Financial Review

(I) REVIEW OF 2013 RESULTS

The Group continued delivering solid financial performance in 2013 with the reported core profit increasing by 2% to HK$11,298 million, despite the absence of the exceptionally large profit attributed from the Shanghai Xiyuan and Hong Kong One Midtown projects in 2012.

The profit attributable to shareholders was HK$29,380 million, decreased by 38% from last year resulting mainly from lower investment property revaluation gain and the absence of the one-time accounting gain on acquisition of an associate, Greentown China Holdings Limited ("Greentown"), in June 2012.

Revenue

Group revenue increased by 3% to HK$31,887 million (2012: HK$30,856 million), benefitting from the continuous rental revenue growth and the higher property sales in the Mainland more than offsetting the lower property sales recognised in Hong Kong.

Investment Property ("IP") has remained the major revenue and profit contributor of the Group, increasing its total revenue by 13% to HK$11,133 million (2012: HK$9,880 million). In Hong Kong, IP revenue increased by 11% to HK$9,872 million, attributable to the robust retail sales achieved by the tenants and the stable positive rental reversions for office areas particularly in Harbour City and Times Square. In the Mainland, IP revenue increased by 25% to HK$1,261 million as benefitted from the escalating revenue generated by Shanghai Wheelock Square and Chengdu Times Outlet.

Development Property ("DP") recognised 6% lower property sales to HK$11,514 million (2012: HK$12,207 million), principally due to the absence of the exceptionally large contribution attributed from Shanghai Xiyuan and Hong Kong One Midtown projects in 2012. DP sales in the Mainland increased by 20%, largely compensating the decrease in reported sales from Hong Kong. Revenue recognition mainly derived from Chengdu Tian Fu Times Square, Suzhou Times City and Changzhou Times Palace in the Mainland totalling HK$11,442 million and from Hong Kong totalling HK$72 million.

During the year, inclusive of associates and joint ventures (other than Greentown) on an attributable basis, the Group recorded a 39% increase in contracted property sales totalling RMB20,850 million (2012: RMB14,955 million) spreading over more than ten cities in the Mainland, increasing the net order book by 31% to RMB20,604 million by the year end 2013 (2012: RMB15,687 million) and pending for recognition in stages of completion.

Hotel revenue increased by 8% to HK$1,498 million (2012: HK$1,391 million) as sustained by the increase in room rates during the year.

Logistics revenue increased by 5% to HK$3,226 million (2012: HK$3,070 million), mainly reflecting the increase in throughput handled in both Hong Kong and the Mainland by Modern Terminals.

CME revenue fell by 4% to HK$3,789 million (2012: HK$3,953 million). Wharf T&T's revenue increased by 2% against i-CABLE's fell by 9%.

Operating Profit

Group operating profit decreased by 6% to HK$13,280 million (2012: HK$14,170 million), principally impacted by lower DP contribution.

IP as the Group's largest profit contributor reported a 13% increase in operating profit to HK$9,268 million (2012: HK$8,187 million). Contributions from Harbour City (excluding hotels) and Times Square increased by 15% and 9%, respectively. Operating profit from the Mainland IP grew by 20%, benefiting mainly from the positive rental reversion achieved by Shanghai Wheelock Square and Chengdu Times Outlet.

DP's operating profit declined by 46% to HK$2,633 million (2012: HK$4,869 million). Mainland DP's contribution dropped by 28% to HK$2,565 million principally due to tighter operating margin, whereas Hong Kong DP's contribution dropped by 95% to HK$68 million due to a decrease in recognised sales.

Hotels operating profit from the three Marco Polo hotels in Harbour City rose by 1% to HK$393 million as benefitted from higher room rates achieved, though impacted by the renovation being undertaken for Gateway Hotel. Including the Mainland hotels, the operating profit decreased by 4% to HK$377 million (2012: HK$391 million) as adversely affected by the pre-operating expenses incurred for the Changzhou Marco Polo Hotel and the operating loss from the Marco Polo Wuhan Hotel.

Logistics' contribution dropped by 16% to HK$974 million (2012: HK$1,161 million) primarily due to an increase in operating costs more than benefitting from the increase in revenue recorded by Modern Terminals.

CME turned around from loss to a profit of HK$212 million (2012: loss of HK$22 million) as Wharf T&T's operating profit increased by 20% to HK$300 million while i-CABLE's operating loss reduced by 68% to HK$88 million.

Profit contribution from Investment and Others increased to HK$750 million (2012: HK$134 million) with an increase in interest and dividend income.

Fair Value Gain of Investment Properties

The book value of the Group's IP portfolio as at 31 December 2013 increased to HK$261.1 billion (2012: HK$231.5 billion), with HK$242.3 billion thereof stated at fair value based on an independent valuation as at that date, which produced a revaluation gain of HK$18,739 million (2012: HK$34,751 million), mainly reflecting the continuous rental growth of the IP portfolio. The attributable net revaluation gain of HK$17,174 million (2012: HK$33,336 million), after deducting related deferred tax and non-controlling interests, was credited to the consolidated income statement.

IP under development in the amount of HK$18,754 million is carried at cost and will not be carried at fair value until the earlier of their fair values first becoming reliably measurable or the dates of completion.

Other Net Income

Other net income decreased by 89% to HK$277 million (2012: HK$2,483 million) mainly due to the absence of the one-time book accounting gain of HK$2,233 million, representing the negative goodwill which arose from the acquisition of additional interests in Greentown as reported last year. Apart from this, for the year under review, Harbour Centre Development Limited ("HCDL") made an impairment provision of HK$543 million (2012: HK$ Nil) for its Changzhou Marco Polo Hotel which is expected to open into a challenging market environment in mid-2014.

Finance Costs

Finance costs charged to the consolidated income statement amounted HK$552 million (2012: HK$939 million), which had been reduced by an unrealised mark-to-market gain of HK$1,256 million (2012: HK$573 million) on the cross currency/interest rate swaps in accordance with the prevailing accounting standards. Net of non-controlling interests, the mark-to-market gain is HK$1,231 million (2012: HK$590 million).

Excluding the unrealised mark-to-market gain, finance costs before capitalisation were HK$2,555 million (2012: HK$2,108 million), representing an increase of HK$447 million mainly as a result of the increase in gross borrowings and rise in effective borrowing rates. The Group's effective borrowing rate for the year was 3.2% (2012: 2.8%).

Excluding the unrealised mark-to-market gain, finance costs after capitalisation of HK$747 million (2012: HK$596 million) in respect of the Group's related assets were HK$1,808 million (2012: HK$1,512 million), representing an increase of HK$296 million.

Share of Results (after tax) of Associates and Joint Ventures

The attributable profit after tax from associates increased by 50% to HK$2,207 million (2012: HK$1,473 million) mainly due to inclusion of Greentown's full-year attributable profit of HK$1,497 million (2012: HK$893 million for the period from June to December 2012), and an increase in profit contributions from the Mainland DP projects undertaken by other associates.

Joint ventures reported a profit of HK$509 million (2012: HK$641 million) with lower profit contributions recognised from the DP projects in the Mainland.

Income Tax

Taxation charge for the year was HK$4,328 million (2012: HK$4,215 million), which included deferred taxation of HK$1,459 million (2012: HK$1,087 million) provided for the current year's revaluation gain attributable to investment properties in the Mainland.

Excluding the above deferred tax, the tax charge decreased by 8% to HK$2,869 million (2012: HK$3,128 million) mainly due to a decrease in profit recognised by DP segment.

Non-controlling Interests

Group profit attributable to non-controlling interests decreased by HK$349 million to HK$752 million (2012: HK$1,101 million), reflecting the decrease in net profits of certain non-wholly-owned subsidiaries.

Profit Attributable to Equity Shareholders

Group profit attributable to equity shareholders for the year ended 31 December 2013 amounted to HK$29,380 million (2012: HK$47,263 million), representing a decrease of 38%. Basic earnings per share were HK$9.70, based on weighted average of 3,030 million shares (2012: HK$15.60 based on 3,029 million shares).

Excluding the net IP revaluation gain of HK$17,174 million (2012: HK$33,336 million), Group profit attributable to shareholders for the year was HK$12,206 million (2012: HK$13,927 million), representing a decrease of 12%.

Excluding the net IP revaluation gain and exceptional items, which included the attributable net mark-to-market gains on certain financial instruments totalling HK$1,231 million (2012: HK$654 million), net impairment provision for properties in the Mainland totaling HK$323 million (2012: HK$Nil) and the book accounting gain arising from the acquisition of the interests in Greentown of HK$2,233 million as reported in last year, the Group's underlying core profit rose by 2% to HK$11,298 million (2012: HK$11,040 million). Core earnings per share were HK$3.73 (2012: HK$3.64).

(II) LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL COMMITMENTS

Shareholders' and Total Equity

As at 31 December 2013, the Group's shareholders' equity increased by HK$27,056 million or 11% to HK$275,557 million, equivalent to HK$90.94 per share based on 3,030 million issued shares (31 December 2012: HK$82.04 per share based on 3,029 million issued shares).

The Group's total equity including the non-controlling interests increased by 11% to HK$284,255 million (31 December 2012: HK$256,906 million).

Assets

The Group's total assets increased by 12% to HK$415.1 billion (31 December 2012: HK$369.0 billion). Total business assets, excluding bank deposit and cash, certain available-for-sale investments, deferred tax assets and other derivative financial assets, increased by 13% to HK$387.7 billion (31 December 2012: HK$343.9 billion).

The Group's IP portfolio continued to grow in value and by new investment and reached HK$261.1 billion as at 31 December 2013, representing 67% of the Group's total business assets. Hong Kong IP increased by 9% to HK$210.5 billion (2012: HK$193.8 billion), comprising mainly Harbour City and Times Square, which are valued at HK$137.8 billion (excluding the three Marco Polo hotels) and HK$46.2 billion, respectively, together representing 70% of the IP portfolio. Mainland IP increased by 34% to HK$50.6 billion (2012: HK$37.7 billion), including those under development of HK$22.5 billion (2012: HK$21.4 billion).

The Group's DP (mainly in the Mainland) increased by 10% to HK$53.8 billion (2012: HK$48.9 billion). In addition, DP investments undertaken through associates and joint ventures amounted to HK$33.5 billion (2012: HK$30.9 billion). Other major business assets included other properties and fixed assets of HK$24.2 billion.

Geographically, the Group's business assets in the Mainland, mainly comprising properties and terminals, increased to HK$155.6 billion (31 December 2012: HK$133.0 billion), representing 40% (2012: 39%) of the Group's total business assets.

Debts and Gearing

The Group's net debt as at 31 December 2013 increased by HK$2.5 billion to HK$58.1 billion (31 December 2012: HK$55.6 billion), which was made up of HK$82.6 billion in debts and HK$24.5 billion in bank deposits and cash. Included in the Group's net debt were HK$11.4 billion (31 December 2012: HK$6.4 billion) attributable to Modern Terminals, HCDL and other subsidiaries, which are without recourse to the Company and its other subsidiaries. Excluding these non-recourse debts, the Group's net debt was HK$46.7 billion (31 December 2012: HK$49.2 billion). Analysis of the net debt is as below:

Net debt/(cash)	31 December 2013 *HK$ Million*	31 December 2012 *HK$ Million*
Wharf (excluding below subsidiaries)	**46,656**	49,201
Modern Terminals	**11,185**	11,193
HCDL	**413**	(4,581)
i-CABLE	**(182)**	(188)
	58,072	55,625

As at 31 December 2013, the ratio of net debt to total equity was 20.4% (31 December 2012: 21.7%).

Finance and Availability of Facilities

The Group's total available loan facilities and issued debt securities as at 31 December 2013 amounting to HK$103.0 billion, of which HK$82.6 billion was utilised, are analysed as below:

	31 December 2013		
	Available Facility *HK$ Billion*	Total Debts *HK$ Billion*	Undrawn Facility *HK$ Billion*
Company/wholly-owned subsidiaries			
Committed bank facilities	50.4	33.0	17.4
Debt securities	31.7	31.7	–
	82.1	64.7	17.4
Non-wholly-owned subsidiaries			
Committed and uncommitted			
— Modern Terminals	13.4	11.7	1.7
— HCDL	7.1	6.2	0.9
— i-CABLE	0.4	–	0.4
	103.0	82.6	20.4

Of the above debts, HK$18.2 billion (31 December 2012: HK$17.6 billion) was secured by a mortgage over certain fixed assets, IP, DP and shares with total carrying value of HK$44.0 billion (31 December 2012: HK$28.2 billion).

The Group diversified the debt portfolio across a bundle of currencies including primarily United States dollar ("USD"), Hong Kong dollar ("HKD") and Renminbi ("RMB"). The funding sourced from such debt portfolio was mainly used to finance the Group's IP, DP and port investments in the Mainland.

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

The Group continued to maintain a strong financial position with ample surplus cash denominated principally in RMB, HKD and USD and undrawn committed facilities to facilitate the Group's business and investment activities. In addition, the Group also maintained a portfolio of available-for-sale investments with an aggregate market value of HK$3.7 billion (31 December 2012: HK$3.9 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 recorded net cash inflows before changes in working capital of HK$14.0 billion (2012: HK$15.1 billion). The changes in working capital resulted in a net cash inflow of HK$5.5 billion (2012: HK$1.9 billion). For investing activities, the Group recorded a net cash outflow of HK$12.0 billion (2012: HK$21.7 billion), mainly for additions to investment properties and other fixed assets, including land and construction costs for Chengdu IFS and the payment for the acquisition of the Murray Building in Hong Kong.

Major Capital and Development Expenditure and Commitments

The Group's major capital and development expenditure incurred in 2013 is analysed as follows:

A. *Major capital and development expenditure*

		Hong Kong *HK$ Million*	Mainland China *HK$ Million*	Total *HK$ Million*
Properties	IP	1,063	8,669	9,732
	DP	56	12,830	12,886
		1,119	21,499	22,618
Others	Hotels	4,631	237	4,868
	Modern Terminals	271	38	309
	Wharf T&T	381	2	383
	i-CABLE	150	–	150
		5,433	277	5,710
Group total		6,552	21,776	28,328

i. IP expenditure incurred during the year was mainly for the land and construction costs for Chengdu IFS.
ii. Hotels expenditure included HK$4.4 billion for the acquisition of the Murray Building in Hong Kong for hotel development purpose.
iii. The Group also incurred HK$12.9 billion for investment in DP mainly related to Mainland projects, including HK$2.7 billion cash contribution to associates and joint ventures.
iv. For Modern Terminals, the capital expenditure was mainly for the additions of other fixed assets and terminal equipment in the Mainland while those for Wharf T&T and i-CABLE were incurred substantially for procurement of production and broadcasting equipment, network rollout and internet service equipment. Modern Terminals and i-CABLE, respectively 67.6% and 73.8% owned by the Group, independently funded their own capital expenditure programmes.

B. *Commitments to capital and development expenditure*

As at 31 December 2013, the Group's major commitments to capital and development expenditures that are to be incurred in the forthcoming years was estimated at HK$78.5 billion, of which HK$28.6 billion was authorised and contracted for. By segment, the commitments are analysed as below:

		As at 31 December 2013		
		Authorised and contracted for *HK$ Million*	Authorised but not contracted for *HK$ Million*	Total *HK$ Million*
IP	Hong Kong	1,136	475	1,611
	Mainland China	8,581	11,318	19,899
		9,717	11,793	21,510
DP	Hong Kong	754	–	754
	Mainland China	17,304	35,043	52,347
		18,058	35,043	53,101
Others	Hotels	290	2,587	2,877
	Modern Terminals	366	69	435
	Wharf T&T	111	273	384
	i-CABLE	10	196	206
		777	3,125	3,902
Group total		28,552	49,961	78,513

Properties commitments are mainly for land and construction cost, inclusive of attributable commitments to associates and joint ventures, to be incurred by stages in the forthcoming years. Attributable committed land cost of HK$5.2 billion is payable in 2014.

The above commitments and planned expenditure will be funded by Group's internal financial resources including its surplus cash of HK$24.5 billion, cash flow from operation, as well as bank and other financings with the construction costs self-financed mainly by pre-sale proceeds and project loans. Other available resources include available-for-sale investments.

(III) HUMAN RESOURCES

The Group had approximately 15,700 employees as at 31 December 2013, including about 2,600 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.

(IV) BUSINESS MODEL

Select investment properties form the backbone of Wharf's business model. The total value they generate combine rental yield growth with annual capital appreciation. Their recurrent cash flow underpins a stable and rising dividend to shareholders. The conservatively leveraged equity cushion offers ample financial capacity to seize new investment opportunities in a timely and selective manner.

Including capital appreciation, the investment properties in operation offered a total return of HK$27 billion in 2013 on an asset base of HK$219 billion at the beginning of 2013. Harbour City and Times Square lead this prized portfolio of select investment properties and accounted for about 9% of total Hong Kong retail sales. With a combined GFA of over 10 million square feet and a market value of HK$192 billion, they generated HK$10.6 billion of revenue and HK$8.4 billion of operating profit in 2013.

New select investment properties under development are led by International Finance Square (IFS) in the very heart of Chengdu and Changsha. At a combined development cost of HK$40 billion, each of them will be as large as Harbour City and designed to be just as dominant in their respective markets. The first phase of Chengdu IFS including a retail mall and an office tower was completed in late 2013 and early 2014, respectively. Three other IFSs are also under development in Chongqing, Wuxi and Suzhou.

This prized portfolio of select investment properties has also provided the financial capacity to enable Wharf to build other businesses. At a total value of HK$261 billion, it represents one of the most valuable in the world that are publicly held.

From nearly a standing start in 2007, Wharf has built itself into one of the most active Hong Kong developers in the Mainland. Inclusive of associated company Greentown, its attributable land bank comprises 16.9 million square metres across more than 40 cities. Excluding Greentown, contracted sales in 2013 totalled RMB20.9 billion for 1.5 million square metres. Including the investment in Sino-Ocean Land, Wharf's total RMB portfolio relating to property investment in the Mainland totalled RMB112 billion or HK$142 billion.

In Hong Kong, the development land bank has a different scale and with a much higher AV per square foot comprises 3.2 million square feet. To selectively turn over this portfolio with timely acquisitions is the plan. The peak portfolio is a unique collection of properties which is being redeveloped over the next few years.

Outside of properties, other main business interests include hotel operation, container terminals and communications. All are recurrent earning based and many are land based.

(V) BUSINESS STRATEGY

The Group endeavours to continuously enhance its competitiveness and drive sustainable growth through:

1. Product leadership on new development projects to lead the local markets and on existing premises replanning & improvement, tenant-mix refinement and effective marketing to maximise operating investment properties' rental growth and value;

2. Replicating the success of Harbour City and Times Square, location advantage, and our special relationship with leading tenants, soft power advantage, to expand the portfolio of select investment properties selectively in the Mainland to create substantial new value;

3. Applying core competencies in site selection and acquisition, development planning and design, construction, premium brand building and marketing to build up a young, fast growing and sustainable property development business in the Mainland to dovetail with the urbanisation programme locally;

4. Continuous development of sustainable and localised organisations in the different regions in the Mainland with local market know how and international standards and execution expertise; and

5. Exercising prudent and disciplined financial management to ensure sustainability at all times.