Management Discussion and Analysis

FINANCIAL OVERVIEW

The consolidated revenue of the Group for 2005 was HK$5,249 million (2004: HK$5,109 million), an increase of 2.7% as compared with last year.

The consolidated net profit attributable to shareholders of the Group for 2005 amounted to HK$1,303 million (2004: HK$896 million (restated)), a significant increase of HK$407 million or 45.5%. The increase was mainly attributable to increases in the revenue from water distribution of HK$74 million (an increase of 2.4%), the retail and shopping mall operations of Teemall of HK$147 million (an increase of 12.3%), as well as the hotel operations and management of HK$35 million (an increase of 16.2%). The revenue from the electric power generation business has however dropped by HK$131 million (a decrease of 24.5%). With the early repayment effected by the Group for some of its debts, the total borrowings decreased and the finance cost for the year decreased by HK$44 million when compared with last year. As a major portion of the Company's floating rate loans has already been hedged, although interest rates are currently in an upward trend, rising interest rates had little impact on the Group's financials.

During the year, an increase in fair value of investment properties of HK$67.3 million (2004: HK$38.2 million) and a write-back of the Group's provision for impairment of a contractual joint venture of HK$54.8 million (2004: a write-back of provision for impairment of interests in jointly controlled entities of HK$24.8 million) were credited to the consolidated income statement for the year. Besides, there was an impairment of property, plant and equipment of HK$0.3 million during the year (2004: HK$113.7 million).

With the adoption of the new and revised HKFRSs as from 1 January 2005, an additional net gain of HK$18.2 million has been credited to the consolidated net profit attributable to shareholders of the Group.

The earnings before interest, tax, depreciation and amortization ("EBITDA") for 2005 increased by 11.0% to HK$3.43 billion (2004: HK$3.09 billion (restated)).

The basic earnings per share were 22.69 HK cents (2004: 16.00 HK cents (restated)), representing an increase of 41.8% as compared with 2004.

BUSINESS OVERVIEW

A summary of the performance of the Group's major businesses during the year under review is as follows:

Water Distribution

Profit contribution from the Dongshen Water Supply Project remained significant to the Group. The Group's effective interest in the Dongshen Water Supply Project has increased by 3.48% to 86.34% during the year. The planned annual capacity of water supply is 2.423 billion cubic meters.

The total water sales to Hong Kong, Shenzhen and Dongguan during the year amounted to 2.05 billion cubic meters, an increase of 2.8% over last year in terms of volume and HK$3.19 billion, an increase of 2.4% in terms of revenue.

BUSINESS OVERVIEW (continued)

Water Distribution (continued)

The volume and price of water sales to Hong Kong has remained the same as last year. In going forward, Hong Kong Water Supply Agreement for 2006 to 2008 has recently formally concluded between the Government of Hong Kong Special Administrative Region and the Guangdong Provincial Government. According to the new agreement, the total annual fixed amount for the water sales to Hong Kong is HK$2,494,800,000. As compared with the total annual revenue for the Hong Kong water sales for respectively 2004 and 2005, there will be a slight decrease of HK$34,900,000. The Guangdong Provincial Government has already undertaken that the revenue to the Group from its Hong Kong water sales will not fall below the 2004 level as a result of any adverse impact of the new agreement. The Guangdong Provincial Government will therefore provide financial subsidies to the Group and the annual amount of such subsidies will definitely be not less than the annual shortfall as aforesaid. The Company is at present following up with the Guangdong Provincial Government on the implementation of the subsidy arrangements on the basis of the water tariff arrangement as stipulated under the previous Hong Kong Water Supply Agreements. The Company will issue a press announcement as soon as all the details of the subsidy arrangements have been worked out.

The water sales volume to Shenzhen and Dongguan increased by 4.7% to 1,225 million cubic meters (2004: 1,170 million cubic meters). In 2004, Guangdong had its worst drought in 15 years and as a result both Shenzhen and Dongguan had to rely very heavily on the Dongshen Water Supply Project to meet their water supply requirements. In 2005, however, because of the unusual heavy rainfall, Shenzhen and Dongguan were less reliant upon our water supply. Also the steps taken by the Shenzhen municipal government to clear many of the unauthorized buildings, had the effect of dispersing the population which in turn slowed down the growth in water demands. These are the reasons why the growth of our water sales to these two regions was not as marked as in 2004.

Benefiting from not only an increase in water tariffs for Shenzhen and Dongguan that came into effect in October 2004 but also the addition of new customers, the water sales revenue to these two regions during the year have increased by 12.6% as compared to last year. The prices of our water sales to the different districts of Shenzhen and Dongguan has been increased further since January 2006, which increases range from 0 to 20% depending on the location of the district.

The profit attributable to the Group from the water distribution business for the year under review (excluding the unrealized gain of HK$96,396,000 on interest rate swap agreements that did not qualify as hedging transactions for accounting purposes) was HK$718,846,000 (2004: HK$647,474,000), 11.1% higher than last year. The EBITDA of the water distribution business for the year amounted to HK$2,695,417,000 (2004: HK$2,591,478,000), 4% higher than last year.

BUSINESS OVERVIEW (continued)

Water Distribution (continued)

In November 2005, the Group formally contracted with Industrial and Commercial Bank of China (Asia) Limited ("ICBC (Asia)") and Industrial and Commercial Bank of China Limited, Shenzhen Branch ("ICBC (SZ)") as the facility agents to reduce the interest margin of the existing syndicated bank loans of the Group totalling HK$10.7 billion at that time. The interest margin for the HK$9.765 billion outstanding loan due to the ICBC (Asia) syndicate was reduced from HIBOR+1.339% to HIBOR+0.6% and the interest margin for the HK$800 million outstanding loan due to the ICBC (SZ) went down from HIBOR+1% to HIBOR+0.6%. The interest margin reduction is a reflection of the banks' recognition of and confidence in the continual improvement in both the credit worthiness and the prospect of the Group.

The interest margin reduction took effect from 20 November 2005. Based on the outstanding loans totalling HK$10.565 billion as at 31 December 2005, the resulting annualized interest saving would amount to approximately HK$76 million.

Electric Power Generation

Shaoguan Power Plant D ("Shaoguan PPD")

The Group's effective interest in Shaoguan PPD is 45.9% (a 51% owned subsidiary of the Company holding a 90% interest in the project joint venture company). Shaoguan PPD had 2 power units with a total installed capacity of 250 MW. The smaller of those power units with an installed capacity of 50 MW was closed in March 2005 in accordance with the policy of the PRC government for the closing down of small power units. In addition, the other power unit underwent a major repair during the period from late May to early August. As a result, the sales of electricity for the year dropped to 1,127 million kwh (2004: 1,605 million kwh), a decrease of 29.78%. Sales revenue for the year was likewise only HK$403,526,000 (2004: HK$534,250,000), a decrease of 24.47%. Because of the drop in sales and the high coal prices (the average price of standard coal for this power plant has increased by 36.72% in 2005), the loss before tax for the year was HK$43,794,000 (2004: HK$22,124,000). The Group's share of the loss before tax was HK$20,101,000 (2004: HK$10,155,000).

廣東省韶關粵江發電有限責任公司 *(Guangdong Shaoguan Yue Jiang Power Supply Limited) ("Yue Jiang Power Plant")*

Yue Jiang Power Plant is a 25% associate held by Shaoguan PPD. Yue Jiang Power Plant currently has 2 power units with a total installed capacity of 600 MW. Sale of electricity for the year reached 2,804 million kwh (2004: 1,641 million kwh), an increase of 70.87%. Sales revenue for the year reached HK$1,039,241,000 (2004: HK$600,262,000), an increase of 73.13%. The increase in revenue was mainly due to a new power unit with installed capacity of 300 MV coming into operation in July 2005. However, because of a temporary suspension of the operation of a power unit in February and March for special repair and maintenance work and the high coal prices (the average price of standard coal for this power plant has increased by 40.82% in 2005), the growth in earnings for the year was not in pace with the revenue growth. The Group's share of the profit before tax from this associate was HK$5,494,000 (2004: HK$11,729,000).

BUSINESS OVERVIEW (continued)

Electric Power Generation (continued)

Meixian Power Plant

The Group's effective interest in Meixian Power Plant is 12.25% (a 49% associate of the Company, Guangdong Power Investment Limited ("GD Power Investment"), holding a 25% interest in the project joint venture company).

Including the new power unit that has come into operation since October 2004, the Meixian Power Plant has a total of 3 power units with a total installed capacity of 385 MW. Mainly as a result of the additional generating capacity of the said new power unit, sales of electricity by the Meixian Power Plant for the year amounted to 2,531 million kwh (2004: 1,867 million kwh), an increase of 35.57%. Likewise, sales revenue for the year reached HK$898,699,000 (2004: HK$638,093,000), an increase of 40.84%. However, because of the high coal prices (the average price of standard coal for this power plant has increased by 46.38% in 2005), the profit before tax was only HK$77,059,000 (2004: HK$198,342,000), a decrease of 61.15%. During the year, GD Power Investment received dividend income of HK$28,504,000 (2004: HK$50,118,000) from this investment.

There is yet another new power unit with installed capacity of 135 MW that has been commissioned. Construction has already been completed. However, full commercial operation will only be able to commence when all the new approval requirements that have since come into force are also met.

Zhongshan Power Plant

In 1993, the Group through its 95% owned subsidiary, Zhongshan Power (Hong Kong) Limited ("ZPHK"), participated in a contractual joint venture, 中山火力發電廠 ("Zhongshan Power Plant"), with a tenure of 20 years. Agreement has now been reached with the joint venture partner to completely overhaul the terms of the joint venture agreement and the supplemental joint venture agreement formally signed in January 2006. At the same time, the conditional sale and purchase agreement which the Company has entered in 2001 for the disposal of its entire interest in ZPHK and Zhongshan Power Plant but the completion of which transaction never took place had now also been terminated in its entirety. In going forward, Zhongshan Power Plant will be a subsidiary of the Company. Also, provision written back and interest income totalling HK$62 million was credited in connection with Zhongshan Power Plant for the year under review. Zhongshan Power Plant currently has two power units with a total installed capacity of 110MW.

BUSINESS OVERVIEW (continued)

Toll Roads and Bridges

"2 Roads and 2 Bridges"

In 2005, the profit before tax generated by the Group's two 51% jointly-controlled entities (each a "JCE") which hold interests in the "2 Roads and 2 Bridges" project amounted to HK$150,094,000 in aggregate (2004: HK$72,522,000). However, the increase in the profit before tax is to a large extent because after making the provision for impairment of investment in respect of the Guangzhou-Shantou Highway (Huizhou Section) in 2004, no further provision was made in 2005. Operationally, the Humen Bridge recorded growth in traffic flow and performed well during the year while Guangzhou-Shantou Highway (Huizhou Section) and Shantou Haiwan Bridge suffered a drop in traffic flow.

(i) Humen Bridge

A JCE of the Group holds a 30% interest in this project. The Humen Bridge recorded a growth of 9% in traffic flow. The average daily traffic for 2005 increased to 42,820 vehicle trips (2004: 39,171 vehicle trips). Revenue for the year reached HK$633,224,000 (2004: HK$577,395,000), an increase of 10%. This is mainly because the reduction of scheduled ferry service due to bad weather made it necessary for more vehicles to use the bridge and also with private cars becoming a popular means of transport in Humen as a developing city, there was an increase in traffic flow of light vehicles. The profit before tax for the year was HK$313,647,000 (2004: HK$294,351,000), an increase of 7%.

(ii) Shantou Haiwan Bridge

The aforesaid JCE holds a 30% interest in this project. The Shantou Haiwan Bridge recorded a 28% decrease in traffic flow. The average daily traffic for 2005 was 10,273 vehicle trips (2004: 14,170 vehicle trips). The revenue for the year was HK$121,559,000 (2004: HK$153,183,000), a decrease of 21% as compared with that of the last year. This is mainly because the bridge has not been able to take part in the government subsidised annual pass scheme for local commuters. The profit before tax for the year was HK$81,990,000 (2004: HK$101,468,000), a decrease of 19%.

(iii) Guangzhou-Shantou Highway (Huizhou Section)

The aforesaid JCE holds a 51% interest in this project. Mainly as a result of the competition of the Guangzhou-Huizhou Expressway, the Guangzhou-Shantou Highway (Huizhou Section) suffered 5% drop in traffic flow in 2005. The average daily traffic for 2005 was 17,885 vehicle trips (2004: 18,793 vehicle trips). Revenue for the year was HK$65,464,000 (2004: HK$68,834,000), a decrease of 5%. Moreover, mainly because of the increase in road repair and maintenance charges, the profit before tax for the year was only HK$7,797,000 (2004: HK$11,875,000), a decrease of 34%.

BUSINESS OVERVIEW (continued)

Toll Roads and Bridges (continued)

"2 Roads and 2 Bridges" (continued)

(iv) Qinglian Highway

The other JCE of the Group used to hold a 14.18% interest in this project. As reported in the 2004 Annual Report, the Group entered into an agreement with an independent third party in January 2005 to dispose of its entire equity interest in Qinglian Highway and accordingly a write-back provision of HK$24,800,000 was credited to the Group's result in 2004. The disposal has since been duly completed in July 2005.

Yingkeng Highway

The Group's effective interest in this project is 70%. The average daily traffic flow for 2005 of Yingkeng Highway was 4,670 vehicle trips (2004: 4,464 vehicle trips), a 5% increase as compared with the year before. Furthermore, as there are now more heavy vehicles that pay a higher tariff using the road, revenue increased markedly by 24% to HK$12,234,000 (2004: HK$9,868,000). The profit before tax for the year was HK$2,637,000 (2004: HK$1,322,000), an increase of 99%.

Panyu Bridge

The Panyu Bridge has been a 20% associate of the Group since October 2004. Panyu Bridge recorded a growth of 6% in traffic flow in 2005. The average daily traffic for the year was 69,116 vehicle trips (2004: 64,993 vehicle trips). However, as there are now more light vehicles that pay a lower tariff using the road, revenue for the year has increased modestly by 3% to HK$172,425,000 (2004: HK$167,736,000). The profit before tax for the year was HK$85,001,000 (2004: HK$74,128,000), an increase of 15%, which was mainly due to the increase in revenue and the recognition of an exchange gain of approximately HK$8,778,000 on the bank loan denominated in US currency. The profit attributable to the Group for the year amounted to HK$17,000,000 (2004: HK$8,683,000).

Two Pak Kong Bridges

The Group's effective interest in this project is 24.5%, which is classified as available-for-sale investments. The actions taken by the local government have created problems in operating the Two Pak Kong Bridges in Qingyuan as toll bridges and collecting toll revenue from those bridges since 1 October 2004. The local government has however been making periodic payment to the foreign partners, including the Group, to compensate their losses. The local government has now also arranged for 清遠市交通建設開發公司 to buy out the interest of the foreign parties in the project. Subsequent to the balance sheet date, the Group has signed an agreement with 清遠市交通建設開發公司 for the sale of the Group's interest in the project for a total consideration of RMB59,980,000, of which RMB42,000,000 was received by the Group in March 2006.

BUSINESS OVERVIEW (continued)

Property Investment and Development

Mainland China

Teemall

Teemall, one of the most popular shopping malls in the premier area of Guangzhou, has a total gross floor area and lettable area of approximately 160,000 square metres and 96,340 square metres respectively. The plaza continued to enjoy high average occupancy rate of approximately 99% during the year (2004: 99%). Revenue of the plaza during the year reached HK$309,636,000 (2004: HK$293,690,000), an increase of 5.43%. The profit before tax for the year increased by HK$34,605,000 to HK$293,977,000 (2004: HK$259,372,000). The ability of the plaza to attract brand-name tenants such as Mont Blanc, Starbucks, Rolex, Swarovski, Guess and the like and the efforts by the management to introduce new shopping sections such as the Digital Circle and the Health Corner were the key reasons for such increases.

Building upon the success of the shopping mall operations, the Group is proceeding with the development of two new tower blocks on the site.

The East Tower, which is expected to be completed in late 2006, will be a 45-storey A-class office tower, with a total gross floor area and lettable area of approximately 113,380 square metres and 91,000 square metres respectively. Colliers International, a prestigious international property agent, has been engaged to market and promote the leasing of all the East Tower units. The estimated total cost of the East Tower development (inclusive of also the historic land and infrastructure costs now attributed to the East Tower) is about HK$840 million of which approximately HK$410 million has been invested as at the balance sheet date.

The West Tower, which is expected to be completed in 2008, will be a 5-star hotel with approximately 450 hotel rooms. In February 2006, Sheraton Overseas Management Corporation, a renowned international hotel management company, has been engaged to operate, manage and promote the hotel under the name of Sheraton Guangzhou Hotel (粵海喜來登酒店) for an initial 10 year term. The estimated total cost of the West Tower development (inclusive of also the historic land and infrastructure costs now attributed to the West Tower) is about HK$780 million of which approximately HK$140 million has been invested as at the balance sheet date.

At the balance sheet date, the Group holds an effective equity interest of 75.40% in the development made up of the shopping mall and the two tower blocks.

BUSINESS OVERVIEW (continued)

Property Investment and Development (continued)

Hong Kong

Guangdong Investment Tower

The average occupancy rate of the Guangdong Investment Tower for 2005 was 96.27% (2004: 87.29%), 8.98% higher than last year. The total rental income for the year was HK$19,359,000 (2004: HK$18,127,000), an increase of 6.8%.

Department Stores

The Group holds an effective equity interest of 84.74% in 廣東天河城百貨有限公司 (Guangdong Teemall Department Stores Ltd.) ("GDTDS") for the operation of department stores.

GDTDS operates with a total leased area of approximately 34,510 square metres (2004: 33,390 square metres) selling a wide range of products and is ranked, in terms of sales, as one of the major department stores in Guangzhou. During the year, GDTDS continued to enjoy record high revenue of HK$1,036,525,000 (2004: HK$905,052,000), an increase of 14.53%. The increase in revenue arose from the addition of about 1,120 square metres leased area and the launching of the new outlets for sporting goods, brand-name products and also the jewellery and gold corners. Besides, the holding of different trade fairs and festival shows throughout the year and the regular change in the products mix also helped to increase the customer traffic and turnover of GDTDS. The profit before tax for the year was HK$84,574,000 (2004: HK$61,429,000), an increase of 37.68%.

廣東吉之島天貿百貨有限公司 (Guangdong Jusco Teem Stores Co., Ltd.) ("JUSCO Teem"), an 26.39% associate of the Group, is jointly managed by 廣東天貿(集團)股份有限公司 (Guang Dong Teem (Holdings) Ltd.), the Group's 75.40%-owned subsidiary, and JUSCO Japan. It has achieved satisfactory growth in its business since its establishment in 1996.

Hotel Operations and Management

As at 31 December 2005, our hotel management team managed a total of 19 hotels (as at 31 December 2004: 13 hotels), of which 2 were in Hong Kong, 1 in Macau and 16 in Mainland China (located in Shenzhen, Zhuhai, Dongguan, Guangzhou, Qingdao, Jilin, Dalian, Shanghai and Beijing). Out of the above hotels, 7 were owned by the Group (2 in Hong Kong, 4 in Shenzhen and 1 in Zhuhai).

BUSINESS OVERVIEW (continued)

Hotel Operations and Management (continued)

With the 'free travel' policy extending to more cities in Mainland China and also the attraction of the new Hong Kong Disneyland theme park, the number of Mainland visitors to Hong Kong continued to increase. This is part of the reason why the average occupancy rate of our 4 hotels in Hong Kong, Zhuhai and Shenzhen has increased by 1.3% to 85.8% (2004: 84.5%) and the average room rate has increased by 14.5% to HK$473 (2004: HK$413). The turnover for our hotel business (excluding the limited service hotels as more particularly set out below which only went into operation in the second half of the year) for the year increased by 14% to HK$249,468,000 (2004: HK$218,989,000). The profit before tax increased by 53% to HK$43,401,000 (2004: HK$28,285,000 (restated)), which the increase was mainly attributable in part to the increase in turnover and in part to the recognition of an exchange gain for HK$5,399,000.

To meet the strong demands of a growing number of budget conscious travellers in Mainland China, the Group is in the course of setting up a chain of limited service hotels under the "粵海之星商務快捷連鎖酒店" brand name to provide a basic, but quality, bed-and-breakfast type service. The first three of such hotels has already commenced operation in Shenzhen in the second half of the year. The number of rooms in each of such hotels ranges from 57 to 220 and the total capital expenditure required for each of them is in the range of RMB5 million to 14 million. Their total turnover for the year was HK$4,998,000.

LIQUIDITY, GEARING AND FINANCIAL RESOURCES

As at 31 December 2005, the cash and bank balances of the Group increased by HK$472 million to HK$2,140 million (31 December 2004: HK$1,668 million), of which 23% in Hong Kong dollars, 62% in Renminbi and 15% in US dollars.

As at 31 December 2005, the level of the Group's financial borrowing decreased by HK$1,589 million. The decrease was mainly due to the repayment of certain interest-bearing debts and the exercise of the conversion right by the holder of the Convertible Bonds in their entirety during the year.

As at 31 December 2005, the Group had financial borrowings amounting to HK$15,166 million (31 December 2004: HK$16,755 million (restated)), including non-interest bearing Hong Kong government loan of HK$2,009 million. Of the Group's total financial borrowings, HK$164 million was repayable within one year while the remaining balance of HK$4,122 million and HK$10,880 million are repayable within two to five years and beyond five years from the balance sheet date, respectively.

Save for the bank debts incurred in our water distribution business, the Group maintained credit facilities of RMB50 million as at 31 December 2005 (31 December 2004: nil).

The gearing for the Group as at 31 December 2005 was 1.17 times (31 December 2004: 1.54 times (restated)). The improvement mostly reflected the reduction in the level of the Group's financial borrowings, together with an increase in net asset value of the Group. The Group is in a healthy debt servicing position as the EBITDA/finance cost is 4.55 times (31 December 2004: 3.87 times (restated)).

LIQUIDITY, GEARING AND FINANCIAL RESOURCES (continued)

The existing cash resources and available credit facilities of the Group, together with steady cash flows generated from the Group's operations, are sufficient to meet the Group's payment obligation and business requirements.

PLEDGE OF ASSETS

As at 31 December 2005, none of the Group's fixed assets, investment properties and bank deposits were pledged to secure general banking facilities granted to the Group (31 December 2004: nil)

CAPITAL EXPENDITURE

The Group's capital expenditure in 2005 amounted to HK$260 million principally related to the construction in progress of the East Tower at Teemall, the additions of plant and machinery for the power plant and renovation works for our existing hotels and new limited services hotels.

EXPOSURE TO FLUCTUATIONS IN EXCHANGE AND INTEREST RATES AND RELATED HEDGES

As at 31 December 2005, total Renminbi borrowings amounted to HK$1,360 million (31 December 2004: HK$1,422 million).

As at 31 December 2005, the Group's total floating rate borrowings amounted to HK$11,925 million (31 December 2004: HK$12,954 million). For the purpose of interest rate risk management, the Group entered certain fixed or re-indexing interest rate swap agreements, contract amounted to HK$9,900 million (31 December 2004: HK$11,700 million), with an average remaining life ranging from 2–7 years.

EMPLOYEE AND REMUNERATION POLICY

As at 31 December 2005, the Group had a total of 3,470 employees. Among the employees, 3,235 were employed by subsidiaries in Mainland China and 235 were employed by the head office and subsidiaries in Hong Kong. Out of the total number, 704 were managerial employees of the head office and its subsidiaries. Total remuneration paid for the year under review was approximately HK$260,647,000 (2004: HK$225,237,000).

EMPLOYEE AND REMUNERATION POLICY (continued)

The human resources of an enterprise are the foundation of its development. The Group places great emphasis on the building up and strengthening of its human resources. Adhering to the "Credibility, Integrity and Profitability" core values of our corporate culture, we conduct all our staff selection processes in a fair, just and open manner. We have in place also the mechanism for the periodic performance appraisal of our senior management staff to ensure their integrity and high performance. Our remuneration and incentive packages for our staff are driven mainly by the operating results of their respective companies. In order to most effectively motivate our staff to actively create added value in their work, the incentive bonuses we pay to our management, key staff in their respective fields and staff with outstanding performance are determined not only by reference to the operating net cashflow and profits after tax of their respective companies, but also by applying a progressive scale depending on the extent by which the operating results of their companies have exceeded expectation and further taking into account of the individual performance of the staff himself or herself. Moreover the Group has adopted a share option scheme to attract, retain and motivate outstanding staff to contribute to the continuing success of the Group in the long run. In terms of staff training and development, the Group encourages its staff to actively participate in relevant professional development programmes. The Group has also achieved very good results in enhancing the quality of its staff through all the functional skill-based or general corporate culture internal training that it continues to offer on an on-going basis.