OPERATING AND FINANCIAL REVIEW

OPERATING REVIEW

FUNDAMENTALS STRENGTHENED

In a year when the world's major economies receded, the overall Hong Kong economy also experienced a downturn particularly during the second half of the year. Generally, corporate expenditure were reduced in response to a lower level of activity. The rise in unemployment also affected consumer sentiment. Despite this challenging environment, our office portfolio achieved a 98% occupancy rate. We also made solid progress across all property sectors (office, retail and residential) in implementing steps to strengthen our fundamentals, following the strategic directions mapped out in the previous year.

- **Leadership position in Causeway Bay.** We consolidated the minority interests in the retail Lee Theatre Plaza complex, further consolidating our dominance in the prime office/retail area of Causeway Bay;

- **Continual review of the performance of individual buildings and improve their quality by selective refurbishment and re-development.** Our Bamboo Grove luxury residential development underwent a major renovation programme which includes both visible enhancements and the equally important service upgrades;

- **Strengthening our retail sector located in the retail hub of Causeway Bay.** We further expanded our retail sector and advanced our objective to enhance our neighbourhood as a distinct hub for dining, shopping and recreation. A diversity of retail and leisure offers were introduced to our retail portfolio, complemented by a new "lifestyle" theme in the Lee Theatre Plaza area;

- **Financial prudence.** We continued to have a strong balance sheet and emphasize financial prudence. Our new Medium Term Note Programme and the US$200 million Notes issuance obtained solid investment grade ratings (Moody's: Baa1; Standard and Poor's: BBB+);

- **Operational efficiency and good customer service.** Our property management has been further enhanced with upgraded operational efficiency, focusing on good customer service. The Bamboo Grove project will be relaunched with a full range of enhanced and personalized property management services.

ACTIVITIES IN THE YEAR

Investment Properties

- **Office**

The period in review witnessed a worsening of the general market environment. There was an increased secondary stock of office properties following company cost-cuttings. These include premises occupied by telecommunications and financial institutions. We continue to have a diversified but focused tenant base covering large multinationals and Hong Kong organizations, and achieved an occupancy rate of 98%.

Our strategy of continually anticipating the needs of our customers stood us in good stead and we enjoy an excellent relationship with our tenants. We interact closely with our tenants to ensure that we anticipate and meet their needs, and are encouraged by the response.

- **Retail**

Retail markets are generally sensitive to the overall economic environment. Consumer confidence, in particular, was affected after the events on 11 September. Our portfolio, located in the retail hub of Causeway Bay, achieved a 97% occupancy rate. The proactive approach we adopted in managing our tenant mix resulted in the introduction of new complementary tenants to the portfolio, further strengthening the "lifestyle" theme in the Lee Theatre Plaza area.

In our retail portfolio, our objective is to create an attractive environment for dining, shopping and recreation. All these are to be achieved by the provision of a diversity of complementary retail and leisure offers that meet the needs of customers. The introduction of new-style food and beverage establishments in our neighbourhood during the year has further advanced this aim. We continued our marketing efforts, partnering with tenants to our mutual benefit. The annual Hysan Street Party held in November successfully rounded off a busy year for our team.

- **Residential**

The major refurbishment programme for the Group's Bamboo Grove luxury residential complex in the Mid-levels commenced in 2001. The programme seeks to enhance the external façade, apartment interiors, as well as clubhouse and common facilities to provide a comfortable and family-friendly living environment. A full range of enhanced and personalized property management services will be introduced. Re-launch is scheduled to commence in the second quarter of 2002.

Development Properties

The Grand Gateway commercial and residential complex in Puxi, Shanghai, where we have a 17% interest, has established itself as one of the most popular shopping centers in Puxi area. The retail podium is virtually fully-let. The average occupancy rate of the residential tower for year 2001 was 96%.

Pre-sales in our two joint-venture residential developments in Singapore, Sanctuary Green and the Gardens at Bishan (10% interest), are in progress. Pre-sale in Amaryllis Ville project (25% interest) is expected to be launched shortly.

FINANCIAL REVIEW

2001 was characterized by a weakening economy and falling interest rates. The weakening local economy, made worse by the global slowdown and the negative economic impact of the September 11 terrorist attack in the United States, inevitably led Hong Kong property rental and asset values to fall during the year. The U.S. Central Bank aggressively cut interest rates during the year to counter the U.S. slow down and Hong Kong interest rates followed suit because of the currency peg.

Despite the difficult operating environment, the Group was able to achieve strong occupancy rates, operating profits and cash flows. Financial gearing and interest coverage were also maintained at comfortable levels such that strong credit ratings from both Standard & Poor's Rating Agency (BBB+) and Moody's Investor Services (Baa1), reflecting the strong and stable financial profile of the Group, were achieved.

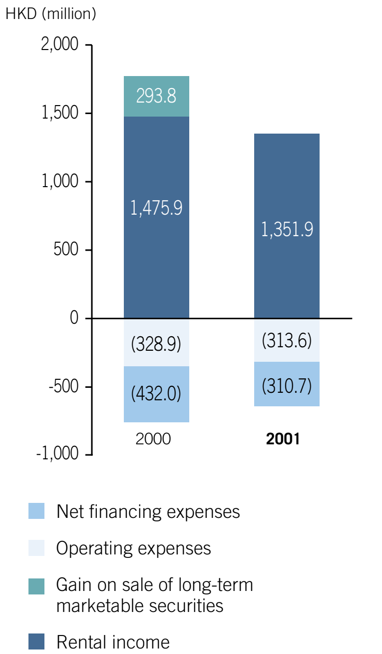
The Group was able to reduce interest expenses significantly during the year by keeping debt facilities largely on a floating rate basis to take advantage of declining interest rates. The Group also took advantage of the low rates to lengthen debt tenure and diversify funding sources. This was achieved by the Group establishing a Medium Term Note Programme in December, followed in February 2002 by the inaugural issue US$200 million 7% 10-year Notes under the Programme.

RESULTS

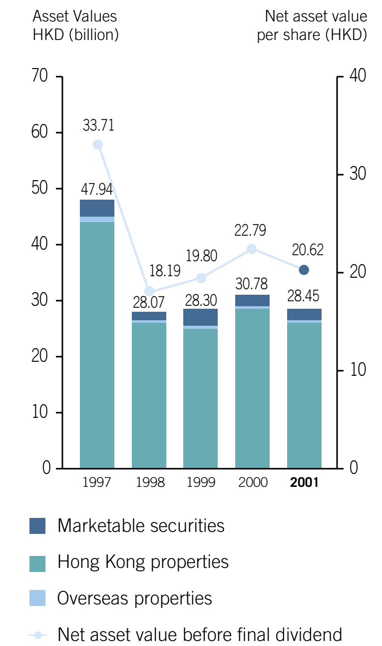
The Group's net profit attributable to shareholders in 2001 was HK$600 million, which was 29.4% lower than the HK$850 million in 2000 mainly because of the absence of gains on disposal of long-term investment in marketable securities of HK$294 million realized in 2000. Earnings per share were HK$0.58 against 2000's figure of HK$0.82. The Group's core leasing earnings, however, were up by 1.8%, which more accurately reflect the Group's strong effort during the past difficult year.

Rental income from the Group's property portfolio dropped by 8.4% year-on-year as a result of negative rental reversions and high vacancy at Bamboo Grove with the commencement of refurbishment in July 2001. Excluding Bamboo Grove, the fall year-on-year was a more modest 5.0%. To help cope with falling rental income, the Group tightened expenses. Operating expenses fell by 4.7% to HK$314 million and net financing charges were HK$121 million lower despite higher debt. The net interest expense cover ratio improved from 2000 year-end's 3.6 times to 3.7 times at 31 December 2001.

Performance Analysis



Asset Values



REVIEW OF ASSET VALUES

The Group's investment properties were revalued independently by professional valuers at year end 2001 at HK$26,639 million. The resulting net revaluation deficit for the year of HK$1,841 million has been charged to reserves. This movement, together with the decrease in value of the Group's marketable security holdings, was the most significant elements in the fall in shareholders' funds of 9.4% to HK$21,267 million. Net asset value per share (before final dividend) correspondingly decreased from HK$22.79 to HK$20.62.

DEBT AND MATURITY PROFILE

The total debt outstanding at the end of 2001 amounted to HK$5,628 million (excluding amount due to minority shareholders and advances from investees), an increase of HK$522 million from the previous year end. Loan draw down from existing and new facilities during the year were mainly used to finance the minority interest acquisition in The Lee Theatre Plaza and the refurbishment expenditures at Bamboo Grove. Net debt (gross borrowings less cash, cash equivalent and marketable securities at year-end market value) amounted to HK$4,544 million.

Net debt as a percentage of shareholder equity increased from 14.6% at December 2000 to 21.4% at year-end 2001 as a result of the additional borrowings and reduced shareholder equity from lower property asset valuation.

During the year, the Group continued to maintain all of its debt in Hong Kong dollars and on an unsecured basis. Over 98% of the borrowings were on a committed basis.

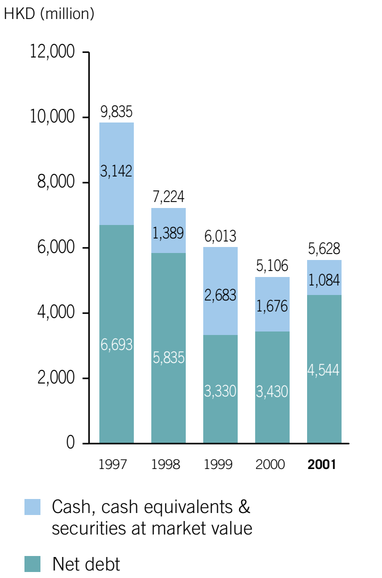
The maturity profiles of the Group's gross debt at 31 December 2001 and 31 December 2000 are summarised as follows:

	2001	2000
	HKD(million)	HKD(million)
Repayable within a period		
– Not exceeding 1 year	**2,140**	816
– Between 1 to 2 years	**436**	2,150
– Between 2 to 5 years	**2,572**	2,140
– After 5 years	**480**	0
	5,628	5,106

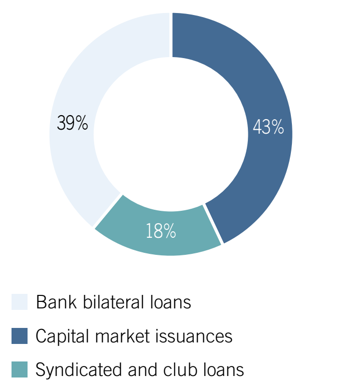
Sources of funds at 2001 year-end comprised of 43% from capital market issuances, 39% from bank bilateral loans and 18% from syndicated and club loans.

After the 10-year Notes issue in February 2002 and the repayment of the HK$2 billion Floating Rate Notes in March 2002, about 36% of the debt will not mature for 5 to 10 years. Similarly, the sources of debt facilities from capital market issuances and bank bilateral loans will be changed to 35% and 47% respectively.

Gross and Net Debt



Sources of Debt Facilities at 2001 Year-end



NOTABLE NEW FINANCING

In February 2002, the Group issued the inaugural US$200 million 7% Notes under the established Medium Term Note Programme. The Notes have a tenure of 10 years and were priced at 200 basis points over the benchmark 10-year U.S. Treasury Notes with a yield of 7.02%. The Notes received a credit rating of Baa1 from Moody's Investors Service and BBB+ from Standard & Poor's Rating Agency. The issue was well received by a wide group of predominately new Asian and European investors, including assets managers, insurance companies, and private investors. The net proceeds will help refinance the HK$2 billion Floating Rate Notes due in March 2002 as well as fund other Group needs.

CREDIT RATINGS

With respect to the Group's credit strength, Standard & Poor's Rating Agency maintained a stable outlook on its credit rating of BBB+. In January 2002, Moody's Investor Services assigned a Baa1 credit rating to the Company with a stable outlook. Both investment grade credit ratings reflect the Group's strong financial profile underpinned by sound financial management and stable operations with large recurring rental income cash flows.

CAPITAL EXPENDITURES

To further strengthen the Group's dynamic and long-term presence in Causeway Bay, HK$508 million were paid to acquire the 30% minority interest in The Lee Theatre Plaza in September 2001. Other capital expenditures incurred relate to additions and improvements to the Group's investment properties including the refurbishment program at Bamboo Grove. Regarding those Singapore development projects, where pre-sale is in progress, it is expected that such proceeds are sufficient to fund the construction costs and future cash flow requirements would be minimal.

At year end, the Group had HK$1,661 million in undrawn committed bank facilities. This availability, together with the Medium Term Note Programme in place, should be sufficient to cover the Group's refinancing and capital expenditure needs over the next few years.

As planned, the Group will fund its capital expenditures through debt while maintaining acceptable gearing and interest expense coverage ratios.

FINANCIAL RISK AND MANAGEMENT

The Group's financial risk management strategies include broadening the Group's financing channels, expanding the investor base, extending the tenure of facilities, and achieving a well-balanced spread of facility maturities. The Group also uses interest rate swaps and other instruments to manage interest rate risks with an objective to minimize the impact of fluctuations on earnings while achieving a balance with cost effectiveness. Transactions are conducted for hedging purposes only and no speculative positions have been or will be undertaken. As of 31 December 2001, 88% of the Group's borrowings were at floating rates.

The Group's foreign exchange exposure is minimal. As of 31 December 2001, all debt outstanding are Hong Kong dollars denominated, and investment in overseas projects totalled the equivalent of HK$703 million or 3.3% of the Group's shareholder equity.

CONTINGENT LIABILITIES

As and when required, in the ordinary course of business, the Group will provide guarantees, counter indemnities or undertakings to cover the Group's obligations in respect of projects undertaken by the Group.

The Group has provided guarantees for banking facilities granted to associated companies and investee companies. At 31 December 2001, the Group's share of guarantees and counter guarantees amounted to approximately HK$148 million (2000: HK$153 million) and HK$79 million (2000: HK$84 million) respectively.