FINANCIAL REVIEW

(I) REVIEW OF 2016 RESULTS

The Group attained several records for its financial results with the core profit rising by 25% from the year 2015 to a new high at HK$13,754 million (2015: HK$10,969 million). The increase was sustained by IP gaining 6% core profit growth to record high at HK$8,839 million and DP gaining 185% growth to record high at HK$3,822 million.

Profit attributable to shareholders increased by 34% to HK$21,440 million (2015: HK$16,024 million), including a gain of HK$7,260 million from disposal of the entire equity interests in Wharf T&T Limited ("Wharf T&T"), though with a lower IP revaluation surplus from year end revaluation.

Revenue and Operating Profit

IP revenue and operating profit continued growing by 6% to HK$15,289 million (2015: HK$14,470 million) and 7% to HK$12,541 million (2015: HK$11,759 million), respectively. Hong Kong revenue and operating profit increased by 6% and 7%, respectively, benefitting from firm retail base rent and stable positive office rental reversion for both Harbour City and Times Square. Mainland revenue and operating profit increased moderately by 2% and 1%, respectively, or up by 9% and 7% in term of RMB, which depreciated by 6% in 2016.

DP recognised 29% higher property sales to HK$23,275 million (2015: HK$18,018 million) and operating profit by 63% to HK$3,650 million (2015: HK$2,241 million). The growth was attributable to the completion of Peninsula East in Hong Kong and more projects in the Mainland. Hong Kong revenue and operating profit were HK$1,985 million (2015: Nil) and HK$387 million (2015: loss of HK$25 million), while Mainland rose by 18% and 44%, respectively. Together with joint venture projects on an attributable basis, DP core profit rose by 185% to a record high at HK$3,822 million (2015: HK$1,340 million).

Hotel revenue rose by 2% to HK$1,587 million (2015: HK$1,549 million) and operating profit grew by 4% to HK$289 million (2015: HK$278 million). Hong Kong revenue was adversely impacted by the soft market while the newly opened hotels in Mainland China have started to contribute.

Logistics revenue decreased by 4% to HK$2,748 million (2015: HK$2,848 million) but operating profit rose by 4% to HK$719 million (2015: HK$689 million) resulting from lower operating costs from Modern Terminals.

CME revenue dropped by 10% to HK$3,145 million (2015: HK$3,501 million) and operating profit by 47% to HK$59 million (2015: HK$112 million). i-CABLE revenue decreased by 7% and operating loss widened to HK$313 million. The Group disposed Wharf T&T in November 2016, making its contributed revenue reducing by 13% while operating profit increasing only by 3%.

Investment and others revenue rose by 12% to HK$878 million (2015: HK$787 million). Operating profit fell by 2% to HK$455 million (2015: HK$464 million) chiefly due to decrease in dividend income.

Consolidated revenue and operating profit rose by 14% and 15% to HK$46,627 million and HK$17,065 million, respectively.

DP Sales

Total DP contracted sales, inclusive of joint venture projects on an attributable basis, surged by 21% to a record high at HK$40,104 million (2015: HK$33,064 million).

Mainland contracted sales increased by 21% to RMB31,420 million (2015: RMB26,044 million), sales recognition by 12% to HK$30,676 million (2015: HK$27,404 million) and operating profit by 22% to HK$5,133 million (2015: HK$4,200 million). Net order book increased to RMB27,436 million (December 2015: RMB24,635 million).

Hong Kong contracted sales, mainly attributable to Mount Nicholson joint-venture, amounted to HK$4,980 million (2015: HK$1,978 million). Sales recognition, including Mount Nicholson and Peninsula East, amounted to HK$6,419 million (2015: Nil), which contributed an operating profit of HK$2,400 million (2015: loss of HK$82 million).

Fair Value Gain of Investment Properties

The book value of the Group's IP portfolio as at 31 December 2016 increased to HK$319.3 billion (2015: HK$310.2 billion) with HK$302.6 billion thereof stated at fair value based on independent valuation, which produced a revaluation gain of HK$910 million for the year (2015: HK$6,729 million). The attributable net revaluation gain of HK$906 million (2015: HK$6,231 million), after taking into account the related deferred tax and non-controlling interests, was credited to the consolidated income statement.

IP under development in the amount of HK$16.7 billion 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/(Charge)

Other net income of HK$6,252 million (2015: charge of HK$460 million) primarily included a gain of HK$7,260 million arising from the Group's disposal of the entire equity interests in Wharf T&T.

Included in the net charge for 2015 was a non-recurrent accounting loss of HK$1,620 million arising from the deemed disposal of the Group's 24.3% interest in Greentown China Holdings Limited ("Greentown") upon reclassification of such interest as financial investment instead of an associate and a gain of HK$908 million arising from Modern Terminals' partial disposal of its equity interests in Taicang container port businesses.

Finance Costs

Finance costs charged to the consolidated income statement amounted to HK$1,361 million (2015: HK$1,879 million), including an unrealised mark-to-market gain of HK$237 million (2015: loss of HK$406 million) on the cross currency and interest rate swaps in accordance with prevailing accounting standards.

The Group's effective borrowing rate for the year was 3.2% (2015: 2.8%). Excluding the unrealised mark-to-market gain, finance costs before capitalisation were HK$2,163 million (2015: HK$2,151 million), representing an increase of HK$12 million. Finance costs after capitalisation were HK$1,598 million (2015: HK$1,473 million), representing an increase of HK$125 million.

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

Attributable profit from associates decreased by 20% to HK$923 million (2015: HK$1,156 million) with lower profit contributions from Mainland DP.

Joint ventures increased profit significantly to HK$1,983 million (2015: HK$236 million) attributable to Mount Nicholson in Hong Kong and more completed Mainland DP projects.

Income Tax

Taxation charge for the year was HK$4,107 million (2015: HK$3,829 million), which included deferred taxation of HK$23 million (2015: HK$488 million) provided for the current year's revaluation gain attributable to investment properties in the Mainland.

Excluding the above deferred tax, the tax charge increased by 22% to HK$4,084 million (2015: HK$3,341 million) mainly due to higher profits from IP and China DP segments.

Non-controlling Interests

Group profit attributable to non-controlling interests decreased to HK$225 million (2015: HK$782 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 amounted to HK$21,440 million (2015: HK$16,024 million), representing an increase of 34%. Basic earnings per share were HK$7.07, based on weighted average of 3,031 million shares (2015: HK$5.29 based on 3,031 million shares).

Excluding the net IP revaluation gain of HK$906 million (2015: HK$6,231 million), Group profit attributable to shareholders for the year increased by 110% to HK$20,534 million (2015: HK$9,793 million), including a gain of HK$7,260 million from disposal of Wharf T&T.

Group core profit rose by 25% to HK$13,754 million (2015: HK$10,969 million), of which 64% was attributable to IP and 28% to DP. Core earnings per share were HK$4.54 (2015: HK$3.62).

Core profit is a performance indicator of the Group's major business segments and arrived at after excluding mainly net IP revaluation gain, disposal gain of Wharf T&T of HK$7,260 million (2015: Nil) and other non-recurrent items. A loss of HK$1,620 million from the deemed disposal of Greentown and attributable gain of HK$613 million from Modern Terminals' disposal of its interest in Taicang were also excluded in last year.

Early adoption of HKFRS 9 "Financial Instruments"

The Group has early adopted the complete version of HKFRS 9 "Financial Instruments" in its consolidated financial statements with effect from 1 January 2016. As a result, the investments in equity securities of HK$5,723 million that were previously classified as available-for-sale investments under HKAS 39 have been re-designated as equity investments measured at fair value through other comprehensive income. Accordingly, HK$14 million of gain on disposal of equity securities in the year was recognised through other comprehensive income instead of the income statement as previously accounted for (2015: HK$178 million profit through the income statement).

(II) LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL COMMITMENTS

Shareholders' and Total Equity

As at 31 December 2016, shareholders' equity increased by HK$9.1 billion to HK$316.8 billion (2015: HK$307.7 billion), equivalent to HK$104.48 per share based on 3,032 million issued shares (2015: HK$101.53 per share based on 3,031 million issued shares), which had been partly impacted by a net exchange deficit of HK$5.9 billion arising from translation of RMB net assets in the midst of 6% depreciation in RMB in 2016.

The Group's total equity including non-controlling interests increased by HK$8.2 billion to HK$325.4 billion (2015: HK$317.2 billion).

Assets and Liabilities

The Group's total assets as at 31 December 2016 stood at HK$443.8 billion (2015: HK$443.9 billion). Total business assets, excluding bank deposit and cash, financial and deferred tax assets, slightly decreased to HK$403.0 billion (2015: HK$414.8 billion), mainly due to selling down of DP but mitigating by IP increase.

Geographically, the Mainland business assets, mainly comprising properties and terminals, decreased to HK$121.0 billion (2015: HK$139.8 billion), representing 30% (2015: 34%) of the Group's total business assets.

Investment properties

Included in the Group's total assets is the IP portfolio of HK$319.3 billion, representing 79% of total business assets. Core assets in this portfolio are Harbour City and Times Square in Hong Kong, which were valued at HK$164.5 billion (excluding the three hotels) and HK$54.5 billion, respectively, together representing 69% of the IP portfolio. Mainland IP amounted to HK$58.5 billion, mainly including Chengdu IFS and Shanghai Wheelock Square, as well as Changsha IFS and Suzhou IFS which were under development and stated at cost of HK$16.7 billion.

During the year, the Group acquired the entire office tower and a prime shop in Wheelock House, Central, Hong Kong, for HK$6.2 billion, to further expand the IP portfolio.

Properties for sale

DP assets dropped to HK$23.9 billion (2015: HK$37.8 billion), mainly reflecting the selling down of Mainland DP portfolio during the year.

Interests in associates and joint ventures

Interests in associates and joint ventures amounted to HK$31.1 billion (2015: HK$35.4 billion), mainly representing various joint-venture DP projects undertaken in the Mainland and Hong Kong.

Deposits from sale of properties

Deposits from sale of properties amounted to HK$18.9 billion (2015: HK$18.9 million), representing contracted sales in Mainland China pending revenue recognition in the coming years.

Debts and Gearing

The Group's net debt as at 31 December 2016 was reduced drastically by 50% to HK$23.8 billion (2015: HK$47.2 billion), resulting from the Group's strong recurrent operating cash inflow, record DP sales and disposal of Wharf T&T. The net debt was made up of HK$60.8 billion in debts and HK$37.0 billion in bank deposits and cash. Included in the net debt were HK$7.1 billion (2015: HK$7.3 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$16.7 billion (2015: HK$39.9 billion). An analysis of the net debt is as below:

Net debt/(cash)	**31 December 2016** ***HK$ Million***	31 December 2015 *HK$ Million*
Wharf (excluding below subsidiaries)	**16,755**	39,863
Modern Terminals	**8,502**	8,763
HCDL	**(1,904)**	(1,647)
i-CABLE	**484**	218
	23,837	47,197

As at 31 December 2016, the ratio of net debt to total equity declined to 7.3% (2015: 14.9%).

Finance and Availability of Facilities

The Group's total available loan facilities and issued debt securities as at 31 December 2016 amounting to HK$77.7 billion, of which HK$60.8 billion was utilised, are analysed as below:

	31 December 2016		
	Available Facility *HK$ Billion*	Total Debts *HK$ Billion*	Undrawn Facility *HK$ Billion*
Company/wholly-owned subsidiaries			
Committed bank facilities	27.9	15.6	12.3
Debt securities	32.6	32.6	–
	60.5	48.2	12.3
Non-wholly-owned subsidiaries			
Committed and uncommitted			
— Modern Terminals	11.4	8.7	2.7
— HCDL	4.9	3.3	1.6
— i-CABLE	0.9	0.6	0.3
	77.7	60.8	16.9

Of the above debts, HK$6.7 billion (2015: HK$4.0 billion) was secured by mortgages over certain IP, DP and property, plant and equipment with total carrying value of HK$17.7 billion (2015: HK$24.3 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.

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 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 equity investments with an aggregate market value of HK$5.7 billion (2015: HK$8.1 billion), which is immediately available for liquidation for the Group's use when in need.

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$18.0 billion (2015: HK$16.0 billion). The changes in working capital increased the net cash inflow from operating activities to HK$29.1 billion (2015: HK$24.1 billion), resulting from increase in China DP sales. For investing activities, the Group recorded a net cash outflow of HK$2.5 billion (2015: HK$7.3 billion), mainly attributing to the acquisition of Wheelock House at HK$6.2 billion and construction costs for Mainland IP but partly compensating by the net proceeds from disposal of Wharf T&T of HK$9.4 billion.

Major Capital and Development Expenditure and Commitments

The Group's major capital and development expenditure incurred in 2016 is analysed as follows:

A. *Major capital and development expenditure*

		Hong Kong *HK$ Million*	Mainland China *HK$ Million*	Total *HK$ Million*
Properties	IP	7,942	4,465	12,407
	DP	219	12,356	12,575
		8,161	16,821	24,982
Others	Hotels	981	40	1,021
	Modern Terminals	359	72	431
	Wharf T&T	258	1	259
	i-CABLE	238	–	238
		1,836	113	1,949
Group total		9,997	16,934	26,931

i. IP expenditure was mainly for the acquisition of Wheelock House and construction costs of the Mainland IFS projects.

ii. DP expenditure included HK$6.4 billion for DP projects undertaken by associates and joint ventures.

iii. Modern Terminals' capital expenditure was mainly for terminal equipment while those of Wharf T&T and i-CABLE were incurred substantially for facilities and equipment.

B. *Commitments to capital and development expenditure*

As at 31 December 2016, the Group's major commitments to capital and development expenditure that are to be incurred in the forthcoming years was estimated at HK$34.8 billion, of which HK$14.6 billion was committed. By segment, the commitments are analysed as below:

		As at 31 December 2016		
		Committed *HK$ Million*	Uncommitted *HK$ Million*	Total *HK$ Million*
IP	Hong Kong	990	429	1,419
	Mainland China	4,035	6,301	10,336
		5,025	6,730	11,755
DP	Hong Kong	–	–	–
	Mainland China	7,959	12,729	20,688
		7,959	12,729	20,688
Others	Hotels	1,379	412	1,791
	Modern Terminals	247	126	373
	i-CABLE	18	211	229
		1,644	749	2,393
Group total		14,628	20,208	34,836

Properties commitments are mainly for construction cost, inclusive of attributable commitments to associates and joint ventures, to be incurred by stages.

The commitments and planned expenditure will be funded by Group's internal financial resources including its surplus cash, cash flows from operations, as well as bank and other borrowings and pre-sale proceeds. Other available resources include equity investments available for sale.

(III) HUMAN RESOURCES

The Group had approximately 13,500 employees as at 31 December 2016, including about 2,300 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 offer combines rental yield stability and growth with capital value appreciation. The recurrent cash flow they generate 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 value appreciation, the investment properties in operation offered a total return of HK$11 billion in 2016 on an asset base of HK$303 billion at the beginning of the year.

Harbour City and Times Square in Hong Kong together contributed over 85% of that total return (with HK$9.4 billion), from an asset base of HK$227 billion. With a combined GFA of over 10 million square feet, they generated HK$13.1 billion of revenue and HK$10.7 billion of operating cash flow in 2016.

New growth in the Mainland are spearheaded by International Finance Square (IFS) in the very heart of Chengdu and Changsha, at a combined development cost of HK$40 billion and comparable to Harbour City in critical mass and dominance in their respective markets. At Chengdu IFS, a retail mall and three office towers, including a new hotel Niccolo Chengdu and serviced apartments, have already been completed. Changsha IFS is scheduled to open in phases from 2017.

Development properties represented the next largest contributor to Group profit in 2016. On an attributable basis, combined sales in Hong Kong and the Mainland totalled HK$40 billion and revenue recognition amounted to HK$37 billion.

Mount Nicholson is the flagship project in Hong Kong. It is a joint venture co-led by fellow subsidiary Wheelock Properties and set new benchmarks for luxury residential properties.

On the Mainland, Wharf has built itself into one of the most active Hong Kong developers although market conditions have diminished its land bank. Contracted sales in 2016 totalled RMB31.4 billion to exceed all past years. Current portfolio of development properties in the Mainland totals 4.2 million square metres with a book value of RMB44 billion.

Outside of properties, main business interests include hotels and ports, which together combined to contribute less than 10% of the Group's core profit in 2016.

(V) BUSINESS STRATEGY

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

1. Continuous product leadership for existing and new investment properties from site selection, planning, design, tenancy management and marketing to maximise the value of the portfolio;

2. Replicating the success of Harbour City and Times Square, location advantage, and strong professional relationship with leading tenants to expand the portfolio of investment properties selectively to create substantial new value;

3. Applying core competencies in site selection and acquisition, development planning and design, construction, premium branding and marketing to operate a property development business in the Mainland to dovetail with the urbanisation programme;

4. Continuous development of sustainable and localised organisations 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.