

FINANCIAL INFORMATION AND ANALYSIS

Net Revenue

"Net Revenue" in any year means the gross revenues (from whatever sources including, without limitation, any compensation payable to the Franchisee after the Operating Date by the Government under the Project Agreement or the Ordinance and any amounts payable after the Operating Date to the Franchisee in respect of any breach of contract by any third party, but excluding Interest Income and any revenue of other receipt of a capital nature which is received in respect of any act, event, omission or circumstance which occurred during the Construction Period) of the Franchisee for that year, calculated on an accruals basis in accordance with the Franchisee's normal accounting principles, less Interest Expense and Operating Costs for that year, adjusted (if appropriate).

The Company's actual revenues are far below the Minimum Estimated Net Revenue stipulated in the WHC Ordinance (Chapter 436) and are summarised below:

HK\$m	Y/E Jul-07	Y/E Jul-06	Y/E Jul-05	Y/E Jul-04	Y/E Jul-03	Y/E Jul-02	Y/E Jul-01	Y/E Jul-00	Y/E Jul-99	Y/E Jul-98	Cumulative
Minimum Estimated Net Revenue in the Ordinance	1,549	1,455	1,190	880	794	713	506	253	201	154	7,695
Actual Net Revenue/(Deficit)	658	567	492	400	325	299	172	59	(52)	(208)	2,712
Shortfall	891	888	698	480	469	414	334	194	253	362	4,983

The main reason for the shortfall in Net Revenue is that actual traffic volume has been much less than the forecast due to:

- the development of rail and public transport system;
- large toll differential with other tunnels; and
- poor access roads such as the congestion of ingress and egress (Central and Tsim Sha Tsui).

Under the WHC Ordinance, the Company is entitled to request the Government to gazette a toll increase should the actual Net Revenue generated be less than the Minimum Estimated Net Revenue.

If the actual Net Revenue earned is greater than the Upper Estimated Net Revenue but less than the Maximum Estimated Net Revenue, the Company is entitled to the Upper Estimated Net Revenue plus 50% of the excess and the balance, another 50% excess will go to Toll Stability Fund.

If the actual Net Revenue earned is greater than the Maximum Estimated Net Revenue, the Company is entitled to the Upper Estimated Net Revenue plus 50% of the excess between Upper Estimated Net Revenue and Maximum Estimated Net Revenue and all surplus will go to Toll Stability Fund.

Internal Rate of Return

Internal Rate of Return (IRR) of the Company up to July 2007 generated is negative 4.52%.

Remarks: IRR is a calculation of equity return and to compare against the opportunity cost of capital. The IRR is the discount rate at which these cash flows would have a zero NPV.

$$NPV = \frac{\text{Cash flow for period zero}}{1} + \frac{\text{Cash flow for period one}}{1+IRR} + \frac{\text{Cash flow for period two}}{(1+IRR)^2} + \frac{\text{Cash flow for period ...}}{(1+IRR)^{\dots}} + \frac{\text{Cash flow for period n}}{(1+IRR)^n} = \text{Zero}$$

WHC's IRR upto July 2007

Period/ Year ended	Shareholders' (Investment)/ Return \$'000	#Discount Factor	NPV of 1994 cash flow x discount factor \$'000	
	a	b	a x b	
IRR = - 4.52%				
0	(Jul-94)	(555,000)	1.0000	(555,000)
1	(Jul-95)	(515,200)	1.0473	(539,583)
2	(Jul-96)	(537,500)	1.0969	(589,581)
3	(Jul-97)	(592,300)	1.1488	(680,439)
4	(Jul-98)	-	1.2032	-
5	(Jul-99)	(138,000)	1.2601	(173,897)
6	(Jul-00)	(172,000)	1.3198	(226,999)
7	(Jul-01)	(160,000)	1.3822	(221,156)
8	(Jul-02)	(250,000)	1.4476	(361,910)
9	(Jul-03)	(190,000)	1.5162	(288,069)
10	(Jul-04)	-	1.5879	-
11	(Jul-05)	130,000	1.6631	216,198
12	(Jul-06)	110,000	1.7418	191,595
13	(Jul-07)	1,770,000	1.8242	3,228,841
	Total	(1,100,000)		-

$$\# \text{ Discount factor for period } 0 = 1$$

$$\text{Discount factor for period } n = \frac{1}{(1+IRR)^n}$$

Risk Management

It is the company policy to manage the interest rate risk. During the year, new hedging contracts (excluding forward starting interest rate swap and swaptions) in the sum of HK\$300 million were entered into while hedging contracts in the sum of HK\$500 million was expired. Given the outstanding hedging contract of HK\$1,300 million as at 31 July 2007, hedged loan represented 42% of the bank loan outstanding on the balance sheet date. At the end of July 2007 and after taking into account further HK\$300 million forward start interest rate swap and swaptions, there were HK\$1,600 million hedging contracts outstanding at the fixed rate between 3.50% and 4.715%.

To protect the company asset and operation, appropriate insurance coverage has been arranged.



Profit and Loss Account

Profit and Loss Account for the Year Ended 31st July Yearly

	2007 HK\$'000	2006 HK\$'000	2005 HK\$'000	2004 HK\$'000	2003 HK\$'000
Toll income	774,195	715,620	665,717	613,403	567,359
Other income	36,425	50,904	38,992	22,863	33,471
Turnover	810,620	766,524	704,709	636,266	600,830
Operating and administrative expenses	(327,824)	(261,845)	(255,918)	(257,277)	(246,671)
Operating profit	482,796	504,679	448,791	378,989	354,159
Finance costs					
- Interest on bank loans	(131,107)	(113,712)	(114,704)	(124,980)	(165,513)
- Interest on shareholders' loans	(20,296)	(28,426)	(29,251)	(30,238)	(29,744)
	(151,403)	(142,138)	(143,955)	(155,218)	(195,257)
Profit before taxation	331,393	362,541	304,836	223,771	158,902
Deferred tax provision	(58,637)	(63,458)	(53,625)	(39,833)	(5,484)
Profit after taxation	272,756	299,083	251,211	183,938	153,418
Retained profits/ (Accumulated losses) brought forward	337,035	37,952	(213,259)	(397,197)	(639,085)
Prior year adjustment on deferred taxation	-	-	-	-	88,470
Retained profits/ (Accumulated losses) carried forward	609,791	337,035	37,952	(213,259)	(397,197)

Operating and Administrative Expenses for the Year Ended 31st July Yearly

	2007 HK\$'000	2006 HK\$'000	2005 HK\$'000	2004 HK\$'000	2003 HK\$'000
Staff costs	50,670	48,288	46,411	46,538	46,590
Maintenance costs	7,996	8,598	8,513	10,319	9,862
Utility expenses	6,679	6,767	6,582	6,673	6,795
Rates	28,858	26,450	24,318	23,082	22,839
Insurance	18,183	19,236	18,390	17,565	15,835
PR & promotion, professional fee, administrative expenses and others	7,526	7,143	7,744	6,524	7,708
Operating & administrative expenses before depreciation	119,912	116,482	111,958	110,701	109,629
Depreciation	207,912	145,363	143,960	146,576	137,042
Total	327,824	261,845	255,918	257,277	246,671

Balance Sheet

Balance Sheet as at 31st July Yearly

	2007	2006	2005	2004	2003
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Non-current assets					
Fixed assets	5,399,565	5,606,227	5,750,394	5,935,070	6,080,760
Deferred taxation assets	-	-	-	43,153	82,986
Derivative financial instruments #2	5,465	21,386	-	-	-
	<u>5,405,030</u>	<u>5,627,613</u>	<u>5,750,394</u>	<u>5,978,223</u>	<u>6,163,746</u>
Current assets					
Inventories	1,469	1,519	1,296	1,291	1,306
Accounts receivable and prepayments	47,655	39,071	36,909	32,234	31,316
Derivative financial instruments #2	3,816	12	-	-	-
Cash and bank balances	12,794	6,378	7,433	7,287	4,266
	<u>65,734</u>	<u>46,980</u>	<u>45,638</u>	<u>40,812</u>	<u>36,888</u>
Current liabilities					
Accounts payable and accruals	95,699	86,521	105,300	149,379	144,318
Current portion of long-term bank loans #1	395,903	263,110	234,566	210,907	185,907
Derivative financial instruments #2	-	1,319	-	-	-
	<u>491,602</u>	<u>350,950</u>	<u>339,866</u>	<u>360,286</u>	<u>330,225</u>
Net current liabilities	<u>(425,868)</u>	<u>(303,970)</u>	<u>(294,228)</u>	<u>(319,474)</u>	<u>(293,337)</u>
Net assets	<u>4,979,162</u>	<u>5,323,643</u>	<u>5,456,166</u>	<u>5,658,749</u>	<u>5,870,409</u>
Financed by:					
Share capital	400,000	400,000	400,000	400,000	400,000
Retained profits/(Accumulated losses) brought forward	337,035	37,952	(213,259)	(397,197)	(639,085)
Prior year adjustment on deferred taxation	-	-	-	-	88,470
Retained profits/(Accumulated losses) after reinstatement	337,035	37,952	(213,259)	(397,197)	(550,615)
Profit after taxation	272,756	299,083	251,211	183,938	153,418
Retained profits/(Accumulated losses) carried forward	609,791	337,035	37,952	(213,259)	(397,197)
Hedging reserve	7,443 ^{#2}	16,565 ^{#2}	-	-	-
Shareholders' equity	1,017,234	753,600	437,952	186,741	2,803
Shareholders' loan	1,113,786	2,863,490	2,945,064	3,045,813	3,015,575
Shareholders' funds	2,131,020	3,617,090	3,383,016	3,232,554	3,018,378
Long-term bank loans #1	2,713,737	1,629,109	2,062,678	2,426,195	2,852,031
Deferred taxation liabilities	134,147	77,444	10,472	-	-
Derivative financial instruments #2	258	-	-	-	-
	<u>4,979,162</u>	<u>5,323,643</u>	<u>5,456,166</u>	<u>5,658,749</u>	<u>5,870,409</u>

Balance Sheet (Continued)

Note:

#1 Deferred expenditure consists mainly of the Front End Fee and Arrangement Fee for 1st refinancing in 8/2002 & 2nd refinancing in 2/2007. For the avoidance of doubt, the unamortized deferred expenditure due to 1st refinancing has been written off upon 2nd refinancing. According to HKAS 32 & 39, the deferred expenses are treated as transaction costs and should be net off the fair value of bank loans and the comparative amounts have been reclassified.

The breakdown are shown below:

	2007	2006	2005	2004	2003
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<u>Long-term bank loans</u>					
Secured bank loans	2,726,000	1,639,610	2,081,390	2,449,000	2,879,000
Less: Unamortized deferred expenditure	(12,263)	(10,501)	(18,712)	(22,805)	(26,969)
	<u>2,713,737</u>	<u>1,629,109</u>	<u>2,062,678</u>	<u>2,426,195</u>	<u>2,852,031</u>
<u>Current portion of long-term bank loans</u>					
Secured bank loans	400,000	268,856	238,659	215,000	190,000
Less: Unamortized deferred expenditure	(4,097)	(5,746)	(4,093)	(4,093)	(4,093)
	<u>395,903</u>	<u>263,110</u>	<u>234,566</u>	<u>210,907</u>	<u>185,907</u>
Total deferred expenditure	<u>(16,360)</u>	<u>(16,247)</u>	<u>(22,805)</u>	<u>(26,898)</u>	<u>(31,062)</u>

#2 According to HKAS 32 & 39, all outstanding interest rate swap contracts entered into by the Company are classified as cash flow hedge and stated at fair value. HK\$3 million liabilities on derivative financial instruments are debited to opening hedging reserve as at 1 August 2005, HK\$3.6 million credited to derivative financial instruments and HK\$0.6 million debited to deferred taxation whereas the comparative amounts as at 31 July 2005 have not been restated.

Cash Flow Statement

Cash Flow Statement for the Year Ended 31st July Yearly

	2007	2006	2005	2004	2003
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Net cash surplus from operating activities	578,773	523,083	476,388	409,876	346,650
Cash flow from investing activities					
Net payment of tunnel costs and fixed assets	(1,791)	(2,555)	(2,291)	(1,855)	(1,172)
Net cash used in investing activities	(1,791)	(2,555)	(2,291)	(1,855)	(1,172)
Cash flow from financing activities					
New loans from/(repayment to) shareholders	(1,770,000)	(110,000)	(130,000)	-	190,000
New secured bank loans drawn down	3,345,000	-	-	-	3,350,000
Transaction cost for new bank loans	(18,100)	-	-	-	(34,866)
Net repayment of secured bank loans	(2,127,466)	(411,583)	(343,951)	(405,000)	(3,851,000)
Net cash outflow from financing	(570,566)	(521,583)	(473,951)	(405,000)	(345,866)
Net increase/(decrease) in cash and bank balances	6,416	(1,055)	146	3,021	(388)
Cash and bank balances at beginning of year	6,378	7,433	7,287	4,266	4,654
Cash and bank balances at end of year	12,794	6,378	7,433	7,287	4,266

Cash Flow Since Construction

	From Construction to 31/7/2007 HK\$'000
Inflow	
Fund from Shareholders	3,110,000
Bank Loans	4,776,500
Revenue	6,199,378
	<u>14,085,878</u>
Outflow	
Capital Expenditure	6,732,562
Operating Expenses (excl. depreciation)	1,037,328
Finance Charge on Bank loan	2,641,495
Bank Loan Repayments	1,650,500
Loan Repayment to Shareholders	2,010,000
Working Capitals	1,199
	<u>14,073,084</u>
Net Cash Balance	<u>12,794</u>