

Management Discussion and Analysis

(I) REVIEW OF 2002 RESULTS AND SEGMENTAL PERFORMANCE

REVIEW OF 2002 RESULTS

Profit attributable to Shareholders

The Group reported a profit attributable to shareholders of HK\$2,303 million for the year 2002, a decrease of HK\$216 million or 9% as compared to HK\$2,519 million achieved in 2001. The reduction in profit is primarily due to the inclusion in the results of aggregate attributable impairment provisions of HK\$813 million for properties and properties under development, including the Sorrento and Bellagio projects held through associates, and a provision of HK\$134 million for impairment in value of investments. Earnings per share were HK\$0.94, compared to HK\$1.03 recorded in the previous year.

Excluding the above-mentioned provisions in both years, the Group's net profit would be HK\$3,250 million in 2002, an increase of 14% compared to HK\$2,844 million in 2001. Such a growth reflected the comparative resilience and steady performance of the Group's core business assets in a deflationary local economy and competitive business environments.

The Group's investment and hotel property portfolios were revalued by independent valuers at December 31, 2002, resulting in a transfer of a net revaluation deficit of HK\$6,077 million to the Group's revaluation reserves. Primarily because of this downward revaluation, the Group's consolidated net asset value was reduced to HK\$48,713 million or HK\$19.91 per share at December 31, 2002, compared to HK\$54,645 million or HK\$22.33 per share at December 31, 2001, respectively.

Group's Turnover

The Group's turnover for the year under review was HK\$11,333 million, a decrease of HK\$392 million or 3% against HK\$11,725 million earned in 2001. Decrease in turnover was principally due to substantial reduction in property sales by HK\$613 million given that the Group's property sales activities during the year were substantially sustained by its associates undertaking the Sorrento and Bellagio projects, the sale proceeds derived from which were not accounted for as the Group's turnover. This unfavorable variance was mitigated by the continued improvement in revenue from the Group's investment property portfolio, Pay TV and broadband services.

Group Operating Profit

Group operating profit before borrowing costs for the year 2002 was HK\$5,341 million, increased by HK\$289 million or 6% from HK\$5,052 million in 2001. The improvement was primarily driven by additional profit contribution from the Group's core businesses, particularly the Property Investment and Communications, Media and Entertainment ("CME") segments. All business units attained improvements in operating margins in the year under examination mainly as a result of effective cost rationalization programmes and productivity gains.

Net Operating Profit

Net operating profit in 2002 recorded an increase of 16% against the previous year due to a substantial reduction in borrowing costs.

SEGMENTAL PERFORMANCE

Property Investment

The Property Investment segment, including its two core assets Harbour City and Times Square, reported a revenue growth of 2% to HK\$4,442 million.

Harbour City

Harbour City generated total revenue of HK\$2,878 million in 2002, an increase of HK\$41 million or 1% from HK\$2,837 million reported in 2001 as a consequence of the improvement in occupancy rates at Gateway Towers 3, 5 and 6. Pressure on office rental had increased and there was rental loss in certain parts of Ocean Terminal, which had been reserved for renovation and refurbishment programmes. The operating profit of Harbour City increased by HK\$138 million or 7% to HK\$2,001 million in 2002.

Times Square

Times Square, another core investment property, generated total revenue of HK\$895 million, which was slightly above last year's level of HK\$892 million. The operating profits for both years were kept at HK\$762 million.

Aggregate revenue from other investment properties including those in Mainland China also recorded satisfactory improvement in 2002.

Communications, Media and Entertainment ("CME")

Against a backdrop of a weak economy and poor consumer sentiment, the CME segment continued to sustain growth both in revenue and operating profit, though at a slower pace than in previous years. Its revenue came under pressure amidst the severe economic conditions and keener competitions. In 2002, the segment managed to increase its total revenue by HK\$278 million or 9% to HK\$3,435 million and increased its operating profit by HK\$117 million or 38% to HK\$429 million compared to the previous year. Increases in customers from its pay TV, Broadband Internet multimedia and telecommunication services were reported.

i-CABLE

Pay TV

Pay TV turnover grew by HK\$116 million or 7% to HK\$1,711 million, as a result of increase in airtime sales revenues and growth in subscribers by 8% to surpass 605,000 during the year spurred by the 2002 FIFA World Cup and the effectiveness of the anti-piracy measures. In spite of the increase in revenue, Pay TV reported a decline in operating profit of HK\$17 million or 5% to HK\$332 million compared with the previous year primarily due to the increase in non-recurring programming costs related to the 2002 FIFA World Cup. Average revenue per subscriber ("ARPU") rose to HK\$233.

Internet and multimedia

Internet and multimedia revenue for the year grew by HK\$114 million or 34% to HK\$450 million as broadband subscribers grew by 42% to surpass 225,000. On the back of subscriber growth and high operating leverage, the operating results achieved a turnaround from loss of HK\$50 million to profit of HK\$9 million in 2002. Amid extremely keen competitions, ARPU dropped to HK\$180.

As compared to 2001, the combined results of Pay TV and Internet and multimedia businesses increased the group revenue of i-CABLE by HK\$230 million or 12% to HK\$2,161 million and increased its operating profit before corporate expenses by HK\$42 million or 14% to HK\$341 million.

Wharf T&T (Telecommunication services)

Defying the unfavorable business environment and intense competition, Wharf T&T increased its telecommunication revenue by HK\$28 million or 3% to HK\$1,117 million. Its installed base of fixed lines grew by 41% to reach 340,000 lines at the end of 2002, which represented a record gain in market shares to 9% overall. The company's revenue from fixed-line telephony services rose by 6% to HK\$833 million which accounted for 75% of its total revenue, while IDD revenue fell by 6% to HK\$284 million. Coupled with operating efficiency, Wharf T&T recorded a more than five-fold increase in operating profit to HK\$53 million.

Logistics

Modern Terminals

The total revenue of Logistics segment including Modern Terminals Limited ("MTL"), a 55.3%-owned subsidiary, was HK\$3,203 million, a decrease of HK\$77 million or 2% as compared with HK\$3,280 million in 2001.

The revenue drop was mainly due to a reduction in MTL's revenue by HK\$133 million from 2001 as a result of a decline in tariff generally in line with the market development. MTL's operating profit was maintained at almost the 2001 level.

Operating profit of the segment increased by HK\$43 million or 2% to HK\$1,838 million in 2002 partly because of increase in other logistics income.

Further information on the segmental details is provided in Note 2 to the Accounts.

Depreciation and amortisation

Depreciation and amortisation charge for the year 2002 totalled HK\$1,208 million (including the amortisation of goodwill HK\$22 million), an increase of 11% over 2001. The rise resulted from the combined effect of an increase in depreciation of i-CABLE and Wharf T&T on their expanded capital expenditures, and an increase in amortisation of the programming library of i-CABLE. This was offset by a reduction of depreciation charge of HK\$76 million following an extension of estimated useful lives of some plant and equipment of the Group (including MTL) in 2002.

Borrowing costs

Net borrowing costs charged for the year decreased substantially by HK\$351 million or 32% to HK\$755 million from HK\$1,106 million incurred in the previous year as a result of market interest rate cuts as well as the Group's success in reducing interest margins through its refinancing activities in 2002. The charge was after capitalisation to related assets of HK\$94 million for the year compared to HK\$189 million in 2001. The Group's average borrowing cost for the year was 3.59% p.a., a reduction from 5.45% p.a. in 2001.

Net other charges

Net other charges for the year amounted to HK\$434 million compared to HK\$99 million in 2001. The charges in 2002 mainly comprised net provisions of HK\$285 million for impairment in value of various properties under development as a result of a review of the prevailing market conditions and HK\$149 million for impairment in value of investments. The net other charges in 2001 covered a provision for impairment in value of investments of HK\$438 million net of write-back of a property provision of HK\$339 million.

Share of profits less losses of associates

The share of losses of associates for the year was HK\$495 million compared to HK\$281 million in 2001. The attributed losses for the year mainly resulted from the Group's share of the aggregate provisions of HK\$589 million made by the associates for the impairment in value of two property development projects, namely, Sorrento and Bellagio, 40% and 33-1/3% respectively owned by the Group. The losses in 2001 principally reflected the attributable loss for impairment in value of Bellagio.

Other items

The Group's profit before taxation increased by HK\$91 million to HK\$3,657 million from HK\$3,566 million of 2001.

The taxation charge for the year was HK\$682 million compared to HK\$403 million reported in 2001. The change primarily resulted from the increase in the Group's net operating profit and the inclusion of an under-provision of HK\$108 million in relation to prior years' assessments.

Minority interests were HK\$672 million compared to HK\$644 million in 2001.

Included in the Group's profit attributable to the shareholders are profit of HK\$883 million (2001: HK\$833 million) contributed from three major non-wholly owned subsidiaries, namely the 55.3%-owned MTL, 79.2%-owned i-CABLE Communications Limited ("i-CABLE") and 66.8%-owned Harbour Centre Development Limited ("HCDL"). Total dividends received from these subsidiaries amounted to HK\$853 million for the year 2002 (2001: HK\$925 million).

(II) LIQUIDITY AND FINANCIAL RESOURCES**Shareholders' funds**

As at December 31, 2002, the shareholders' funds of the Group totalled HK\$48,713 million, a decrease of HK\$5,932 million from HK\$54,645 million at December 31, 2001. As explained above, the decrease was mainly due to the inclusion of a net revaluation deficit of HK\$6,077 million arising from a downward revaluation of the Group's investment and hotel property portfolios to HK\$52,373 million and HK\$3,339 million respectively. On that basis, the consolidated net asset value of the Group at that date was HK\$19.91 per share, compared to net asset value of HK\$22.33 per share at December 31, 2001.

Supplemental Information

To better reflect the underlying net asset value of the Group, the following objective-base adjustments are given below:

	Per share
Book net asset value at December 31, 2002	HK\$19.91
Add adjustments for:-	
Modern Terminals - based on the previous average transaction prices	2.22
i-CABLE - based on market value at December 31, 2002 (@\$2.58 p.s.)	1.20
Adjusted net asset value per share at December 31, 2002	HK\$23.33

Net cash generated from the Group's operating activities

For the year under review, net cash generated from the Group's operating activities amounted to HK\$4.7 billion, increased from HK\$3.1 billion in 2001. This reflects the Group's steady recurrent cash inflows generated by its core business assets. Investing activities comprised mainly purchase of fixed assets, net purchase of non-trading investments and net advances to associates mainly for property development of Bellagio and Sorrento.

Capital expenditure

The capital expenditure, including programming library, incurred by the Group's core businesses during the year and their capital commitments at the year-end date are analysed as follows:

Business Unit/Company	Capital expenditure in 2002 HK\$Million	Capital Commitments as at December 31, 2002	
		Authorised and contracted for HK\$Million	Authorised but not contracted for HK\$Million
Property investments/others	350	183	1,206
Logistics	502	1,340	218
i-CABLE	644	61	92
Wharf T&T	678	116	90
	2,174	1,700	1,606
At December 31, 2001	2,588	1,767	2,007

The capital expenditure of i-CABLE and Wharf T&T was mainly related to network equipment while that of the Logistics was substantially for construction of Container Terminal 9.

In addition to the above, the Group had planned expenditures of approximately HK\$1.1 billion (2001: HK\$1.2 billion) related to the properties under development for sale at the end of 2002.

Major property projects undertaken by associates

Regarding the Sorrento and Bellagio property development projects undertaken by associates, pre-sales had been launched with good progress in 2002. Accumulated sales of Sorrento exceeded 81% of the 1,272 Phase I units and 30% of 854 Phase II units by the end of 2002. The sale of Bellagio was first launched in September 2002 with tremendous success. 74% of the 1,704 Phase I and II units were sold by the end of 2002.

Pre-sale proceeds received by the investing companies of the two projects have been utilized for repayments of the relevant shareholders' advances partially and bank loans in full with the remaining proceeds retained in stakeholders accounts for future payment of construction costs. At December 31, 2002, the cash deposits in Sorrento's stakeholders account amounted to HK\$0.9 billion, which would be sufficient to fully cover its outstanding construction cost for completion of the whole project while that of Bellagio's amounted to HK\$1.1 billion, which would also be sufficient to fully cover the outstanding construction cost of Phase I and II and substantially cover the outstanding construction cost of Phase III and IV of the project. The two project companies did not have any borrowings at the end of 2002.

Gearing Ratios

As at December 31, 2002, the ratio of net debts to total assets increased to 26%, while the ratio of net debts to shareholders' equity increased to 42%, compared to 23.4% and 36% at December 31, 2001, respectively. The Group's net debts increased slightly from HK\$19.8 billion at December 31, 2001 to HK\$20.5 billion at December 31, 2002, which was made up of HK\$22.7 billion in debts less HK\$2.2 billion in deposits, debt securities and cash. Included in the Group's debts were loans of HK\$941 million and HK\$386 million borrowed by two non wholly-owned subsidiaries, MTL and i-CABLE, respectively (2001: HK\$992 million borrowed by MTL and HCDL). These loans are without recourse to the Company and other subsidiaries of the Group.

Availability of committed and uncommitted facilities

High liquidity continued to sustain in the banking market during the year 2002. The Group arranged an aggregate of HK\$6.9 billion loan facilities to refinance a number of its loan facilities with substantial reduction in interest margins and on more favourable terms. Amongst these financing activities, the Group arranged in June 2002 the issue of Retail Bonds totalling HK\$600 million via a wholly-owned subsidiary. The result was satisfactory and the Bonds were fully subscribed for. This was the first ever retail bond issued by private corporation in Hong Kong.

Excluding the project loan facilities of totalling HK\$1 billion available to Sorrento and Bellagio, which are undertaken by associates, the Group's available loan facilities and debt securities amounted to HK\$31.9 billion. Debts totalling HK\$22.7 billion were outstanding at December 31, 2002, against the available facilities as analysed below:

Debt Maturity	31/12/2002			
	Available facility HK\$ Billion	Total debt HK\$ Billion		Undrawn facility HK\$ Billion
Company and wholly-owned subsidiaries				
Committed facilities				
Repayable within 1 year	4.8	4.8	21%	-
Repayable between 1 to 2 years	8.6	7.6	33%	1.0
Repayable between 2 to 3 years	2.0	1.8	9%	0.2
Repayable between 3 to 4 years	2.6	2.6	11%	-
Repayable between 4 to 5 years	7.2	3.4	15%	3.8
	25.2	20.2	89%	5.0
Uncommitted facilities	2.3	1.0	4%	1.3
	27.5	21.2	93%	6.3
Non wholly-owned subsidiaries				
- Committed and uncommitted				
Modern Terminals Limited	2.7	0.9	4%	1.8
i-CABLE Communications Limited	0.9	0.4	2%	0.5
Others	0.8	0.2	1%	0.6
	31.9	22.7	100%	9.2
- Secured	5.4	5.0	22%	0.4
- Unsecured	26.5	17.7	78%	8.8
Total	31.9	22.7	100%	9.2

Secured Notes in the amount of HK\$4.5 billion will be prepaid in May 2003, which will cause the secured debts to drop from 22% to 2%.

As at December 31, 2002, the banking facilities of the Group were secured by mortgages over certain investment properties with an aggregate carrying value of HK\$17,923 million (2001: HK\$19,171 million).

An analysis of the Group's total debts by currency at December 31, 2002 is shown as below:

	HK\$ Billion
Hong Kong dollar	14.9
United States dollar (swapped into Hong Kong dollars)	7.3
Renminbi	0.5
	<u>22.7</u>

The Group's debts are primarily denominated in Hong Kong and US dollars and all US dollars loans have been effectively swapped into Hong Kong dollar loans by forward exchange contracts.

The use of financial derivative products is strictly controlled. The majority of the derivative products entered into by the Group were used for management of the Group's interest rate exposures.

The Group maintained a reasonable level of surplus cash, which was denominated principally in Hong Kong and US dollars, to facilitate the Group's business and investment activities. As at December 31, 2002, the Group also maintained a portfolio of long-term investments, primarily in blue-chip securities, with a market value of HK\$1.1 billion.

(III) EMPLOYEES

The Group has approximately 10,111 employees. Employees are remunerated according to nature of the job and market trend, with a built-in merit component incorporated in the annual increment to reward and motivate individual performance. Total staff costs for the year 2002 amounted to HK\$1,983 million, compared to HK\$1,987 million of 2001.