Shanghai Shimao Sheshan Villas

Management Discussion and Analysis

Wuhan Shimao Splendid River *(artist impression)*

Shanghai Shimao Wonderland *(artist impression)*

The Year Under Review

"A Rewarding and Fruitful Year"

Shimao Property was successfully listed on The Stock Exchange of Hong Kong Limited on 5 July 2006. The Group's outstanding performance and sound expansion strategies secured investors' confidence. Such confidence sustained into the second half of 2006 as the Group's new projects and initiatives announced in the second half of the year were very well received by the investing public.

Prior to the IPO, the Group entered into subscription agreements with financial institutions including Morgan Stanley, Standard Chartered Bank and CCB International. In addition to offering financial support, their experience and expertise, which is highly regarded in the financial service industry, would further enhance the Group's financial and operational management capabilities, strengthen its overall risk control system, and endorse the Group's brand profile.

Furthermore, Shimao Property became a constituent of the MSCI Standard Equity Index and MSCI China Index in November 2006, in recognition of the Group's heavyweight status amongst China's real estate developers. Effective as of 12 March 2007, the Group was also selected as a constituent of the 200-stock Hang Seng Composite Index Series and Hang Seng Freefloat Index Series.

Having foreseen rising opportunities in China, the Group issued US$600 million of Senior Notes through an international offering in November 2006, which was received with very strong investors' demand. This has enabled the Group to further strengthen its financial position and fuel the process of its expansion.

During the year under review, the Group made consistent efforts to strengthen its presence in the Yangtze River Delta and extend to the Bohai Bay region. To speed up the development of large scale residential, commercial and hotel projects, the Group adopted a highly-strategic approach, increasing its current land bank portfolio for new projects to a substantial GFA of 20.16 million sq.m.. Every piece of land is acquired with a specific development plan which ensures that the project pipeline is mapped out to shorten the gap between site acquisition to presale for cash generation towards the timely delivery of projects upon completion.

Financial Review

Turnover

The Group announced its first interim results on 30 August 2006 with excellent performance from the first half, the positive trend has continued into the second half of the year.

The Group's turnover for the year ended 31 December 2006 was RMB6,913 million (2005: RMB2,500 million) comprising primarily proceeds from property sales. Turnover increased by 176.5%, mainly because more projects were completed and units were delivered during the year. The Group's revenue from property sales amounted to RMB6,736 million or 97.4% of total revenue, representing an increase of 173.5 % over 2005. Total booked saleable area (including the attributable booked saleable area of 110,950 sq.m. contributed by associated companies) has increased to 674,611 sq.m., or increased by 159.6% compared to 2005.

Harbin Shimao Riviera New City

Fuzhou Shimao Bund Garden

Property sales by projects, for the year ended 31 December 2005 and 2006, can be analysed as follows:

Project name	2006 Booked saleable area (sq.m.)	2006 Turnover (RMB' million)	2005 Booked saleable area (sq.m.)	2005 Turnover (RMB' million)
Shanghai Shimao Riviera Garden	**187,885**	**3,974**	108,652	2,098
Kunshan Shimao Butterfly Bay	**124,019**	**627**	0	0
Changshu Shimao The Center	**114,811**	**584**	0	0
Harbin Shimao Riviera New City — Phase 1	**59,772**	**251**	112,594	365
Beijing Shimao Olive Garden	**61,414**	**800**	0	0
Shanghai Shimao Sheshan Villas	**15,760**	**500**	0	0
Sub-total	**563,661**	**6,736**	221,246	2,463
Fuzhou Shimao Bund Garden — attributable (Note)	**57,349**	**644**	38,569	249
Nanjing Shimao Riviera New City — Phase 1 — attributable (Note)	**53,601**	**547**	0	0
Sub-total	**110,950**	**1,191**	38,569	249
Total	**674,611**	**7,927**	259,815	2,712

Note: Sales revenue from associated companies, Nanjing Shimao Riviera New City and Fuzhou Shimao Bund Garden attributable to the Group, has not been included in the turnover of the Group for the year ended 31 December 2006.

Average selling price of the booked GFA for the Group (including associated companies) rose from approximately RMB10,400 per sq.m. in 2005 to RMB11,700 per sq.m. in 2006. The rise was attributable to the higher-than-average selling price of Shanghai Shimao Riviera Garden, Shanghai Shimao Sheshan Villas and Beijing Shimao Olive Garden in 2006.

Recurring income amounted to RMB177 million or 2.6% of the total revenue (2005 : RMB38 million or 1.5%), closely reflecting the increase in the proportion of investment properties and hotels in the Group's portfolio. Recurring income includes income from both hotel and retail properties, which accounted for 82.3%, and 17.7% of the Group's recurring income respectively.

Cost of Sales

Cost of sales mainly comprised land cost, construction costs, capitalised borrowing cost, sales tax, land appreciation tax ("LAT") and the direct operating costs of hotels and retail properties. The items can be analysed as:

	2006 (RMB' million)	2005 (RMB' million)
Sales tax	**350**	129
LAT	**355**	162
Land cost, construction cost and capitalised borrowing costs	**3,640**	1,607
Direct operating costs of hotels and retail properties	**88**	5
Total	**4,433**	1,903

Beijing Huaping Plaza

Other Gains

Other gains of RMB157 million (2005: RMB 106 million) mainly included interest income, gain on disposal of property, plant and equipment, and income tax refund on reinvestment. Other gains increased by RMB51 million compared to 2005, mainly due to substantial increase in interest income derived from proceeds received from the IPO and Senior Notes issuance.

Selling and Marketing Costs and Administrative Expenses

Selling and marketing costs and administrative expenses were RMB208 million and RMB460 million (2005: RMB106 million and RMB189 million) respectively, accounting for 3.0% and 6.7% (2005: 4.3% and 7.6%) of the Group's total revenue. The increase in the selling and marketing costs and administrative expenses were mainly because more projects were being launched or under development compared to 2005.

Fair Value Gains on Investment Properties

The Group recorded a fair value gain of RMB633 million contributed by Phase 1 retail property of Shanghai Shimao International Plaza. The fair value gain after deferred income tax was RMB424 million.

On 29 December 2006, we acquired an office and a commercial building at a prime location in Beijing CBD. The total acquisition cost, including deed tax and stamp duty, was RMB1,082 million and the fair value, according to a valuation report prepared by DTZ Debenham Tie Leung Limited dated 31 December 2006, was RMB1,450 million. As a result, we recognised a fair value gain after deferred income tax of RMB247 million.

Changshu Shimao The Center *(artist impression)*

Wuhan Shimao Splendid River

Share of Results of Associated Companies

Share of results of associated companies amounted to RMB201 million (2005: RMB18 million). The increase was because more units were completed and delivered in Fuzhou project in 2006 than 2005. Nanjing project started to contribute net profit to the Group with the completion and delivery of units in 2006.

Finance Costs

Finance costs increased by RMB35 million from RMB9 million in 2005 to RMB44 million in 2006 mainly due to the interest expense incurred in relation to the US$600 million Senior Notes issued in November 2006.

Taxation

The Group's total income tax expense amounted to RMB705 million (2005: RMB326 million) for the year. Applicable income tax rates for Shanghai Shimao Riviera Garden and Shimao Jianshe were 15%, for Shanghai Shimao Sheshan Villa was 27% and for Harbin Shimao Riviera New City was 30%, while the applicable rate for the Group's other projects stood at 33%.

Profit Attributable to Equity Holders

The Group's net profit attributable to equity holders amounted to RMB2,279 million for the year ended 31 December 2006 (2005 : RMB908 million), representing an increase of 151.0% relative to last year. Profit attributable to equity holders, excluding the fair value gain on investment properties net of deferred income tax of RMB671 million, goodwill impairment of RMB132 million and fair value adjustment for Shanghai Shimao Riviera Garden net of deferred income tax of RMB457 million, would be RMB2,197 million (2005 : RMB526 million).

Kunshan Shimao Butterfly Bay

Analysis on the Financial Performance after Exclusion of Management Analysed Non-cash Items

	2006 (RMB' million)	2005 (RMB' million)
Management analysed gross profit	**3,018**	947
Management analysed operating profit	**2,495**	750
Management analysed profit attributable to equity holders for the year	**2,197**	526
Management analysed earnings per share — Basic (RMB)	**0.824**	0.295

Management's analysis showed that after eliminating certain non-cash items which included fair value adjustment for Shanghai Shimao Riviera Garden, and the fair value gain on investment properties and impairment of goodwill, the Group's net profit attributable to equity holders increased 3.2 times compared to 2005, amounting to RMB2,197 million (2005: RMB526 million). The components of these non-cash items, which have been excluded in the preparation for the above management analyses, are set out as follows:

	2006 (RMB' million)	2005 (RMB' million)
Fair value adjustment — included in cost of sales (Note)	**537**	350
Fair value gains on investment properties	**(1,001)**	(903)
Impairment of goodwill — included in other operating expenses	**132**	—
Total deduction before tax	**(332)**	(553)
Total deduction after tax and minorities interest	**(82)**	(382)

Note: In respect of Shanghai Shimao Riviera Garden project

Management analysed gross profit netting off these non-cash items included in cost of sales was RMB3,018 million (2005: RMB947 million) and the management analysed gross profit margin was 43.7% (2005: 37.9%).

Management analysed operating profit, netting off these non cash items included in cost of sales, fair value gains on investment properties and impairment of goodwill, was RMB2,495 million (2005: RMB750 million), with an increase of 2.3 times over 2005.

Management analysed profit attributable to shareholders netting off all non-cash items for the year was RMB2,197 million (2005: RMB526 million) or increased 3.2 times compared to 2005.

Financing Activities

The Group's excellent business performance has substantiated its move to step up its expansion efforts. To prepare for further expansion, the Group saw the need to raise funds from the international bond market. On 21 November 2006, the Group announced the issuance of US$500 million of Senior Notes through an international offering, which was eventually increased to US$600 million in view of strong investors' demand. This, undoubtedly, has further strengthened the Group's capital resources for the future development.

Liquidity and Financial Resources

As of 31 December 2006, the Group's cash and bank balance was RMB6,023 million (2005 : RMB734 million), in which HK$801 million (equivalent to RMB805 million) were the remaining proceeds from the initial public offering and US$419 million (equivalent to RMB3,276 million) was from the issuance of the Senior Notes. Approximately 81% of total cash and bank balances are denominated in US dollars and HK dollars and the rest is denominated in RMB. The Group's total debts amounted to RMB8,123 million which comprise bank loans of RMB3,550 million and Senior Notes of US$600 million (equivalent to RMB4,573 million). Net debts (total debts less cash and bank balance) of the Group was RMB2,100 million which, converted into net gearing ratio (net debts/ total equity), of 18.2% (2005 : 75.8%). The net gearing ratio improved significantly mainly due to the broadening of the Group's equity base through capital injection by financial investors and IPO during the year.

The maturity of the borrowings is set out as follows:

	As of 31 December	
	2006	2005
Group	**(RMB' million)**	(RMB' million)
Bank borrowings		
Within 1 year	**1,652**	724
Between 1 and 2 years	**353**	728
Between 2 and 5 years	**1,060**	796
Over 5 years	**485**	390
Senior notes		
Between 2 and 5 years	**1,905**	—
Over 5 years	**2,668**	—
	8,123	2,638

Financial Guarantees

The Group provided guarantees in respect of mortgage facilities granted by certain banks relating to the mortgage loans arranged for certain purchasers of the Group's properties. As of 31 December 2006, the amount was RMB883 million (2005 : RMB1,450 million).

Pledges of Assets

As of 31 December 2006, the Group has pledged a portion of its investment properties with carrying value of RMB11,495 million which included land and buildings completed and under development, for sale and for investment, to banks to secure general banking facilities (2005 : RMB6,575 million).

Foreign Exchange Risks

Other than financing activities such as foreign currency bank borrowings, the IPO and the US$600 million Senior Notes which were denominated in foreign currencies, the Group conducts its business almost exclusively in Renminbi and does not have any other direct exposure to foreign exchange fluctuations. Should the value of Renminbi appreciate, the Group would be affected mainly by the outstanding foreign currency borrowings and the level of US$ and HK$ cash and bank balances maintained. At present, Renminbi is not a freely convertible currency. The PRC government may adopt progressive measures to adjust the exchange rate of Renminbi upwards in the future which may expose the

Group to exchange rate losses when converting the rest of IPO proceeds from HK$ and when converting the rest of Senior Note Issue proceeds from US$ into RMB. However, the Group may benefit from exchange rate gains when converting RMB to pay back the Senior Notes and foreign currency borrowings denominated in HK$ and US$. As of 31 December 2006, borrowings in foreign currencies included bank loans of US$40 million and HK$79 million, and the Senior Notes of US$600 million.

Use of Proceeds from the Initial Public Offering

The Company's shares were listed on the main board of the Stock Exchange of Hong Kong Limited on 5 July 2006. The Group has raised the net proceeds of approximately HK$4,060 million from the IPO. The Company had applied approximately HK$3,259 million into existing and new projects, which is in compliance with the intended use of proceeds as entailed on pages 183 and 184 of the prospectus. As of 31 December 2006, the balance of approximately HK$801 million remained as bank deposits.

Employees and Remuneration Policy

As of 31 December 2006, the Group employed a total of 987 employees. Total remuneration for the year amounted to RMB223 million. The Group has adopted a performance-based rewarding system to motivate its staff. In addition to a basic salary, year-end bonuses will be offered to those staff with outstanding performance. Share option schemes were adopted to attract and retain talents to contribute to the Group. In relation to staff training, the Group also provides different types of programmes for its staff to improve their skills and develop their respective expertise.

Market Overview

Throughout year 2006, the central government continued to announce a series of macroeconomic policies designed to slow down the rapid growth of China's economy to a balanced and sustainable level by controlling money supply, credit availability and fixed assets investments. Particular attention has been paid to regulate certain high-growth sectors including the property market. Such measures include:

- Tighter controls over land supply
- Controlling the construction ratio of high end housing units against small sized residences
- Raising banks' benchmark lending rate and introducing a minimum capital adequacy ratio of 35% on property developers
- Levying a business tax on the total sale price of residential properties sold within five years after purchase
- Increasing minimum down payment for certain property purchases
- Foreigner buyers are subject to a value-added tax for capital gain from property disposals and not allowed to buy residences that are not for their own use; foreign firms are required to hold capital no less than 50% of the value of a property investment worth over US$10 million
- LAT will be levied on income derived from the transfer of land use rights, buildings, premises or related facilities on such land
- Government plans to build houses for low-income families

Meanwhile, according to the preliminary estimation of the National Bureau of Statistics, the national economy maintained steady while China's gross domestic product for 2006 increased by 10.7% to reach RMB20,940.7 billion, which is 0.3% higher than last year. The substantial growth signifies an economic boom where the demand for office and retail properties are expected to increase in foreseeable future.

The Bureau also revealed that the per capita disposable income of urban population was RMB11,759, a year-on-year growth of 12.1%, or the real growth rate of 10.4%, or 0.8% above the previous year. The per capita net income of rural population was RMB3,587, a year-on-year growth of 10.2%, or a real growth of 7.4% which was 1.2% higher than 2005. The prospects for a general increase in income would help spur home buying demand and improve living conditions.

Shanghai Hyatt on the Bund *(artist impression)*

According to the National Development and Reform Commission, in February 2007, property prices in 70 large and medium sized mainland cities rose by an average of 5.3% year on year while first hand residential property prices rose 5.9% year-on-year. In December 2006, investment in domestic real estate amounted to RMB1,938.2 billion, representing an increase of 21.8% year on year, or equivalent to 2% above the relevant growth rate in last year.

Data from the National Tourism Administration showed that 22.21 million foreign visitors arrived in China in the year of 2006, representing an increase of 9.7% from 2005. Total revenue in foreign currency associated to inbound foreign visitors rose by 15.9% to about US$34 billion. Overseas visitors received by the cities of Shanghai, Beijing and Nanjing reached 4 million, 3.38 million and 0.65 million respectively, up 5.3%, 8.3% and 27.5% from year 2005. The steady growth in the number of overseas visitors suggested rising demand for hotel rooms in China. With more international conferences, exhibitions, trade shows and other events to be held in China, the number of business travelers and tourists entering the mainland is expected to rise in the long run hence stimulating the demand for accommodation and in particular benefiting the five star hotel market in leading mainland cities.

Operational Review

I Land Bank and Land Acquisitions

During the review period, through tender, auctions and listing-for-sale, the Group has strategically expanded its land bank in various provinces and cities in China. This is a testimony of the Group's capability as an integrated large scale real estate developer in the mainland.

Six plots of land with a total planned GFA of 6.31 million sq.m., were secured in 2006. Subsequently, in the first two months of 2007, three more plots of land with a total planned GFA of 3.52 million sq.m. were acquired and planned for large scale projects. The land plots are characterised by their excellent location and transportation connectivity to regional city centers, or are located in second and third tier cities where development potential is high.

Tactically, the Group has speeded up its geographic expansion through acquiring more land in the Yangtze River Delta area to strengthen its foothold in this region. The Group also entered the property market in Liaoning and Shandong provinces in order to capitalise on China's endeavor to enhance the development momentum in the Bohai Bay area, to complement the two economic powerhouses in Yangtze River Delta and Pearl River Delta.

The Group is of the view that profit margins generated from projects in first tier cities will gradually narrow while the residential markets in second and third tier cities will grow substantially and continuously. The Group has identified and entered into numerous high growth markets in a timely manner, enabling the Group to purchase plots of land in prime locations (or locations expected to be prime sites later) and at a reasonable cost.

Since 1 January 2006, the Group has acquired land parcels and one completed investment property with a total planned GFA of 9.83 million sq.m. Details of the newly acquired land are tabled as follows:

Project name	Acquisition date	Total Planned GFA (sq.m.)	Uses	Land cost (RMB' million)
2006 (before IPO)				
Shaoxing Shimao	May	1,299,700	Residential, Retail & Office	1,555
Wuhu Shimao	May	609,000	Residential, Retail & Hotel	401
2006 (after IPO)				
Yantai Shimao	August	280,000	Residential, Retail & Hotel	372
Jiaxing Shimao	August	1,050,000	Residential, Retail & Hotel	484
Changzhou Shimao	October	1,500,000	Residential & Retail	2,408
Shenyang Shimao	December	1,500,000	Residential, Retail, Office & Hotel	1,600
Beijing Huaping Plaza	December	70,175	Retail & Office	1,050
	Sub total	**6,308,875**		**7,870**
2007				
Suzhou Shimao	January	1,500,000	Residential & Retail	1,704
Xuzhou Shimao	February	1,300,000	Residential & Retail	1,200
Hangzhou Shimao	February	718,840	Residential	816
	Sub total	**3,518,840**		**3,720**
	Total	**9,827,715**		**11,590**

As of 31 December 2006, total planned GFA of the Group's land bank reserve stood at 16.64 million sq.m. The Group adheres to a strategy where land acquired would immediately undergo meticulous planning and development. This approach also complements the Group's long term strategy to balance its portfolio of properties-for-sale versus investment properties to approximately seventy-thirty distribution to secure recurring income and a healthy cash flow.

Development status of the Group's land bank as of 31 December 2006 is analysed below:

Project Name	Completed — Of which held for investment/held for sales GFA (sq.m.)	Under development Planned GFA (sq.m.)	Held for future development Planned GFA (sq.m.)	Pending land use rights Planned GFA (sq.m.)	Attributable interest to the Group %
Shanghai Shimao Riviera Garden	11,905	193,529	43,000	39,800	100%
Shimao International Plaza	138,515	32,420	—	—	100%
Shanghai Shimao Sheshan	85,088	15,437	28,058	—	100%
Shanghai Hyatt on the Bund	—	100,972	—	—	100%
Shanghai Shimao Wonderland	—	—	551,000	—	100%
Beijing Shimao Olive Garden	18,075	206,341	—	—	100%
Kunshan Shimao Butterfly Bay	156,157	286,882	657,960	—	100%
Kunshan Shimao International City	—	—	202,400	1,126,784	100%
Changshu Shimao The Center	19,860	368,966	—	1,444,678	100%
Harbin Shimao Riviera New City — Phase 1	389,265	108,651	—	—	100%
Harbin Shimao Riviera New City — Phase 3	—	—	—	949,238	100%
Wuhan Shimao Splendid River	—	173,749	—	1,642,251	100%
Shaoxing Shimao	—	460,000	—	839,700	100%
Wuhu Shimao	—	—	—	609,000	100%
Yantai Shimao	—	—	—	280,000	100%
Jiaxing Shimao	—	—	—	1,050,000	100%
Changshu Shimao	—	—	—	1,500,000	100%
Shenyang Shimao	—	—	—	1,500,000	100%
Beijing Huaping Plaza	70,175	—	—	—	100%
Nanjing Shimao Riviera New City — Phase 1	21,292	286,149	61,852	—	50%
Nanjing Shimao Riviera New City — Phase 2	—	—	—	962,653	50%
Fuzhou Shimao Bund Garden	12,830	—	—	—	50%
Total	**923,162**	**2,233,096**	**1,544,270**	**11,944,104**	
Attributable GFA	**906,101**	**2,090,022**	**1,513,344**	**11,462,778**	

Latest land bank and land acquisition status

The array of acquisitions has made the Group one of the largest property developers in China in terms of land bank reserve. Currently, the Group's land bank reserve has a total planned GFA of approximately 20.16 million sq.m., taking into account the two new plots of land acquired in Suzhou and Xuzhou in January 2007 and one in Hangzhou in February 2007 with a combined planned GFA of 3.52 million sq.m.

II Property Development and Sales

During the year under review, revenue from property sales amounted to RMB6,736 million, representing an increase of 173.5% over 2005. Total GFA sold (including attributable GFA of 110,950 sq.m. contributed by associated companies) was about 675,000 sq.m., representing an impressive increase of 159.6% from a year earlier. This is because certain properties of eight projects were completed in 2006, compared to three projects in 2005.

As of 31 December 2006, 97.4% of the Group's turnover was attributable to residential sales.

(1) Completed projects (residential, commercial, retail)

The Group completed a total saleable GFA of 1,301,706 sq.m. in eight projects in Shanghai, Harbin, Beijing, Changshu, Kunshan, Nanjing and Fuzhou, compared to three projects with a saleable GFA 421,332 sq.m. in 2005.

Projects completed in the year ended 31 December 2006 include:

	Project Name	**Saleable Area** (sq.m.)	**Group's Interest in Project** (%)
1)	Shanghai Shimao Riviera Garden	198,612	100%
2)	Shanghai Shimao Sheshan Villas	33,692	100%
3)	Harbin Shimao Riviera New City — Phase 1	345,013	100%
4)	Beijing Shimao Olive Garden	67,123	100%
5)	Changshu Shimao The Center	139,748	100%
6)	Kunshan Shimao Butterfly Bay	280,176	100%
7)	Nanjing Shimao Riviera New City — Phase 1	121,360	50%
8)	Fuzhou Shimao Bund Garden	115,982	50%
Total		**1,301,706**	

(2) Projects in the pipeline

The Group expects that eight projects, with a total GFA of approximately 1 million sq.m., would be completed in 2007. In addition, as of 31 December 2006, inventory of saleable GFA stood at approximately 638,010 sq.m. Total GFA available for sale in 2007 will be approximately 1.65 million sq.m.

Looking ahead, the Group is optimistic that total GFA completed in 2008 would grow substantially from 2007.

Details of the projects available for sale in 2007 are analysed as follows:

Project Name		Total Planned GFA (sq.m.)	Group's Interest in Project (%)
1)	Shanghai Shimao Sheshan Villa	25,305	100%
2)	Harbin Shimao Riviera New City — Phase 1	80,000	100%
3)	Beijing Shimao Olive Garden	171,519	100%
4)	Changshu Shimao The Center	140,000	100%
5)	Kunshan Shimao Butterfly Bay	130,000	100%
6)	Wuhan Shimao Splendid River	160,000	100%
7)	Nanjing Shimao Riviera New City — Phase 1	121,507	50%
8)	Shaoxing Shimao	180,000	100%
Sub total		**1,008,331**	
Total inventory GFA as of 31 December 2006 held by			
•	Our subsidiaries	611,022	100%
•	Our associated companies	26,988	50%
Sub total		**638,010**	
Total		**1,646,341**	

III Investment Properties and Hotels

The Group continued to expand into property investment to mitigate its exposure to market volatility or policy changes. In order to achieve greater balance in revenues, stability in income streams, and cash flow, the long term target of the Group is to increase the proportion of hotel, retail and office properties so that the Group's investment properties will account for about 30% of the Group's profit.

During the year under review, turnover from the Group's hotels investment and leasing income from retail properties amounted to RMB177 million, or 2.6% of the Group's turnover. This represents an increase of 372.0% over last year.

(1) Hotels

The Group strives to develop a portfolio of five-star hotels targeting business and high net worth overseas and domestic travellers. Building a portfolio of self-owned hotel properties is an essential move towards the Group's objective in maintaining a diversified property portfolio.

During the year under review, Shanghai Le Méridien Sheshan celebrated its grand opening in April 2006 and Le Royal Méridien Shanghai commenced trial operation in September and was formally opened for business in December. Two other five-star hotels, namely Hyatt on the Bund Shanghai and Nanjing Hyatt Regency are under construction. We intend to build more hotels to complement our geographic expansion plan. New hotel projects are planned for cities such as Wuhan, Yantai and Shenyang.

To maintain the service quality at a superior level, the Group has entered into management contracts with leading international hotel management groups. Starwood Group has been appointed to operate Shanghai Le Méridien Sheshan and Le Royal Méridien Shanghai while the Hyatt Hotel Group has been commissioned to operate another two five-star hotels, namely Hyatt on The Bund Shanghai and Nanjing Hyatt Regency. Similar management contracts are planned for other upcoming hotel projects.

With the opening of Hyatt on the Bund in 2007, the Group's hotel room inventory in Shanghai will increase to 1,728 rooms which will account for approximately 15% of the five-star hotel market in Shanghai. During the year, revenue generated from hotel business climbed 14 times to RMB146 million (2005: RMB10 million). The Group expects even more substantial growth in revenue in 2007.

Analysis of the status of the Group's hotel property developments is as follows:

Completed hotels as of 31 December 2006

Project name (location)	Opening date	No. of rooms	Total completed GFA (sq.m.)	Revenue for the year (RMB' million)
Shanghai Le Méridien Sheshan (Shanghai)	2006 April	327	69,328	89
Le Royal Méridien Shanghai (Shanghai)	2006 September	770	99,696	57
Sub total		**1,097**	**169,024**	**146**

Hotels under construction as of 31 December 2006

Project name (location)	Planned completion date	No. of rooms	Total planned GFA (sq.m.)	Revenue (RMB' million)
Hyatt on The Bund (Shanghai)	2007 second quarter	631	100,972	N.A.
Nanjing Hyatt Regency (Nanjing)	2008	426	60,010	N.A.
Shanghai Shimao Wonderland (Shanghai)	2010	400	73,000	N.A
Sub total		**1,457**	**233,982**	**N.A.**
Total		**2,554**	**403,006**	**146**

(2) Completed investment properties for lease

The Group's strategy is to secure long term tenancy agreements with reputable anchor tenants while lining-up selected global retail brands as the tenancy base for investment properties.

Subsequent to year 2006, the Group entered into a management agreement with China's largest retail group, Shanghai Brilliance (Group) Co. Ltd, to engage it as operation manager for the shopping mall of Shimao International Plaza. Tenancy agreements of 10 years with large commercial tenants are preferred in order to provide the Group with recurrent, substantial rental income. Other tenancy agreements are mostly termed for one to two years.

The Group also announced the formation of a strategic alliance with some leading worldwide retail brands, including CJ CGV of

South Korea, Decathlon from France, McDonald's Inc. (China) Ltd., Parkson Corp. from Malaysia, Starbucks Coffee Taiwan Corp. (Taiwan), SEGA (Japan) Vanguard (Hong Kong), and Watson's (Hong Kong). The move demonstrates the partners' strong confidence, reliance, and trust in the quality and opportunities accessible through the Group's projects. This followed an earlier partnership formed with Auchan from France and B&Q from the U.K. which are both Fortune 500 corporations. The alliance laid a cornerstone for the Group to tap into the commercial real estate market. Upon the establishment of this formal alliance, these brands will populate the Group's various commercial property projects.

During the year, the Group acquired Beijing Huaping Plaza with a GFA of 70,175 sq.m. Construction of Phase 2 shopping mall of Shanghai Shimao International Plaza is expected to be completed in 2007. In addition, Shaoxing Shimao and Changshu Shimao, with a total planned GFA of nearly 200,000 sq.m. for retail purpose, are expected to commence business in 2008.

Revenue generated from commercial properties totalled RMB31 million (2005: RMB28 million), which was mainly contributed by Phase 1 of the shopping mall of Shanghai Shimao International Plaza, representing a 12.7% increase from last year.

The Group plans to maintain most of its retail and office properties in first tier cities such as Shanghai and Beijing, and certain portions in second tier cities, such as Kunshan, Wuhan, Shaoxing and Changshu, as long term investments.

The portfolio of the Group's investment properties is summarised as follows:

Completed investment properties for rental as of 31 December 2006

Project name	Time of completion/ acquisition	Total GFA (sq.m.)	Uses	Revenue for the year (RMB' million)
Shanghai Shimao International Plaza — Phase I	2004 December	38,819	Retail	31
Beijing Huaping Plaza	2006 December	70,175	Office & Retail	N/A
Sub total		**108,994**		**31**

Investment properties for rental under construction as of 31 December 2006

	Planned completion date	Total planned GFA (sq.m.)	Uses	Revenue (RMB' million)
Shanghai Shimao International Plaza — Phase II	2007 first half	32,420	Retail	N.A.
Sub total		**32,420**		**N.A.**
Total		**141,414**		**31**

Business Outlook

The Board is confident of the prospects of the Group's future and believes that it has the potential to become one of the largest integrated real estate developers in China.

As the central government is determined to stabilise housing prices and curb over-investment, the authorities are expected to roll out other macroeconomic adjustments and vigorously implement existing adjustment measures. The Group considers these measures as strategic moves by the central government to consolidate and regulate the market to allow properly managed developers the room to grow. As a leading property developer specialising on large scale, high quality projects, the Group is well positioned to benefit from a better-regulated real estate market.

A flourishing yet sustainable economy is even more evident with China's accession into the World Trade Organisation (WTO), where over 70 of the world's top 100 retailers, including nearly all of the top 50, have entered the China market. Under the WTO agreement, service sector of China will also be opened up orderly. With the WTO entrance, the Group sees huge potential in the market of high end market properties for commercial and residential purposes.

Further, the mainland's hotel industry will benefit from China's booming tourism in the eve of the 2008 Beijing Olympics and the 2010 World Expo, reinforcing the Group's strategy to speed up its expansion in the fast growing hotel sector.

Company Prospect

With China's overall domestic economy maintaining a healthy growth momentum, the industry in general and the Group in particular will have room for further expansion. The Group will hasten its geographic expansion, increase its holding of investment properties and bolster its brand name.

In 2007, the Group will continue to acquire large land parcels and identify other development opportunities amongst second and third tier cities. Riding on its business success in the Yangtze River Delta region and the Bohai Bay area, the Group plans to venture into central and western China and other fast growing regions which will likely offer tremendous economic potential, while also exploring possible opportunities presented in inner cities where the markets are largely untapped.

The Group reckons that the entry barrier for commercial property development is relatively higher than the residential property development, and the percentage of Chinese developers investing in this category is lower than the global average of 2 to 3%. To ensure a stable income stream and to maintain its market leadership, the Group will seek to broaden its investment portfolio towards achieving a seventy-thirty proportion between properties-for-sale and investment properties, and mitigate potential risks through the two-pronged strategy on both short term and long term investments.

Having built up its credibility through years of consistently delivering quality projects, the "SHIMAO" brand is virtually synonymous with service and product quality. Such a wealth of brand equity has set the Group apart from its peers. The Group will further enhance its brand value through upholding its outstanding management, effective human capital, experienced sales and customer service team, and quest for innovation.

The Group believes the above strategies will facilitate the Group's corporate mission in "Cultivating Lifestyle, Realising Urban Dreams", developing quality real estate projects and maximising shareholders' returns.