Introduction

The core businesses of the Company and its subsidiaries and associates consist of property investment, property development, hospitality related activities and financial services. The Company is a subsidiary of Allied Group Limited ("Allied Group"), another publicly listed company in Hong Kong. The Company's interests in property investment and development and hospitality related activities in Hong Kong are mainly held through its wholly-owned subsidiaries or the 50% owned Allied Kajima Limited, and in respect of property investment and development and hospitality related activities in The People's Republic of China ("PRC"), through the 43.27% holding in Tian An China Investments Company Limited ("Tian An") held by Sun Hung Kai. The Company's financial services business is mainly conducted through its 52.29% holding in Sun Hung Kai.

Financial Review

The turnover of the Group for the year 2001 was approximately HK$660.4 million, which was an increase of 148.9% compared with the year 2000, primarily due to the consolidation of the turnover of Sun Hung Kai, which became the Group's listed subsidiary in May 2001.

The loss attributable to shareholders for the year was approximately HK$178.9 million, an improvement of 54.8% compared to the corresponding loss in the previous year of approximately HK$396.1 million.

Segmental Information

Detailed segmental information in respect of the Group's turnover and contribution to loss from operations as well as other information is shown in note 5 to the financial statements.

Financial Resources, Liquidity and Capital Structure

The Group is principally financed by net cash inflow from operating activities, banking facilities granted by the banks and net proceeds of the rights issue. The banking facilities of the Group are reviewed from time to time and new banking facilities will be secured or renewed to meet the funding requirements for capital commitments, investments and operations of the Group.

During the year, the Group enlarged its capital base by way of rights issue from a subscription of 1,450,269,712 shares at HK$0.25 per share. The net proceeds (after deduction of expenses) from the rights issue amounted to HK$358.7 million, of which HK$112.0 million was used to set off against the amount due by the Company to the ultimate holding company and the remaining balance was applied for reducing the Group's debts and as general working capital of the Group.

The liquidity of the Group as evidenced by the current ratio (current assets/current liabilities) was 1.51 times, which improved from the 0.91 times applicable at the end of last year. At 31st December, 2001, the Group's net bank borrowings amounted to HK$2,198.3 million (2000: HK$1,780.2 million), representing bank borrowings of HK$2,477.1 million (2000: HK$1,803.9 million) less bank deposits, bank balances and cash of HK$278.8 million (2000: HK$23.7 million) and the Group had net assets of HK$4,998.4 million (2000: HK$4,979.7 million). Accordingly, the Group's ratio of net bank borrowings to net assets was 44.0% (2000: 35.7%).

Financial Review (Cont'd)

Financial Resources, Liquidity and Capital Structure (Cont'd)

The bank borrowings of the Group at 31st December, 2001 and 2000 are repayable as follows:

	2001	2000
	HK$'000	HK$'000
Within one year or on demand	**1,599,010**	896,051
More than one year but not exceeding two years	**157,615**	210,933
More than two years but not exceeding five years	**226,086**	423,423
More than five years	**494,378**	273,508
	2,477,089	1,803,915

During the year, the Group refinanced a number of short term bank loans to longer term loans with decreases in interest margins. However, the consolidation of Sun Hung Kai has led to an overall increase in short term borrowings. The major portion of the Group's bank borrowings are charged at floating rates.

Risk of Foreign Exchange Fluctuation

Other than the Group's finance business (the foreign exchange risk will be mentioned later in this report), the Group's other operating activities are mainly denominated in Hong Kong dollars. Accordingly, the Group has no other significant exposure to foreign exchange fluctuations.

Acquisition of Interests in Subsidiaries and Associates

During the year, a further 4.98% interest in Sun Hung Kai was acquired by a subsidiary of the Company through the market at a cost of HK$108.4 million. Therefore, the Group's interest in Sun Hung Kai increased from 47.31% to 52.29% at year-end. Accordingly, Sun Hung Kai was reclassified as a subsidiary of the Company and its results, assets and liabilities were consolidated in the Group's financial statements. The Group's share of Sun Hung Kai's results up to 30th April, 2001 is included in the Group's financial statements on an equity accounting basis.

During the year, the Group acquired three indirect wholly-owned subsidiaries of a jointly controlled entity for an aggregate consideration of HK$62.6 million.

At 30th June, 2001, Sun Hung Kai reclassified an 8.83% interest in Tian An, a listed associate, from trading securities to interest in associates. At 28th December, 2001, a 21.36% interest in Yu Ming Investments Limited ("Yu Ming") (inclusive of 3.6% interest acquired during the year) was also reclassified by Sun Hung Kai from other investments to interest in associates.

Financial Review (Cont'd)

Contingent Liabilities

At 31st December, 2001, the Group had contingent liabilities as follows:

(a) The Group had guarantees of HK$347.0 million (2000: HK$245.0 million) in respect of banking and loan facilities utilised by an investee company and subsidiaries of jointly controlled entities.

(b) Guarantees of the Group in respect of indemnities on banking guarantees made available to a clearing house and regulatory body and others were HK$5.3 million (2000: Nil).

(c) Sun Hung Kai Securities Limited ("SHKSL"), a wholly-owned subsidiary of Sun Hung Kai, issued proceedings against New World Development Company Limited ("NWD") on 22nd December, 1998, claiming, inter alia, the repayment of HK$35.3 million paid by SHKSL to NWD as restitution of monies received by NWD in relation to a hotel project in Kuala Lumpur, Malaysia.

NWD and its wholly-owned subsidiary, namely, Stapleton Developments Limited, subsequently issued proceedings against SHKSL, claiming, inter alia, the specific performance of SHKSL's commitment with them in respect of the development project to provide funding of HK$115.9 million, of which HK$18.7 million represents interest accrued. A trial date, originally set for April 2002 was vacated at NWD's request, and a new date is to be set.

Legal costs are recorded in the income statement as incurred.

Pledge of Assets

At 31st December, 2001, certain of the Group's investment properties, hotel property, land and buildings, properties under development, properties under development for sale, properties held for sale and bank deposits with an aggregate carrying value of HK$3,406.2 million (2000: HK$3,521.5 million), certain securities in respect of a listed subsidiary with a cost of HK$1,607.9 million (2000: HK$1,527.7 million) and listed investments belonging to the Group and margin clients with an aggregate carrying value of HK$3,798.9 million (2000: Nil) were pledged to secure loans and general banking facilities to the extent of HK$4,276.2 million (2000: HK$1,981.8 million) granted to the Group. Facilities amounting to HK$2,431.9 million (2000: HK$1,759.7 million) were utilised at 31st December, 2001.

Operational Review

Hong Kong

The Group's commercial/office property portfolio performed satisfactorily, and both China Online Centre at 333 Lockhart Road, Wanchai and Allied Kajima Building, have been earning good rentals.

The Group continued to develop its residential property portfolio. St. George Apartments on Waterloo Road is undergoing preparations for marketing and the occupation permit has recently been obtained. These apartments will add approximately 12,000 sq. m. of gross floor area to the Group's existing portfolio of luxurious residential properties.

OPERATIONAL REVIEW (CONT'D)

PRC

The divestment programme on the Group's remaining non-core property development projects in the PRC continued with the disposal of the remainder of the property interests in Shanghai.

Tian An, the listed associate of Sun Hung Kai and an established PRC property developer and investor with a substantial PRC residential landbank, reported a 51.3% increase in profit. The acquisition by Tian An in May 2001 of a controlling stake in Interform Ceramics Technologies Limited, which has been renamed Shanghai Allied Cement Limited ("SAC"), a building materials provider, is expected to complement Tian An's core property operations.

Hospitality Related Activities

The Century Hong Kong Hotel, renamed as Novotel Century Hong Kong, was adversely affected by the drop in visitor arrivals especially in the last quarter of 2001. However, the performance of the Westin Philippine Plaza Hotel exceeded the previous year due to lower hotel operating costs. The Century Inn North Point, at Java Road and renamed as Ibis North Point, has contributed a profit before interest since its opening in early 2001. The first stage of Phase two has commenced with the demolition of the adjacent building. The renovation of Hua Yuan Building, an existing commercial/residential building in Wanchai and renamed as Century Court, was completed and the building is enjoying satisfactory occupancy rates.

Details of all major properties are contained in the schedule headed "Particulars of Major Properties".

Financial Services

Sun Hung Kai reported a 76.2% increase in profit to HK$220.2 million. It benefited from an improved performance by its securities dealing and term lending businesses, contributions from its associates and reduced interest expenses. Sun Hung Kai's strategy for growth to counter difficult trading conditions is to expand its distribution capacity and to achieve a broad based, quality client base. Accordingly, in addition to the branches in Mongkok, Tsuen Wan, North Point and the Macau office, branches were opened in Kwun Tong and Sheung Shui during the year under review.

Among other operating divisions, the corporate finance division successfully completed four sponsorships of initial public offerings during the year and SHK Online's marketing campaigns managed to increase its online trading client base with a very substantial increase in both client assets and daily turnover.

In December 2001, Sun Hung Kai acquired the operations of Bali International Finance Limited and its subsidiaries ("Bali"). The securities trading business of Bali has been merged with that of Sun Hung Kai Investment Services Limited, further strengthening Sun Hung Kai's position in the industry.

Towards the end of 2001, Sun Hung Kai increased its shareholding in Yu Ming to 21.36% so that Yu Ming is now an associate of Sun Hung Kai. Yu Ming is publicly listed in Hong Kong and its principal activities include investments in Hong Kong and the PRC.

Major Suppliers and Customers

The Group's five largest and top suppliers contributed 89.6% and 36.9% respectively of the total purchases in the year under review. The aggregate sales attributable to the Group's five largest customers accounted for less than 30% of the total turnover. No Directors, their associates, or shareholders of the Company who to the knowledge of the Directors own more than 5% of the Company's share capital, have an interest in any of the five largest suppliers or customers.

Employees

The total number of staff of the Group at 31st December, 2001 was 1,347 (2000: 922). Total staff costs, including Director's emoluments, amounted to HK$145.8 million (2000: HK$45.0 million). The increases in both cases were mainly due to the consolidation of Sun Hung Kai.

The Group reviews remuneration packages from time to time and normally annually. Besides salary payments, other staff benefits include contributions to employee provident funds, medical subsidies and a discretionary bonus scheme.

Management of Risks

The management of risks in respect of the Group's finance business is primarily conducted by Sun Hung Kai and described as follows:

Credit Risk

Credit risk arises from a number of areas. These include the possibility that the counterparty in a transaction may default during the settlement process. It also arises from lending, settlement, treasury, market-making, derivatives trading and other activities undertaken by the Group.

The Group's credit manual sets out in detail the credit approval and monitoring procedures, which are established in accordance with sound business practices, the requirements and provisions of the relevant ordinances and where applicable, the guidelines issued by the Securities and Futures Commission of Hong Kong.

Day-to-day credit management is performed by the credit department with reference to the criteria including creditworthiness, collateral pledged and risk concentration of the counterparties. Decisions made by the credit department are reviewed daily by the management and by the credit and risks management committee at its regular (normally fortnightly) meetings.

Liquidity Risk

The Group manages its liquidity position to ensure it maintains a prudent and adequate liquidity ratio, in strict accordance with statutory requirements. This is achieved by the management monitoring the liquidity position of the Group on a daily basis to ensure the availability of sufficient liquid funds to meet all obligations and compliance with the statutory requirements such as the Financial Resources Rules applying to various registered subsidiaries. The monitoring process and the results of the same are reported to the management and the various committees at the regular meetings.

Management of Risks (Cont'd)

Capital Risk

The Group maintains a strong capital base to support the development of its finance business and to comply, where necessary, with minimum statutory ratios.

Capital is allocated to the various activities of the Group depending on requirements and the degree of risk appropriate to various activities. Cost of capital, as determined from time to time, is allocated against its users.

Interest Rate Risk

Interest rate risk primarily results from timing differences in the repricing of interest bearing assets, liabilities and commitments. The Group's interest rate risk exposure arises mainly from margin financing and other lending activities undertaken. The Group has the legal capacity to quickly recall such loans or reprice its margin loans to an appropriate level. Its interest-sensitive positions can readily be identified. Interest rates paid by the Group are managed with the aim of maximising the spread of interest consistent with liquidity and funding obligations.

Foreign Exchange Risk

Foreign exchange risk is the risk to earnings or capital arising from movements of foreign exchange rates.

The Group's foreign exchange risk primarily arises from currency exposures originating from its leveraged foreign exchange business or purchases on behalf of clients of foreign securities. Foreign exchange risk is managed and monitored by the relevant department under the limits approved by the management. In relation to our leveraged foreign exchange activity, our position is that of a market-maker and accordingly our risk is primarily a derivative foreign exchange risk for a client who does not or cannot meet margin calls following any period of substantial currency turbulence. The Group's principal lending operations are primarily carried out in local currency.

Market Risk

Market risk is the risk arising from changes in interest rates, foreign exchange rates, equity, real property or commodity prices. It may affect the prices of financial instruments or other assets held by the Group. Financial instruments taken or held by the Group include foreign exchange contracts, futures contracts, equity, derivative and fixed income securities.

Market risk limits are approved by the management and the various committees. Actual positions are compared with approved limits and monitored regularly by the relevant divisional head, the credit department and by the senior management. Exposures are measured and monitored on a "mark-to-market" basis with stop-loss limits. Market risk trading positions are subject to daily mark-to-market valuation, which is also reported daily to the senior management for their review. The internal audit and compliance department also performs regular audits to supplement the above controls to ensure compliance with the established market risk limits and guidelines.

Management of Risks (Cont'd)

Calamity Risk

In common with all companies and particularly financial services groups, the Group is exposed to the potential impact of natural and man-made disasters. In our case, being heavily dependent on information technology and its associated infrastructural requirements, we need to be particularly vigilant in this regard, especially with the prevalence of world-wide "hacking" and "virus-attacks".

In the aftermath of the various disasters impacting on the insurance industry during 2001, appropriate insurance cover has been harder than normal to obtain, and more expensive. However, working with our insurance broking division, we have managed to obtain what we believe is adequate cover for the potential risks of this type to which we may be exposed.

In the case of our IT infrastructure, we also maintain stringent security procedures, as well as off-site back-up and recovery programmes which we continually review and refine.

Reputational Risk

A key factor for businesses in the financial services sector is their reputation for financial probity and prudence. Recent examples of "rogue traders" impacting on such reputations elsewhere in the world have drawn attention to such risks. In our case with our important and valuable "brand", we manage these risks through our strong internal controls and risk management regime, by comprehensive employee and operational manuals in key areas, and by the strength and independence of our internal audit and compliance department.

Business Outlook

Although there have been some optimistic signs in respect of the U.S. economy, and notwithstanding the accession of the PRC to the World Trade Organisation, we intend to take a cautious and conservative approach in relation to the future.

Patrick S. W. Lee
Chief Executive
Hong Kong, 11th April, 2002