.6%-owned by the Group, respectively, funded their own capital expenditure programmes.

In addition to the above, the Group also had planned expenditure and other commitment at the end of December 2005 of approximately HK$3.5 billion for trading properties under development mainly in China, HK$1.9 billion as committed by Modern Terminals for its investment in Taicang and Dachan Bay port projects and HK$0.7 billion mainly for i-CABLE's own programming expenditures.

Debts and Gearing

The Group's net debt increased from HK$14.1 billion at December 31, 2004 to HK$16.1 billion at December 31, 2005, which was made up of HK$18.6 billion in debts less HK$2.5 billion in deposits and cash. Included in the Group's debts were loans of HK$3.2 billion (2004: HK$1.6 billion) borrowed by a non wholly-owned subsidiary, Modern Terminals. The loan is without recourse to the Company and other subsidiaries of the Group.

As at December 31, 2005, the ratio of net debt to shareholders' equity and total equity was 24.6% and 23.5%, compared favourably to 25.6% and 24.0% at December 31, 2004, respectively.

Finance and Availability of Facilities

With its inherent strong recurrent operating cash inflow and ample market liquidity, the Group continued to be able to raise funds at low costs in domestic market. In 2005, the Group cancelled some of its loan facilities with higher interest margins and/or shorter maturity and refinance them on more favorable terms. Meanwhile, this enabled the Group to further reduce its average borrowing margin and lengthened its average debt maturity.

The Group's available loan facilities and debt securities totally amounted to HK$26.8 billion, of which HK$18.6 billion were outstanding at December 31, 2005 analysed as below:

	31/12/2005			
	Available Facility *HK$ Billion*	Total Debts *HK$ Billion*		Undrawn Facility *HK$ Billion*
Company/wholly-owned subsidiaries				
Committed facilities	17.3	13.7	74%	3.6
Uncommitted facilities	1.7	1.2	6%	0.5
	19.0	14.9	80%	4.1
Non wholly-owned subsidiaries				
Committed and uncommitted				
– Modern Terminals Limited	6.5	3.2	17%	3.3
– i-CABLE Communications Limited	0.7	–	–%	0.7
– Others	0.6	0.5	3%	0.1
	26.8	18.6	100%	8.2
Analysis by currency				
Hong Kong dollar		15.7		
United States dollar (swapped into HK dollar)		2.9		
		18.6		

As at December 31, 2005, only HK$86 million of the Group's debt was secured by mortgage over a property under development with carrying value of HK$345 million (2004: HK$271 million).

The Group's debts are primarily denominated in Hong Kong and US dollars and all US dollar loans have been effectively swapped into Hong Kong dollar loans by forward exchange contracts.

The use of derivative financial instruments is strictly controlled. The majority of the derivative financial instruments entered into by the Group are primarily used for management of the Group's interest rate exposures.

The Group maintained a reasonable level of surplus cash, which was denominated principally in Hong Kong and US dollars, to facilitate the Group's business and investment activities. As at December 31, 2005, the Group also maintained a portfolio of available-for-sale investments, primarily in listed blue-chip securities, with a market value of HK$1.7 billion.

(III) HUMAN RESOURCES

The Group had approximately 12,629 employees as at the end of 2005, as compared with 10,904 at the end of 2004. The increase of 1,725 employees mainly resulted from the recruitment by i-CABLE and Wharf T&T for their Customer Services maintained in Mainland China. Employees are remunerated according to the nature of the job and market trend, with a built-in merit component incorporated in the annual increment to reward and motivate individual performance. Total staff costs for the year 2005 amounted to HK$2,216 million, compared to HK$2,145 million in 2004.