Operating and Financial Review

FINANCIAL REVIEW

CONSOLIDATED PROFIT AND LOSS ACCOUNT

Rental Income

The Group's gross rental income of HK$1,229.6 million was 9.0% lower year-on-year mainly because of negative rental reversions and high vacancy at Bamboo Grove due to renovation for repositioning. Excluding the impact of Bamboo Grove, the rental fall was 4.9%.

Operating Expenses

Property expenses increased by 5.5% to HK$235.8 million year-on-year largely due to the significant increase in utilities and insurance expenses which are largely out of the Group's control, and higher marketing expenses associated with active leasing activities, in particular for the repositioning of Bamboo Grove. The higher property expenses were partly offset by a 4.6% decrease in administration expenses to HK$85.8 million due to cost reduction.

Financial Expenses

Further helping with cost reduction was a substantial 30.6% year-on-year decrease in net financial expenses to HK$215.7 million, despite relatively stable debt level, as the Group was able to take advantage of Hong Kong's prevailing low interest rates.

Profit Attributable to Shareholders

The Group's profit attributable to shareholders for the year ended 31 December 2002 decreased by 9.4% year-on-year to HK$543.9 million (recurring profit decreased by 4.1% as 2001's result included a gain on disposal of an associate of HK$33.5 million). Earnings per share were correspondingly 9.6% lower at HK52.66 cents.

CONSOLIDATED BALANCE SHEET

Assets

Total assets decreased by 7.2% to HK$26,555.2 million mainly due to the decrease in the valuation of investment properties as the Hong Kong property market continues to be weak.

Current Liabilities

Current liabilities decreased by HK$1,280.3 million to HK$1,282.2 million mainly due to the HK$2 billion five-year floating rate notes being repaid in March 2002 and reclassification of long-term bank loans of HK$597.8 million due within one year.

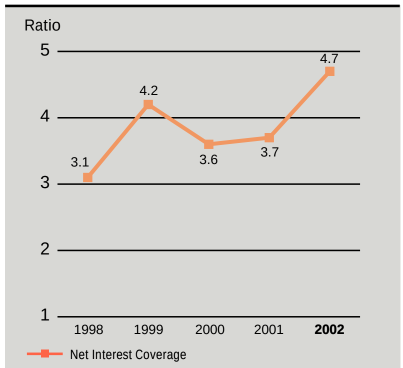
Non-current Liabilities

The increase in non-current liabilities of HK$1,478.6 million to HK$5,309.6 million reflected the refinancing of the HK$2 billion floating rate notes through the issue of the US$200 million 7% ten-year fixed rate notes under the Medium Term Note (MTN) Programme.

Shareholders' Funds

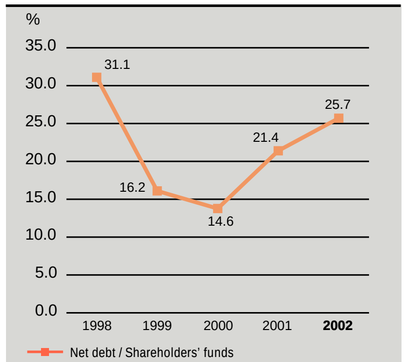
Shareholders' funds decreased by 10.3% to HK$19,087 million principally due to the decrease in property valuation of HK$2,073.2 million, partially offset by profits retained during the year of HK$440.5 million from strong recurring income.

Net Interest Coverage at Year-end



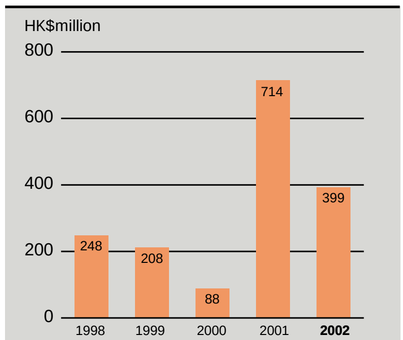
Note: Net interest coverage ratio (defined as profit from operations before depreciation less dividend and interest income, divided by net interest expenses)

Net Gearing at Year-end



Note: Net gearing (defined as gross debt less cash and cash equivalents and marketable securities at year-end market value, divided by shareholders' funds)

Capital Expenditure at Year-end



KEY FINANCIAL RATIOS

Net Interest Coverage

As of year-end 2002, the net interest coverage ratio (defined as profit from operations before depreciation less dividend and interest income, divided by net interest expenses) was 4.7. This is the highest the ratio has been in the past five years principally because of modest debt outstanding and low interest rates.

Net Gearing

The year-end 2002 net gearing (defined as gross debt less cash and cash equivalents and marketable securities at year-end market value, divided by shareholders' funds) was 25.7%, which is close to its average for the past five years. The re-investment in the Group's property portfolio, as discussed in the next section, and the downward revaluation of assets are reflected in the gearing rise of the past two years.

CAPITAL EXPENDITURE

Investment Appraisal

The Group appraises the feasibility and priority of proposed capital expenditure projects based on their strategic importance as well as their ability to improve rental yield or reduce operating cost. Project financial feasibility is generally assessed by net present value and internal rate of return calculated from projected discounted cash flows.

Capital Expenditure During 2002

The Group spent HK$399.3 million during the past year. Most of this was incurred for refurbishment of the Group's investment properties, including Bamboo Grove and One Hysan Avenue. In addition, HK$25 million were incurred on the China and Singapore projects and HK$9.4 million were spent for upgrades to the Group's computer system.

Capital Expenditure Funding

Capital expenditures were primarily financed by internally generated funds from operations. With substantial committed banking facilities in place and solid recurrent rental cash flow, the Group is in a strong liquidity position and has sufficient financial resources to satisfy its capital commitments and ongoing working capital requirements.

CONTINGENT LIABILITIES

The Group has provided guarantees for banking facilities granted to associated companies and investee companies. At 31 December 2002, the Group's share of guarantees and counter guarantees amounted to HK$156 million (2001: HK$148 million) and HK$84 million (2001: HK$79 million) respectively.

FINANCING

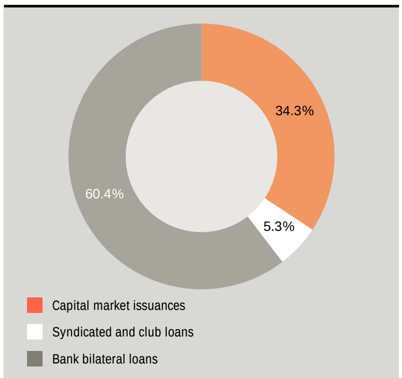
Total gross debt was relatively unchanged at HK$5.71 billion versus HK$5.63 billion at 2001 year-end, of which, all were unsecured and over 97% were on a committed basis.

Sources of Financing

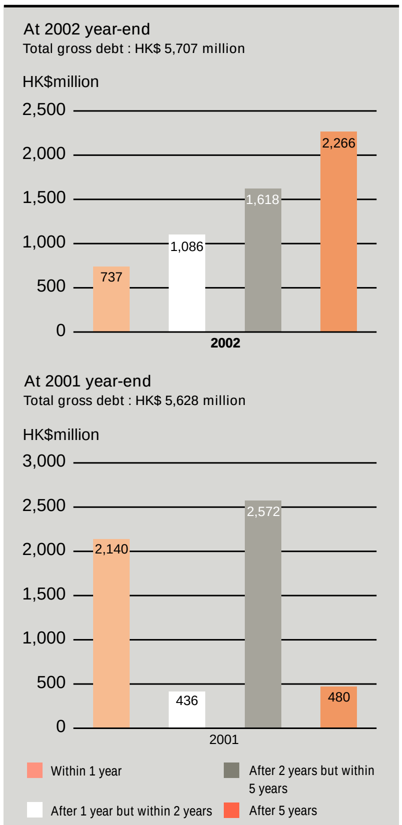
The Group maintains diversified sources of funding to minimize over-dependence on any one source as well as to reach new investors for the Group's debt instruments, particularly as the Group grows going forward.

Within the bank segment, the Group maintains bilateral funding relationship with over 15 banks.

Sources of Financing at 2002 Year-end



Maturity Profile



Note: Subsequent to the balance sheet date, a HK$300 million loan originally maturing in 2004 has been prepaid and refinanced by a 7-year bank loan with maturity in 2010.

Operating and Financial Review

Fund Raising During 2002

The Group took a major step forward in the process of developing and maintaining access to the international capital markets by launching a MTN Programme, and subsequently issuing in early 2002 US$200 million ten-year inaugural notes on the European and Asian capital markets. The proceeds were used to help repay HK$2 billion five-year floating rate notes that matured later in the year. The new ten-year issuance was well received and established a benchmark for the Group going forward.

During the past year, the Group also refinanced HK$1.2 billion of bank and syndicated loans to take advantage of the current high-liquidity, low-cost banking environment in Hong Kong.

Maturity Profile

To improve the tenor matching of assets and liabilities as well as to reduce refinancing risk, the Group during the year moved to a mix of short-term and intermediate-term maturities from a previous dependence on shorter-term instruments. The 2002 year-end maturity is significantly stronger with little short-term maturity pressure and balanced repayment schedule over the intermediate term.

CREDIT RATINGS

The current credit ratings assigned by Moody's and Standard and Poor's are Baa1 and BBB respectively. Both investment credit ratings continue to reflect the Group's strong financial position. It should be noted that the Group's rating is to some extent capped by Hong Kong's foreign currency long-term debt ratings of A3 from Moody's and A+ from Standard and Poor's.

FINANCIAL RISK MANAGEMENT

The Group's normal business operation involves a number of financial risks and are mitigated and managed as described below.

Liquidity Risk

The Group maintains sufficient liquidity at all times to fund its working capital. Liquidity requirements are met by strong recurring cash flows from the investment property portfolio and low-cost standby revolving bank facilities. At year-end 2002, the Group had HK$1,367 million undrawn committed facilities.

Funding Risk

The Group maintains diversified sources of funding to reduce the risk of being unable to draw sufficiently from any one source. The diversification includes drawing from international capital markets as well as multiple banks. The latter include banks of various nationalities, including a significant number who have been working with the Group for many years. Standby revolving bank facilities are also maintained to reduce refinancing risk.

Currency Risk

The Group aims to have minimal mismatches in currency and does not speculate in currency movements. Over 97% of the Group's assets by value and all rental income are in Hong Kong and denominated in Hong Kong dollars, the balance is in Singapore dollars and Renminbi corresponding to the Group's property projects in those two countries. At year-end 2002, all of the Group's debts were in Hong Kong dollars with the exception of the US$200 million ten-year notes, which in turn has been hedged by appropriate hedging instruments.

Interest Rate Risk

The Group manages its interest rate exposure based on interest rate level and outlook as well as potential impact on the Group's financial position arising from volatility. At year-end 2002, 91% of the Group's gross debt were on a floating rate basis, but could change with changes to the interest rate trend going forward. The Group's weighted average cost of borrowing for the past year was 3.65% vis-á-vis 5.81% for 2001.

Credit Risk

The Group manages its credit risk mostly on two fronts: rent receivable from tenants and counter-party financial obligations in currency and interest rate derivative contracts. For the former, credit checks are part of the normal leasing process and stringent procedures are in place to deal with delinquent rent (over one month overdue). As of year-end 2002, the amount of delinquent rent was HK$0.8 million or less than 1% of the Group's average monthly rental income. To mitigate counter-party risk, the Group enters into derivative contracts only with sound financial institutions with strong investment-grade credit ratings, limits exposure to each, and monitors each's rating regularly.

Michael T. H. Lee
Chief Operating Officer and Director
Hong Kong, 11 March 2003