

MANAGEMENT DISCUSSION AND ANALYSIS

Review of Results and Operation

During the first half of 2006, the Group's core travel and travel related businesses were thriving. The Group's operations including travel agencies, hotels, passenger transportation, theme parks and art performance sustained steady growth. The integration of the resources for the travel and travel related business were effective, and the on-line business developed in synergy with the traditional travel businesses. Key investment projects including Zhuhai Ocean Spring Resort and Mangocity.com commenced operation smoothly in January and March this year respectively. All of these have greatly enhanced the Group's core competitiveness, travel products and resources.

For the six months ended 30 June 2006, the unaudited consolidated revenue of the Group was HK\$3,162 million, an increase of 22.8% from the same period last year. Unaudited net profit attributable to shareholders was HK\$211 million, a decrease of 50.1% from HK\$423 million for the same period last year as restated in accordance with the new and revised Hong Kong Financial Reporting Standards. Without taking into account the non-recurring income of HK\$127 million which includes revaluation surplus of investment properties, hotel properties and change of fair value in convertible bonds, the net profit attributable to shareholders decreased 30.2% from the same period last year. The decrease in net profit attributable to shareholders was mainly due to the initial operating losses of the newly-launched Mangocity.com and Zhuhai Ocean Spring Resort and the decrease in share of profit of Shaanxi Weihe Power Co. Ltd. of HK\$33.10 million from the same period last year, which was caused by reduced sale of on-grid electricity due to oversupply and high levels of coal and fuel prices. In the first half of 2006, the earnings per share were 4.03 Hong Kong cents, representing a decrease of 55.2% from the same period last year. As at 30 June 2006, the equity attributable to shareholders of the Company was HK\$10,518 million, representing an increase of 11.2% from the end of last year.

Tour Operation and Leisure Business

The tour operation and leisure business of the Group includes travel agency business, Mangocity.com, three theme parks and a golf club in Shenzhen, Zhuhai Ocean Spring Resort and China Heaven, an art performance company. During the first half of 2006 the unaudited revenue was HK\$1,514 million, an increase of 35.8% from the same period of last year. Net profit attributable to shareholders was HK\$78.92 million, a decrease of 41.7% from the same period last year. Excluding the newly-launched Mangocity.com and Zhuhai Ocean Spring Resort, the revenue and net profit attributable to shareholders of the tour operation and leisure business increased by 19% and 14% respectively from the same period last year.

MANAGEMENT DISCUSSION AND ANALYSIS *(continued)*

Tour Operation and Leisure Business *(continued)*

During the first half of 2006, China Travel Service (Hong Kong) Limited (“CTSHK”) actively developed high-end travel market such as business conference and exhibition travel. Through cooperating with the tourism administration bureaus in provinces and cities such as Guizhou, Jiangxi and Shenyang, CTSHK was recognized as “China Travel Expert” in those provinces and cities, and further expanded its market share in Hong Kong and Macau for outbound tour to Mainland China. China Travel International Limited continued to develop its businesses in the highly competitive market, and launched tour business to Russia and India. The number of inbound tourists also continued to grow.

In light of the intense competition, Window of the World and Splendid China added novel programs to attract customers in all kind, and their operating results were better than expectation. China Heaven launched a series of new shows successfully in the United States, Canada, and Mainland China.

Operation of Tycoon Golf Club in Shenzhen continued to improve despite rainy weather in the first half of 2006 and the aging facilities. Zhuhai Ocean Spring Resort commenced operation smoothly in January this year. Constructed in Mediterranean style with comfortable hotels, an ocean hot spring center and a theme park with five one-of-a-kind amusement facilities in Asia, Zhuhai Ocean Spring Resort hosted 1.22 million customers within five months since the commencement of its operations, and was well-received by the market. Mangocity.com commenced operations at the end of March this year after a test run for a three-month period. Number of membership and click-through on the website of Mangocity.com increased robustly, and Mangocity.com became more popular in Shenzhen, Guangzhou, Beijing and other cities. Mangocity.com partnered with numerous hotels, and established delivery network of air tickets and tour package products in Mainland China.

Hotel Operation

During the first half of 2006, the Group’s hotel operations sustained steady growth. Average room rate and occupancy rate among the Group’s five hotels in Hong Kong and Macau increased 12% and 6.58% respectively from the same period last year. Revenue for the first half of 2006 was HK\$203 million, an increase of 13.1% from the same period last year. Net profit attributable to shareholders was HK\$22.79 million, an increase of 65.5% from the same period last year.

MANAGEMENT DISCUSSION AND ANALYSIS (continued)

Transportation

The Group's passenger transportation made record performance during the first half of 2006 despite the high oil price and adverse effect brought about by the implementation of the new cross-border regulations. Number of passengers reached 2.65 million, among which 2.45 million were passengers of regular bus service, an increase of 28.6% from the same period last year. During the first half of 2006, the revenue was HK\$132 million, an increase of 17.8% from the same period last year. The combined net profit attributable to shareholders of the passenger transportation services was HK\$19.49 million, an increase of 17.9% from the same period last year. China Travel Tours Transportation Development (HK) Limited continued to maintain a high standard of operational safety, with its safety indicators far superior over industry average. The operating results of the joint venture passenger ferry operations with Shun Tak China Travel Shipping Investment Limited grew satisfactorily.

In respect of the freight forwarding operation, China Travel Service Cargo continued to maintain its dominant position in railway cargo transportation operations, and also developed its air freight and sea freight operations, streamlined its business and internal resources, and actively seized opportunities to establish strategic alliance with freight forwarding and logistic partners. During the first half of 2006, the consolidated revenue and net profit attributed to shareholders was HK\$1,312 million and HK\$23.98 million respectively, representing an increase of 12.4% and 16.1% respectively from the same period last year.

Infrastructure

As there was an excess of supply over the demand of electricity, utilization hours of Shaanxi Weihe Power Co. Ltd. decreased 14.85% compared with the same period last year. During the first half of 2006, coal and oil prices remained at high level, resulting in a decrease of HK\$33.10 million for the Group's share of profit attributable to shareholder, representing a decrease of 29% from the same period last year.

Prospects for second half of 2006

In the second half of 2006, it is expected that China will continue to enjoy stable social and political situation, and that the economy in Mainland China and Hong Kong will continue to grow rapidly. Personal income of Mainland China residents is expected to rise steadily, with a change in their spending pattern towards a higher living standard. All these factors will give solid support to the sustainable growth, and create significant strategic development opportunities, for the Group's core travel and travel related businesses.

MANAGEMENT DISCUSSION AND ANALYSIS *(continued)*

Prospects for second half of 2006 *(continued)*

In the second half of 2006, besides increasing improvement and renovation of the current business facilities and hardware, the Group will continue to develop its business innovatively, improve operational efficiency and resources utilisation, and further enhance the sales capacity of its existing travel agencies network throughout Hong Kong, Mainland China and overseas. The Group will also continue to actively pursue business integration of its internal resources, achieve further operational synergy among its traditional travel network and the on-line network, and further expand its core travel business.

The Group's management is of the view that core tour operation and leisure business will sustain steady growth and the operating performance of Mangocity.com and Zhuhai Ocean Spring Resort will be improved by more smooth operation, higher service standard and quality and completed facilities, the initial loss will narrow gradually in the second half year. The Group's management also expect that the five hotels located in Hong Kong and Macau will perform even better than the first half of 2006 due to favorable seasonal factors and reopening of new renovated Metropark Hotel Wanchai Hong Kong which is focused on business traveler market, Passenger transportation business will grow continuously with the increasing of cross-border travelers, the Group will invest more resources to expand operating capacity and strengthen our passenger transportation business profitability. Even though there is very fiercely competition in the freight forwarding market, our freight forwarding business will still extend more development room because of strong domestic economy growth of China. Due to unfavorable market conditions, it is expected that the results of the power generation business for the second half of 2006 will continue to decline.

In general, due to the non-recurring factors and the loss of two growing new investment projects, the Group's consolidated operation result for the whole year is expected to decrease compared to that of last year. However, the Board is of the view that excluding above-mentioned factors, the Group's operating income from core recurring businesses will sustain satisfactory growth.

Employee Relations

As of 30 June 2006, the Group had approximately 10,975 employees of whom 2,664 are based in Hong Kong, 242 are based in overseas countries and 8,069 are based in Mainland China. Total remuneration cost for the period was HK\$378 million (six months ended 30 June 2005: HK\$331 million).

The employees are remunerated based on their work performance, professional experience and prevailing industry practices. The remuneration policy and package of the Group's employees are periodically reviewed by the Group's management. Apart from medical coverage, provident funds, in-house training programs and long service awards, discretionary bonuses are awarded to certain employees according to the assessment of individual performance.

MANAGEMENT DISCUSSION AND ANALYSIS (continued)

Liquidity, Financial Resources and Capital Structure

The Group's financial position remains strong. As of 30 June 2006, the cash and cash equivalents of the Group amounted to HK\$3,226 million (31 December 2005: HK\$2,259 million). The interest bearing bank borrowings amounted to HK\$2,032 million (31 December 2005: HK\$2,021 million). The net cash to equity ratio was 11.4% (31 December 2005: 2.5%).

As at 30 June 2006, the Company had loan facilities, which were subject to, inter alia, a specific performance obligation on the controlling shareholder of the Company, China Travel Services (Holdings) Hong Kong Limited ("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 40% of the total issued share capital of the Company throughout the tenure of the loan facilities granted to the Company. 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 lenders according to the respective terms and conditions thereof. The details of the loan facilities are as follows:

Amount outstanding as at 30 June 2006	Final maturity of the loan facilities
HK\$1,500 million	3 January 2009

Interest is charged on the outstanding balance at 0.25% 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.

For the six months ended 30 June 2006, the total capital expenditure on property, plant and equipment during the period amounted to HK\$94 million (2005: HK\$96 million). These capital expenditures were funded mainly by internal resources.

There was no material charge on the Group's assets during the six months ended 30 June 2006, whereas contingent liabilities had increased from HK\$2.14 million as at 31 December 2005 to HK\$6.83 million at the end of the period.

During the six months ended 30 June 2006, 656,511,650 bonus warrants were exercised for 656,511,650 shares of HK\$0.10 each at the subscription price of HK\$1.508 per share. Accordingly, the number of issued share capital of the Company increased from 5,038,843,875 shares as at 31 December 2005 to 5,695,355,525 shares as at 30 June 2006.