



Management's Discussion and Analysis

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BUSINESS REVIEW

In 2006, the audited consolidated revenue of the Group was HK\$6,980 million, which represented an increase of HK\$1,344 million and 23.8% from HK\$5,636 million of last year. All Group's business segments sustained growth. Among all, turnover of the Group's freight forwarding operation increased by HK\$348 million over last year. The newly launched businesses including on-line travel consolidator (Mangocity.com) and Zhuhai Ocean Spring Resort ("OSR") generated HK\$568 million turnover for the Group. The consolidated profit attributable to shareholders was HK\$375 million, which was a decrease of HK\$238 million and 38.8% from HK\$613 million of last year. The reasons for the decrease in the consolidated profit attributable to shareholders were partly caused by non-recurring items, including goodwill impairment of HK\$17 million, a decrease of HK\$38 million in surplus from revaluations of hotels and investment properties, and the fair value gains on convertible bonds amounting to HK\$99 million in 2005. Without taking into account these non-recurring items, the Group's consolidated profit attributable to shareholders decreased by HK\$84 million, or 18.8%, over last year, mainly due to the fact that the Group had invested heavily in the start-up cost and marketing for the newly-launched Mangocity.com and OSR so as to lay solid foundation for their future growth. These two investments did not contribute profits to the Group in 2006. The Group's consolidated net asset value was HK\$11,093 million as at 31 December 2006, representing an increase of HK\$1,230 million and 12.5% from the end of last year.

Tour Operation and Leisure Business

The Group's tour operation and leisure business comprise ground travel agencies, on-line travel consolidator (Mangocity.com), OSR, three theme parks and a golf club in Shenzhen, and art performance produced by China Heaven Creation International Performance Art Co. Ltd. ("China Heaven"). The Group continued to invest heavily in core travel business during 2006. The Group's travel agencies actively targeted MICE (meetings, incentives, conference, and events) market and corporate travel markets to expand business in high end market. OSR and Mangocity.com, two of the major investment projects of the Group, commenced operation in early 2006. Splendid China and Window of the World continued to invest in remodeling and creating new attraction programs. All these investments significantly increased the Group's long term competency in core travel business. During the year, the turnover of the Group's tour operation and leisure business was HK\$3,368 million, representing an increase of 37.6% over last year. The net profit was HK\$167 million, representing a decrease of 47.5%. The decrease was mainly due to the Group's heavy investment in Mangocity.com and OSR.



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During the year, China Travel Service (Hong Kong) Limited ("CTSHK") actively pursued a branding strategy of being an "Expert of China Tour" as well as targeted MICE and specialty tours markets. CTSHK is the authorized General Sales Agent ("GSA") in Hong Kong for the 2008 Olympics Games ticketing sales. CTSHK was awarded with the Gold prize in the Hong Kong Top Service Brand Award during the year. China Travel International Limited ("CTI") and Shanghai China Travel International Limited ("CTI Shanghai") launched series of new travel products such as "Island Tour", "Individual Travelers Tour", "Cruise Trip", etc. Destinations of tour package products include Japan, Korea, Singapore, Australia, and England. CTI successfully won a contract with Visa International to host guests during 2008 Olympics Games. CTI Shanghai was rewarded the title of "Recommended Service Provider" for the 2010 World Exhibition in Shanghai. CTI, CTI Shanghai, and China Travel International (Shandong) Ltd. were all ranked among the top 100 travel agencies in China in 2006. Our travel agencies in Australia, New Zealand, US, Canada, Northern Europe, and South Korea all contributed to the Group's results.

The Group's on-line travel consolidator, Mangocity.com, officially commenced operation on 31 March 2006. Mangocity.com successfully executed a creative marketing strategy and built up a young and energetic image in Mainland China. It has entered contracts with 3,450 hotels, offered discount airfares in over 2,500 flight routes, and launched more than one thousand travel package products. Its delivery network covers more than 40 major cities in China. Total number of membership amounted to over 1.6 million. Mangocity.com is rapidly becoming one of the most prominent on-line travel consolidators in China.

OSR commenced operation on 22 January 2006. With its strong competitive edge to provide multiple facilities and services catering for different recreational and business purposes, OSR has rapidly become one of the leading resorts in Zhuhai City as well as in the Pearl River Delta region. Total number of customers reached three million in 2006, contributing to turnover of HK\$332 million. Most recently, the city government of Zhuhai is planning to zone an area of 30 square kilometers surrounding OSR to develop a satellite city especially for tourism purpose. This will further facilitate OSR's growth in the future.

In light of the intense market competition, the Group's three theme parks, namely the Window of the World, Splendid China and China Folk Culture Villages, continued to invest in remodeling, launched new performance shows and theme activities to generate traffics. Turnover from the three theme parks was HK\$415 million for 2006, an increase of 9.2% over last year.



Turnover of Tycoon Golf Club in Shenzhen was HK\$50 million, representing an increase of 14.6% over last year. During the year, Tycoon Golf Club adopted innovative marketing strategy to bundle its membership sales with China Merchants – Overseas Chinese Town Group’s villa property promotion campaign and expect to reach agreement in 2007, and explore new customer base in Korea.

During the year, China Heaven launched revised versions of “The Legend of KungFu” and “The Romantic River Li”. “The Legend of KungFu” won Gold prize as the best stage shows in foreign countries, and will be invited to perform in Japan in 2007.

Hotel Operation

During 2006, the Group’s five hotels in Hong Kong and Macau strengthened their cooperation with Mangocity.com to increase the mix of business travelers and individual guests so as to gear up average room prices and gross margins. The five hotels actively participated in industry shows in order to promote their branding and acquire new customers. Average occupancy rate increased by 3% to 88% and average room price increased by 11% over last year. Metropark Hotel Wanchai Hong Kong completed a major remodeling and successfully upgraded itself into a boutique hotel targeting business travelers. However, as Metropark Hotel Wanchai Hong Kong suspended operation between April and November for remodeling, turnover of the Group’s five hotels was HK\$423 million, an increase of only 8.8% over last year; net profit was HK\$74 million, a decrease of 10.9% over last year. Metropark Hotel Wanchai Hong Kong reopened in November and its average room price increased by 20%. The result of the remodeling was to the Management’s satisfaction.

Transportation

Regarding the passenger transportation operations, the number of passengers carried by China Travel Tours Transportation Development (HK) Limited (“CT Tours”) reached 2.33 million in 2006, representing an increase of 28.9% as compared with last year. Turnover increased by 17.7% over last year to HK\$270 million. CT Tours’ turnover, the number of passengers carried and the number of safety mileages all achieved new record high. CT Tours has become one of the largest cross-border bus companies and its business is developed all over the greater Pearl River Delta region, including Hong Kong, Macau, Guangdong and Guangxi Province. The cross-border shuttle bus service between Hong Kong and Shenzhen sustained steady



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growth. CT Tours' operation in Macau recorded significant growth during the year. As a result, CT Tours' net profit increased by 10.6% over last year. The profit contribution from the ferry operation in the joint venture of Shun Tak China Travel Shipping Investments Limited increased by 26.5% over last year as a result of Macau's robust tourism and the increase of number of passengers in some of the new routes.

Regarding the freight forwarding operation, the consolidated turnover and net profit increased by 13.6% and 14.1%, respectively, to reach HK\$2,917 million and HK\$95 million respectively in 2006. CTS International Transportation Company Limited ("CTS International") in Shanghai, with its stronghold in Yangtse River Delta region, further enhanced its presence in northern China and regions around the gulf of Bohai Sea. During the year, CTS International set up business branches in Wuhan, and Chengdu, and extended its sea freight and air freight forwarding business network internationally to Korea, Dubai, and Los Angeles. Overall gross profit from sea freight forwarding operation increased by 20%. Turnover and profit after tax of CTS International in Shanghai increased by 14.2% and 17.7%, respectively, and are expected to sustain health growth.

Infrastructure

During the year, the Group's share of profit of Shaanxi Weihe Power Company Limited was HK\$131 million, a decrease of 25.4% as compared with last year. The decrease of share of profit was mainly due to decrease in amount of on-grid electricity and continuous rise in coal and fuel prices.

NUMBER AND REMUNERATION OF EMPLOYEE

At the end of 2006, the Group had approximately 12,807 employees. The employees are remunerated based on their work performance, professional experience and prevailing industry practices. The remuneration policy and package of the Group's employees are periodically reviewed by the management. Apart from pension funds and in-house training programs, discretionary bonuses and share options are awarded to certain employees according to the assessment of individual performance.



LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

The Board of Directors considers that financial position of the Group is strong. At the end of 2006, the cash and bank balance of the Group amounted to HK\$2,157 million whereas the interest bearing bank borrowings amounted to HK\$680 million. The net interest bearing debt to equity ratio was -0.13.

The net book value of the Group's property, plant and equipment held under finance leases and hire purchase contracts included in the total amount of motor vehicles and furniture, fixtures, and equipment at 31 December 2006 amounted to HK\$99,000 (2005: HK\$1,257,000).

As at 31 December 2006, the Company had loan facilities, which were subject to, inter alia, a specific performance obligation on the controlling shareholder of the Company, CTS (Holdings), during the tenure of such loan facilities. The specific performance obligation is that CTS (Holdings) shall maintain a holding of no less than 40% of the total issued share capital of the Company throughout the tenure of the loan facilities granted to the Company. A breach of the obligation will constitute an event of default. As a result of such breach, the loan facilities may become due and repayable on demand by the relevant lenders according to the respective terms and conditions thereof. The details of the loan facilities are as follows:

Amount outstanding as at 31 December 2006 Final maturity date of the loan facilities

HK\$500 million

2 January 2009

Interest is charged on the outstanding balance at 0.25% per annum over the Hong Kong Interbank Offered Rate for the applicable loan period. The loans are secured by the corporate guarantee given by the Company.

As at 31 December 2006, the Group had no significant pledge of its assets. The contingent liability increased to HK\$10.25 million from HK\$2.14 million as at 31 December 2005.

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In 2006, 656,511,650 bonus warrants were exercised for 656,511,650 shares of HK\$0.10 each at a subscription price of HK\$1.508 per share. Accordingly, the number of issued share capital of the Company increased from 5,038,843,875 shares as at 31 December, 2005 to 5,695,355,525 shares as at 31 December 2006.

FUTURE PROSPECTS

Hong Kong's tourism industry is expected to sustain steady growth in 2007. The number of Mainland China's cities that are entitled to IVS is expected to increase. The Hong Kong Government will continue to sponsor various events to attract tourists from around the world. The number of tourist arrivals in Hong Kong is expected to reach 26 million in 2007, an increase of 4.6% over 2006. As Mainland China's per capita income increases, travel spending shall continue to increase. Business travel will also become increasingly frequent as a result of the rapidly growing economy. The PRC government has indicated clearly in its 11th 5-year Plan to actively encourage the development of Mainland China's travel industry. As a consequence, travel industry in Mainland China shall sustain rapid growth.

The Group will seize opportunity to regroup its ground travel agency network and integrate the ground travel agency network with the online travel platform, Mangocity.com, and leverage on its travel resources to increase market share. OSR will continue to increase new leisure facilities and improve quality of service so as to bring in additional customers from Hong Kong, Macau, Taiwan, Pearl River Delta and the MICE market. OSR is modifying its Phase II development plan, which involves an area of 3.8 square kilometers, to complement with Phase I facilities to cater for different market segments. The Group has launched a campaign of "Year of Quality Service" in 2007, striving to become one of the leading and reputable players to offer quality services in Mainland China's travel industry, and further enhance the Group's corporate image. The Group will pursue a rigorous 3-year cost saving plan to reduce cost and expense so to create higher value for shareholders. The Group will also pursue a branding strategy to develop "CTS" into one of the leading brand names internationally. The Group's strategic goal is to continuously enhance the core travel business competency, and to lay solid foundation to develop into one of the leading travel business groups in Mainland China as well as in Asia, and one of the most prominent companies in the world travel industry.

The Board and the Management are of the view that although the market environment has placed the Group in a favorable position, the Group is facing various uncertainties and unfavorable factors such as global warming and natural disasters. Increasing coal and fuel prices will pose threats to the bottom line of Group's passenger transportation operations and power generation operations. Mangocity.com will require additional investment to facilitate its growth. The Management shall continuously improve the Group's corporate governance standard, rigorously execute the 3-year cost saving plan, conduct stringent risk management measures and streamline existing businesses, so as to strive for healthy growth of the Group.