Financial Review

“In 2012, the Group raised new funds from the debt capital markets that amounted to RMB10,089 million. These proceeds were mainly used to finance funding needs under the Three-year Plan.”

Daniel Y. K. WAN
Managing Director & CFO

Report from the CFO

Extraordinary is a fitting description for how global debt capital markets performed in 2012, especially compared to 2011 when gloom over high government debt in the United States and Europe drove global uncertainty and market volatility. Overall global debt capital market activity during the full year of 2012 marked the strongest annual period since 2009, with the volume of high yield corporate debt setting a new record since 1980. Against this backdrop, the Group raised new funds from the debt capital markets that amounted to RMB10,089 million, including USD- and SGD-denominated 3- year senior notes equivalent to RMB6,952 million. In addition, the Group issued 5-year non-callable USD-denominated perpetual capital securities equivalent to RMB3,137million. These proceeds were mainly used to finance funding needs under the Three-Year Plan.

The Group continues to maintain a close business relationship with its bankers in Hong Kong and mainland China. In addition, the Group has widened its network and established new relationships with several Taiwan and Singapore banks. Thanks to the continual support of the banks, in 2012 the Group obtained new facilities amounting to RMB7,679 million and refinanced RMB6,010 million in loans with an upsize of the existing facilities by RMB722 million.

The increased debt for the accelerated Three-Year Plan development inevitably increased the gearing ratio to 70% as of 31 December 2012. The Group continues to closely monitor the gearing ratio and maintain adequate liquidity to meet debt obligations and development needs. However, the Group is also considering new sources of funding other than debt instruments. For example, there is the potential of spinning off certain commercial properties by way of a separate listing of China Xintiandi Limited (currently a wholly-owned subsidiary of the Group) in Hong Kong. On 28 May 2012, the Group submitted a listing application to The Stock Exchange of Hong Kong Limited for the proposed initial public offering of China Xintiandi. Preparation work is currently in progress to obtain listing approval with careful consideration as to the appropriate timing for the proposed listing in order to monetize the value from the Group’s commercial properties.

I would like to express my gratitude to the shareholders, investors and bankers whose confidence and continuous support the Group deeply values. Their loyalty is the encouragement that spurs the Group to seek and to reap the best of business opportunities ahead.

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Turnover of the Group dropped by 43% to RMB4,821 million (2011: RMB8,484 million), primarily due to the decrease in recognised property sales in 2012.

Property sales declined by 53% to RMB3,541 million (2011: RMB7,581 million) as a result of the decreased in area handed over in 2012 from 329,400 sq.m. to 199,700 sq.m.. Details of property sales during the year ended 31 December 2012 are contained in the paragraph headed "Property Sales" in the Business Review Section.

Rental and related income from investment properties of the Group rose by 47% to RMB1,249 million (2011: RMB849 million), principally due to additional income of RMB101 million and RMB169 million contributed through the acquisitions of Shanghai Shui On Plaza and Shanghai Langham Xintiandi Hotel. These acquisitions were completed in March 2012. Other than the revenue contributed by these newly acquired properties, rental income grew by 15% in the year 2012. Details of the business performance of investment properties are contained in the paragraph headed "Investment Property" in the Business Review Section.

Gross profit for 2012 declined to RMB2,060 million (2011: RMB3,701 million) with gross profit margin maintained at 43% (2011: 44%).

Other income increased by 16% to RMB282 million (2011: RMB244 million). It consisted of interest income of RMB181 million (2011: RMB152 million), accounting gain from acquisition of Shanghai Langham Xintiandi Hotel of RMB50 million (2011: nil) together with grants received from local government and sundry income of RMB51 million (2011: RMB92 million).

Selling and marketing expenses increased by 6% to RMB207 million (2011: RMB195 million) mainly due to the increase in contracted sales achieved by the Group (excluding sales by associates) by 16% to 218,100 sq.m. (2011: 188,000 sq.m. omitting *en-bloc* sales that incurred fewer marketing and promotional expenses).

General and administrative expenses increased by 16% to RMB738 million (2011: RMB634 million) mainly due to the increase in depreciation expense by RMB109 million to RMB176 million (2011: RMB67 million). This increase resulted from the acquisition of Shanghai Langham Xintiandi Hotel in March 2012 and the completion of Marco Polo Lingnan Tiandi Foshan Hotel in May 2012.

The various factors described above brought about a reduction in *Operating profit* by 55% to RMB1,397 million (2011: RMB3,116 million).

Increase in fair value of investment properties reached RMB2,698 million (2011: RMB2,696 million), of which RMB708 million (2011: RMB1,648 million) was derived from completed investment properties and RMB1,990 million (2011: RMB1,048 million) from investment properties under development or construction. Details of the investment properties are contained in the paragraph headed "Investment Property" in the Business Review Section.

Share of results of associates was RMB82 million (2011: RMB137 million), which included a revaluation gain on the investment properties under development or construction (net of related taxes) amounting to RMB88 million (2011: RMB95 million) attributable to the Group.

Finance costs after netting off exchange gain of RMB54 million (2011: RMB311 million) was RMB459 million (2011: net gain of RMB94 million). With the new issues of notes in 2012 that amounted to RMB6,952 million, total interest costs increased to RMB2,487 million (2011: RMB1,800 million). Of these interest costs, 80% (2011: 89%) or RMB2,002 million (2011: RMB1,608 million) were capitalised as cost of property development, with the remaining 20% (2011: 11%) interest relating to mortgage loans on completed properties and borrowings for general working capital purposes were expensed.

Profit before taxation decreased by 39% to RMB3,718 million (2011: RMB6,060 million), as a result of the various factors outlined above.

Taxation decreased by 34% to RMB1,363 million (2011: RMB2,062 million). The effective tax rate for the year 2012 was 29.9% (2011: 26.0%), after excluding the land appreciation tax of RMB334 million (2011: RMB641 million) (which was assessed based on the appreciation value of the sold properties) together with its corresponding enterprise income tax effect of RMB83 million (2011: RMB160 million). The increase in effective tax rate resulted from the increase in interest from offshore borrowings that are not deductible in the PRC.

Profit attributable to shareholders of the Company for 2012 was RMB2,029 million, a decrease of 41% when compared to 2011 (2011: RMB3,428 million). Return on equity for 2012 was 7.3% (2011: 14%), which was calculated based on profit attributable to shareholders for the year divided by shareholders' equity at the beginning of the year.

Profit attributable to shareholders excluding the increase in fair value of investment properties is as follows:

	2012 RMB'million	2011 RMB'million	Change %
Profit attributable to shareholders of the Company	**2,029**	3,428	-41%
Less:			
Increase in fair value of investment properties of the Group (net of deferred tax effect and share of non-controlling interests)	**(1,740)**	(1,761)	
Share of increase in fair value of investment properties of associates (net of tax effect)	**(88)**	(95)	
Profit attributable to shareholders of the Company before revaluation of investment properties	**201**	1,572	-87%

Earnings per share RMB0.35 (2011: RMB0.66) was calculated based on a weighted average of approximately 5,773 million shares (2011: 5,212 million shares) in issue during the year ended 31 December 2012.

Dividend payable to shareholders of the Company has to comply with certain covenants under the senior notes and perpetual capital securities as follows:

- Dividend payable to the shareholders of the Company (together with any redemption, repurchase or acquisition of the Company's shares) should not exceed 20% of the Company's consolidated net income (which approximates profit attribute to shareholders of the Company but adjust for, among others, exchange differences, gain/loss from non-ordinary course asset disposals and extraordinary or non-recurring gains based on the terms of the senior notes) for any two semi-annual periods unless certain conditions pursuant to the terms of the senior notes have been met.
- In the case where the Company opts for deferring the payment of coupons to the owners of perpetual capital securities, no dividend payments should be made to the shareholders of the Company unless all coupons so deferred has been paid in full.

The Board has resolved to recommend the payment of 2012 final dividend of HK$0.035 per share (2011: HK$0.10 per share) to shareholders of the Company. On 28 March 2013, the Company announced a proposed rights issue of rights shares on the basis of 1 rights share for every 3 existing shares. If the rights shares (in their fully-paid form) are allotted and issued on or before the record date for the 2012 final dividend and shareholders approve the 2012 final dividend at the forthcoming annual general meeting, then holders of fully-paid rights shares whose names appear on the register of members of the Company on the record date for the 2012 final dividend will be entitled to receive the 2012 final dividend of HK$0.035 per share on the same basis as holders of existing shares in issue. In such case the aggregate amount of the 2012 final dividend will be HK$280 million (equivalent to RMB226 million).

Together with the 2012 interim dividend of HK$0.025 (2011: HK$0.025) paid in October 2012 amounted to RMB122 million, the total dividend for 2012 was RMB348 million (2011: RMB580 million). This represents a dividend payout ratio of 17% (2011: 17%).

In addition, the Company has RMB2,720 million convertible bonds in issue with conversion price of HK$4.47 at a fixed rate of RMB1.00 to HK$1.1439 and share options exercisable with exercise price ranged from HK$2.61 to HK$11.78. If all these convertible bonds and share options are to be converted into new ordinary shares of the Company on or before the record date for the 2012 final dividend, then holders of convertible bonds and share options whose names appear on the register of members of the Company on the record date for the 2012 final dividend will be entitled to receive the 2012 final dividend of HK$ 0.035 per share on the same basis as holders of existing shares in issue and holders of fully-paid rights shares. In such case the aggregate amount of the 2012 final dividend will be HK$315 million (equivalent to RMB255 million).

Capital Structure, Gearing Ratio and Funding

In January and February 2012 respectively, the Group issued SG$250 million 8% senior notes and US$475 million 9.75% senior notes, each with a maturity of three years.

On 6 August 2012, the Group issued a further US$400 million in 9.75% senior notes at 102.785% of the principal amount plus accrued interest from 16 February 2012 to 6 August 2012. The effective finance cost on this notes issue was 8.5% per annum (excluding direct expenses incurred). These additional notes will mature in February 2015, and were consolidated and formed a single class with the US$ notes issued in February 2012.

The proceeds from these notes issues were used to finance the land relocations of existing projects and for working capital purposes.

The structure of the Group's borrowings as of 31 December 2012 is summarised below:

	Total (in RMB equivalent) RMB'million	Due within one year RMB'million	Due in more than one year but not exceeding two years RMB'million	Due in more than two years but not exceeding five years RMB'million	Due in more than five years RMB'million
Bank borrowings – RMB	**9,735**	2,084	2,529	3,912	1,210
Bank borrowings – HK$	**6,561**	2,643	1,059	2,859	–
Other borrowings – US$	**2,507**	376	279	1,852	–
	18,803	5,103	3,867	8,623	1,210
Convertible bonds – RMB	**2,346**	2,346	–	–	–
Notes – RMB	**6,554**	2,980	–	3,574	–
Notes – SG$	**1,298**	–	–	1,298	–
Notes – US$	**5,667**	–	–	5,667	–
Total	**34,668**	**10,429**	**3,867**	**19,162**	**1,210**

In addition, on 4 December 2012, the Group issued US$500 million perpetual capital securities guaranteed by the Company with an annual coupon of 10.125% ("Perpetual Capital Securities"). These Perpetual Capital Securities have no fixed maturity and are redeemable at the Group's option on or after 10 December 2017 at their principal amounts together with any accrued, unpaid or deferred coupon payments. The coupon payments on the Perpetual Capital Securities are payable semi-annually in arrears and may be deferred at the discretion of the Group. The Perpetual Capital Securities are classified as equity instruments in the financial statements as there are no fixed maturity terms and the Group does not have a contractual obligation to make the coupon payments.

Total cash and bank deposits amounted to RMB8,633 million as of 31 December 2012 (31 December 2011: RMB6,370 million), which included RMB2,163 million (31 December 2011: RMB2,512 million) of deposits pledged to banks and RMB183 million (31 December 2011: RMB335 million) of restricted bank deposits which can only be applied to designated property development projects of the Group.

As of 31 December 2012, the Group's net debt balance was RMB26,035 million (31 December 2011: RMB19,118 million) and its total equity was RMB37,268 million (31 December 2011: RMB29,471 million). The Group's net gearing ratio was 70% as of 31 December 2012 (31 December 2011: 65%), calculated on the basis of the excess of the sum of convertible bonds, notes, bank borrowings net of bank balances and cash (including pledged bank deposits and restricted bank deposits) over the total equity.

Total undrawn banking facilities available to the Group were approximately RMB7,578 million as of 31 December 2012 (31 December 2011: RMB6,406 million).

Pledged Assets

As of 31 December 2012, 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 RMB43,203 million (31 December 2011: RMB28,963 million) to secure its borrowings of RMB16,692,million (31 December 2011: RMB13,981 million).

The boutique fashion district at Ruihong Tiandi will feature the Korean and Japanese trends

The Lingnan styled architecture at Foshan Lingnan Tiandi

Capital and Other Development Related Commitments

As of 31 December 2012, the Group had contracted commitments for development costs and capital expenditure in the amount of RMB14,442 million (31 December 2011: RMB11,967 million).

Future Plans for Material Investments and Sources of Funding

On 9 September 2011, the Group entered into a sales and purchase agreement with certain subsidiaries of Shui On Company Limited (a substantial shareholder) to acquire 80% interest in Shanghai Shui On Plaza and 66.7% interest in Shanghai Langham Xintiandi Hotel. These acquisitions were completed on 16 March 2012 at a final consideration of RMB1,766 million. An aggregate of 626,909,643 new and fully paid ordinary shares of the Company was issued as consideration to the sellers. These new shares ranked pari passu with the existing shares of the Company.

The Group shall continue to focus on the development of the existing landbank which is spread throughout prime locations. As appropriate opportunities arise, the Group may participate in projects of various sizes wherein its competitive strengths provide advantages. The Group may also pursue other plans, including different ways to acquire land development rights for the purpose of undertaking property projects or to leverage its master planning expertise towards increasing the scale of current operations.

Cash Flow Management and Liquidity Risk

Management of the Group's cash flow is the responsibility of the Group's treasury function at the corporate level.

The Group's objective is to maintain a balance between continuity of funding and flexibility through a combination of internal resources, bank borrowings, and debt or equity securities, as appropriate. The Group is comfortable with the 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 times.

Exchange Rate and Interest Rate Risks

The revenue of the Group is denominated in RMB. The convertible bonds and the notes issued in 2010 and 2011 were also denominated in RMB. As a result, the coupon payments and the repayment of the principal amounts of the convertible bonds and notes issued in 2010 and 2011 do not expose the Group to any exchange rate risk. A portion of the revenue, however, is converted into other currencies to meet our foreign-currency-denominated debt obligations, such as bank borrowings denominated in HK$ and US$, and senior notes denominated in SG$ and US$ issued in 2012. As a result, to the extent that the Group may have a net currency exposure, this exposure would be subject to fluctuations in foreign exchange rates.

The relatively stable currency regime of the RMB is maintained by the PRC Central Government, which permits the exchange rate to fluctuate only within a predefined range to a portfolio of various currencies. Given these defined circumstances, the Group does not expect any material adverse effects of the exchange rate fluctuation between the RMB and US$/HK$/SG$. Nevertheless, the Group continues to monitor closely its exposure to exchange rate risk, and is prepared to employ derivative financial instruments to hedge against its exchange rate risk, if necessary.

The Group's exposure to interest rate risk results from fluctuations in interest rates. Most of the Group's bank borrowings 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. Increases in interest rates would raise interest expenses relating to the outstanding variable rate borrowings and cost of new debt. Fluctuations in interest rates may also lead to significant fluctuations in the fair value of the debt obligations.

At 31 December 2012, the Group had various outstanding loans that bear variable interests linked to Hong Kong Inter-bank Borrowing Rates ("HIBOR"), London Inter-bank Borrowing Rates ("LIBOR") and Singapore Inter-bank Borrowing Rates ("SIBOR"). The Group has hedged against the variability of cash flow arising from interest rate fluctuations by entering into interest rate swaps in which the Group would receive interest at variable rates at HIBOR or LIBOR and pay interest at fixed rates ranging from 0.63% to 1.45% based on the notional amount of HK$3,530 million and US$150 million, in aggregate. The Group continues to monitor closely its exposure to interest rate risk, and may further consider additional derivative financial instruments to hedge against its remaining exposure to interest rate risk, if necessary.

Save as disclosed above, as of 31 December 2012, the Group did not hold any other derivative financial instruments which were linked to exchange rate or interest rates. The Group continues to monitor closely its exposure to exchange rate and interest rate risks, and may employ derivative financial instruments to hedge against risk when necessary.

Tiandi Hui at Wuhan Tiandi will be the first environmental friendly and family-oriented one-stop shopping centre in Wuhan