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, property development and financial services. The Company's interests in property investment and development in Hong Kong are mainly held through its 74.08% 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 present 54.91% effective holding in United Asia Finance Limited ("UAF") as well as Allied Properties' 74.27% holding in Sun Hung Kai.

Financial review

For the year ended 31st December, 2002, the turnover of the Group was approximately HK$1,812.3 million, an increase of 3.9% over the 2001 turnover of approximately HK$1,743.8 million.

The profit attributable to shareholders, however, was adversely affected due to impairment losses and deficits primarily relating to Hong Kong properties held by Allied Properties and its subsidiaries amounting to HK$562.0 million. As a consequence, there was a loss attributable to shareholders of approximately HK$144.6 million for the year, compared to a profit of approximately HK$103.4 million for the previous year.

It should be noted that the Group's financial statements have since May 2001 consolidated those of Sun Hung Kai, when that company became a subsidiary of the Company. Accordingly, the comparative consolidated income statement should be interpreted with regard to this abbreviated period of consolidation.

Segmental Information

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

Financial Resources, Liquidity and Capital Structure

At 31st December, 2002, the net assets of the Group amounted to HK$4,076.3 million, representing a decrease of HK$197.7 million or approximately 4.6% from 2001. The Group maintained a strong cash and bank balance position and had cash and bank balances of approximately HK$620.5 million as at 31st December, 2002 (2001: HK$655.8 million). Finance costs decreased from HK$166.9 million in 2001 to HK$93.3 million in 2002 as a result of reduction of bank loans and lower interest rates. The Group's bank and other borrowings decreased to HK$1,919.0 million (2001: HK$3,216.5 million) of which the portion due on demand or within one year decreased to HK$957.0 million (2001: HK$2,338.4 million), although the remaining long term portion slightly increased to HK$962.0 million (2001: HK$878.1 million). The liquidity of the Group as evidenced by the current ratio (current assets/current liabilities) was 2.52 times, which improved from 1.89 times of the previous year. The Group's gearing ratio (net bank and other borrowings/net assets) substantially decreased to 31.9% (2001: 59.9%).

The Group's capital expenditure, investments and net repayments of bank loans and other borrowings were primarily funded by the net cash inflow from operating activities.

Financial review (Cont'd)

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

All of the bank borrowings of the Group are charged at floating interest rates. There was no change in the share capital of the Company during the year. A proposed share repurchase offer to repurchase a maximum of 750,000,000 shares of the Company was announced on 16th January, 2003. A shareholders' circular containing details of the share repurchase offer and other related matters is expected to be dispatched to shareholders on or before 9th May, 2003 and an extraordinary general meeting for the purpose of approving the proposed share repurchase offer and other related matters is expected to be held in June 2003.

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 Additional Interests in Subsidiaries

During the year, the Company and wholly-owned subsidiaries acquired an additional interest in Allied Properties, increasing the shareholding in Allied Properties from 67.74% to 73.58% at a total cost of HK$173.9 million. Subsequent to the year end, the Group has acquired a further interest in Allied Properties to the present level of 74.08%.

Allied Properties acquired an additional 9.38% interest in Sun Hung Kai during the year at a total cost of HK$180.9 million, increasing from 52.29% to 61.67% at the end of the year. Since the year end, Allied Properties' interest in Sun Hung Kai has further increased to 74.27% following the completion of the repurchase of shares by Sun Hung Kai as announced on 27th February, 2003 by Sun Hung Kai.

Acquisition of an Associate

On 17th December, 2002, the Group acquired a 28.53% shareholding interest in Quality HealthCare Asia Limited ("QHA") for a total consideration of HK$142.0 million.

Contingent Liabilities

Details of contingent liabilities are set out in note 39 to the financial statements.

Pledges of Assets

Details regarding pledges of assets are set out in note 43 of the financial statements.

Operational review

FINANCIAL SERVICES

Consumer finance

The continuing downturn in the Hong Kong economy leading to increases in personal bankruptcies during the year adversely affected the profit of UAF, as well as impacting the results of SHK Finance Limited ("SHK Finance"), which had 27 and 13 branches respectively at the end of 2002. Subsequent to the year end, UAF completed the acquisition of the remaining 50% interest in SHK Finance which it had not already owned resulting in SHK Finance now being a wholly-owned subsidiary of UAF. This acquisition is expected to result in operational savings.

Broking and finance

Sun Hung Kai reported a 7.0% decrease in profit to HK$204.9 million. Notwithstanding the difficult economic climate, Sun Hung Kai managed to enlarge its market share and remained profitable in 2002, largely as a result of ongoing efforts to diversify its products and services. Sun Hung Kai's involvement as a liquidity provider of derivative warrants and equity linked instruments for several leading issuers and international investment banks provided a significant income stream. Another valuable income source came from third party execution and clearing services which it provides to non-exchange participants.

Sun Hung Kai's term loan portfolio reduced substantially compared to the previous year due to caution on behalf of its borrowers and a more stringent lending policy. It will continue to develop this profitable business. The corporate finance division continued to be active in the local market, successfully completing three initial public offerings during the year as sponsors. Following the success of its marketing programmes in 2001, SHK Online began the year 2002 with a successful client and asset transfer programme which substantially increased SHK Online's client base and customer asset level and further consolidated its dominant position within the industry.

In December 2002, Sun Hung Kai acquired a 28.53% shareholding interest in QHA, which is the largest publicly listed healthcare company in Hong Kong and provides care for private and corporate contract patients through an extensive network of medical centres, dental and physiotherapy centres.

Operational review (Cont'd)

PROPERTIES

Hong Kong

Allied Properties reported a loss attributable to its shareholders of HK$374.9 million for the year, compared to a loss of HK$178.9 million for the preceding year. This is due to further impairment losses and revaluation deficits relating to the Hong Kong properties of Allied Properties and its subsidiaries charged to the income statement.

On the positive side, Allied Properties group's diversified Hong Kong portfolio of properties are all completed and generating substantial and recurrent income, except for phase two of the Ibis North Point, the hotel in Java Road, for which phase foundation works are continuing.

The offices of Allied Kajima Building enjoyed nearly 100% occupancy throughout the year, whilst the occupancy rate of China Online Centre, the commercial/office building at 333 Lockhart Road, Wanchai, has been increasing gradually despite a soft office rental market.

The progress of sales of St. George Apartments on Waterloo Road was satisfactory in the circumstances. Allied Properties has decided to retain certain of these apartments for investment purposes and has leased them out accordingly.

The Novotel Century Hong Kong hotel was able to recover from the drop in visitor arrivals, which commenced in the last quarter of 2001 and extended into the early part of 2002. However, the performance of the Westin Philippine Plaza Hotel was adversely affected due to the renovation and refurbishment works carried out during the year, as well as the difficult tourism market conditions in the Philippines. Both the Ibis North Point, which enjoyed its second full year of operation since its opening in early 2001, and Century Court, a renovated commercial/residential building located directly opposite Allied Kajima Building and Novotel Century Hong Kong, contributed significantly to Allied Properties group's recurrent income.

Mainland PRC

Property sales in eastern China contributed significantly to the satisfactory performance of Tian An, which posted a turnover and profit attributable to its shareholders of HK$1,080.3 million and HK$97.2 million respectively, compared to the corresponding figures of HK$299.3 million and HK$102.8 million in 2001. The large-scale infrastructure projects undertaken by the government in China together with improved social facilities should stimulate individuals' demand for new houses and improvement in living standards. As a nationwide and experienced property developer with an adequate quality landbank in various cities of China, Tian An is confident that with its strengths it will capitalise on the opportunities in the China market in 2003.

Operational review (Cont'd)

Major suppliers and customers

The Group's five largest and top suppliers contributed 86.2% and 54.7% 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, 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, 2002, the total number of staff of the Group was 2,002 (2001: 1,816). Total staff costs, including Directors' emoluments, amounted to HK$285.3 million (2001: HK$274.1 million).

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 codes or 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 counter parties. 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 at least the 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 to obviate foreign exchange risk. Accordingly, the Group has no significant exposure to foreign exchange fluctuations.

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 world-wide of "hacking", and "virus-attacks".

In the aftermath of the various disasters impacting on the insurance industry during the past two years, 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.

Management of risks in respect of the group's broking and finance businesses (Cont'd)

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

The short to medium term outlook for the local economy remains, at best, uncertain, as Hong Kong is faced with considerable difficulties including the painful restructuring of its property based economy and the recent outbreak of atypical pneumonia. Whilst we are hopeful of the gradual recovery of the Hong Kong economy in the longer term, the Group will continue to adopt a cautious and conservative approach for the foreseeable future.

Lee Seng Hui

Lee Seng Hui
Chief Executive
10th April, 2003