Group Capital Resources and Liquidity

Treasury Management

The Group's treasury function sets financial risk management policies in accordance with policies and procedures approved by the Executive Directors, which are also subject to periodic review by the Group's internal audit function. The Group's treasury policies are designed to mitigate the impact of fluctuations in interest rates and exchange rates and to minimise the Group's financial risks. The Group's treasury function operates as a centralised service for managing financial risks, including interest rate and foreign exchange risks, and for providing cost efficient funding to the Group and its companies. It manages the majority of the Group's funding needs, interest rate, foreign currency and credit risk exposures. The Group cautiously uses derivatives, principally interest rate and foreign currency swaps and forward currency contracts as appropriate for risk management purposes only, for hedging transactions and managing the Group's assets and liabilities. It is the Group's policy not to enter into derivative transaction for speculative purposes.

Cash Management and Funding

The Group operates a central cash management system for all of its unlisted subsidiaries. Except for listed and certain overseas entities conducting businesses in non-Hong Kong or non-US dollar currencies, the Group generally obtains long-term financing at the Group level to on-lend or contribute as equity to its subsidiaries and associates to meet their funding requirements and provide more cost-efficient financing. These borrowings include a range of capital market issues and bank borrowings, which change depending upon financial market conditions and projected interest rates. The Group regularly and closely monitors its overall debt position and reviews its funding costs and maturity profile to facilitate refinancing.

Interest Rate Exposure

The Group manages its interest rate exposure with a focus on reducing the Group's overall cost of debt and exposure to changes in interest rates. When considered appropriate, the Group uses a combination of interest rate swaps and forward rate agreements to manage its long-term interest rate exposure and exposure to short-term interest rate volatility respectively. The Group's main interest rate exposures relate to US dollar, British pound, Euro and HK dollar borrowings.

At 31 December 2006, approximately 51% of the Group's principal amount of borrowings were at floating rates and the remaining 49% were at fixed rates. The Group has entered into various interest rate agreements with major creditworthy financial institutions to swap approximately HK$89,700 million principal amount of fixed interest rate borrowings to effectively become floating interest rate borrowings. In addition, HK$8,650 million principal amount of floating interest rate borrowings were swapped to fixed interest rate borrowings. After taking into consideration these interest rate swaps, approximately 79% of the Group's principal amount of borrowings were at floating rates and the remaining 21% were at fixed rates at 31 December 2006.

Foreign Currency Exposure

For overseas subsidiaries and associates and other investments, which consist of non-HK dollar or non-US dollar assets, the Group generally endeavours to establish a natural hedge with an appropriate level of borrowings in those same currencies. For overseas businesses that are in the development phase, or where borrowings in local currency are not attractive, the Group may not borrow in the local currency and instead monitor the development of the businesses' cashflow and the debt markets and, when appropriate, would refinance these businesses with local currency borrowings. Exposure to movements in exchange rates for individual transactions directly related to the underlying businesses is minimised using forward foreign exchange contracts and currency swaps where active markets for the relevant currencies exist. During the year, the HK dollar weakened against the currencies of most of those countries where the Group has overseas operations. This gave rise to an unrealised gain of HK$15,416 million (2005 charge – HK$13,904 million) on translation of these operations' net assets to the Group's HK dollar reporting currency, which was reflected as a movement in the Group's reserves.

At 31 December 2006, the Group had currency swap arrangements with banks to swap US dollar principal amount of borrowings equivalent to HK$1,365 million to non-US dollar principal amount of borrowings to match currency exposures of the underlying businesses. The Group's borrowings, excluding loans from minority shareholders and after taking into consideration these currency swaps, are denominated as to 14% in HK dollars, 33% in US dollars, 8% in British pounds, 31% in Euro and 14% in other currencies.

Credit Exposure

The Group's holdings of cash, managed funds and other liquid investments expose the Group to credit risk of counterparties. The Group controls its credit risk to non-performance by its counterparties through monitoring their credit ratings and setting approved counterparty credit limits which are regularly reviewed.

Credit Profile

The Group aims to maintain a capital structure that is appropriate for long-term investment gradings of A3 on the Moody's Investor Service scale, A- on the Standard & Poor's Rating Services scale and A- on the Fitch Ratings scale. Actual credit ratings may depart from these levels from time to time due to economic circumstances. At 31 December 2006, our long-term credit ratings were A3 from Moody's, A- from Standard & Poor's and A- from Fitch.

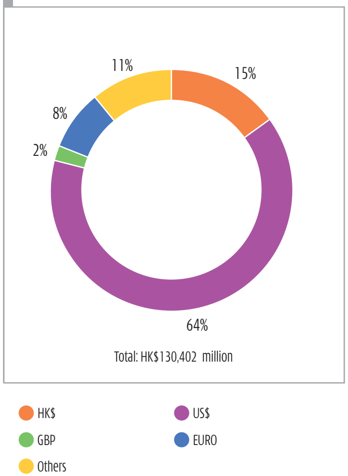
Liquid Assets

The Group continues to have a strong financial position benefiting from both the steady and growing cash flow from its established businesses and improving cash flow from the **3** Group businesses. Cash, liquid funds and other investments ("liquid assets") on hand increased 18% over last year's balance and amounted to HK$130,402 million at 31 December 2006 (2005 – HK$110,386 million). The year-on-year increase in liquid assets mainly reflects the cash proceeds of US$4,388 million received on the disposal of a 20% equity interest in the ports and related services division in April 2006. Of the liquid assets, 15% were denominated in HK dollars, 64% in US dollars, 2% in British pounds, 8% in Euro and 11% in other currencies.

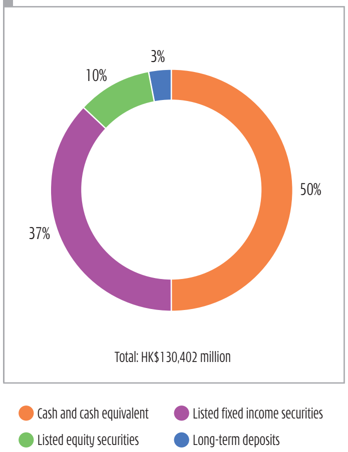
Cash and cash equivalents represented 50% (2005 – 46%) of the liquid assets, listed fixed income securities 37% (2005 – 42%), listed equity securities 10% (2005 – 9%) and long-term deposits 3% (2005 – 3%).

The listed fixed income securities, including those held under managed funds, comprise US treasury notes (47%), government issued guaranteed notes (22%), supranational notes (17%) and others (14%). Of these listed fixed income securities, 83% are rated at Aaa/AAA, with an average maturity of approximately 2.1 years on the overall portfolio.

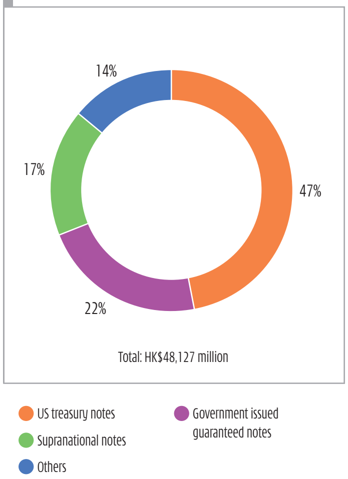
Liquid Assets by Currency Denomination at 31 December 2006



Liquid Assets by Type at 31 December 2006



Listed Fixed Income Securities by Type at 31 December 2006



Cash Flow

Consolidated EBITDA before all CACs amounted to HK$96,853 million in 2006, a 32% increase from 2005. This included cash profits from disposals totalling HK$25,131 million, of which HK$24,380 million arose from the disposal of a 20% equity interest in the ports and related services division. Excluding the cash profits from disposals in both years, EBITDA before all CACs increased 26% to HK$71,722 million (2005 – HK$56,715 million). Funds from operations ("FFO"), before cash profits from disposals, capital expenditure, investment in all CACs and changes in working capital amounted to HK$31,096 million (2005 – HK$25,872 million), a 20% increase. The increase in recurring EBITDA and FFO are attributed to the solid and steady improvement in financial performance of the Group's established businesses and the significantly better **3** Group results which reported a 625% improvement in EBITDA before all CACs and 148% improvement in FFO. Recurring EBITDA and FFO from the Group's established businesses continued to be sound, totalling HK$58,499 million (2005 – HK$54,890 million) and HK$27,842 million (2005 – HK$32,681 million) respectively.

The **3** Group's investment in CACs totalled HK$20,717 million, a 12% reduction from last year's total of HK$23,543 million, mainly due to a lower average cost to acquire a customer. Prepaid CACs, which are expensed as incurred, totalled HK$5,494 million, a 52% reduction from last year's total of HK$11,444 million. Postpaid CACs totalled HK$15,223 million, an increase of 26% compared to HK$12,099 million last year due to a greater focus on and penetration of the postpaid customer segment, particularly in Italy, the UK and Australia.

In 2006, the Group's capital expenditures reduced by 11% to total HK$23,908 million (2005 – HK$27,006 million) of which HK$11,559 million (2005 – HK$14,051 million) related to the **3** Group. The decrease in the Group's total capital expenditures reflects the reduced **3** Group expenditures as a majority of its networks has been completed and the non-consolidation of HTIL, which became an associated company in December last year. Capital expenditures for the **3** Group decreased 18% to total HK$11,559 million (2005 – HK$14,051 million). Capital expenditures for the ports and related services division amounted to HK$9,049 million (2005 – HK$4,951 million); for the property and hotels division HK$221 million (2005 – HK$226 million); for the retail division HK$2,668 million (2005 – HK$2,454 million) and for the energy, infrastructure, finance & investments and others division HK$411 million (2005 – HK$500 million).

The capital expenditures of the Group are primarily funded by cash generated from operations, cash on hand and to the extent appropriate, by external borrowings.

Debt Maturity and Currency Profile

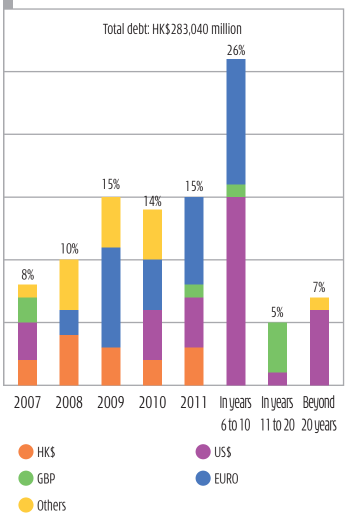
The Group's total borrowings, excluding loans from minority shareholders, at 31 December 2006 amounted to HK$283,040 million (2005 – HK$259,482 million). The increase in borrowings was mainly due to the effect of the translation of foreign currency denominated loans as a result of the weakened HK dollar of HK$14,293 million and the increased borrowings by the ports and related services division to fund its construction of new capacity at its existing terminals. Loans from minority shareholders, which are viewed as quasi equity, totalled HK$12,030 million at 31 December 2006 (2005 – HK$5,429 million). The increase arose as part of the sale of a 20% equity interest in the ports and related services division to PSA. The Group's weighted average cost of debt during 2006 was 5.7% (2005 – 4.7%).

The maturity profile of the Group's total borrowings, excluding loans from minority shareholders and after taking into consideration foreign currency swaps, at 31 December 2006 is set out below:

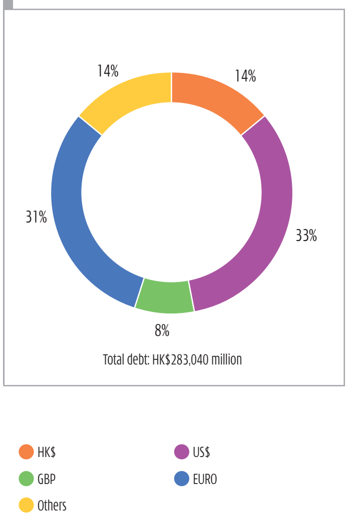
	HK$	US$	£	€	Others	Total
In 2007	2%	3%	2%	–	1%	8%
In 2008	4%	–	–	2%	4%	10%
In 2009	3%	–	–	8%	4%	15%
In 2010	2%	4%	–	4%	4%	14%
In 2011	3%	4%	1%	7%	–	15%
In years 6 to 10	–	15%	1%	10%	–	26%
In years 11 to 20	–	1%	4%	–	–	5%
Beyond 20 years	–	6%	–	–	1%	7%
Total	14%	33%	8%	31%	14%	100%

The non-HK dollar and non-US dollar denominated loans are either directly related to the Group's businesses in the countries of the currencies concerned, or the loans are balanced by assets in the same currencies. None of the Group's consolidated borrowings, as a matter of policy, have credit rating triggers that would accelerate the maturity dates of the debt outstanding.

Debt Maturity Profile by Period and Currency Denomination at 31 December 2006



Debt Profile by Currency Denomination at 31 December 2006



Changes in Financing

The significant financing activities in 2006 were as follows:

- In March, obtained a short-term bridging loan of €500 million (approximately HK$4,885 million) to refinance the redemption at maturity of a €500 million bond;

- In April, entered into a structured transaction with an investment bank involving a private placement of an effective, approximately 10% indirect interest in **3** Italia S.p.A. for a cash consideration of €420 million (approximately HK$3,864 million), which has been accounted for as debt as required pursuant to Hong Kong Financial Reporting Standards;

- In July, A S Watson obtained a five-year, floating rate, €600 million syndicated loan (approximately HK$5,862 million), mainly to refinance existing loans and provide funding to its operations in France;

- In September, issued ten-year, fixed rate, €1,000 million (approximately HK$10,260 million) of guaranteed notes to refinance existing indebtedness;

- In November, issued eleven-year, fixed rate, £300 million (approximately HK$4,581 million) of guaranteed notes to refinance a portion of the intercompany loan investment in **3** UK;

- In November, issued twenty-year, fixed rate, £400 million (approximately HK$6,108 million) of guaranteed notes to refinance a portion of the intercompany loan investment in **3** UK;

- In November, obtained a short-term 6-month, floating rate, £500 million (approximately HK$7,635 million) bank loan facility to refinance a portion of the intercompany loan investment in **3** UK; and

- In December, arranged a five-year, floating rate, €3,000 million (approximately HK$30,780 million) syndicated bank loan facility, which was fully drawn in January 2007, to refinance **3** Italy's existing loans.

Capital, Net Debt and Interest Coverage Ratios

The Group's total shareholders' funds increased 12% to HK$273,794 million at 31 December 2006 compared to HK$243,554 million at the end of last year. The increase in shareholders' funds mainly reflects the profit for the year and the favourable impact of exchange translation differences arising on translation of the net assets of overseas businesses to HK dollars recorded in reserves as mentioned previously.

At 31 December 2006, consolidated net debt of the Group, excluding loans from minority shareholders which are viewed as quasi equity, was HK$152,638 million (2005 – HK$149,096 million) and on this basis, the Group's net debt to net total capital ratio decreased to 33% from 36% at the end of last year.

As additional information, the following table shows the net debt to net total capital ratio calculated on the basis of including loans from minority shareholders and also with the Group's investments in its listed subsidiaries and associated companies marked to market value at 31 December 2006. The pro-forma column shows these ratios after accounting for receipt of the HK$15,976 million special dividend announced by HTIL payable upon the imminent completion of the announced sale of its India mobile telecommunications operation.

Net debt / Net total capital ratios at 31 December 2006:	Total	Pro-forma
A1 – excluding loans from minority shareholders from debt	33%	29%
A2 – as in A1 above and investments in listed subsidiaries and associated companies marked to market value	27%	23%
B1 – including loans from minority shareholders as debt	36%	31%
B2 – as in B1 above and investments in listed subsidiaries and associated companies marked to market value	29%	25%

The Group's consolidated gross interest expense and finance costs of subsidiaries, before capitalisation for the year, increased to total HK$17,036 million, compared to HK$15,984 million last year, mainly due to higher effective market interest rates in 2006, partially offset by a lower average loan balance due to the non-consolidation of HTIL.

Consolidated EBITDA and FFO before all CACs covered consolidated net interest expense and finance costs 7.9 times and 3.6 times respectively (2005 – 6.5 times and 3.3 times).

Secured Financing

At 31 December 2006, the shares of H3G S.p.A. owned by the Group were pledged as security for its project financing facilities. The assets of H3G S.p.A. amounted to approximately HK$81,007 million (2005 – HK$66,845 million). In January this year, the project financing facilities were repaid and the shares are not pledged under the new replacement syndicated bank loan. In addition, HK$10,781 million (2005 – HK$8,554 million) of the Group's assets were pledged as security for bank and other loans of the Group.

Borrowing Facilities Available

Committed borrowing facilities available to Group companies, but not drawn at 31 December 2006, amounted to the equivalent of HK$12,946 million (2005 – HK$4,007 million), of which HK$3,182 million (2005 – HK$2,628 million) related to the **3** Group.

Contingent Liabilities

At 31 December 2006, the Group provided guarantees for banking and other borrowing facilities granted to associated companies and jointly controlled entities of HK$13,322 million (2005 – HK$15,125 million), and provided performance and other guarantees of HK$5,681 million (2005 – HK$6,165 million).