To Our Shareholders

RESULTS AND DIVIDENDS

For the year ended 30 June 2001, turnover and net profit increased by 6.4% and 54.9% to $281.1 million and $33 million respectively. Earnings per "A" share and earnings per "B" share both increased by 54.9% to 4.84 cents per share and 0.48 cent per share respectively.

The Board recommends a final dividend of 1.7 cents per "A" share and 0.17 cent per "B" share. If accepted by shareholders, full year dividends would be 3.2 cents per "A" share and 0.32 cent per "B" share, representing an increase of 52.4% from those of last year in both categories of scrips.

BUSINESS REVIEW

During the second half of 2000, the hospitality sector appeared to have finally ended a three-year bear market. Although it was not expected to turn robust any time soon, at least many, including ourselves, were breathing a sigh of relief. That turned out to be premature. As 2001 rolled around, the industry took another dive. What we saw late last year was nothing more than a brief hiatus before the second leg down. It is 1997/98 all over again! Worse yet, there is no end in sight.

For the 12 months ending this June, tourist arrivals grew by 14% from a year ago to 13.5 million. This number is misleading because much of the increase is from same day travellers — they arrive through one mode of transportation and leave on the same day through another mode. The year before, about 3.5 million visitors or 29% of total arrivals fell under this category. This year the number is 4.6 million or 34% of the total. In other words, two-thirds of the additional visitors are same-day sojourners.

These people fall under two categories — one from each side of the Taiwan Strait. Since Taiwan does not allow direct transport links between the island and the mainland, their citizens must fly through a third city. For that, Hong Kong is the most convenient. Of late, the increase in number of Taiwan people doing business or otherwise working on the other side of the Strait has been phenomenal.

At the same time, many mainlanders going overseas prefer to fly to Shenzhen, which is adjacent to Hong Kong's northern border, and be transported by land or sea to the Hong Kong airport for the international leg of their journey. On their return, they will reverse the route. While Hong Kong's airport has many more overseas flights, the reason why many individuals go through Shenzhen is that domestic flights are a lot cheaper than those arriving and departing Hong Kong for the mainland. As wealth accumulates, mainland Chinese will increasingly travel abroad. Since many of them have already visited Hong Kong before, they are not spending time here except in our airport. Maybe this explains why there are now a good number of people sleeping on benches each night inside!

The same phenomenon partially explains the plight of our hotel industry. With the Hong Kong dollar tied to the U.S. dollar and with most of our neighboring countries having devaluated their currencies during the Asian crisis, our city has become even more expensive than before. Tour packages to Southeast Asia or South Korea are incredibly cheap, and tourists, including many from mainland China, are flocking there.

Thus we are witnessing the beginning of a new trend. Not only will China become one of the world's most popular tourist spots, its citizens will increasingly flood the streets and beaches of other countries. With 1.26 billion people whose income is rising, the rest of the world should get used to them. We saw Japanese tourists everywhere in the 1980's, and now it is China's turn. There are already rumors that the biggest shoppers of high fashion goods in Paris are the Chinese. Judging from the experience of our sister company Amoy Properties' shopping centers in Shanghai, this is possible. For example, Plaza 66 which has a very high concentration of the world's top brand names is doing amazingly well compared to all other Asian cities.

Six months ago, I wrote about the spillover effect that hotel and airline capacity constraints in Southeast Asia had in diverting tourists to Hong Kong. As the global economy slows, the situation has reversed. Falling visitor numbers have forced their hotels to slash prices thus making our neighbors even more attractive. This trend will continue in the aftermath of the September 11 tragedies as westerners cut down on travels. The only compensating factor is the arrival of Chinese tourists. However, the Chinese economy cannot remain for long as the only bright spot in the world. Market cyclicality will not fail to wave its magic wand and China will one day feel the chill like everyone else. That, unfortunately, will be no help to the world.

Back in Hong Kong, there are domestic reasons for market feebleness. True tourist arrivals, i.e. not same day travellers, only grew moderately, and those who stayed were spending less time and money. At the same time, the number of hotel rooms has been increasing. Since 1999 it rose by 3% to 4% per annum, and the rate will pick up to 7% to 8.5% each year for the next three years. All these factors explain why in the face of increasing arrivals, city wide occupancy remained the same at 82% for the past two years.

Our room rates grew by 20% for the year and the equivalent figure for the first six months was 28%. Our hotels were 86% full for the fiscal year as compared to

91% of the previous period and 88% for the first six months. These numbers clearly indicate the weakening of the industry. The lower than usual occupancy rate is, however, deliberate. Pre-committed contracts at higher tariffs were signed when the market was good, and too big a price drop soon afterwards would encourage them to default.

PROSPECTS

As stated above, the number of mainland Chinese tourists has increased substantially. The first wave not many years ago were poorer and less sophisticated. Over time, they became wealthier, and in the past two years, their per capita spending exceeded that of the average tourist. Some of those mainland travellers I suspect are now the ones going to Bangkok, Phuket, Kuala Lumpur, and Singapore. In their place is another group of mainland visitors in Hong Kong who, as indications seem to show, is again of lesser financial means. These individuals contribute less to our economy in general and to our industry in specifics.

On the other hand, the bigger spenders from the U.S. and Europe are diminishing in number. As such, Hong Kong hotels of all price points are hurt.

Given this difficult environment, I anticipate for the present fiscal year a decline in both occupancy and average room tariffs. The result is that both turnover and profit will retreat somewhat. Needless to say, management will do our best to cushion the fall.

Looking further down the road, it will take a lot to reverse the slide. As a prerequisite, China must continue to grow. Not only will that ensure a steady stream of tourists, it will attract more foreign investments into China which always benefits Hong Kong. The U.S. and European economies must also recover although the recent tragedy in New York City will cast a shadow that is expected to last at least a year or two. Whereas business travellers from the West will return first, discretionary trips by holiday makers will take more time to recover.

High costs notwithstanding, there is much that Hong Kong can do to strengthen our position as a tourist destination. There are only a handful of cities in the world such as New York City and San Francisco in North America and Paris and London in Europe which truly have character. Besides economic vibrancy, they have a charm not found in the likes of Los Angeles and Dallas or Frankfurt and Zurich. In Asia, I can only think of two such alluring cities — Hong Kong and Shanghai.

Besides the physical beauty of our harbor and the high energy level of our streets, Hong Kong is a true bridge between the East and the West, the old and the new. The development of our tourism sector should exploit these elements. While further developing modern infrastructures, Hong Kong should not forget its Chinese roots and its local culture. Tourists everywhere like the convenience of modernity (which we already have), but it is a city's uniqueness which draws them back. Hong Kong should avoid the mistakes of those which have made themselves sterile and plastic.

The blending of Oriental with Occidental and ancient with modern, should not be limited to the physical appearance. Our "software" must embrace them all. For example, Hong Kong has always been the cuisine capital of Asia. It should be developed further. Our entertainment industry can also improve. Besides pubs and clubs, rock and classical concerts, how about Cantonese, Shanghainese and Pekingese operas? Where in the world can they be heard in a single location? Chinese acrobats and western mime should be found on the same street, as should cappuccino and herbal drinks, New York hot-dogs and local dim-sum.

About ten years ago the now famous Chinese fashion store, Shanghai Tang, was founded in Hong Kong. Several similarly successful shops were soon opened. For a few years the fad swept through major western cities — one can readily find photographs of socialites wearing their products in gossip magazines from New York City to London. Instead of complaining about our citizens going north to cheaper Shenzhen for shopping, Hong Kong people should manufacture Shanghai Tang and other products there. A coat selling for several hundred U.S. dollars on Fifth Avenue in New York City should take no more than twenty to thirty to make in Shenzhen and is even cheaper in neighboring towns. Hong Kong companies should design such products here (or wherever), make them north of the border, and market them to the world.

The development of these businesses should be done purely by the private sector. Hong Kong has the talent to do all that. What the government should do is to facilitate the logistics such as ensuring smooth border crossings. Beyond that, the government may need to take the lead to develop certain tourist attractions. Land prices are simply too expensive and the risks of starting certain businesses too high. (On this point, the government should be commended for bringing Disneyland to our shores.)

The quasi – governmental Hong Kong Tourism Board should then redouble efforts to market our city to the world. We cannot afford to rest on our former laurels and let the world pass us by. There is certain first mover advantage which must not be yielded, for competition is fierce. Foremost among them is Shanghai which is not burdened by a divided citizenry caused by democracy.

Traditionally Hong Kong is the international financial center of Asia (while Tokyo mainly serves Japan's huge domestic market). Moreover, we must be the best located city in East Asia — equal distance to Japan in the north and Indonesia in the south; within a five hour flight is almost half of the world's population; and situated at the door step of mainland China, the most dynamic emerging economy in the world. Our physical infrastructure is already one of the best in the world. All these factors have brought — and will continue to bring — millions to our city each year. We already are — and can continue to be — one of the world's most attractive cities for business and tourism alike.

Tourism has for decades been one of four economic pillars (with the others being financial services, manufacturing and real estate) of our city. Now in the industry's darkest hour, it is precisely the time to refocus our attention on it and plan for the future. The latest New York City tragedy notwithstanding, global tourism will grow in the coming decades. We must position ourselves to take advantage of this trend. In the process, tourism can become a locomotive to revive our economy. As a hotel company, we can only benefit from it.

Ronnie C. Chan
Chairman

Hong Kong, 24 September 2001

It takes great courage to care. The nurturing spirit relies on the ability to look within and understand one's own strengths and weaknesses.