# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OVERALL OPERATIONS REVIEW

**Turnover** – The three leasing sectors continued to enjoy growth in rental income in the first half of 2006 although the rates were more moderate. Revenue growth in the rest of our investment property portfolio has more than offset the rental income shortfall from the disposal of Entertainment Building at the end of 2005. As a result, the Group's turnover increased by 1.2% to HK$620 million (2005: HK$613 million), while turnover excluding the contribution of Entertainment Building increased by 7.9% (2005: HK$575 million).

***Office sector*** – Positive rental reversion, which began in the second half of 2005, has benefited the sector for leases renewed during the review period. The reversion has brought about a 6.6% increase in office revenue, to HK$242 million, when the contribution from Entertainment Building was excluded. Reflecting the effect of such disposal, overall office sector revenue, however, decreased slightly by 2.1%.

***Retail sector*** – Local consumer confidence and tourist arrivals remained the key drivers of the rental growth in the retail sector. The Group's retail space was virtually fully let with stable increase in rental rate for new leases and renewals. Overall retail sector revenue increased 1.2%; and when Entertainment Building was excluded, retail revenue increased 9.2% to HK$250 million.

***Residential sector*** – There was sustained demand for luxury residential property on the back of the steady arrival of expatriates with more flexible housing budgets. Both rental rate and occupancy have improved from the corresponding period in 2005, resulting in an increase of 10.2% in rental income.

**Property Expenses** – The property expenses to turnover ratio remained broadly the same as last year. Total property expenses increased by HK$5 million (4.3%) to HK$111 million (2005: HK$106 million; HK$100 million excluding Entertainment Building), due to increases in electricity tariff and higher direct costs such as agency fees and refurbishment.

**Other Income** – The increase of HK$96 million was mainly attributable to recognition of a recovery item and additional interest income on higher deposit levels from proceeds for the sale of Entertainment Building.

**Administrative Expenses** increased by HK$7 million (15.7%) to HK$52 million (2005: HK$45 million) principally due to the increase in staff costs for human resources upskilling and pay rise in line with the market, higher share option costs following the adoption of new accounting standards from 2005 and timing differences in other administrative expenses.

**Fair Value Changes on Investment Properties** – As at 30 June 2006, the investment properties of the Group were revalued at HK$30,972 million (31 December 2005: HK$29,815 million) by an in-house professional valuer. This valuation has been reviewed and endorsed by Knight Frank Petty Limited, an independent professional valuer. Excluding additions and disposals, fair value gains on investment properties of HK$1,130 million (up 3.8%) were recognised to the consolidated income statement during the period (the Group's share after minority interests was HK$1,054 million).

**Fair Value Changes on Financial Instruments** – The Group enters into hedging arrangements from time to time to hedge volatilities and pricing risks of its treasury assets and liabilities. The HK$70 million recognised in the consolidated income statement mainly represented the aggregate of the mark-to-market fair value movements of these financial instruments.

**Net Realised Gains on Disposal of Available-for-Sale Investments,** being the net realised gains arising from the disposal of certain available-for-sale investments during the period, amounted to HK$104 million. The remaining available-for-sale investment portfolio will continue to be held as the Group's long-term investment.

**Share of Results of Associates** increased by HK$32 million (160%) and was mainly attributable to fair value gain on properties at Shanghai Grand Gateway where the Group has an effective interest of 23.7%. Leasing activities for Phase 1 and Phase 2 (except for the luxury residential tower currently under construction) continued to perform well.

**Finance Costs** – The decrease of HK$9 million (9.9%) to HK$82 million (2005: HK$91 million) was mainly attributable to the lower debt level. The Group's weighted average borrowing costs for the period was 4.85%, up from 3.05% in the first half of 2005 and 3.60% for 2005 full year.

**Taxation** – The movement in taxation was broadly in line with the movement in the profit before taxation.

**Contingent Liabilities** – Since the publication of the Group's 2005 Annual Report in March 2006, S$18.6 million in respect of an undertaking to a bank for facility granted to a Singapore joint venture property project has been released.

**Capital Expenditure** – The Group is committed to enhancing the asset value of its investment property portfolio. Expenditure on refurbishment, renovation and additions to investment properties amounted to HK$33 million during the period.

The Group considers that there are sufficient financial resources to fund the level of planned capital expenditure including the Hennessy Centre redevelopment project which will commence in the fourth quarter of 2006 with expected completion by the end of 2009. These financial resources are funds generated from operating activities, liquid treasury assets, access to the debt capital market through Medium Term Note Programme and availability of undrawn committed banking facilities.

**Financial Management** – The key objective of the Group's financial management is to maintain prudent liquidity and manage financial risks. This is achieved by way of an even spread of debt maturity to minimise funding and refinancing risks; diversified funding sources; and minimising interest rate and foreign exchange exposures.

**Liquidity** – As at 30 June 2006, the Group's total gross debt level stood at HK$3,044 million, a decrease of HK$1,331 million from the balance at 31 December 2005 (2005: HK$4,375 million).

The Group's average debt maturity was about 5.5 years (repayable within one to five years: HK$1,270 million, over five years: HK$1,774 million). Following the disposal of Entertainment Building at the end of 2005, certain bank loans have been repaid during the period by applying the sales proceeds thereon. As at 30 June 2006, bank loans accounted for approximately 24% of the Group's total gross borrowing with the remaining 76% from capital market financing. The ratio of fixed rate borrowing was approximately 52% of the total gross borrowing as at the period end.

All of the Group's debts are unsecured and on a committed basis. To maintain sufficient liquidity for the Group's operations, undrawn committed facilities of HK$3.6 billion were maintained as at 30 June 2006 (31 December 2005: HK$3.6 billion).

**Risk Management** – Interest expenses account for a significant proportion of the Group's total expenses. Therefore, the Group monitors its interest rate exposure closely. Depending on the Group's medium-term projections of interest rates, an appropriate hedging strategy would be adopted to manage the 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 in overseas projects in Singapore and Shanghai. These foreign exchange exposures as at 30 June 2006 amounted to the equivalent of HK$1,216 million or 3.6% of the Group's total assets.

**Financial Ratios** – Net interest coverage ratio (defined as gross profit less administrative expenses before depreciation divided by net interest expenses) was 6.9 times as at 30 June 2006 (31 December 2005: 4.6 times).

Net gearing (defined as gross debt less cash and cash equivalents and marketable securities at period-end market value, divided by adjusted shareholders' funds) as at 30 June 2006 was 5.1% (31 December 2005: 6.4%).

**Credit Ratings** as at 30 June 2006 remained unchanged, being Baa1 from Moody's and BBB from Standard and Poor's.