Financial Review

Shanghai Taipingqiao Project

Profit attributable to Company's shareholders for 2008 was RMB2,480 million, a slight increase of 1% when compared to 2007 (2007: RMB2,462 million).

FINANCIAL REVIEW

Turnover decreased by 22% to RMB3,556 million (2007: RMB4,570 million), primarily due to the drop in property sales in the second half of the year.

Property sales decreased by 28% to RMB2,939 million (2007: RMB4,085 million). During the year, the Group sold a total of 907 units or 85,100 sq.m. (2007: 951 units or 138,000 sq.m.). Details of the property sales during the year are all contained in the paragraph headed "Property Sales" in the Business Review Section referred to above.

Property investment turnover increased by 25% to RMB593 million (2007: RMB474 million), benefitting from increases in the average rental rates in Shanghai Xintiandi and Shanghai Corporate Avenue as well as increases in occupancy rates at Shanghai Knowledge and Innovation Community and Wuhan Tiandi since many new tenants commenced their leases towards the end of 2007.

Gross profit for the year ended 31 December 2008 was RMB2,032 million (2007: RMB2,685 million) and the gross margin was 57% (2007: 59%). The slightly reduced gross margin in 2008 was due mainly to a lower gross margin from the sales of Casa Lakeville (Shanghai Taipingqiao, Lot 113) in 2008 against the comparatively higher gross margin from the sales of Lakeville Regency (Shanghai Taipingqiao, Lot 114) in 2007, both of which were the key contributors to gross profit for the respective years.

Other income increased by 27% to RMB342 million (2007: RMB269 million) largely attributable to tax refunds from reinvestment of dividends and grants received from certain local government authorities totalling RMB109 million.

Selling and marketing expenses increased by 18% to RMB134 million (2007: RMB114 million) due to more projects were launched for sale in 2008.

In 2008, *general and administrative expenses* increased by 25% to RMB697 million (2007: RMB556 million) due to higher employee benefits expenses and a higher level of professional and consulting fees that were required for the Group's business expansion. The increase in employee benefits expenses included share compensation costs of RMB54 million (2007: RMB36 million) in respect of share options granted to staff so far and the effect of an increase in the number of average headcount to 1,250 for the year 2008 (2007: 1,031).

Operating profit decreased by 32% to RMB1,543 million (2007: RMB2,284 million) due to the various items referred to above.

Increase in fair value of investment properties gave rise to a gain of RMB382 million in 2008 (2007: RMB577 million).

Details of the *gains on partial disposal of equity interests in subsidiaries* are all contained in the paragraph headed "Accelerate Growth through Strategic Partnerships" in the Business Review Section referred to above.

Finance costs, net of exchange gain amounted to RMB133 million (2007: RMB125 million), which comprised mainly interest expenses of RMB824 million (2007: RMB458 million) less amount capitalised to properties under development of RMB618 million (2007: RMB358 million). The increase in interest expenses was mainly the result of a higher level of bank borrowings, which as of 31 December 2008 amounted to RMB8,198 million (31 December 2007: RMB4,405 million). In addition, finance costs include fair value change on cross currency interest rate swaps of RMB242 million (2007: RMB188 million). The increase in the finance costs was partly offset by an exchange gain of RMB343 million (2007: RMB197 million) arising from the appreciation of RMB against HK dollar and US dollar in relation to the Group's bank borrowings that are denominated in HK dollar and US dollar.

Profit before taxation increased slightly by 1% to RMB3,719 million (2007: RMB3,687 million) as a result of the various items described above.

Taxation was RMB977 million (effective tax rate: 26%) for the year 2008 as compared to RMB820 million (effective tax rate of 22%) for 2007. The increase in the effective tax rate was due largely to the PRC Land Appreciation Tax of RMB539 million (2007: RMB224 million), which included additional provision of RMB270 million that has been made and charged against the consolidated income statement for the year ended 31 December 2008. That in turn resulted in adjustments to the allocation of certain public facilities costs as development costs among the various property development companies incorporated in the PRC that undertake the development of the various phases of our Shanghai Taipingqiao project. The revised cost allocation has been accepted by the relevant local tax bureau in the recent income tax filings.

Furthermore, the lower effective tax rate for the year ended 31 December 2007 reflected a non-recurring deferred tax credit adjustment of RMB343 million being recognised. As a result of the enactment in March 2007 of the new Corporate Income Tax Law of the PRC, enterprises were subjected to a uniform income tax rate of 25% with effect from 1 January 2008. To reflect this change in the tax rate from 33% to 25%, the carrying value of the deferred tax liabilities as of 31 December 2007 was written down by RMB343 million and credited to the consolidated income statement for the year then ended.

Profit attributable to shareholders of the Company for the year ended 31 December 2008 was RMB2,480 million, a slight increase of 1% when compared to 2007 (2007: RMB2,462 million).

The effects on profit attributable to shareholders of the change in fair value of the Group's investment properties, net of related tax effect, and fair value change of derivative financial instruments are as follows:

	2008 RMB'million	2007 RMB'million	% change
Profit attributable to shareholders of the Company	**2,480**	2,462	+1%
Revaluation increase on investment properties (net of deferred tax effect and share of minority interest)	**(279)**	(419)	
Loss on change in fair value of derivative financial instruments	**13**	17	
Profit attributable to shareholders of the Company before (i) revaluation of investment properties; and (ii) fair value adjustment on derivative financial instruments	**2,214**	2,060	+7%

Earnings per share were RMB0.59 calculated based on a weighted average of approximately 4,186 million shares in issue during the year (2007: RMB0.59 calculated based on a weighted average of approximately 4,185 million shares in issue).

CAPITAL STRUCTURE, GEARING RATIO AND FUNDING

During the year, the notes were redeemed by using internal resources and borrowings at market lending rates. As of 31 December 2008, the Group's utilised bank borrowings amounted to approximately RMB8,198 million (31 December 2007: RMB7,072 million, including the notes of RMB2,667 million), of which RMB7,493 million were secured debts and RMB705 million were unsecured debts (31 December 2007: RMB3,843 million and RMB3,229 million, respectively).

The structure of the Group's bank borrowings as of 31 December 2008 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	Due more than five years RMB'million
Secured	RMB	1,794	462	576	407	349
	US$	750	750	–	–	–
	HK$	4,949	36	974	3,939	–
Unsecured	HK$	705	705	–	–	–
Total		**8,198**	**1,953**	**1,550**	**4,346**	**349**

Total cash and bank deposits amounted to RMB3,380 million as of 31 December 2008 (2007: RMB3,697 million), which included RMB1,709 million (31 December 2007: RMB854 million) of deposits pledged to banks. The decrease in our cash balance was due mainly to the redemption of notes which matured in October 2008, capital injections for DALIAN TIANDI.software hub and payments of land costs for Foshan Tiandi, partially offset by the drawdown of new bank loans and the proceeds from property sales as well as the proceeds received from transfers of equity interests to strategic partners.

As of 31 December 2008, the Group's net debt balance was RMB4,818 million (31 December 2007: RMB3,375 million) and its total equity was RMB19,164 million (2007: RMB16,706 million). Accordingly, the Group's net gearing ratio was approximately 25% as of 31 December 2008 (2007: 20%), calculated on the basis of dividing the excess of the sum of bank loans over the sum of bank balances and cash by total equity.

The Group's rental income during the year ended 31 December 2008 expressed as a percentage of the Group's total interest costs before capitalisation to property under development was approximately 60% (2007: approximately 88%).

Total assets of the Group amounted to RMB35.1 billion (31 December 2007: RMB29.9 billion). The Group's secured debts to total assets ratio as of 31 December 2008 was 21% (31 December 2007: 13%). The total assets have not reflected the increase in the valuation of our landbank with the exception of investment properties that are being carried at independent valuations. During the three years ended 31 December 2008, the Group has sold equity interests in certain of our projects to strategic partners. In 2006, a 19.8% interest in Chongqing Tiandi was sold which resulted in a gain of RMB582 million. In 2007, a 25% interest in Wuhan Tiandi and a 49% interest in Lot 116 of Shanghai Taipingqiao were sold, giving rise to a gain of RMB480 million and RMB364 million, respectively. In 2008, the sale of a 25% interest in Shanghai Rui Hong Xin Cheng and 25% equity interest in Rightchina Limited in relation to Chongqing Super High Rise resulted in a gain of RMB862 million and RMB819 million (RMB1,021 million net of share of minority interests of RMB202 million) respectively. All of these transactions were based on arm's length negotiations and, therefore, reflect the valuations ascribed to between a willing buyer and a willing seller. If we adjust the valuation of our landbank as of 31 December 2008 to that of the transacted values of each of these projects, the Group's adjusted total assets would have increased to RMB49.7 billion; and the ratio of secured debts to adjusted total assets would have been reduced to 15% as of 31 December 2008.

Total undrawn banking facilities available to the Group were approximately RMB340 million as of 31 December 2008 (31 December 2007: RMB1,718 million). Subsequent to 31 December 2008, Shui On Group and Agricultural Bank of China ("ABC") signed a Memorandum of Understanding for a three-year loan facility up to RMB13 billion. According to this, ABC will provide part of the facilities to Shui On Land and its subsidiaries up to RMB8 billion for property development, subject to the formal approval by ABC. In addition, the Bank of China ("BOC") has offered a letter of intent for granting a RMB4 billion medium to long term loan facility for the development of our Foshan project. These collaborations with ABC and BOC will help the Group to further strengthen the Group's financial capability to expand our business and to create more values for investors and customers.

PLEDGED ASSETS

As of 31 December 2008, the Group had pledged certain land use rights, completed properties for investment and sale, properties under development, accounts receivable and bank and cash balances totalling RMB14,015 million (31 December 2007: RMB11,663 million) to secure our borrowings of RMB7,493 million (31 December 2007: RMB3,843 million).

CAPITAL AND OTHER DEVELOPMENT RELATED COMMITMENTS

As of 31 December 2008, the Group had contracted commitments for development costs and capital expenditure in the amount of RMB5,418 million (31 December 2007: RMB5,065 million).

In addition, the Group entered into a Confirmation Agreement with the Land Exchange Centre confirming the Group's successful bid for a plot of land in Foshan. Under this Confirmation Agreement, a total consideration for acquiring the land use rights is RMB7,510 million, against which RMB2,864 million has been paid to the Land Exchange Centre up to 31 December 2008. The remaining balance of RMB4,646 million will be paid in stages in line with relocation progress (2007: the Group has made a refundable deposit amounting to RMB1,200 million).

The Group has agreed to provide further funding to the associates formed for the development of DALIAN TIANDI. software hub project, whereby the Group will ultimately hold a 48% effective interest. As of 31 December 2008, the Group has issued guarantees amounting to RMB 528 million (2007: RMB285 million) to banks in respect of banking facilities granted to the associates, in which the associates have drawn down bank loans amounting to RMB480 million (2007: RMB250 million). In addition, the Group had commitment to provide further funding to the associates amounting to approximately RMB121 million (31 December 2007: nil).

The Group has also committed to building certain educational facilities to be located in the Taipingqiao area of the Luwan District as compensation for the removal of educational facilities originally located in the area. As of 31 December 2008, the Group had not entered into any construction contracts relating to such educational facilities (2007: nil).

FUTURE PLANS FOR MATERIAL INVESTMENTS AND SOURCES OF FUNDING

We will continue focus on the development of our existing landbank which is located in prime locations. While our primary focus is on city-core development projects and integrated residential development projects, we will, in appropriate cases, consider other opportunities to participate in projects of various scale where we can leverage our competitive strengths. 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.

Material investments will be funded, in the main, by using a combination of project construction loans, mortgage and other loans, and cash provided by operating activities, including from the rental, sales and pre-sales of properties, and proceeds from sale of equity interests in our projects to strategic partners, as appropriate.

CASHFLOW MANAGEMENT AND LIQUIDITY RISK

The management of cashflow in the Group is the responsibility of the Group's treasury function at the corporate centre based in Shanghai.

Our objective is to maintain a balance between continuity of funding and flexibility through a combination of internal resources, and bank and other borrowings, where appropriate. We are comfortable with our present financial and liquidity position and will continue to maintain a reasonable liquidity buffer to ensure sufficient funds are available to meet liquidity requirements at all time.

EXCHANGE RATE AND INTEREST RATE RISKS

The turnover of the Group is denominated in Renminbi. A portion of the turnover, however, is converted into other currencies to meet the foreign currency denominated debt obligations, such as the bank borrowings denominated in Hong Kong dollars and the notes denominated in US dollars. As a result, the Group is exposed to fluctuations in foreign exchange rates.

In December 2006 and January 2007, the Group had entered into cross currency interest swaps to hedge against the variability of cash flows arising from the fluctuation of currency in relation to the notes previously issued by the Group. The terms of the cross currency interest swap have been negotiated to match the terms of the notes, whereby the Group received interest at a fixed rate of 8.5% per annum based on notional amount of US$375 million, paid interest at a fixed rate of 5.2% per annum and exchanged the principal at maturity whereby the Group would receive US$375 million and pay RMB2,931 million. In April 2008, the cross currency interest rate swap was terminated early. The residual hedge reserve of RMB138 million, which mainly represented the fair value loss arising from the cross currency interest rate swap, was recognised in the consolidated income statement against exchange gain upon the maturity of the notes in October 2008.

Considering that a relatively stable currency regime with regard to the Renminbi is maintained by the PRC Government which only allows the exchange rate to fluctuate within a narrow range going forward, the Group expects that the fluctuation of the exchange rates between Renminbi, Hong Kong dollars and US dollars may not be significant.

The Group's exposure to cash flow interest rate risk results from fluctuation in interest rates. Most of the bank borrowings of the Group consist of variable rate debt obligations with original maturities ranging from two to four years for project construction loans; and two to ten years for mortgage loans. Increase in interest rates would increase interest expenses relating to the outstanding variable rate borrowings and increase the cost of new debt. Fluctuations in interest rates can also lead to significant fluctuations in the fair value of the debt obligations.

In December 2007 and April 2008, the Group has refinanced two mortgage loans that bear variable interests which were linked to Hong Kong Inter-bank Borrowing Rate. Pursuant to the loan agreements of these mortgage loans, the Group is required to hedge against the variability of cash flows arising from the interest rate fluctuations. Accordingly, during the year, the Group has entered into interest rate swaps in which the Group would receive interests at variable rates at Hong Kong Inter-bank Borrowing Rate and pay interest at fixed rates ranging from 3.32% to 3.58% based on the notional amounts of HK$4,581 million in aggregate.

Save as disclosed above, the Group did not hold any other derivative financial instruments as of 31 December 2008. In view of the increasing market volatility, the Group is closely monitoring its exposure to interest rate and exchange rate risks. If there is a need to further employ derivative financial instruments to hedge against the risks exposed, the Group will carefully assess the effectiveness of these instruments and the credit worthiness of the counter party.