

# Chairman's Report



Dear shareholders,

I am pleased to present the Annual Report of the Company for the year ended 31st December, 2006.

## **FINANCIAL RESULTS**

For the year ended 31st December, 2006, the Group achieved a consolidated profit attributable to shareholders of HK\$331.3 million, as compared with the profit of HK\$528.4 million attained for the financial year in 2005. The overall net profit achieved was relatively lower than that in the preceding year due primarily to the fact that, while general interest costs have increased and much less profit contribution has been attributed from associates,

there was also a deferred tax charge as compared to the recognition of substantial deferred tax income last year.

At the operational level, total operating profits (including hotel net rental income) generated by the five Regal Hotels in Hong Kong and the Group's hotel management business amounted to HK\$570.5 million in the year under review, which represented an increase of 13.8% over the HK\$501.3 million attained in 2005.

Shareholders would however have noted that the Group has successfully completed the spin-off and separate listing of Regal Real Estate Investment Trust on The Stock Exchange of Hong Kong Limited in March 2007. As further elaborated below, under the spin-off transaction, the Group has disposed of its interests in the five Regal Hotels in Hong Kong to Regal REIT at a gross sale consideration of HK\$12,500 million and, at the same time, has entered into leases with Regal REIT for the leasing of the five hotels for a term until 31st December, 2015. The Group has derived from the transaction a gain of not less than HK\$2,000 million, which is attributable to the Group's initial disposal of 28% interest in Regal REIT and before taking into account further gains that may arise from any exercise of the over-allotment option. The profit derived will be reflected in the results of the current financial year of 2007.

After the spin-off transaction, the operational model of the Group will be substantially different from that undertaken in the year under review, as the Group will no longer own the five Regal Hotels in Hong Kong directly, but will however continue to be the hotel operator pursuant to the leases with Regal REIT as the new hotel owner. Consequently, there will not be any more depreciation and amortisation charges with respect to the hotel properties, but the rental payments under the leases will be charged as operational expenses in the Group's income statement. On the other hand, the Group's interests in Regal REIT will be treated as investments in an associate and the results of Regal REIT will be accounted for by the Group on an equity-accounting basis.

### **DIVIDEND**

In view of the satisfactory progress achieved, the Directors have resolved to recommend the payment of a final dividend of HK0.6 cent (2005 - HK0.55 cent) and a special cash dividend of HK1 cent (2005 - Nil), aggregating to HK1.6 cents (2005 - HK0.55 cent) per ordinary share for the year ended 31st December, 2006, absorbing a total amount of approximately HK\$146.5 million (2005 - HK\$46.1 million), payable to holders of ordinary shares on the Register of Ordinary Shareholders on 12th June, 2007. The special cash dividend being recommended is relatively modest due to the fact that the substantial profit derived from the spin-off transaction will only be reflected in the 2007 financial year. Together with the interim dividend of HK0.25 cent per ordinary share paid in November 2006 (2005 - HK0.25 cent), total dividends (including the special cash dividend) per ordinary share for the year ended 31st December, 2006 will amount to HK1.85 cents (2005 - HK0.8 cent), representing an increase of 131.3% over the total dividends paid for the 2005 financial year.

### CLOSURE OF REGISTER

The Register of Ordinary Shareholders will be closed from Friday, 8th June, 2007 to Tuesday, 12th June, 2007, both days inclusive, during which period no transfers of shares will be effected. In order to qualify for the proposed final and special cash dividends, all transfers of ordinary shares, duly accompanied by the relevant share certificates must be lodged with the Company's branch registrar in Hong Kong, Computershare Hong Kong Investor Services Limited, no later than 4:30 p.m. on Thursday, 7th June, 2007, and all documents for subscriptions of the outstanding 2007 warrants, duly accompanied by the relevant warrant certificates together with the relevant subscription moneys, must be lodged with the Company's branch registrar no later than 4:00 p.m. on Thursday, 7th June, 2007. The relevant dividend warrants are expected to be despatched on or about 29th June, 2007.

### REVIEW OF OPERATIONS

#### HOTELS

##### Hong Kong

In 2006, Hong Kong received a new record number of 25.3 million visitor arrivals, a growth of approximately 8.1% over the comparative figure in 2005, which generated for Hong Kong total tourism expenditure of some HK\$117.3 billion. There were about 13.6 million visitors from Mainland China in 2006, a year-on-year increase of approximately 8.4%, while steady growth was also seen in those from most major long haul markets.

For the year under review, the hotels in Hong Kong as a whole continued to catch up in achieved room rates, as the overall hotel room rates in Hong Kong still lag behind those prevailing in other major international cities. On the other hand, due to the moderately increased hotel room supply in 2006, average hotel room occupancy rate has only modestly grown from 86% in 2005 to 87% in 2006.

Total revenue from the Group's hotel operations (including rental income) and management business increased by approximately 11.1% from HK\$1,082.7 million for the year ended 31st December, 2005 to HK\$1,202.5 million in 2006. The increased revenue was mainly attributable to the increase in the average room rates achieved by the Group's five hotels in Hong Kong and an improvement in the mix of business and leisure travelers. Compared on a year-on-year basis, the combined average room rate of the five hotels in 2006 enhanced by approximately 11.5% in 2006. While Regal Airport Hotel is still working to catch up on its room occupancy, the other four Regal Hotels in Hong Kong were steadily operating at an average occupancy level of about 90%. Overall for the five hotels, the combined average room occupancy in 2006 was maintained at about 81%, approximately the same level as that recorded in 2005. Taking into account the intermittent disruptions on the business operations caused by the asset enhancement programme and renovation works, the operating results achieved by the Group's hotels in Hong Kong in the year under review should be considered as satisfactory.

The present marketing strategy for the Regal Airport Hotel is to further build up its customer base and occupancy level ahead of room rate optimisation, so as to facilitate future yield enhancement when the business activities at the airport community further mature, particularly with the opening of the Asia World-Expo Convention Center in December 2005 and the SkyMart just a few months ago. To strengthen its position and competitiveness, the hotel has completed in the latter part of 2006 the Executive Conference Center comprising 13 new state-of-the-art meeting and conference rooms as well as the renovation of 21 hotel rooms fitted with spa facilities. In this regard, the hotel has been able to secure increasing business from the growing meetings, incentives, conventions and exhibitions segment (MICE). Businesses from MICE segment are most sought after by hotels as they tend to produce much larger business volume and the customers from this segment usually have a higher per capita spending.

A major part of the asset enhancement programme planned for the four hotels is scheduled to be completed before the end of the third quarter in 2007. The remaining phase relates to the addition of three stories, comprising 274 additional rooms, on top of the existing hotel building at the Regal Riverside Hotel in Shatin, the construction works for which will soon commence and are targeted to be completed before the end of 2008.

By the end of the third quarter this year, the total hotel room stock of the five Regal Hotels in Hong Kong will increase from the present number of 3,348 to 3,542 and when the asset enhancement programme is fully completed, will boost the aggregate number of hotel rooms to 3,816.

### **The People's Republic of China**

Benefiting from the buoyant economy in China, the two managed hotels in Shanghai continued to perform satisfactorily. The Group has been managing successfully these two hotels in Shanghai since 1997 with high repute and this is exemplary of the quality and dedication of professional services that the Group commits to its hotel management business.

To enhance the image and recognition of the Regal brand, the Group is planning to strengthen and expand its footholds in China, through development of new hotel projects and the provision of management services, with initial focus on major cities.

In January 2007, the Group entered into a letter of intent with Cosmopolitan International Holdings Limited, a listed company in Hong Kong, to participate in a large scale development project in Shenyang City, Liaoning Province, the subject of an overall development cooperation framework agreement between Cosmopolitan and the Shenyang Menrong Economic District.

Under the letter of intent, the Group will provide consultancy services to Cosmopolitan with respect to the hotel and related project, comprising hotels, service apartments, shopping, exhibition, entertainment and recreational facilities, to be included within the overall development project. The Group will also have the right of first refusal to invest in 55% interest (or such other percentage as may be mutually agreed) in the hotel and related project, subject to Cosmopolitan having entered into a legally binding agreement with the relevant government authorities.

In early April 2007, the Group together with other investors entered into a conditional subscription agreement with Cosmopolitan, pursuant to which the Group has agreed to subscribe for new convertible bonds in a principal amount of HK\$102.5 million proposed to be issued by Cosmopolitan group, which will be convertible into new ordinary shares of Cosmopolitan at an initial conversion price of HK\$0.205 per share and, if not converted, will be redeemable on the third anniversary of the date of issue of the convertible bonds at a yield to maturity of 5% per annum.

### **PROPERTIES**

#### **Hong Kong**

##### **Regalia Bay, Stanley**

For the year under review, the Regalia Bay, a project that is 70% owned by the Group, contributed a profit of approximately HK\$203.6 million to the Group mainly from a write back of provision. The Group is optimistic of the high-end luxury residential market and will continue to lease out the remaining houses for rental income unless the prices offered by prospective purchasers are attractive.

#### **The People's Republic of China**

##### **Development project in the Central Business District of Beijing**

As reported in the Interim Report 2006, the Group and Paliburg Holdings Limited each beneficially owns a 50% equity interest in a company which, in turn, holds a 59% interest in an investee company established in the PRC, the remaining 41% interest of which is held by a local joint venture partner. The investee company has fully settled the land premium payable under the Land Grant Contracts for the Phase I land in April 2006 and is seeking to obtain the relevant Land Use Right Certificate. In the meanwhile, the investee company is actively working to secure its rights to the remaining Phase II land site comprised in the overall development project. The overall development project, comprising both Phase I and Phase II, is expected to have total permissible gross floor area of about 4,630,000 square feet encompassing office, hotel, commercial, residential and car parking accommodations. Due to the longer time anticipated to be needed to obtain relevant planning approvals and to secure the development rights to the Phase II land site, it is expected that there will be a delay in the overall development timetable for this project.

### **OUTLOOK**

With the booming economy in China, the number of visitors from the Mainland will continue to increase in large numbers. To cater to the influx of visitors from Mainland as well as from overseas countries, Hong Kong is undertaking and planning a number of transport infrastructure projects, including additional land linkages between Hong Kong and Southern China, the enhancement of facilities at the Hong Kong International Airport and a new cruise terminal in South East Kowloon. In addition, Hong Kong is also embarking on the expansion of its various tourism and conference infrastructure, in order to secure the position of Hong Kong as a financial centre of global significance, an international conference and exhibition centre as well as a transport and aviation hub.

Over the next few years, there will be a number of new hotels scheduled for completion in Hong Kong, but a majority of these new hotels is located in non-traditional tourist areas. Moreover, based on the forecast growth in visitor arrivals, it is anticipated that the demand for hotel rooms in Hong Kong will continue to outstrip supply and while average room occupancy will be maintained at a high level, average room rate should be able to further improve.

The five Regal Hotels in Hong Kong continued to perform well during the first few months of 2007 in keeping with their forecast trend of growing profitability. Apart from the second phase works at the Regal Riverside Hotel, the asset enhancement programme is targeted to be completed before the end of the third quarter in 2007, which will bring into operation 194 additional new hotel rooms. Given the favourable operating environment presently prevailing, the Directors are confident that the five Regal Hotels in Hong Kong will be able to generate in 2007 much enhanced operating profits than those attained in 2006.

Subsequent to the year end, the Group has successfully completed on 30th March, 2007 the spin-off of Regal REIT, which is now separately listed on the main board of the Hong Kong Stock Exchange. Detailed information on the spin-off proposal was contained in the circular to shareholders dated 21st February, 2007.

Summarily, pursuant to the spin-off proposal, the Group sold its interests in the five Regal Hotels in Hong Kong to Regal REIT at a gross sale consideration of HK\$12,500 million. As part of the transaction, the Group leased from Regal REIT the five Regal Hotels on the terms set out in the relevant lease agreements, with lease terms that continue until 31st December, 2015. The rents payable for the period from 30th March, 2007 to 31st December, 2010 consist of escalating base rents, starting from HK\$476 million for the period from the lease commencement date to 31st December, 2007 to HK\$780 million for 2010, plus variable rents. The rents payable for the term after 2010 will be determined by a jointly appointed independent professional property valuer, subject to a floor rent of HK\$400 million per annum. The Group has also been appointed as the hotel manager for the five Regal Hotels for a term of 20 years from 30th March, 2007, on the terms set out in the relevant hotel management agreements. Regal REIT is managed by Regal Portfolio Management Limited, which is a wholly-owned subsidiary of the Group but functioning independently.

Out of the gross proceeds received, approximately HK\$6,000 million was applied by the Group to subscribe initially for approximately 72% of the total outstanding units of Regal REIT. The Group has granted to the joint international underwriters under the initial public offering of Regal REIT an over-allotment option for up to approximately 4.2% of the total outstanding units of Regal REIT owned by the Group.

Another HK\$4,350 million of the proceeds received has been applied to repay all the outstanding bank indebtedness of the Group. Consequently, the Group is now free of any bank debt and the remaining proceeds in the amount of approximately HK\$2,160 million have been retained for general working capital and for the funding of new acquisitions and investments.

In addition, the Group has derived from the transaction a gain of not less than HK\$2,000 million, which is attributable to the Group's initial disposal of 28% interest in Regal REIT and before taking into account further gains that may arise if the over-allotment option is exercised.

Following the completion of the spin-off of Regal REIT, the Group plans to further expand its investments in the property and hotel development sectors. When suitable opportunities arise, the Group will also seek to diversify into other sectors that are complementary to its existing business base. Initial focus will be placed to secure appropriate hotel and other property development opportunities in major cities in Mainland China. The Group believes that the undertaking by the Group of new hotel developments will not only facilitate the planned expansion of its hotel management network, but potentially will also foster the parallel growth of Regal REIT through the right of first refusal granted to Regal REIT, as and when the Group should decide to dispose of any of its developed hotels after they have been completed and started to operate profitably. The Group is in the course of finalising a dynamic and sustainable Strategic Development Plan for the long term growth of the Group, which will take into consideration the Group's present and potential financial strength, its extensive experience, expertise and business network as well as its strong alliance with Century City International Holdings Limited, Paliburg and the newly listed Regal REIT.

As the gain realised on the spin-off of Regal REIT will be reflected in the current financial year, 2007 will undoubtedly be a very fruitful year for the Group. Given that the Group's financial position has now been substantially strengthened, the Group is now well poised to move forward with its expansion plan and the Directors are confident that the Group will be able to grow from strength to strength and to generate to shareholders increasing returns.

### **DIRECTORS AND STAFF**

First of all, I would like to express my special thanks to Mr. Kai Ole Ringenson for all his past contribution to the Company since he came on Board in June 2002. Mr. Ringenson resigned as a Director of the Company in November 2006 to take up full time services as the Chief Executive Officer of Regal Portfolio Management Limited, the appointed manager of Regal REIT. I am also grateful to the other members of the Board for all their valuable advice and support during the past year. Last but not least, I would like to take this opportunity to extend my sincere appreciation to all management and staff members for their hardwork and dedication, which had made possible the continuing progress achieved by the Group and, in particular, the recent successful implementation of the separate listing of Regal REIT.

### **LO YUK SUI**

Chairman

Hong Kong  
19th April, 2007