

Financial Review

Management Discussion and Analysis

The following comments should be read in conjunction with the Company's audited financial statements and the related notes thereto.

In preparing the financial statements for the year ended 30 June 2006, the Group has adopted the new and revised Hong Kong Financial Reporting Standards, including all applicable Hong Kong Accounting Standards and relevant Interpretations. Applicable prior year adjustments have also been made to the 2005 financial statements. The resulting effects of the changes in accounting policies and presentation are detailed in note 3 on the accounts.

Turnover and Profit

For the year ended 30 June 2006, the Group's turnover amounted to HK\$6,773.0 million, an increase of HK\$939.7 million or 16.1% over that for the previous year. The increase in turnover was attributable to improved revenue contributions by all business segments (with the exception of the infrastructure and the others segments). In particular, property development revenue showed an increase of 43.7% over the previous year.

The profit attributable to equity shareholders of the Company amounted to HK\$13,548.7 million for the year, an increase of HK\$2,695.9 million or 24.8% over that for the year before. Earnings per share were HK\$7.47 (2005 re-stated: HK\$5.98).

The underlying profit for the year, excluding the unrealized surplus on revaluation of investment properties (net of deferred tax), was HK\$5,268.2 million or an increase of HK\$855.4 million or 19.4%. Based on the underlying profit, the earnings per share were HK\$2.90 (2005 re-stated: HK\$2.43).

Property Development

Property development revenue amounted to HK\$2,708.6 million in the year under review, an increase of HK\$823.8 million or 43.7% over that for the previous year. The increased revenue was mainly attributable to the sales of residential units in various property developments including CentreStage and Royal Terrace. As a result, this business segment recorded a profit contribution for the year of HK\$1,354.1 million. Compared to the amount of HK\$455.0 million for the previous year, this represented an increase of HK\$899.1 million or 197.6%.

Property Leasing

Property leasing revenue including attributable contributions from rental properties owned by subsidiaries and jointly controlled entities amounted to HK\$2,730.0 million. This represented an increase of HK\$376.1 million or 16.0% over the amount of HK\$2,353.9 million for the previous year. Excluding attributable contributions from jointly controlled entities, the Group's gross rental income amounted to HK\$2,261.0 million and accounted for some 33.4% of the Group's total turnover. The increase reflected the higher rental rates in Hong Kong during the year as a result of improving local economic conditions. Profit contribution of this business segment for the year amounted to HK\$1,707.5 million, an increase of HK\$256.2 million or 17.7% over the amount of HK\$1,451.3 million for the previous year.

The surplus on revaluation of the Group's investment properties, excluding those of jointly controlled entities, (before deferred tax and minority interests) amounted to HK\$7,297.0 million for the year, as compared with re-stated amount of HK\$6,765.5 million for the previous year.

Financial Services

Revenue from financial services representing interest received from purchasers of units in the Group's developments on property mortgage loans amounted to HK\$114.6 million, an increase of HK\$24.4 million or 27.1%.

Building Construction

Building construction activities which are mainly catered to the developments participated by the Group recorded a turnover of HK\$856.4 million for the year, as against HK\$639.6 million for the previous year.

Infrastructure

Revenue from the investment in infrastructure projects in Mainland China that is mainly operated through the Group's subsidiary, China Investment Group Limited, amounted to HK\$136.4 million, representing a decrease of HK\$99.1 million or 42.1%. The decrease was mainly due to reduced traffic volume of a toll bridge in Hangzhou as a result of repair and maintenance work during the year. The profit contribution from this segment for the year decreased by HK\$70.3 million or 46.2% to HK\$81.8 million.

Hotel

Hotel operations registered an increase of 11.8% to HK\$134.5 million for the year, on the back of higher average occupancy and average room rates which benefited from an increase in inbound tourists. The profit contribution from this segment amounted to HK\$48.2 million, an increase of HK\$14.8 million or 44.3%.

Others

The segment revenue of other business activities of the Group including department stores operations, property management and security guard services decreased by HK\$204.4 million or 26.7% to HK\$561.5 million for the year. This was mainly attributable to the decrease in sales commission for the year, as compared with that for the year before, relating to a property development project managed by the Group. The profit contribution from this segment decreased by 72.3% to HK\$72.9 million.

Privatisation of Subsidiaries

As a result of the privatisation of Henderson China Holdings Limited and Henderson Cyber Limited, the Group recorded a gain of approximately HK\$812.5 million and an impairment loss of some HK\$161.8 million respectively. The net gain has been included in other operating income.

Dilution of Interest in Henderson Investment Limited ("Henderson Investment")

On 18 April 2006, pursuant to a placing agreement a subsidiary of the Company sold 230 million existing shares of Henderson Investment at the placing price of HK\$13.55 per share and subscribed 230 million new shares at the placing price adjusted for this purpose by the expenses incurred in relation to the placing and the subscription. The new shares represented approximately 8.2% of Henderson Investment's then existing issued share capital and about 7.5% of its issued share capital as enlarged by the subscription. The profit to the Group on dilution of its interest in Henderson Investment amounted to HK\$829.6 million which has been included in other operating income.

Associates

The Group's share of profits less losses of associates net of taxation amounted to approximately HK\$2,534.8 million, as compared with the re-stated amount of HK\$2,751.7 million for the previous year. Excluding the unrealized surplus on revaluation of investment properties (net of deferred tax) of HK\$745.4 million for the year (2005: HK\$555.0 million), the Group's share of the underlying profits less losses of associates amounted to some HK\$1,789.4 million, as against the re-stated amount of HK\$2,196.7 million for the year before.

In particular, the Group's share of after tax profits from the three listed associates totalled approximately HK\$2,380.1 million for the year as against the re-stated amount of HK\$2,213.1 million for the previous year. Excluding the unrealized surplus on revaluation of investment properties (net of deferred tax) of HK\$653.6 million for the year (2005: HK\$426.9 million), the Group's share of the underlying profits of the three listed associates amounted to HK\$1,726.5 million as against the re-stated amount of HK\$1,786.2 million for the year before. The slight decrease in such underlying profits was due to a smaller number of units in a property development project which were sold during the year, as compared with that for the year earlier.

Jointly Controlled Entities

The Group's share of profits less losses net of taxation of jointly controlled entities which are mainly engaged in property development and property investment activities increased by HK\$1,554.6 million or 69.1% to approximately HK\$3,805.3 million as compared with HK\$2,250.7 million for the previous year. The increase was attributable to the substantial surplus on revaluation of investment properties being mainly the International Finance Centre Complex. Excluding such unrealized surplus on revaluation (net of deferred tax but before minority interest) which amounted to HK\$2,766.8 million for the year (2005: HK\$1,025.8 million), the Group's share of the underlying profits less losses of

jointly controlled entities amounted to HK\$1,038.5 million, as against HK\$1,224.9 million for the previous year. The decrease in such underlying profits less losses was due to a smaller number of units in a property development project which were sold during the year, as compared with that for the previous year.

Finance Costs

Finance costs charged to the profit and loss account increased to HK\$496.2 million (2005: HK\$209.5 million) as a result of interest rate rises during the year. Finance costs capitalized for properties under development for sale in the year under review amounted to HK\$381.3 million (2005: HK\$193.2 million). The Group's effective borrowing interest rate was approximately 4.47% per annum (2005: 2.16% per annum).

Financial Resources and Liquidity

(a) Net Borrowings and Gearing

At 30 June 2006, the aggregate amount of the Group's total net bank borrowings amounted to approximately HK\$13,035.4 million (2005 re-stated: HK\$11,843.0 million). The Group's borrowings were mainly unsecured, with the vast majority having been obtained on a committed term basis. The maturity profiles of the Group's bank loans and borrowings were as follows:

	At 30 June 2006 HK\$ million	At 30 June 2005 re-stated HK\$ million
Bank loans and borrowings repayable:		
Within 1 year	7,029.2	3,097.4
After 1 year but within 2 years	3,848.5	4,920.1
After 2 years but within 5 years	6,085.0	6,744.3
After 5 years	3,731.8	1,250.0
Guaranteed convertible notes	0.0	186.9
Total bank loans and borrowings	20,694.5	16,198.7
Deduct: Cash at bank and in hand	7,659.1	4,355.7
Total net bank borrowings	13,035.4	11,843.0
Shareholders' funds	77,964.1	65,637.7
Gearing ratio (%)	16.7%	18.0%

Calculated on the basis of total net bank borrowings as a ratio of shareholders' funds at 30 June 2006, the Group's gearing ratio has improved to 16.7% from 18.0% at 30 June 2005.

	Year ended 30 June 2006 HK\$ million	Year ended 30 June 2005 re-stated HK\$ million
Profit from operations before changes in fair value of investment properties plus the Group's share of the underlying profits less losses of associates and jointly controlled entities (after excluding the unrealized surplus on revaluation of investment properties and taxation)	7,397.0	6,249.3
Interest expense (before capitalization of interest)	843.2	287.5
Interest cover (number of times)	8.8	21.7

Interest cover is measured by reference to (a) the Group's profit from operations before changes in fair value of investment properties plus the Group's share of profits less losses of associates and jointly controlled entities (after excluding the unrealized surplus on revaluation of investment properties and taxation) and (b) the interest expenses before capitalization of interest. On this basis the Group's interest cover for the year was 8.8 times, compared to 21.7 times for the year before.

The Group is in a strong financial position by having (a) a large capital base; (b) a relatively low net bank borrowings position; (c) a low gearing ratio; and (d) high interest cover. With abundant committed banking facilities in place and continuous cash inflow generated from a solid base of recurrent income, the Group has adequate financial resources in meeting the funding requirement for its ongoing operations as well as future expansion.

During the year, apart from the privatisation of Henderson China Holdings Limited and Henderson Cyber Limited, the Group did not undertake any significant acquisition or disposal of assets outside its core business.

(b) Treasury and Financial Management

The Group's financing and treasury activities were centrally managed at the corporate level. Bank loans and borrowings of the Group are principally of floating rate in nature obtained from international banks in Hong Kong. While the Group's borrowings were denominated mainly in Hong Kong Dollars, a portion of such borrowings was in Renminbi to support the Group's business activities in Mainland China. Apart from its investments in China which are denominated in Renminbi and are not hedged, the Group had no other material open foreign exchange positions at the year end.

The Group does not make use of any derivative instruments for speculative purposes.

Assets of the Group had not been charged to any third parties in the financial year under review except that security was provided in respect of a very small portion of project financing facilities that was extended by banks to a subsidiary of the Group engaged in infrastructural projects in Mainland China.

(c) Future Plans of Material Investments or Capital Assets

At 30 June 2006, capital commitments of the Group amounted to HK\$7,264.7 million (2005: HK\$7,188.9 million).

Contingent Liabilities

Contingent liabilities of the Group amounted to HK\$2,102.7 million at 30 June 2006 (2005: HK\$2,560.3 million). These mainly comprised the guarantees given by the Company to commercial banks to secure banking facilities granted to an associate and a jointly controlled entity.

Employees

At 30 June 2006, the Group had about 6,800 (2005: 6,500) full-time employees. The remuneration of employees was in line with the market trend and commensurable with the level of pay in the industry. Discretionary year-end bonus was paid to employees based on individual performance. Other benefits to employees include medical insurance, retirement scheme, training programmes and educational subsidies.

Total employee costs for the year amounted to HK\$1,005.0 million (2005: HK\$854.7 million).