# Managing Director's Report

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# Financial Review

## (I) Review of 2009 Results

Despite the global economic downturn in 2009, the Group achieved an all-time high profit attributable to shareholders of HK$7,817 million before and HK$17,501 million after the net investment property revaluation surplus, representing an increase of 86% and 180% over 2008 respectively. The unprecedented results reflected the Group's strong rental revenue growth, the sharp rise in profit on property sales in China, the benefit from the persistent low interest environment, the one-off profit on disposal of Beijing Capital Times Square and the appreciation of the underlying value of the Group's investment property portfolio.

### Turnover

The Group's turnover for 2009 rose by 10% to HK$17,553 million (2008: HK$15,940 million), benefiting from the robust growth in rental revenue and the encouraging property sales in the Mainland.

Property Investment's rental revenue from Hong Kong recorded a 10% increase to HK$6,637 million whilst that from China rose by 15% to HK$592 million. However, the worldwide slowdown of the hotel industry stemming from the global financial crisis persisted, albeit to a lesser extent in the second half of 2009, resulting in the Group's hotel revenue declining by 9% to HK$963 million. In aggregate, the segment reported a net increase of 8% to a record high of HK$8,192 million.

Property Development recorded a significant increase in revenue by 332% to HK$3,065 million as the Group's China segment experienced strong growth in property sales and with the phased completion of the residential towers in Dalian Times Square and Chengdu Tian Fu Times Square.

Logistics revenue decreased by 20% to HK$3,091 million, mainly reflecting the 13% reduction in volume throughput at Modern Terminals as world trade sharply contracted.

CME revenue dropped by 9% to HK$3,404 million, primarily due to the decrease reported by i-CABLE.

### Operating Profit

The Group's operating profit increased by 13% to HK$8,554 million, mainly driven by the increase in rental revenue and the robust profit contribution from property sales in China.

Property Investment continued to be the key profit contributor with its operating profit increasing by 12% to HK$6,191 million. Harbour City (excluding Hotels) and Times Square rose by 14% and 10%, respectively, reflecting the underlying strong rental reversion and consistently high occupancy for the retail areas, despite the pressure on office rental rates and occupancy since late 2008. The investment properties in China also performed well and increased their operating profit by 26%, partly due to the expanding portfolio.

Hotel operating profit decreased by 21% to HK$242 million with both occupancy and average room rate adversely affected by the weak demand in the hotel industry under the prevailing economic conditions. That performance was largely in line with the market.

Property Development's operating profit expanded to HK$1,012 million, an increase of HK$928 million from its low level in 2008, wholly attributable to the expanding property sales in the Mainland.

Logistics' operating profit dropped by 20% to HK$1,418 million primarily due to the decrease in Modern Terminals' consolidated throughput from its terminal operations in Hong Kong and the Mainland. However, favourable finance costs together with proactive cost saving initiatives helped to mitigate its bottom line to a decrease of 4% against 2008.

CME's operating profit recorded an increase to HK$163 million (2008: HK$64 million). Wharf T&T's operating profit increased by 52% to HK$213 million. i-CABLE, through effective cost control initiatives, narrowed its operating loss by HK$28 million.

Investment and Others segment reported a decrease in operating profit to HK$90 million (2008: HK$304 million), mainly due to the reduction in interest income amid the exceptionally low interest rate environment.

## Profit on Disposal of an Investment Property

Profit on disposal of Beijing Capital Times Square in the year amounted to HK$1,110 million. Together with the net tax credit of HK$283 million mainly related to the release of the deferred tax previously provided in view of the revaluation surpluses, the net profit for the disposal amounted to HK$1,393 million.

## Increase in Fair Value of Investment Properties

The book value of the Group's investment property portfolio as at 31 December 2009 was HK$115.5 billion, with HK$111.8 billion thereof stated at fair value based on an independent valuation as at 31 December 2009, which produced a revaluation surplus of HK$12,204 million (2008: HK$1,793 million). The attributable net revaluation surplus of HK$9,684 million (2008: HK$1,363 million), after deducting related deferred tax and minority interests, was credited to the consolidated income statement.

Investment properties in the amount of HK$3.7 billion not revalued were all under development and not carried at fair value until at the earlier of when their fair values first become reliably measurable or the dates of their respective completion. This is to accord with the revised accounting standard HKAS 40, which expands the definition of an investment property to include an investment property under development.

## Other Net Income/Net Other Charge

Other net income for the year amounting to HK$227 million (2008: HK$96 million) mainly included profit on disposal of available-for-sale investments, certain subsidiaries and jointly controlled entities. Net other charge of HK$52 million (2008: HK$145 million) represented the write-off of certain fixed assets.

## Finance Costs

Finance costs charged to the consolidated income statement were HK$338 million for the year (2008: HK$1,521 million). Included in finance costs was a mark-to-market unrealised gain of HK$46 million (2008: unrealised loss of HK$612 million) on the cross currency/interest rate swaps in compliance with the prevailing accounting standard.

Excluding the impact of the unrealised mark-to-market changes on the swaps, finance cost after capitalisation was HK$384 million (2008: HK$909 million), representing a reduction of HK$525 million due to the persistent low interest rate in the prevailing market during the year.

Finance costs was stated after capitalisation of HK$212 million (2008: HK$200 million) in respect of the Group's related assets.

## Share of Results (after tax) of Associates and Jointly Controlled Entities

The share of profit of associates increased by 107% to HK$281 million (2008: HK$136 million). Profit contribution from the jointly controlled entities increased by HK$70 million to HK$75 million, mainly benefitting from the property sales recognised by a jointly controlled entity involved in property development in China.

## Income Tax

Taxation charge for the year was HK$3,973 million (2008: HK$1,189 million), which included deferred taxation of HK$2,449 million (2008: HK$433 million) provided for the current year's investment properties revaluation surplus. In 2008, there was a credit adjustment of HK$768 million in respect of the previous years' deferred tax liabilities, mainly related to investment property revaluation surplus, resulting from the 1% reduction in Hong Kong profits tax rate.

Excluding the above deferred tax charge and credit adjustment, the tax charge was HK$1,524 million (2008: HK$1,524 million), which included a provision of HK$194 million (2008: HK$292 million) made for certain tax cases primarily relating to interest deductibility under discussion with the Inland Revenue Department.

## Minority Interests

Minority interests increased by HK$116 million to HK$587 million reflecting the increase in net profits of certain non-wholly-owned subsidiaries, mainly from HCDL.

## Profit Attributable to Equity Shareholders

The Group's profit attributable to equity shareholders increased by 180% to HK$17,501 million (2008: HK$6,247 million). Earnings per share were HK$6.35 (2008: HK$2.28), based on 2,754 million issued shares.

Excluding the net investment property revaluation surplus after associated deferred tax of HK$9,684 million (2008: HK$1,363 million and the related deferred tax credit of HK$690 million), the Group's profit attributable to shareholders for the year was HK$7,817 million (2008: HK$4,194 million), a rise of 86% over 2008.

# (II) Liquidity, Financial Resources and Capital Commitments

## Shareholders' and Total Equity

As at 31 December 2009, the Group's shareholders' equity increased by HK$15,716 million to HK$115,210 million, equivalent to an increase of 16% to HK$41.83 per share (2008: HK$36.13 per share).

Including the minority interests, the Group's total equity increased by 15% to HK$122,164 million (2008: HK$105,857 million).

## Total Assets

The Group's total assets increased by 13% to HK$190.5 billion (2008: HK$168.6 billion). Total business assets, excluding bank deposit and cash, held-to-maturity investment and available-for-sale investment, increased by 12% to HK$170.0 billion (2008: HK$152.0 million).

Included in the Group's total assets is the Investment Property portfolio of HK$115.5 billion, representing 68% of total business assets. The core assets in this portfolio are Harbour City and Times Square in Hong Kong, which are valued at HK$62.6 billion (excluding the 3 Hotels) and HK$24.0 billion, respectively. Together, they represent 75% of the value of the Investment Property portfolio.

Other major business assets included other properties and fixed assets of HK$18.5 billion, interest in jointly controlled entities and associates (mainly for China property and port projects) of HK$11.8 billion and properties under development and held for sale (mainly in China) of HK$17.8 billion.

Geographically, the Group's business assets in China, mainly properties and terminals, increased to HK$53.4 billion, represented 32% of the Group's business assets.

In previous years, an investment property under development was not classified as investment property and stated at cost. As a result of the change in the relevant accounting standard, such property has been classified as investment property and carried at fair value at the earlier of when the fair value first becomes reliably measurable or the date of completion of the property.

## Debts and Gearing

The Group's net debt decreased by HK$0.7 billion to HK$21.4 billion as at 31 December 2009 (2008: HK$22.1 billion), which was made up of HK$39.8 billion in debts and HK$18.4 billion in bank deposits and cash. Included in the Group's net debts were HK$12.0 billion (2008: HK$11.6 billion) attributable to Modern Terminals, HCDL and other subsidiaries, which are without recourse to the Company and other subsidiaries of the Group. Excluding these non-recourse debts, the Group's net debt was reduced by 10% to HK$9.4 billion (2008: HK$10.5 billion).

As at 31 December 2009, the ratio of net debt to total equity was 17.5% (2008: 20.9%).

## Finance and Availability of Facilities

The Group's available loan facilities and debt securities totally amounting to HK$58.9 billion, of which HK$39.8 billion were drawn, as at 31 December 2009 are analysed as below:

| | 31 December 2009 | | |
|---|---|---|---|
| | **Available Facility** *HK$ Billion* | **Total Debts** *HK$ Billion* | **Undrawn Facility** *HK$ Billion* |
| **Company/wholly-owned subsidiaries** | | | |
| Committed facilities | 33.8 | 25.0 | 8.8 |
| Uncommitted facilities | 0.5 | – | 0.5 |
| | 34.3 | 25.0 | 9.3 |
| **Non-wholly-owned subsidiaries** | | | |
| Committed and uncommitted | | | |
| – Modern Terminals | 16.8 | 11.1 | 5.7 |
| – HCDL | 4.6 | 3.0 | 1.6 |
| – i-CABLE | 0.4 | – | 0.4 |
| – Others | 2.8 | 0.7 | 2.1 |
| | 58.9 | 39.8 | 19.1 |

Of the above debts, HK$8,996 million (2008: HK$8,160 million) was secured by mortgage over certain properties under development and fixed assets with total carrying value of HK$22,474 million (2008: HK$15,915 million).

The Group's debts were primarily denominated in Hong Kong dollar ("HKD"), United States dollar and Renminbi ("RMB"). RMB borrowings were used to fund the Group's property development and port-related investments in China.

The use of derivative financial instruments was strictly monitored and controlled. The majority of the derivative financial instruments entered into by the Group were primarily used for management of the Group's interest rate and foreign currency exposures.

The Group maintained a very strong financial position with ample surplus cash denominated principally in HKD and RMB and undrawn committed facilities to facilitate the Group's expanding business and investment activities. As at 31 December 2009, the Group also maintained a portfolio of available-for-sale investments with an aggregate market value of HK$1.3 billion (2008: HK$0.7 billion), which is immediately available for liquidation for the Group's use.

## Cash Flows for the Group's Operating and Investing Activities

For the year under review, the Group's net cash inflow before change in working capital increased to HK$9.7 billion (2008: HK$8.6 billion). The changes in working capital resulted in a net cash outflow of HK$2.1 billion (2008: HK$6.9 billion), primarily due to payment for land and construction cost for trading properties under development in China. For investing activities, the Group reported a net cash outflow of HK$5.4 billion (2008: HK$5.7 billion), mainly representing payment of construction cost for investment properties under development in China and investments in jointly controlled entities involved in property development projects in China.

## Major Expenditure and Commitments

The major expenditure incurred by the Group's core businesses during the year and related commitments at 31 December 2009 are analysed as follows:

| | | | Commitments as at 31 December 2009 | |
|---|---|---|---|---|
| Business Unit/Company | | Expenditure for 2009 *HK$ Million* | Authorised and Contracted for *HK$ Million* | Authorised but not Contracted for *HK$ Million* |
| **a.** | **Capital expenditure** | | | |
| | Property Investments | 1,586 | 6,264 | 11,212 |
| | Wharf T&T | 287 | 92 | 141 |
| | i-CABLE (73.8%-owned) | 261 | 45 | 90 |
| | Modern Terminals (67.6%-owned) | 862 | 553 | 1,416 |
| | | 2,996 | 6,954 | 12,859 |
| **b.** | **Programming and others** | 87 | 2,226 | 139 |
| **c.** | **Trading properties under development** | | | |
| | Subsidiaries (China/Hong Kong) | 4,018 | 8,027 | 20,428 |
| | Jointly controlled entities/associates (China) | 1,788 | 4,335 | 10,459 |
| | | 5,806 | 12,362 | 30,887 |

For the Property Investment segment, the capital expenditure incurred was mainly for the construction of Shanghai Wheelock Square, Chengdu International Finance Centre and certain refurbishment and renovation work in particular for Harbour City. For i-CABLE and Wharf T&T, the capital expenditures were incurred substantially for procurement of production and broadcasting equipment, network rollout and internet service equipment while those for Modern Terminals were mainly for the construction of the Dachan Bay Phase I and Taicang Phase II ports. i-CABLE and Modern Terminals, respectively 73.8% and 67.6% owned by the Group, independently funded their own capital expenditure programmes.

In addition to the capital expenditure, the Group also incurred HK$5.8 billion for development of its trading properties in China, either wholly-owned or undertaken through associates and jointly controlled entities.

As at 31 December 2009, the total outstanding commitment for the development of properties for investment or trading purposes was about HK$60.7 billion, including attributable land cost of HK$13.2 billion payable by installments mainly from 2010 to 2013. These developments will be executed by stages in the forthcoming years and funded by the Group's internal financial resources including its surplus cash of HK$18.4 billion, as well as bank and other financings. Other available resources include proceeds from sales and pre-sales of properties.

In January and February 2010, the Group acquired another two land parcels in Chengdu and Tianjin respectively with total attributable land cost payable of HK$2.7 billion.

### Rights Issue by a subsidiary

In May 2009, HCDL, a non-wholly-owned listed subsidiary, completed a rights issue for 236 million new ordinary shares at HK$3.99 each with proceeds of about HK$277 million received from the minority shareholders. The Group maintained its interest in HCDL at 70.37% as that before the rights issue.

## (III) Human Resources

The Group had approximately 12,700 employees as at 31 December 2009, including about 1,900 employed by managed operations. Employees are remunerated according to their job responsibilities and the market pay trend with a discretionary annual performance bonus as variable pay for rewarding individual performance and contributions to the respective group's achievement and results.