Management Discussion and Analysis

Business Review

2006 was a year of continued high growth trajectory for the Group. Turnover was RMB 4,729 million (2005: RMB 1,018 million), representing an increase of 3.6 times over 2005.

Profit attributable to shareholders before revaluation of investment properties and Fair Value Adjustment on Derivative Financial Instruments increased significantly by 14.8 times to approximately RMB 1,536 million (2005: approximately RMB 97 million) and exceeded the profit forecast of RMB 1,450 million by 5.9% for 2006 as stated in the Company's prospectus dated 20 September 2006.

Profit attributable to shareholders after revaluation of investment properties and Fair Value Adjustment on Derivative Financial Instruments increased significantly by 2.0 times to approximately RMB 1,146 million (2005: approximately RMB 380 million) and also exceeded the profit forecast of RMB 982 million by 16.7% for 2006 as stated in the Company's prospectus dated 20 September 2006.

Set out below is a comparison of the profits achieved to the profit forecasts for 2006 and the profits for 2005.

	2006 RMB million	**2006 Forecast RMB million**	**2005 RMB million**
Net profit attributable to equity holders of the Company before (i) revaluation of investment properties and (ii) Fair Value Adjustment on Derivative Financial Instruments	1,536	1,450	97
Revaluation increase on investment properties (net of deferred tax effect and share of minority interests)	88	76	284
Fair Value Adjustment on Derivative Financial Instruments	(478)	(544)	(1)
Net profit attributable to equity holders of the Company after (i) revaluation of investment properties and (ii) Fair Value Adjustment on Derivative Financial Instruments	1,146	982	380

We continue to focus on our unique business model of creating value through master planning in city-core development and integrated residential development projects. We have five city-core development projects and one integrated residential development project in our portfolio with a combined approximately 8.4 million sq.m. of gross floor area ("GFA") including open areas and other public facilities, all located in prime locations, three in Shanghai, and one each in Chongqing, Wuhan and Hangzhou. Through this unique business model and our premium branding and reputation we have been able to establish in China accelerated capital value appreciation in our property portfolio and premium pricing of our residential projects.

Property Development and Sales

For the year under review, the Group completed properties for sale with a total saleable GFA of 229,000 sq.m. that comprised:

All GFA figures are in sq.m. rounded to the nearest thousand

Project	Total GFA	Residential GFA	Office GFA	Other* GFA	Group's interest
Shanghai Taipingqiao Lot 114 ("Lakeville Regency")	136,000	127,000	—	9,000	69%
Shanghai Rui Hong Xin Cheng Phase 2 (Blocks 15 & 16)	31,000	31,000	—	—	99%
Shanghai Knowledge and Innovation Community R1	71,000	41,000	30,000	—	70%
Total GFA	**238,000**	**199,000**	**30,000**	**9,000**	
Less: Non-Saleable GFA	(9,000)	—	—	(9,000)	
Total Saleable GFA	**229,000**	**199,000**	**30,000**	**—**	

** Other includes GFA from clubhouse, which is not for sale.*

Saleable GFA completed and unsold as of 1 January 2006 was approximately 16,000 sq.m. As such, the total GFA available for sale in 2006 was 245,000 sq.m.

Turnover from property sales was RMB 4,283 million in 2006, representing approximately 123,000 sq.m. of GFA. The majority of our 2006 property sales were derived from Lakeville Regency, phase 2 of our Shanghai Taipingqiao project and from our Shanghai Rui Hong Xin Cheng project which is located in Hongkou.

An analysis of our GFA sold and our average selling prices in 2006 is set out below:

All GFA figures are in sq.m. rounded to the nearest thousand

Project	Date completed	Total GFA sold (sq.m.)	Average selling price (RMB/sq.m.)	Group's interest
Shanghai Taipingqiao Lot 114 ("Lakeville Regency")	Sept 2006	74,000	50,000	69%
Shanghai Rui Hong Xin Cheng Phase 2	Sept 2006	44,000	16,000	99%
Shanghai Knowledge and Innovation Community R1	Aug 2006	5,000	16,000	70%
Total		**123,000**		

Lot 113 of our Shanghai Taipingqiao project and the first phases of our Chongqing Tiandi and Wuhan Tiandi projects are currently under construction. We expect pre-sale and leasing activities to commence towards the end of 2007 or early 2008.

The Chongqing Tiandi project is a city-core development, situated on the south bank of Jialing River, with an expected total leasable and saleable GFA of approximately 2.8 million sq.m. upon completion. It comprises a large residential area, entertainment and cultural properties, modern high quality office buildings, an exhibition centre and luxury hotels, as well as a man-made lake and is expected to be completed in phases over the next eight years. The Wuhan Tiandi project is also a city-core development project with an expected total leasable and saleable GFA of approximately 1.4 million sq.m. upon completion. The project comprises two main sites and will contain Grade A office buildings, high-end retail facilities and hotels and residential properties, also expected to be completed in phases over the next eight years.

Property Investments

For the year under review, the Group completed investment properties with a GFA of 70,000 sq.m., bringing the Group's total investment properties GFA to 239,000 sq.m. The Group's portfolio of investment properties as at 31 December 2006 comprises:

All GFA figures are in sq.m. rounded to the nearest thousand

Project	Date completed	Total GFA	Office GFA	Retail GFA	Others GFA	Group's interest
Completed prior to 2006						
Shanghai Xintiandi	Aug 2002	57,000	5,000	46,000	6,000	97%
Corporate Avenue (Lot 110)	Mar 2004	83,000	76,000	7,000	—	99%
Shanghai Rui Hong Xin Cheng Phase 2 Commercial Complex, North Building	Sept 2004	30,000	—	25,000	5,000	99%
Hangzhou Xihu Tiandi Phase 1	May 2003	6,000	—	5,000	1,000	100%
Sub-total		**176,000**	**81,000**	**83,000**	**12,000**	
Completed in 2006						
Shanghai Rui Hong Xin Cheng Phase 2 Commercial Complex, South Building	Sept 2006	3,000	—	3,000	—	99%
Shanghai Knowledge and Innovation Community R1	Aug 2006	15,000	8,000	7,000	—	70%
Shanghai Knowledge and Innovation Community Hub 1	Nov 2006	52,000	29,000	23,000	—	70%
Sub-total		**70,000**	**37,000**	**33,000**	**—**	
Total investment property GFA		**246,000**	**118,000**	**116,000**	**12,000**	
Less: Non-leasable GFA*		(7,000)	—	—	(7,000)	
Total leasable GFA as at 31 December 2006		**239,000**	**118,000**	**116,000**	**5,000**	

** Represented by clubhouse which is not for sale nor for lease*

As at 31 December 2006, the occupancy rates of our investment properties were as follows:

Project	Occupancy rate
Shanghai Xintiandi	94%
Corporate Avenue	98%
Shanghai Rui Hong Xin Cheng Phase 2 Commercial Complex	86%
Shanghai Knowledge and Innovation Community R1	9%
Xihu Tiandi Phase 1	98%

Rental income from our investment properties in 2006 was RMB 358 million, representing an increase of RMB 24 million or approximately 7% over 2005, primarily due to an increase in average rental rates for Corporate Avenue and Shanghai Xintiandi.

Shanghai Xintiandi

Shanghai Xintiandi is a portion of Phase 1 of the entire Shanghai Taipingqiao redevelopment area, and is a mixed-use property development project located at the city centre of Shanghai. It has been developed as a low density commercial, residential, entertainment and cultural complex. Shanghai Xintiandi is an award winning historic zone, which has been opened since 2001, and was fully completed in 2002. Shanghai Xintiandi has become popular with both locals and visitors. It also features a boutique hotel (88 Xintiandi). During 2006, we achieved 94% occupancy in Shanghai Xintiandi, with a long waiting list of potential tenants.

Corporate Avenue

Completed in March 2004, Corporate Avenue is the first phase of the Shanghai Taipingqiao corporate headquarters zone and is located overlooking Taipingqiao Lake. The development comprises a 3-storey commercial building and two premium Grade A office towers, both rising above a common 2-storey commercial podium and a 2-level basement, which accommodates car parking spaces and other building facilities.

Shanghai Rui Hong Xin Cheng commercial complex

The commercial complex is located in Phase 2 of Shanghai Rui Hong Xin Cheng, an upper-middle neighbourhood, and is directly connected to a metro station. It includes a 3-level shopping complex and a 2-level commercial podium situated beneath the residential blocks.

Shanghai Knowledge and Innovation Community

Newly opened in 2006, the Shanghai Knowledge and Innovation Community is located close to 17 universities and colleges in the northeast of downtown Shanghai. Shanghai Knowledge Innovation Community is designed to inspire innovation and entrepreneurship, supported by retail, entertainment and sporting facilities to create a “study, live, work and play” lifestyle. Construction of Hub 1 of Shanghai Knowledge and Innovation Community was completed in November 2006 and potential tenants have signed letters of intent indicating that a satisfactory occupancy rate can be achieved in 2007.

Xihu Tiandi

Set in a park on the renowned West Lake in Hangzhou, Xihu Tiandi is another historic restoration project that is similar to Shanghai Xintiandi. Phase 1 of the project comprises 10 retail blocks and amenities completed in May 2003.

Landbank

Landbank includes properties under relocation, planning and construction. They represent projects for which the Group has entered into a legally binding master agreement or similar arrangement with, or which we have been awarded following a competitive tender by the relevant regulatory authorities.

As at 31 December 2006, the Group's landbank amounted to approximately 8.4 million sq.m. of GFA located in four cities, namely Shanghai, Chongqing, Wuhan and Hangzhou. Of that amount, the Group's saleable and leasable area amounted to approximately 6.5 million sq.m. of GFA. This is sufficient for the Group's development plans up to 2015. This area together with our approximately 0.4 million sq.m. of completed and unsold properties and approximately 1.5 million sq.m. of open areas and other public facilities render a total GFA of approximately 8.4 million sq.m.

The table below sets out the GFA information on the Group's total saleable and leasable area, which excludes open areas and other public facilities, as at 31 December 2006:

All GFA figures are in sq.m. rounded to the nearest thousand

		Landbank		Completed properties			
Project	**Total GFA**	**Leasable GFA**	**Saleable GFA**	**Leasable GFA**	**Unsold Saleable GFA**	**Clubhouse GFA**	**Group's Interest**
Shanghai Taipingqiao	1,017,000	474,000	336,000	139,000	53,000	15,000	69%, 97%, & 99%*
Shanghai Rui Hong Xin Cheng	1,080,000	181,000	860,000	28,000	3,000	8,000	99%
Shanghai Knowledge and Innovation Community	518,000	193,000	189,000	67,000	66,000	3,000	70%
Chongqing Tiandi	2,849,000	1,314,000	1,526,000	—	—	9,000	79.4%
Wuhan Tiandi	1,406,000	680,000	725,000	—	—	1,000	100%
Xihu Tiandi	52,000	46,000	—	5,000	—	1,000	100%
Total	**6,922,000**	**2,888,000**	**3,636,000**	**239,000**	**122,000**	**37,000**	

* *We have a 69.3% interest in our development of Lakeville Regency, a 97% interest in Shanghai Xintiandi and a 99% interest in the remaining lots within the Shanghai Taipingqiao project, except for Lot 116, in which we have a 98% interest.*

In response to the market opportunities and development in China, it is our strategy to continue to increase our landbank in prime locations to accelerate our growth. As mentioned in the Initial Public Offering ("IPO") prospectus, we signed an agreement in July 2006 with the Kunming municipal government to collaborate to research and determine the feasibility in the redevelopment of the northern Caohai district of Kunming. The identified site, with a mixed use of entertainment, cultural, live, work and other facilities, is approximately 4 square kilometers in size and is adjacent to the current city centre, the famous Dianchi Lake, and surrounding the Daguan Park. According to our proposed master plan, the project will have an expected GFA of approximately 2.5 million sq.m. upon completion, subject to change and approval.

In November 2006, we also announced plans to acquire development rights to a piece of land in Yangpu district, Shanghai (also known as Plot A of Lot 24), with an aggregate above ground GFA of approximately 137,400 sq.m. for office and commercial use, through the acquisition of a local company.

If we are successful in acquiring the development rights to the above-mentioned projects, the Group's property portfolio is expected to grow from 8.4 million sq.m. to 11.0 million sq.m., representing an increase of approximately 2.6 million sq.m. or 31%.

In addition, we have received recently an invitation from Shui On Company Limited to participate in a joint venture development of the Dalian Software Park Phase 2, a large-scale city-core development in Dalian. This will cater for the software outsourcing industry, a sector identified by the Dalian Municipal Government as an economic priority for the city. The project will have an expected GFA of approximately 3.9 million sq.m. upon completion, subject to change and approval. We are currently evaluating this investment opportunity. The Group is contemplating a non-controlling interest if it decides to participate, although it is expected that the Group will be the largest single shareholder in the company that owns the project.

Accelerate Growth Through Strategic Partnership

In 2006, we sold a 19.8% interest in our Chongqing Tiandi project to two strategic partners for an aggregate consideration of RMB 1,007 million. As a result of this, a gain of RMB 582 million has been reported and is included in the Group's profit in 2006. By seeking opportunities to enter into strategic partnerships with investors, the Company has been able to accelerate capital for other investment opportunities. It has also helped to share the overall risk involved in developing large-scale projects.

We will continue to forge strategic partnership with other developers, contractors, consultants and other investors with a view to realising the value of our existing sites held for future development at an early stage should the opportunity arise. Whenever we develop good working relationships, in a particular project in a particular city, we intend to replicate that relationship, to the extent commercially feasible, in our other projects that we have in the same city or elsewhere, thereby also enhancing our operational efficiency.

Outlook

In 2006, the PRC Government introduced a series of macro control policies designed to stabilize the real estate market with particular focus on the residential sector. China's plan, however, for continuing rapid economic development will continue to further transform and develop its cities (approximately 20 of which have a population of more than five million people). The continued development of its cities should generate significant economic value for China and opportunities for well capitalized and proven property companies such as Shui On Land. We believe an integral part of the transformation of these cities into modern commercial service centres will depend upon efficient innovative master planning of land utilisation. Our business model, built upon large scale master planned development projects, position us to benefit from the expected emergence of modern cities in China. We are one of the few leading property developers with experience in managing large-scale, complex, long term projects in China. We are also one of the few companies that hold a quality portfolio of the properties that we have developed as strategic, long-term investments. We believe that Shui On Land is well positioned to increase the scale of its operations by leveraging on our master planning expertise, if and when we feel the right opportunity presents itself. As such, the Group intends to grow by acquiring further landbank in the manner that is set out below in the section headed "Future Plans for Material Investments, Capital Assets and Sources of Funding".

The Company has been selected as a constituent of the Morgan Stanley Capital International ("MSCI") Standard Index Series and Global Growth Index Series in February 2007 and also as a constituent of both the 200-Stock Hang Seng Composite Index and the Hang Seng Freefloat Index Series in March 2007.

Financial Review

Turnover and Operating Results

Turnover increased significantly by 3.6 times to RMB 4,729 million (2005: RMB 1,018 million), primarily due to an increase in the level of property sales.

Gross profit increased significantly by 3.3 times to RMB 2,984 million (2005: RMB 691 million). Gross margin was 63% for 2006 as compared to 68% in 2005. Sufficient provision for Land Appreciation Tax has been made and included in cost of sales.

Other income increased to approximately RMB 256 million (2005: approximately RMB 102 million) due largely to exchange gains from our foreign currency bank loans as a result of Renminbi appreciation in 2006 and an increased in interest income as a result of an increased level of deposits with banks after our IPO.

Staff costs increased to approximately RMB 146 million in 2006, compared to approximately RMB 78 million in 2005, due to an increased headcount and general salary increment.

Other expenses increased to approximately RMB 512 million in 2006 from approximately RMB 252 million in 2005. The increase includes professional fees of approximately RMB 151 million that had been incurred in relation to the listing of the shares on the Hong Kong Stock Exchange in 2006. In addition, we have incurred a higher level of sales and marketing expenses in promoting our residential properties in Shanghai, namely Lakeville Regency which is located in our Shanghai Taipingqiao project; phase 1 of our Shanghai Knowledge and Innovation Community project; and phase 2 of our Shanghai Rui Hong Xin Cheng project.

Finance costs increased by 31% to approximately RMB 219 million in 2006 from approximately RMB 167 million in 2005 due to an increase in the average level of borrowings in 2006 related largely to the issuance of notes towards the end of 2005.

Taxation increased to approximately RMB 946 million in 2006 (2005: approximately RMB 332 million) in line with the increase in profits from property sales.

Earnings per share increased by 1.2 times to RMB 48 cents in 2006 from RMB 22 cents in 2005.

Capital Structure, Gearing Ratio and Funding

As at 31 December 2006, our utilised project loans, mortgage loans and notes amounted to approximately RMB 6,477 million (2005: RMB 9,583 million) and our shareholders' equity was approximately RMB 13,592 million (2005: RMB 4,756 million).

The structure of our borrowings as at 31 December 2006 is summarised below:

	Currency denomination	Total (in RMB equiv) RMB million	Due within one year RMB million	Due more than one year but not exceeding two years RMB million	Due more than two years but not exceeding five years RMB million
Bank Loans	RMB	1,532	1,462	—	70
	HKD	2,183	221	287	1,675
Notes	USD	2,762	—	2,762	—
Total		**6,477**	**1,683**	**3,049**	**1,745**

Our cash and bank deposits amounted to RMB 5,654 million as at 31 December 2006 (2005: RMB 2,398 million), which included RMB 1,202 million (2005: RMB 409 million) of deposits pledged to banks. The increase in cash balance during the year was due mainly to (i) the net proceeds raised from the issue of shares under the IPO; (ii) proceeds from the sale of our residential units at Lakeville Regency and phase 2 of our Shanghai Rui Hong Xin Cheng project; (iii) rental income from our investment properties; and (iv) sale of equity interests in subsidiaries to strategic partners.

The Group's net gearing ratio was 5% as at 31 December 2006 (calculated on the basis of dividing the excess of the sum of bank loans and notes payable over the sum of bank balances and cash by total equity).

Total undrawn banking facilities available to the Group were approximately RMB 2,560 million as at 31 December 2006. We will continue to adopt a prudent financial policy so as to sustain an optimal level of borrowings to meet our funding requirements. Our low gearing ratio provided us with ample capacity for leverage to fund future growth. Adequate banking facilities are arranged at the group level to support the funding requirements of all group entities. New banking facilities are being obtained at competitive pricing and terms on a timely basis to match business needs and/or to refinance our existing facilities.

Application of Net IPO Proceeds

In October 2006, the Company issued a total of 671,874,600 shares at HK$5.35 each for total gross proceeds of HK$ 3,595 million. The international tranche of the IPO was approximately 17 times over-subscribed and the HK public tranche was 12 times over-subscribed.

The net proceeds from the IPO were approximately HK$ 3,302 million, after deduction of related expenses. We have utilised our net proceeds from the IPO in the manner contained in the Company's prospectus dated 20 September 2006 under the section headed "Use of Proceeds". As such, the net proceeds utilised as at 31 December 2006 was as follows:

Use of Proceeds	Net IPO Proceeds (HK$ millions)		
	Available	**Utilised**	**Unutilised**
Existing projects – being Shanghai Taipingqiao, Shanghai Rui Hong Xin Cheng, Shanghai Knowledge and Innovation Community, Chongqing Tiandi and Wuhan Tiandi	1,864	915	949
Future project funding	445	—	445
General corporate purposes	993	143	850
Total	**3,302**	**1,058**	**2,244**

Future Plans for Material Investments, Capital Assets and Sources of Funding

We intend to continue growing organically by pursuing more property development projects, particularly city-core development projects and integrated residential development projects and to continue to promote our geographic diversification by undertaking projects in appropriate regions in new cities.

We actively screened cities in different regions of China to identify suitable locations for our projects and are continually exploring new opportunities. Out of the cities that we have screened in the PRC, we have provisionally identified eight cities (including Kunming and Dalian) as preferred locations for future projects. We currently have no definitive plan for any such projects. The timing and priority of the cities where such developments might take place has not yet been determined.

We may also pursue other plans, including other ways of acquiring land development rights for the purpose of undertaking property projects, or other ways to increase the scale of our operations by leveraging on our master planning expertise, if we feel the right opportunity presents itself. In addition, we will, in appropriate cases, consider other opportunities to participate in projects of various scale where we can leverage our competitive strengths. While our primary focus is on city-core and integrated residential development projects, our track record, good relationships with business partners and well established reputation may give rise to such other opportunities.

In 2006, the Group has entered into the following land acquisitions:

(i) Chongqing Tiandi: The Group acquired phase 3 of this project on 31 December 2006 for a consideration of RMB 1,134,540,000, consisting of land transfer fee, master planning fee and land cost. The site is approximately 333,100 sq.m. in size with an aggregate GFA of approximately 535,400 sq.m. for the development of commercial and residential spaces as well as for other purposes.

(ii) Yangpu Lot 24, Plot A: The Shanghai Knowledge and Innovation Community project has enjoyed positive market response since it was launched. To further consolidate our Shanghai Knowledge and Innovation Community's position as a major centre in the Yangpu district, we have entered into a sale and purchase agreement to acquire a local company that has the right to develop a site known as Lot 24, Plot A. It has a GFA of up to 137,400 sq.m. The Company believes that the purchase of Lot 24, Plot A, will enhance our Shanghai Knowledge and Innovation Community's scale and also satisfy the increasing office demand in the Yangpu area.

Material investments will be funded, in the main, by using a combination of the proceeds from the IPO, project construction loans and mortgage and other loans, and cash provided by operating activities, including from the rental, sale and pre-sale of properties and additional offerings of equity securities, as appropriate.