Operating Review

INVESTMENT PROPERTIES

Office Leasing - In the light of a challenging economic environment, the office sector experienced weakening demand and was faced with increasing vacancy rates. A 92% occupancy rate as at 30 June 2003 was achieved.

We have been diligently pursuing leasing opportunities by closely managing lease renewals and securing new leases. We have either concluded or are at an advance stage of completing the negotiations of all leases due to expire in 2003.

Retail Leasing - During the first quarter, performance of high-quality retail outlets in prime locations remained strong. The outbreak of SARS towards the end of March posed a serious challenge to the retail sector, resulting in a sharp decline in consumer traffic.

During this difficult period, we maintained a close dialogue with our tenants and organized additional promotional activities to minimise the impact of SARS. Our active approach in managing tenants' concerns helped enhance tenant relations and understanding. We are pleased to witness that local consumer traffic has largely resumed to normal level by the end of June with SARS under control. There has been a steady return of tourists, particularly from China.

We achieved a 98% occupancy levels during the review period, excluding Caroline Centre which is currently undergoing refurbishment.

Good progress was made in the repositioning of the Caroline Centre retail podium. Pre-letting activities are in good progress.

Residential Leasing - Leasing activities for Bamboo Grove progressed well during the first quarter, in the light of a generally weak market. We were particularly encouraged by the success in capturing a good market share of new expatriate arrivals in Hong Kong.

The outbreak of SARS towards late March dampened market sentiment. We were pleased to see market sentiment having considerably improved since June.

Property Services - Good progress was made in the implementation of our new comprehensive tenant service levels. These are specific and measurable performance standards covering certain key aspects of the tenant servicing cycle, which facilitate effective monitoring. Successful pilot-runs have been completed in Sunning Plaza, AIA Plaza, Sunning Court and Bamboo Grove during the review period. These standards are currently being implemented across our entire portfolio.

We continue to further enhance our operational efficiency generally. Energy efficiency measures were successfully implemented without compromising services.

As a responsible landlord, the well-being of our tenants and customers has always been our priority. During the difficult period of the SARS outbreak in the community, precautionary measures aiming at enhancing consumer confidence and strengthening communications with tenants were implemented. We were encouraged by the positive response from our tenants.

Operating Review

CAPITAL IMPROVEMENT PROJECTS

We undertake regular reviews of building performance and seek asset enhancement through appropriate capital improvement initiatives. The refurbishment and repositioning of Caroline Centre retail podium will be completed by late 2003. Upgrade works for Leighton Centre and Hennessy Centre are in progress. Improvement works for Sunning Court residential development had been completed.

DEVELOPMENT PROPERTIES

The Group has minority interests in the following joint venture projects:

Shanghai, PRC - Preliminary works for Phase Two of the Grand Gateway project in Shanghai, which comprises two office towers and two residential towers, had commenced. (Group effective interests in sino-foreign joint venture: 23.7%; Group interests in Hong Kong consortium: 26.3%).

Singapore - Market conditions continued to be weak. Construction and pre-sales of three joint-venture residential developments including Sanctuary Green, the Gardens at Bishan and Amaryllis Ville are in progress.

FINANCE

The Group's financial position remains strong.

Finance costs reduced by 26.5% to HK$88.1 million during the review period.

Overall operating and administrative expenses remain stable. Efficiency savings helped offset the rise in certain expenses including general marketing and promotions. The Group spent HK$177.2 million for capital expenditures during the review period, which were primarily financed by internal resources.

As of 30 June 2003, Group total gross debt was HK$5.9 billion (31 December 2002: HK$5.71 billion). All borrowings are unsecured (capital market issuances: 33%, bank loans: 67%), with over 95.7% being on a committed basis. A balanced repayment schedule over the intermediate term was achieved (total debts repayable within one year: 18%; repayable within two to five years: 34%; repayable after five years: 48%). 91.4% of the Group's gross debt was on a floating rate basis, all denominated in or hedged back to Hong Kong dollars. The Group had minimal foreign currency exposure. As of 30 June 2003, the Group had HK$1.6 billion undrawn committed facilities.

The net interest coverage ratio (defined as profit from operations before depreciation less dividend and interest income, divided by net interest expenses less dividend income) improved significantly from 4.7 times at 31 December 2002 to 6.9 times at 30 June 2003 because of lower interest expenses. Net gearing (defined as gross debt less cash and cash equivalents and marketable securities at period-end market value, divided by shareholders' funds) changed from 25.9% (restated for revised Statement of Standard Accounting Practice 12 "Income Taxes" ("SSAP 12")) at 31 December 2002 to 26.8% at 30 June 2003.

Following the adoption of the revised SSAP 12 from 1 January 2003, the Group recognized an amount of HK$17.8 million in respect of its deferred tax expense for the half-year period. HK$17.3 million has been charged to the income statement, and HK$0.5 million has been charged to equity. It should be noted that such deferred tax expenses are non-cash items. In accordance with the revised SSAP 12, prior-year deferred tax adjustment of HK$112.3 million was also recognized (HK$106.7 million to retained earnings and HK$5.6 million to equity).

The Group has, as a matter of prudence, made a tax provision for prior years of HK$48 million.

Details of Group contingent liabilities are set out in note 14 to the condensed financial statements.

Shareholders' funds at 30 June 2003 were HK$18,979.9 million (shareholders' funds (restated for revised SSAP 12) as at 31 December 2002: HK$18,974.7 million).

Michael T.H. Lee
Managing Director

Hong Kong, 19 August 2003