Introduction

The Company is primarily an investment holding company, with a stated strategy of focusing its management and financial resources on its core businesses of property investment and development and financial services. The Company's interests in property investment and development in Hong Kong are mainly held through its 67.74% holding in Allied Properties and in respect of property investment and development 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 & Co. Limited ("Sun Hung Kai"). The Company's financial services business is mainly conducted through its 53.49% holding (including 2.58% indirect holding through Sun Hung Kai) in United Asia Finance Limited ("UAF") as well as Allied Properties' 52.29% holding in Sun Hung Kai.

Financial Review

The turnover of the Group for the year 2001 was approximately HK$1,743.8 million, which was an increase of 37.6% compared with the year 2000, primarily due to the consolidation of the turnover of Sun Hung Kai, which became a listed subsidiary of the Group in May 2001.

The Group reported a profit attributable to shareholders for the year of approximately HK$103.4 million, increasing by 186.8% compared to the corresponding loss in the previous year of approximately HK$119.2 million.

Segmental Information

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

Financial Resources, Liquidity and Capital Structure

The Group's capital expenditure and investments for the year were primarily funded by net cash inflow from operating activities, loans and advances from banks and net proceeds from a rights issue by a subsidiary.

At 31st December, 2001, the net assets of the Group amounted to HK$4,274.0 million, representing a decrease of HK$38.6 million or approximately 0.9% from that of 2000. The Group's short-term bank deposits, bank balances and cash increased from HK$283.4 million at 31st December, 2000 to HK$655.8 million in 2001. The Group's bank loans, overdrafts and other borrowings increased to HK$3,216.5 million (2000: HK$2,364.7 million) of which the portion due on demand or within one year increased to HK$2,338.4 million (2000: HK$1,456.8 million), and the remaining long term portion decreased to HK$878.1 million (2000: HK$907.9 million). The liquidity of the Group as evidenced by the current ratio (current assets/current liabilities) was 1.89 times, improved from 1.75 times of the previous year. The Group's gearing ratio (net bank and other borrowings and long term debts/net assets) increased to 59.9% (2000: 48.3%).

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.

Financial Review (Cont'd)

Risk of Foreign Exchange Fluctuation

Other than the Group's financial services businesses (in regard to which, 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 under review, Allied Properties acquired a further 4.98% interest in Sun Hung Kai through the market at a cost of HK$108.4 million. Allied Properties' interest in Sun Hung Kai therefore increased from 47.31% to 52.29% at year end. Accordingly, Sun Hung Kai was reclassified as a subsidiary of Allied Properties 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 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.

Contingent Liabilities

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

(a) The Group had guarantees of HK$222.0 million (2000: HK$245.0 million) in respect of banking and loan facilities utilised by a subsidiary of a jointly controlled entity and an investee company.

(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 approximately 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.

Financial Review (Cont'd)

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 and properties held for sale with an aggregate carrying value of HK$3,364.0 million (2000: HK$3,542.8 million), consumer loan portfolio, bank balances and deposits of HK$488.5 million (2000: HK$551.6 million), listed investments belonging to margin clients with a carrying value of HK$3,798.9 million (2000: Nil) together with certain securities in respect of listed subsidiaries held by the Company and its subsidiaries, the net book value of which in their respective accounts totalling HK$3,695.8 million (2000: HK$3,485.4 million) were pledged to secure loans and general banking facilities to the extent of HK$4,980.7 million (2000: HK$2,696.7 million) granted to the Group. Facilities amounting to HK$2,962.4 million (2000: HK$2,310.7 million) were utilised at 31st December, 2001.

Operational Review

Financial Services

Consumer finance

The profit performance of UAF, the consumer finance arm of the Group, was affected by the downturn in the economy of Hong Kong. Accordingly, additional bad debt write-offs were required. Nevertheless, UAF opened three new branches during the year, located respectively at Argyle Street, To Kwa Wan and Kowloon City, thus increasing the total number of branches to 29. In view of the difficult operating environment, UAF implemented strict measures to reduce and control its operating costs and imposed cautious lending criteria and credit checking procedures with the objective of keeping bad debt risk to a reasonable level.

SHK Finance Limited, the equal joint venture between UAF and Sun Hung Kai, was similarly affected by the economy in terms of profit but nevertheless achieved substantial growth in its loan business, with new branches being opened during the year in Wanchai, Nan Fung Centre in Tsuen Wan, Yau Ma Tei and Tai Po, thus increasing the total number of branches to 14.

Broking and finance

Sun Hung Kai, which has been Allied Properties' listed subsidiary since May 2001, 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.

Operational Review (Cont'd)

Financial Services (Cont'd)

Broking and finance (Cont'd)

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.

Properties

Hong Kong

Allied Properties reported a 54.8% improvement in the loss attributable to its shareholders for the year due to lower impairment losses and revaluation deficits and the increase in its shareholding in Sun Hung Kai during the year.

Allied Properties' 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.

Allied Properties maintained its investments in hotel properties and serviced apartments. 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.

Allied Properties 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 Allied Properties' existing portfolio of luxurious residential properties.

A rights issue raising approximately HK$363 million was successfully completed by Allied Properties during June 2001. Further, Allied Properties made a bonus issue of warrants in September 2001.

PRC

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 as Shanghai Allied Cement Limited ("SAC"), a building materials provider, is expected to complement Tian An's core property operations.

Major Suppliers and Customers

The Group's five largest and top suppliers contributed 89.1% and 36.7% 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, former Director, 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

At 31st December, 2001, the total number of staff of the Group was 1,816 (2000: 1,361). Total staff costs, including Director's emoluments, amounted to HK$274.1 million (2000: HK$151.5 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 in Respect of the Group's Consumer Finance Business

Credit Risk

Credit risk is the risk that a customer of the Group will be unable or unwilling to meet a commitment when it falls due. It arises from any lending activities undertaken. The management implements lending guidelines and credit policies to keep credit exposure in check. In view of the current difficult operating environment, the management has implemented stricter lending guidelines and more credit reference checking procedures. Control systems including internal audit functions are in place to check and ensure compliance with such guidelines and policies. The executives review credit exposure reports and bad debt and doubtful debt provision policies periodically and adjustments to credit policies and guidelines are made where appropriate.

Foreign Exchange Risk

The management adopts a conservative policy to limit its foreign exchange exposure to a certain percentage of its total assets. The Group also assesses the risk of exposure according to the fluctuation in foreign exchange rate of the currency concerned. When circumstances justify, the Group will hedge its exposure as appropriate.

Market Risk

Market risk is the risk that interest rates, commodity or equity prices will move in a direction adversely affecting the Group's financial position. The Group will take positions on market risk related financial instruments as circumstances justify. However, the Group adopts a conservative view on exposure to market risk related financial instruments and it monitors its exposure to the market risk on a regular basis.

Management of Risks in Respect of the Group's Broking and Finance Businesses

The management of risks in respect of the Group's broking and finance businesses (other than the consumer 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.

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.

Management of Risks in Respect of the Group's Broking and Finance Businesses (Cont'd)

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.

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.

Lee Seng Hui
Chief Executive
Hong Kong, 11th April, 2002