

MANAGEMENT DISCUSSION AND ANALYSIS

2006 was a year of milestones for the Galaxy Entertainment Group. We successfully opened our first flagship hotel and entertainment complex in October 2006, "StarWorld". In addition we opened three more City Club casinos earlier in the year – Rio Casino, President Casino, and Grand Waldo Casino. Now with five casinos in operation, the Group has firmly established itself as a major player within the Macau gaming market.

REVIEW OF OPERATIONS

Turnover and profit attributable to shareholders for the year ended 31st December 2006 was HK\$4,669 million and a loss of HK\$1,532 million respectively, as compared to a turnover of HK\$1,292 million and a profit of HK\$2,395 million for the year ended 31st December 2005. The Group's turnover was significantly higher than that of last year reflecting the significant expansion in its Gaming and Entertainment division, with the opening of four more casinos in Macau during the year, including the Group's flagship, StarWorld. With the opening of its VIP rooms at the end of November, StarWorld was only opened for one full month of operation during the financial year.

The Group's loss for the year was reported after:

- Depreciation and amortisation charges of HK\$1.19 billion, including the HK\$998 million amortisation of the intangible asset arising from the acquisition of the Macau operation in July 2005;
- HK\$522 million in finance charges;
- Launch and pre-opening expenses associated with opening the four casinos and hotel during the year of HK\$268 million, including staff costs, training costs, marketing and branding.

It should be noted that the profit attributed to shareholders for the 2005 year included a gain of HK\$3,039 million arising from the acquisition of the Macau operation in July 2005.

The 2007 year will be the first full year of operation of the StarWorld Hotel and Casino and all of the City Club casinos and will be a more indicative year upon which to assess the financial success of the Group's Gaming and Entertainment division.

For the first three months of the 2007 financial year, the Group captured over HK\$3.7 billion of Macau gaming revenue, with over HK\$100 billion in VIP rolling turnover. Based on this, Galaxy's market share has now increased to 22% of the total Macau market as reported.

In the fourth quarter of 2006 the Macau gaming market grew at 44% year on year versus 2005, VIP win grew at 65% year on year, with the Mass market at a more modest growth of 15%. This confirms Galaxy's strategy of having a strong focus on the VIP gaming business.

The StarWorld property was developed by Galaxy at a cost of approximately HK\$3 billion, including the acquisition of the land. StarWorld's earnings potential is realised in 2007 and future years. The current market value of this property is significantly greater than its development cost as reflected in the Group's balance sheet. Galaxy is confident that its return on capital for its investment in StarWorld (EBITDA return on development cost) will exceed expectations. This is also true for Galaxy's City Club operations.

Furthermore, the Group's balance sheet does not reflect the current value of one of its most valuable assets, the significant land holding on the Cotai strip – being the site of its Mega Resort development.

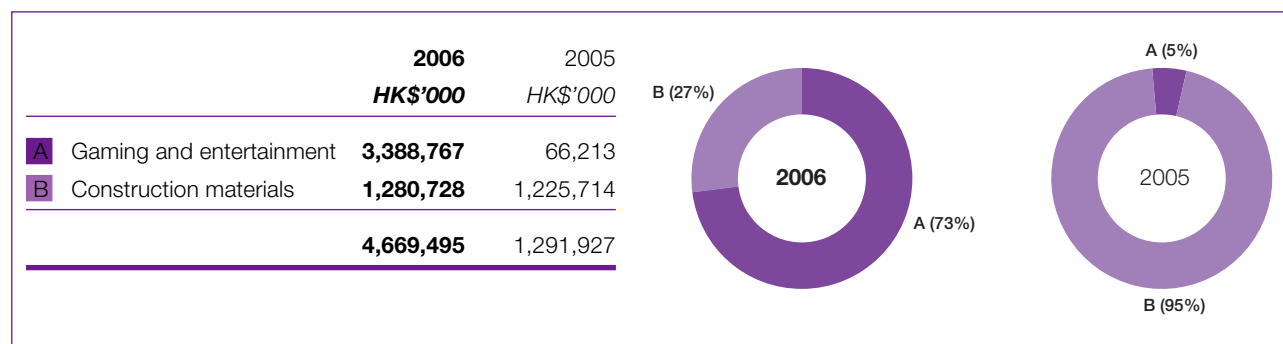
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Set out below is the segmental analysis of the Group's operating result for the year ended 31st December 2006.

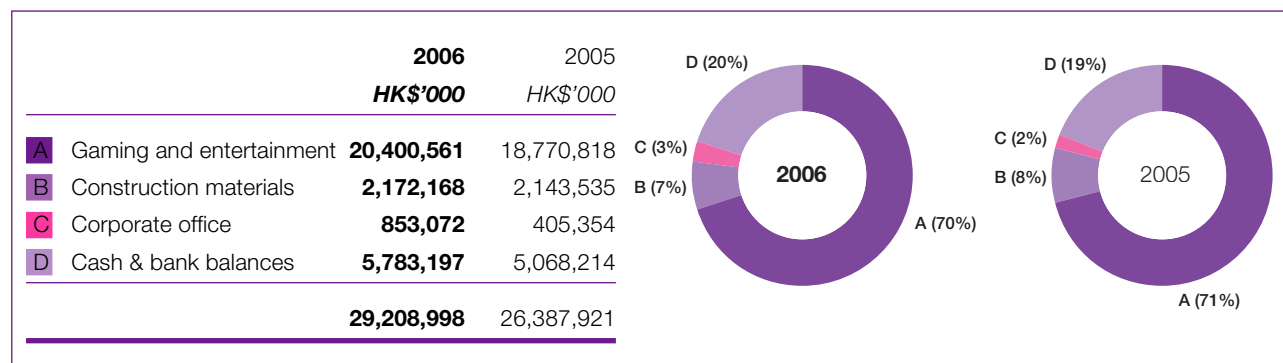
EBITDA EXCLUDING NON-RECURRING ITEMS

	Gaming and entertainment <i>HK\$'000</i>	Construction materials <i>HK\$'000</i>	Corporate <i>HK\$'000</i>	2006 <i>HK\$'000</i>	2005 <i>HK\$'000</i>
Company and subsidiaries:					
Operating profit/(loss)	(1,187,893)	52,512	102,934	(1,032,447)	2,591,824
Jointly controlled entities and associated companies:					
Share of profits less losses before tax	(2,803)	34,165	–	31,362	(73,913)
Depreciation and amortisation	1,067,757	121,188	1,194	1,190,139	536,068
Non-recurring items	267,868	–	(20,000)	247,868	(2,905,203)
EBITDA excluding non-recurring items	144,929	207,865	84,128	436,922	148,776

TURNOVER BY DIVISION

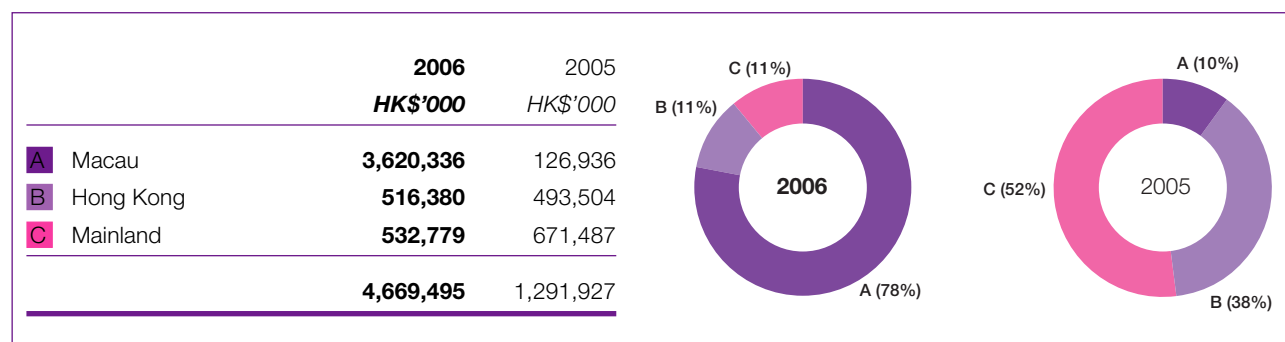


EMPLOYMENT OF TOTAL ASSETS

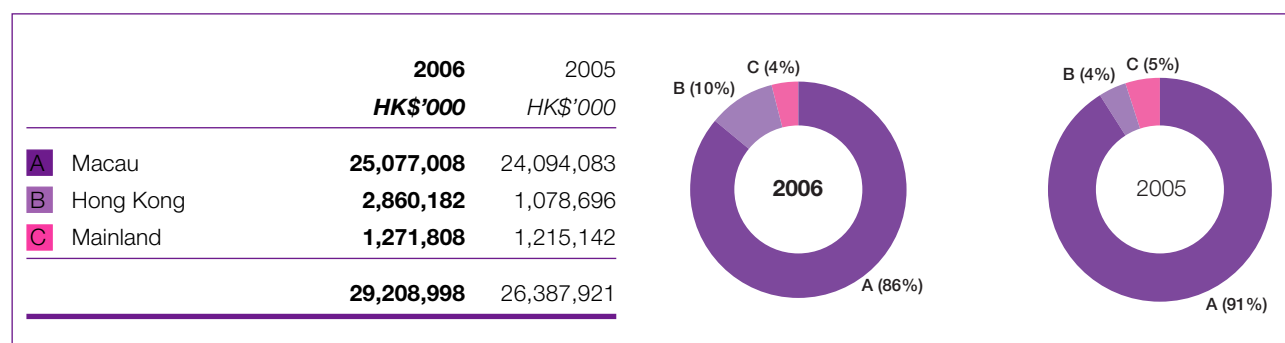


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TURNOVER BY GEOGRAPHICAL SPREAD



TOTAL ASSETS BY GEOGRAPHICAL SPREAD



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GAMING AND ENTERTAINMENT DIVISION

Overview

The Macau gaming market continued to record another year of double digit growth. Macau's net gaming revenues increased by over 20% to HK\$53 billion in 2006. Macau is now the world's largest gaming market and continues to experience one of the world's fastest growth rates in gaming revenues and tourist arrivals.

During 2006, Galaxy's gaming tables increased from 63 to over 500 representing approximately 20% of the number of tables in Macau, while Galaxy's slot machines increased from 75 to over 800, representing nearly 15% of slot machines in Macau. Galaxy's casinos generated net gaming revenues of HK\$7.3 billion for the year (of which HK\$3.4 billion is recognised in the financial statements due to the different accounting treatment of the arrangements with the City Club casinos).

Galaxy's market share of Macau net gaming revenues increased from 9% in the first half of 2006 to 17% in the second half year, following the opening of StarWorld and the three new City Club casinos. For the month of December 2006, Galaxy generated net gaming revenues of over HK\$1.1 billion representing a 19% market share.

In 2006, the Gaming and Entertainment division reported an operating loss of HK\$1,188 million.

In considering this result, it should be noted that this is reported after:

- Depreciation and amortisation charges of HK\$1,068 million, including the amortisation of the gaming licence of HK\$998 million;
- Non-recurring items of HK\$268 million which include the pre-opening expenses related to the opening of StarWorld and the three additional City Club casinos, including staff costs, training, launch, marketing and branding expenses.

As noted above, EBITDA of the Gaming and Entertainment division included only one full month of operation of StarWorld's VIP gaming tables (commenced operation on 26th November 2006).

2007 will be the first full year of operation for StarWorld and all of the City Club casinos and will be a more indicative year upon which to assess the financial performance of Galaxy's Gaming and Entertainment division.

As at 31st December 2006, the Group has HK\$6 billion in cash (including HK\$259 million restricted bank deposits classified as other non-current assets), which together with the cash flows from StarWorld, the City Club casinos and Galaxy's other operations, provides Galaxy with the necessary financial resources to develop and commence operations of the first phase of its Cotai Mega Resort by the end of 2008.

StarWorld

StarWorld, Galaxy's first flagship entertainment complex, at a cost of approximately HK\$3.0 billion, opened with its mass gaming operations on 19th October 2006. StarWorld's acclaimed VIP rooms began a phased opening on 26th November 2006. StarWorld has been specifically designed and themed to appeal to the tastes and preferences of the expanding gaming market. StarWorld's spectacular external lighting has changed the Macau skyline forever and will ensure that StarWorld is a "must-see" casino for all visitors to Macau.

StarWorld is strategically located in downtown Macau and is at the epi-centre in the heart of the "Strip" of the Macau gaming hub, together with Grand Lisboa, Wynn, and MGM. With StarWorld's unique U-shaped hotel configuration, all 500 hotel rooms and suites have outstanding panoramic water views.

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In March 2007, StarWorld completed and opened its VIP high-roller “Jinmen Room” and increased its VIP tables. Once being fully operational, the StarWorld complex will encompass 16,500 m² of gaming space, with over 250 gaming tables and 500 slot machines, together with 500 hotel rooms, suites and Presidential suites to cater for our VIPs. As a gourmet paradise, StarWorld offers an outstanding buffet, “Temptations”, exquisite Chinese cuisine at the award winning Jade Garden and Laurel restaurants, and our soon to be opened Japanese and Western fine dining restaurants. To cater for the increase in demand for conference and banquet facilities, our Grand Ballroom will be opened later this year. We are confident that the StarWorld offering of world-class service, outstanding facilities and our understanding of our valued customers’ preferences will underpin our success.

Cotai Mega Resort

The development of Galaxy’s luxurious Cotai Mega Resort is well advanced with the initial phase of this development scheduled to open in 2008. This phase includes over 25,000 m² of main gaming floor, which can accommodate up to 600 gaming tables and 1,000 slot machines and a 27 floor hotel tower with 1,500 hotel rooms and suites. Additional resort facilities include: spa, sauna, leisure facilities, an Asian paradise of gourmet food with over 20 restaurants, a range of selected specialty retail and extensive water entertainment and experience features.

Going forward, Galaxy’s Cotai development will be developed to include six to eight various star-rated hotels and resorts with up to 12,000 rooms, 1,500 gaming tables, 3,000 slot machines, extensive high-end retail and multiple convention, function and meeting facilities.

Galaxy’s Cotai development site is 4.7 million sq ft in size, making it one of Macau’s single largest development sites. This vast piece of land ensures Galaxy has the flexibility to grow and expand as business opportunities continue to evolve. As previously noted the current value of this most valuable asset has not yet been reflected on Galaxy’s balance sheet.

City Club Casinos

Galaxy’s City Club casinos experienced significant growth during 2006. During this year three additional city club casinos were opened – Rio Casino in late February, President Casino in late April, and Grand Waldo Casino in May.

The operations of the City Club casinos have continued to improve during 2006. The three new City Club casinos, combined with Galaxy’s original City Club casino, Waldo Casino, have helped Galaxy to secure a strong foothold in the Macau gaming market. The City Club casinos now operate over 280 gaming tables and 475 slot machines in Macau.

BOND ISSUE

As noted in the 2005 annual report, Galaxy successfully raised US\$600 million in 2005 through a bond offering. These bonds have been well received by the market, trading on the Singapore stock exchange, and now trade at a premium to their issue price.

CONVERTIBLE NOTE ISSUE

In December 2006, after being approached by a group of US investment funds the Group issued US\$240 million of zero coupon five year convertible notes. These funds, together with the proceeds of the Bond Issue, ensure that Galaxy has the necessary financial capacity to expand and enhance the competitiveness of the Galaxy Mega Resort.

CONSTRUCTION MATERIALS DIVISION

The Construction Materials division recorded a steady growth over last year both in terms of turnover and profit contribution. The division’s continuous focus on cost savings over the past few years has provided a very solid base in maintaining a competitive edge over its competitors. The division has been able to ride on the challenges brought about by softening market demand in Hong Kong and intensifying market competition on the Mainland.

Hong Kong and Macau

The division continues to ensure it maintains a cost effective operation and is highly competitive within the industry. This has enabled the operation in Hong Kong to achieve a good profit contribution amid reducing market demand. To further

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strengthen our market position and to broaden the earnings base, the division acquired 80% of Tarmac Asphalt Hong Kong Limited in August 2006. With this acquisition, in addition to broadening the division's earnings base, the division has enjoyed the synergistic cost savings resulting from combining the operations into one business entity. In October 2006, the division secured a rehabilitation contract with Hong Kong SAR Government at Lam Tei, New Territories through an entity in which the Group has a 36.5% interest. This contract will provide the division with long term supply of aggregates and operation base for further extending market coverage in Hong Kong.

Our construction materials operation in Macau continued to record encouraging growth in 2006 with increased sales volume and higher profit contribution. The production facilities have been further expanded during the year to cope with the increasing market demand.

Mainland

The market has remained highly competitive resulting in falling unit selling prices and narrowing gross margin. The division has consolidated its operations to achieve synergistic cost savings in order to maintain our competitiveness in the market. In respect of the joint ventures with leading steel manufacturers for the manufacture and sale of granulated blastfurnance slag (GGBS), all these joint ventures have made good profit contribution to the division. Further expansion in production facilities of these joint ventures will be carried out to cope with the increasing demand of GGBS in the market.



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The division's investment in cement joint ventures in Yunnan has progressed as planned. The Kunming cement operation has begun making a profit contribution to the division and the second phase production facilities construction work has been completed. The plant is presently under testing stage and is expected to commence production in the near future. In addition, the division has plans to invest in other areas in Yunnan to capitalise on the increasing demand brought about by Central Government's policy of developing the Western Region. In November 2006, the Group together with Kungang, commenced construction work on a new cement production facility in Baoshan, Yunnan. The plant is expected to commence production in 2008. The division will continue to look for valuable investment opportunities in Yunnan and it is envisaged that all these investments will provide a solid and steady profit growth to the division in the coming future.

LIQUIDITY AND FINANCIAL RESOURCES

The financial position of the Group has remained strong during the year. The shareholders' funds as at 31st December 2006 was HK\$13,633 million, a decrease of approximately 9% over that as at 31st December 2005 of HK\$14,932 million while the Group's total assets employed increased to HK\$29,209 million as compared to HK\$26,388 million as at 31st December 2005.

The Group continues to maintain a strong cash position. As at 31st December 2006, total cash and bank balances were HK\$5,783 million as compared to HK\$5,068 million as at 31st December 2005.

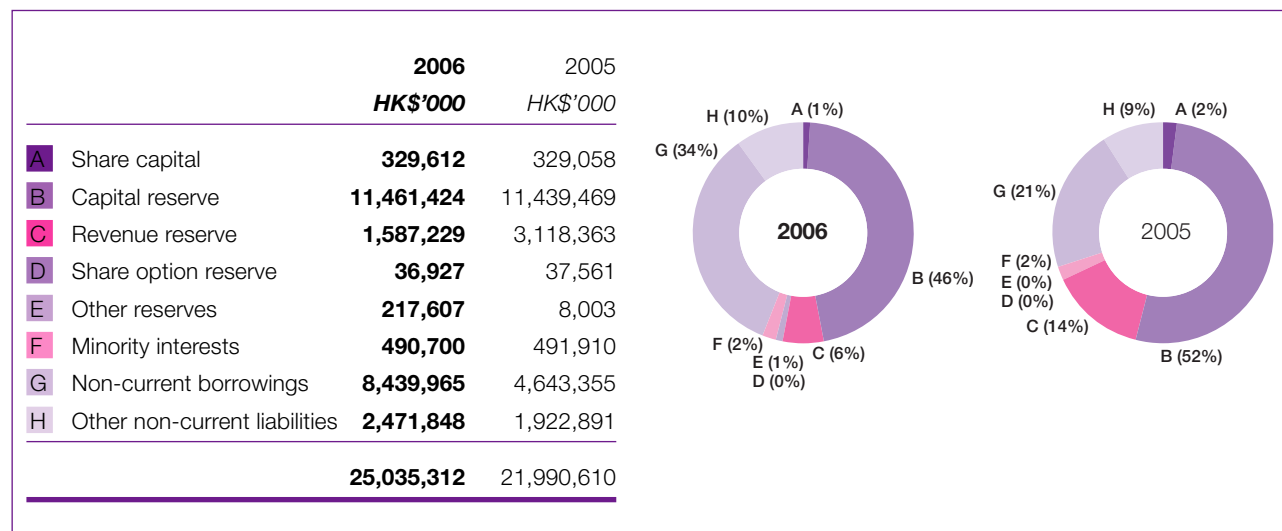
As at 31st December 2006, the Group's total indebtedness was HK\$8,973 million as compared to HK\$7,587 million as at 31st December 2005. The total indebtedness of the Group mainly comprises bank loans, fixed rate notes, guaranteed notes, convertible notes and other obligations which are largely denominated in Hong Kong Dollar and United States Dollar. The Group's borrowings are closely monitored to ensure a smooth repayment schedule to maturity.

The Group's liquidity position remains strong and the Group is confident that sufficient resources could be secured to meet its commitments, working capital requirements and future assets acquisitions.

GEARING RATIO

The gearing ratio, defined as the ratio of total loans outstanding less cash balances to total assets (excludes cash balances), was maintained at a satisfactory level of 14% as at 31st December 2006 as compared to 12% as at 31st December 2005.

SOURCES OF FUNDING



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TREASURY POLICY

The Group continues to adopt a conservative treasury policy with all bank deposits in either Hong Kong Dollar, United States Dollar or in the local currencies of the operating subsidiaries, keeping a minimum exposure to foreign exchange risks. All of the Group's borrowings are in either Hong Kong Dollar, United States Dollar or Renminbi. Forward foreign exchange contracts are utilised when suitable opportunities arise and when considered appropriate, to hedge against foreign exchange exposure. The Group has engaged in the use of cross currency swaps to reduce the Group's exposure in foreign currency fluctuations, which are considered necessary for the Group's treasury management activities.

CHARGES ON GROUP ASSETS

Leasehold land with net book values of HK\$217 million (2005: HK\$221 million) and bank deposits of HK\$259 million (2005: HK\$259 million) have been pledged to secure banking facilities.

GUARANTEES

The Company has executed guarantees in favour of banks in respect of facilities granted to subsidiaries amounting to HK\$210 million (2005: HK\$262 million), of which HK\$175 million (2005: HK\$124 million) have been utilised.

The Group has executed guarantees in favour of a bank in respect of facilities granted to an associated company amounting to HK\$9 million (2005: nil). At 31st December 2006, facilities utilised amounted to HK\$9 million (2005: nil).

EMPLOYEES AND REMUNERATION POLICY

As at 31st December 2006, the Group, excluding associated companies and jointly controlled entities, employed around 10,500 employees in Hong Kong, Macau and Mainland China. Employee costs, excluding Directors' emoluments, amounted to HK\$924 million.

The Group recruits and promotes individuals based on their competencies, merit and development potential and ensures remuneration packages are competitive, fair and subject to regular review. The Group has implemented a share option scheme for executives from 1991 following approval by its shareholders for the purpose of providing competitive package and long term retention of management talents. Likewise in Macau and Mainland China, employees' remuneration is commensurate with market levels with emphasis on provision of training and development opportunities.



SOLID FOUNDATION



We are the most integrated and long established quality construction materials supplier in Hong Kong, with significant presence in Macau and major cities across the Mainland.

