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 present 74.27% holding in Sun Hung Kai.

Financial Review

The turnover of the Group for the year 2002 was approximately HK$903.6 million, which was an increase of 36.8% compared with the year 2001.

The loss attributable to shareholders for the year was approximately HK$374.9 million, an increase of loss of 109.5% compared to the corresponding loss of the previous year of approximately HK$178.9 million. The additional loss was mainly due to further impairment losses and revaluation deficits arising from a revaluation of the Group's Hong Kong properties. The impairment losses and revaluation deficits relating to properties charged to the income statement have increased to HK$564.5 million from the HK$332.5 million in the preceding 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 from operations as well as other information is shown in Note 5 to the financial statements.

Financial Resources, Liquidity and Capital Structure

Other than the conversion of warrants as mentioned below, the Group is principally financed by net cash inflow from operating activities and banking facilities granted by the banks. The banking facilities of the Group are reviewed from time to time and new banking facilities will be obtained or renewed to meet the funding requirements for capital commitments, investments and operations of the Group.

During the year, 542,916,539 warrants, representing approximately 62.4% of the total outstanding 2002 warrants, were converted into 542,916,539 ordinary shares at a subscription price of HK$0.27 per share. A net proceed of HK$146.5 million was raised from the exercise of warrant subscription rights by warrantholders, and the Company's issued share capital increased from HK$870.2 million to HK$978.7 million accordingly.

Financial Review (Cont'd)

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

The liquidity of the Group as evidenced by the current ratio (current assets/current liabilities) was 1.80 times, which improved from the 1.51 times applicable at the end of last year. At 31st December, 2002, the Group's net bank borrowings amounted to HK$1,394.8 million (2001: HK$2,198.3 million), representing bank borrowings of HK$1,774.1 million (2001: HK$2,477.1 million) less bank deposits, bank balances and cash of HK$379.3 million (2001: HK$278.8 million) and the Group had net assets of HK$4,649.2 million (2001: HK$4,998.4 million). Accordingly, the Group's gearing ratio of net bank borrowings to net assets was 30.0% (2001: 44.0%).

The bank borrowings of the Group at 31st December, 2002 and 2001 are repayable as follows:

	2002	2001
	HK$'000	HK$'000
Within one year or on demand	**812,018**	1,599,010
More than one year but not exceeding two years	**259,669**	157,615
More than two years but not exceeding five years	**555,060**	226,086
More than five years	**147,310**	494,378
	1,774,057	2,477,089

All the Group's bank borrowings are charged at floating rates.

Risk of Foreign Exchange Fluctuation

Other than the finance business (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 Interest in Sun Hung Kai

During the year, a further 9.38% interest in Sun Hung Kai was acquired at a total cost of HK$180.9 million. The Group's interest in Sun Hung Kai increased from 52.29% to 61.67% at the year end. Subsequent to the year end, the Group's interest in Sun Hung Kai 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.

Financial Review (Cont'd)

Acquisition of a Subsidiary

During the year, the Group acquired the entire shareholding in Kalix Investment Limited from Allied Group, the ultimate holding company of the Company, for a total consideration of HK$22.0 million.

Acquisition and Disposal of an Associate and a Jointly Controlled Entity

(a) 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.

(b) On 19th December, 2002, the Group entered into a conditional sale and purchase agreement with an indirect subsidiary of Allied Group, to sell its entire 50% shareholding in Earnest Finance Limited ("Earnest Finance"), the holding company of SHK Finance Limited ("SHK Finance"), together with the assignments of advances, for an aggregate consideration of HK$87.5 million. The agreement was completed on 24th January, 2003 and resulted in a loss of HK$3.4 million attributable to the Group in year 2003.

Contingent Liabilities

Details of contingent liabilities are set out in note 37 to the financial statements.

Pledges of Assets

Details regarding pledges of assets are set out in note 41 to the financial statements.

Operational Review

Hong Kong

Due to an unfavourable office rental market, the occupancy rate of China Online Centre, the commercial/office building at 333 Lockhart Road, Wanchai, was adversely affected, but has since been increasing gradually to higher levels. Allied Kajima Building was not affected to the same extent, as its offices were nearly 100% occupancy throughout the year. The progress of sales of St. George Apartments on Waterloo Road was satisfactory in the circumstances. The Group has decided to retain certain of these apartments for investment purposes and has leased them out accordingly.

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)

Hospitality Related Activities

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. Foundation works are continuing at phase two of the Ibis North Point, the hotel in Java Road, which enjoyed its second full year of operation since its opening in early 2001. Century Court, a renovated commercial/residential building located directly opposite Allied Kajima Building and Novotel Century Hong Kong, has become an important contributor to the Group's rental income.

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

Financial Services

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.

Major Suppliers and Customers

The Group's five largest and top suppliers contributed 86.9% and 55.1% 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 as at 31st December, 2002 was 1,463 (2001: 1,347). Total staff costs, including Directors' emoluments, amounted to HK$174.3 million (2001: HK$145.8 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

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 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 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 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.

Management of Risks (Cont'd)

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 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".

Management of Risks (Cont'd)

Calamity Risk (Cont'd)

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.

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 property market remains subdued, as Hong Kong is faced with considerable difficulties including the restructuring of the economy and the recent outbreak of atypical pneumonia. Whilst we are hopeful on the long term future prospects of the Hong Kong property market, the Group will continue to adopt a cautious and conservative approach for the foreseeable future.

Patrick S. W. Lee
Chief Executive
Hong Kong, 10th April, 2003