Management Discussion and Analysis

The Directors of Kerry Properties Limited are pleased to announce the audited consolidated final results of the Company, its subsidiaries and associated companies (the "Group") for the year ended 31 December 2003. The Audit Committee of the Board has met to review the results and the financial statements of the Group for the year ended 31 December 2003 prior to recommending them to the Board for approval.

(A) OVERALL RESULTS

The Group's turnover for the year ended 31 December 2003 was HK$4,204 million (2002: HK$5,156 million). The Group's turnover for 2003 was largely composed of proceeds from the sale of properties, rental income, revenues from hotel operations, warehouse rental and logistics services. The primary reason for the decrease in turnover was because of the low level of sales during the first half of 2003.

The Group's consolidated profit attributable to shareholders decreased by 34% to HK$395 million (2002: HK$600 million). Earnings per share were HK33.44 cents (2002: HK51.50 cents), a decrease of 35%. Revaluation deficits, provisions and deferred tax credits resulted in total exceptional charges attributable to the Group of approximately HK$429 million (2002: HK$260 million) for the year ended 31 December 2003. Excluding these factors, profit attributable to shareholders for the year amounted to HK$824 million (2002: HK$860 million), a slight decrease of 4%.

In accordance with the Group's accounting policies, the Group conducted a revaluation of its investment properties at the end of 2003 with the value of its investment properties decreasing from HK$16,565 million at 31 December 2002 to HK$16,163 million at 31 December 2003. Total revaluation deficits for the Group's investment properties charged to the consolidated profit and loss account amounted to HK$290 million of which HK$270 million is attributable to the Group. During the year, the Group had conducted a revaluation of its investment properties in connection with the privatization proposal. This had resulted in a charge to the consolidated profit and loss account of HK$914 million at 30 June 2003 which was subsequently reduced by HK$644 million due to the revaluation of the properties at the year end resulting in a net charge to the consolidated profit and loss account attributable to the Group of HK$270 million. Total additional provisions of HK$69 million were made for the Constellation Cove project in Tai Po Kau, Hong Kong of which HK$55 million is attributable to the Group. In addition, a HK$111 million provision for a decline in the carrying value of associated companies was also made during the year. Such charges to the consolidated profit and loss account were offset by a deferred tax credit of HK$7 million which arose from the adoption of Statement of Standard Accounting Practice 12 (revised).

Going forward, given the revival in Hong Kong's economy and the expected continuing fast pace of growth in China, the Group does not foresee the need to make any further provisions and looks forward to improving profitability.

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(B) DIVIDENDS

The Directors recommend a final dividend of HK15 cents per share for 2003 (2002: HK12 cents) payable to shareholders whose names appear on the registers of members of the Company on Tuesday, 20 April 2004, with a scrip alternative to offer the right to shareholders to elect to receive such final dividend wholly or partly by allotment of new shares credited as fully paid in lieu of cash (the "2003 Final Scrip Dividend Scheme"). The final dividend is expected to be paid on Friday, 28 May 2004.

The 2003 Final Scrip Dividend Scheme is conditional upon (1) the approval of the proposed final dividend at the Company's Annual General Meeting to be held on Tuesday, 20 April 2004; (2) the issue price of a new share to be issued pursuant thereto being not less than the nominal value of a share of the Company; and (3) the granting by the Listing Committee of the Stock Exchange of Hong Kong of the listing of and permission to deal in the new shares to be issued pursuant thereto. The issue price of the new shares to be issued under the 2003 Final Scrip Dividend Scheme will be fixed after the Company's Annual General Meeting with reference to the average closing prices of the shares of the Company quoted on the Stock Exchange of Hong Kong for the five consecutive trading days to be determined by the Directors. Thereafter, a press announcement setting out the basis of allotment of new shares under the 2003 Final Scrip Dividend Scheme will be published. A circular containing details of the 2003 Final Scrip Dividend Scheme together with the relevant election form, where applicable, will be sent to each shareholder of the Company on or about Friday, 30 April 2004.

An interim dividend of HK13 cents per share was paid during the year which together with the proposed final dividend of HK15 cents per share will make a total dividend of HK28 cents per share for the year ended 31 December 2003 (2002: HK30 cents per share).

(C) PRC PROPERTY DIVISION

The Group's portfolio of developments and investments in the PRC are primarily located in Beijing, Shanghai and Shenzhen and its revenues are primarily derived from rental income, proceeds from the sales of properties and hotel revenue. The PRC Property Division reported total turnover of HK$1,241 million (2002: HK$1,089 million), representing 30% of the Group's total turnover. The turnover from the hotel dropped to HK$174 million (2002: HK$232 million), a 25% drop year on year. Net profit from the Division amounted to approximately HK$300 million (2002: HK$238 million) accounting for 76% of the Group's total profit. Excluding the effects of the revaluation deficits and the deferred tax credit amounting to HK$1 million (2002: HK$62 million), total profit for the PRC Property Division for the year amounted to HK$301 million (2002: HK$300 million). This Division will continue to be one of the main drivers of the Group's profitability.

i) Sales of Properties

Proceeds from sales of properties amounted to approximately HK$596 million (2002: HK$401 million). The increase was due to the continuing sales of Arcadia Court in Shenzhen which was approximately 60% presold at the year end and sales of Central Residences in Fuzhou during the year.

Management Discussion and Analysis

ii) Properties Under Development

The Group has a large development portfolio of approximately 8.5 million square feet in Mainland China. One of the biggest components of the Group's development portfolio is the residential project in Shibalidian district, Beijing. In September 2003, the Group signed a 50:50 joint venture agreement with Beijing Huayuan Property Co., Ltd. to develop a residential site with a buildable gross floor area of approximately 777,000 square metres. Due to the success of its Central Residences in Shanghai, which have largely all been sold, the Group is developing Phase II of Central Residences. The Group has commenced construction and the development is expected to be completed in 2005. The Group is also developing an office complex in Futian, Shenzhen for sale and lease in the central business district of Shenzhen. This new development will be adjacent to the Shenzhen Exhibition Centre and a new five star Shangri-La Hotel. Going forward the Group will continue to build upon its successes by focusing on large mix use developments.

iii) Property Investment

Turnover from property investment, which excludes income from Beijing Kerry Centre Hotel, amounted to approximately HK$471 million (2002: HK$456 million), an increase of 3%. Occupancy rates at the Group's investment properties, excluding the Hotel, were maintained at very high levels and averaged 85% in Beijing, 93% in Shanghai and 96% in Shenzhen. The Group through careful attention to property management, retail outlet mix as well as the provision of value added services to its tenants have created landmark properties in the various Chinese cities that represent prestigious addresses as well as a guarantee of excellence. As a result tenant turnover has been low and vacancy rates kept to a minimum. The hotel in Beijing was badly affected by SARS in the first half of 2003 but operations returned to normal at the year end with occupancy standing at approximately 70% and an average tariff of US$111 per night.

(D) HONG KONG PROPERTY DIVISION

The Group's portfolio of developments and investments in Hong Kong are largely residential followed by office and commercial. The Hong Kong Property Division achieved total turnover of HK$1,255 million (2002: HK$2,705 million), representing 30% of the Group's total turnover and a decrease of 54% compared with last year. The reason for the decrease in turnover is because of the low level of sales in the first half of 2003. The loss from the Division amounted to approximately HK$213 million (2002: profit of HK$1 million). The loss was mainly due to the revaluation deficits, additional provisions for Constellation Cove and provisions for a decline in the carrying value of associated companies. Excluding the effects of the revaluation deficits, additional provisions and the deferred tax credit amounting to HK$317 million (2002: HK$175 million), total profit for the Hong Kong Property Division for the year amounted to HK$104 million (2002: HK$ 176 million).

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Due to the oversupply of mass residential units combined with the weak economy in Hong Kong since the 1997 financial crisis, the Division has been adversely impacted by several development projects in Hong Kong. Going forward, the Group will continue to look at opportunities in Hong Kong as they arise, focusing on top quality properties together with the provision of exceptional property management that showcase the Group's commitment to excellence. The Group also believes that the combination of Hong Kong's improving economic prospects with the limited supply of luxury housing becoming available in the foreseeable future will result in improved profitability for the Hong Kong Property Division. Furthermore, the current low interest rates and the expectation that there will be no substantial interest rate increases during 2004 should sustain the current upswing in Hong Kong's property market.

i) Sales of Properties

Proceeds from the sales of properties for the year were HK$938 million (2002: HK$2,332 million), a decrease of 60% compared with 2002. The advent of SARS which resulted in many potential buyers postponing their buying decisions in conjunction with the Group's low volume of new launches resulted in substantially lower sales volume in 2003. The finalization of sales of Ocean Pointe during the year and the near completion of sales of Constellation Cove, for which there remains unsold, only 10 apartments, 2 duplexes and 3 houses as at 31 December 2003, clears the Group's high costing inventory and as such going forward, profits from sales of properties should improve. Sales of Residence Oasis is also progressing very well with the project being approximately 42% presold at the year end.

ii) Properties Under Development

Branksome Crest is estimated to be completed within the second quarter of 2004 and will target the top most segment of the market providing the ultimate in living standards and environment. The marketing of Branksome Crest should also benefit from the scarcity of luxury residential product available in the Hong Kong market as well as attain a rental pricing premium due to the exceptional quality provided by the Group. Enterprise Square 3, which is expected to be completed within the first quarter of 2004, will provide Grade A office space under strata title in Kowloon Bay.

iii) Property Investment

Rental income for the year amounted to approximately HK$317 million (2002: HK$373 million), a decrease of 15%. The decrease was due largely to lower rental levels caused by the general malaise of the Hong Kong economy and lower demand for luxury housing resulting from corporate downsizing, lower housing allowances as well as fewer expatriates. However in the last quarter of the year due to economic improvement and a generally more optimistic outlook in Hong Kong, rental prices have stabilized and occupancy rates have been improving. Over the next year, it is expected that rental levels will continue to improve gradually.

Despite the lower average rental levels, occupancy rates were approximately 92% at the year end. The Group regularly conducts maintenance reviews of its properties, examines services provided through clubhouses and other food and beverage outlets with a goal of providing the residents of its properties with the best living environment in Hong Kong.

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(E) OVERSEAS PROPERTY DIVISION

The Group's principal investments overseas are a 25% investment in Jacksons Landing in Sydney, Australia and a 73.88% beneficial interest in EDSA Properties Holdings Inc. ("EPHI") a company listed on the Philippines Stock Exchange. Profit attributable to the Group from the Division for the year ended 31 December 2003 amounted to HK$26 million (2002: HK$32 million). Excluding the effects of the revaluation deficits and the deferred tax credit amounting to HK$11 million (2002: HK$14 million), total profit for the Overseas Property Division for the year amounted to HK$37 million (2002: HK$46 million).

In Jacksons Landing, the Group has equity accounted for its share of profits after tax for the year amounting to HK$14 million (2002: HK$13 million). The Group has recorded profits from its investments in EPHI amounting to HK$12 million (2002: HK$19 million).

(F) LOGISTICS NETWORK DIVISION

The Logistics Network Division continues to be one of the major contributors of revenue to the Group in 2003. During the year, the Division achieved a turnover of HK$1,667 million (2002: HK$1,318 million), which represents approximately 40% (2002: 26%) of the Group's total turnover. Within the Division, logistics revenue increased by 42% from HK$919 million in 2002 to HK$1,308 million in 2003, whilst revenue from warehousing dropped by 10% in 2003 to HK$359 million (2002: HK$399 million).

Profit attributable to the Group from the Division during the year amounted to HK$92 million (2002: HK$159 million) of which HK$60 million (2002: HK$134 million) is attributable to warehousing and HK$32 million (2002: HK$25 million) is derived from logistics operations. Excluding the effects of the revaluation deficits of HK$92 million and the deferred tax charge of HK$9 million, total profit for the Division for the year 2003 amounted to HK$193 million (2002: HK$167 million) of which HK$161 million (2002: HK$142 million) is attributable to warehousing and HK$32 million (2002: HK$25 million) is derived from logistics operations.

i) Warehousing Business

The Hong Kong warehouse rental market remained weak in 2003 with demand for warehouse space continuing to decrease. Market rental dropped by another 15% in the first half of 2003 when compared with December 2002. The effects were further compounded by the SARS outbreak in March 2003 which weakened the Hong Kong economy and consumer demand as a whole.

Despite the hard times experienced by many warehouse operators who faced continuing downward pressure in rental rates over the last few years, the Division has been able to maintain high occupancy rates for its warehouse portfolio. This was achieved by upholding the quality of customer services as well as the hygienic condition of the facilities whilst simultaneously taking a proactive approach in marketing in order to secure additional cargo volume and new tenants. The occupancy rate for the entire warehouse portfolio operated by the Division in Hong Kong was 92% as at 31 December 2003 (2002: 91%).

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The Division will continue to take extensive measures to maximize the income stream and yield of its warehouse portfolio through stringent cost control, quality maintenance and the further development of niche sectors such as dangerous goods, bonded cargos and cold storage which offer higher yields and better margins.

ii) Logistics Business

The Division has made significant progress ever since it started expanding the logistics business in 1999. Revenue generated from logistics increased to over HK$1 billion for the year ended 31 December 2003, replacing warehousing as the main source of revenues for the Division. As at 31 December 2003, the Division operates in 14 countries with approximately 1,400 staff.

At present time, "Kerry Logistics" is a well-known brand name in Hong Kong providing a full range of high-quality integrated logistics services including international sea and air freight, warehousing, distribution and contract logistics. With a series of effective marketing strategies and a strong corporate image plus the ability to provide tailor made innovative value added services for customers, the Division has been able to secure a host of prestigious clients covering a broad spectrum of products such as chemical, electrical and electronics, garments and apparels, fast moving consumer goods (FMCG), as well as food and beverages. During the year, the Division also managed to penetrate into new business sectors such as medical supplies and educational materials as well as operating a new regional hub for an internationally famous brand.

In March 2003, KerryFlex Supply Chain Solutions Limited ("KerryFlex") acquired the business of Flex-Merchandising Resources Limited. KerryFlex now represents owners/principals of more than 500 brands in managing their FMCG in retail stores covering over 1,300 outlets in Hong Kong. Through KerryFlex, the Division has acquired direct access to product owners as well as penetration into retail stores. It has also moved upstream into the agency and distribution business. This has helped pave the way for the Division to offer a truly one stop shop solution covering the entire supply chain from freight forwarding to retail stores. In 2003, three distributor contracts covering FMCG and medical products were awarded to KerryFlex.

Leveraging on the Division's expertise and capability in Hong Kong and aiming to become one of the leading third party logistics ("3PL") service providers in Asia, the Division has continued to focus its development efforts to extend its logistics competencies on Mainland China. There were a number of breakthroughs by the Division in 2003. In August 2003, the three storey 43,000 square metres logistics centre in Yantian, Shenzhen became operational. This facility set a new standard in southern China and has been very well received by customers. The Division is also in the process of building another 14,000 square metres bonded logistics centre inside the Shanghai Waigaoqiao Free Trade Zone which is expected to be completed by the third quarter of 2004. Plans are being developed to construct additional logistics facilities with international standards in Beijing, Shanghai and Futian, Shenzhen.

In the second half of 2003, the Division won the contract for managing three Vendor Managed Inventory ("VMI") hubs for the largest computer manufacturer in China. A number of the Division's Hong Kong based clients who have expanded into Mainland China have also

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outsourced their logistics needs to the Division. During the year, the Division has started to provide distribution and warehousing service for Kerry Oils & Grains Limited in Shanghai and Beijing through its associated companies. The Division is also using its China import and export licence to assist its overseas customers to import their merchandise into Mainland China.

In 2003, the Division opened freight offices in Xiamen and Ningbo in addition to its current network which includes Beijing, Tianjin, Shanghai, Qingdao and Shenzhen. The Division is also planning to expand further by setting up offices in Guangzhou as well as other major cities along the Yangtze River Basin. At the same time efforts are being made to explore the various opportunities created by the signing of the Closer Economic Partnership Agreement ("CEPA") between Hong Kong and the PRC in October 2003.

In Thailand, the Division's 17,000 square metres logistics centre became operational in June 2003. This facility is located near the Port of Laem Chabang which is south of Bangkok and customer support has been extremely encouraging. In view of the rapidly recovering Thai economy and the continuous improvement in infrastructure in Thailand, the Division will continue to explore opportunities for further expansion.

To further strengthen the Division's international freight forwarding network, additional freight offices were set up in Philippines and Vietnam during the year. Looking forward, the Division will continue to further strengthen its international network through the appointment of solid and proactive agents as well as through joint ventures and acquisitions in selected countries.

iii) Information Technology ("IT")

Information Technology is crucial to the Division's business development. "Kerrier", the Division's proprietary software for integrated logistics, was rolled out in 2002. "KerrierWMS", "KerrierTMS", "Kerrier Track & Trace" as well as the sea freight module of "KerrierFMS" have been fully operational in Hong Kong since the second quarter of 2003. The air-freight module will be launched by the first quarter of 2004. Once fully tested, all the modules will be rolled out to other stations within 2004. The development of the "KerrierSSS", which serves the Division's agency and distribution business, is underway. The Division is developing other specific IT capabilities for targeted industries in order to secure a leading position in the market. It is also operating two data centres set up respectively in Beijing and Yantian to provide vital data-links back to the Hong Kong headquarters.

iv) Future Plans

Asia and in particular, Mainland China, will continue to play an increasingly important role in the global economy as more stages of the production process are shifted there. Mainland China due to its growing consumer base is also the world's largest potential market for consumer goods. The result of these two dynamics are large cargo volumes that all require handling creating numerous logistics opportunities for the Division. As such, the Group expects to continue to experience high rates of growth in its logistics business and will continue to invest in its development in order to enhance its competitiveness and strengthen its penetration throughout Asia.

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(G) INFRASTRUCTURE DIVISION

The Infrastructure Division is comprised mainly of the Group's holdings in three infrastructure projects, which are Chiwan Container Terminal ("CCT"), Asia Airfreight Terminal ("AAT") and Western Harbour Tunnel ("WHT"). These investments are an excellent source of recurrent income for the Group. Profit attributable to the Group from the Division amounted to approximately HK$149 million for the year ended 31 December 2003 (2002: HK$101 million). Profit attributable to the Group from CCT, AAT and WHT for the year ended 31 December 2003 were HK$85 million (2002: HK$49 million), HK$29 million (2002: HK$27 million) and HK$35 million (2002: HK$25 million), respectively. The Group will work closer with CCT and AAT to better leverage the synergies and the opportunities amongst these two companies and the Group's Logistics Network Division.

(H) FINANCIAL REVIEW

The Group has centralized funding for all its operations at the Group level. This policy achieves better control of treasury operations and lower average cost of funds. Total borrowings for the Group, as at 31 December 2003 amounted to HK$6,208 million, of which 13% was repayable in one year whilst 5% and 82% were repayable in two years and between three to five years, respectively. During the year, the Group continued to maintain most of its borrowings on an unsecured basis with unsecured debt accounting for 97% of total borrowings as at 31 December 2003. The gearing ratio for the Group amounted to approximately 23% based on net debt of HK$4,616 million and shareholders' equity of HK$19,883 million. The Group will continue to obtain financing on a fully unsecured basis whenever possible and supplement such borrowings with secured project financing as and when the need arises. The Group will also continue its policy of maintaining a prudent gearing ratio.

Foreign exchange exposure for the Group is small relative to its total asset base. As at 31 December 2003, total foreign currency borrowings excluding Renminbi ("RMB") borrowings amounted to approximately HK$74 million. RMB loans at the year end amounted to RMB532 million (2002: RMB510.5 million) and are used to finance the Group's projects on Mainland China.

The majority of the Group's borrowings are subject to floating interest rates. As of 31 December 2003, the Group has outstanding interest rate swap contracts amounting to HK$3.76 billion in total, enabling the Group to hedge its interest rate exposure in the current low interest environment and to have a more stable interest rate profile over the next few years.

On 18 August 2003, Standard and Poor's reaffirmed the Group's corporate rating to be of investment grade with a "BBB-" rating with a negative outlook.

As and when required, the Group will also pledge specific assets for banking facilities granted for the development or acquisition of specific assets.

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As at 31 December 2003, the Group had total undrawn bank loan and overdraft facilities of approximately HK$6,598 million and net cash on hand of approximately HK$1,592 million. The generation of strong recurring cash flows from its investment property portfolio provides the Group with a strong financial position and enables it to act upon investment opportunities as they arise.

(I) CONTINGENT LIABILITIES

The Group had provided guarantees for banking and other facilities granted to associated companies and investee companies and guarantees to certain banks for mortgage facilities granted to first buyers of certain properties developed by the Group in the PRC. At 31 December 2003, the utilised amount of such facilities covered by the Group's guarantees which also represented the financial exposure of the Group amounted to approximately HK$789 million (2002: HK$912 million) and approximately HK$210 million (2002: HK$84 million), respectively. As and when required, in the ordinary course of business, the Group will provide guarantees, counter indemnities or undertakings to cover the Group's obligations in respect of projects undertaken by the Group.

(J) CORPORATE GOVERNANCE

The Company is committed to high standards of corporate governance and transparency which the Directors believe provides a positive framework for the overall performance of the Group as well as enhances shareholders value. The Audit Committee, which is comprised entirely of Independent Non-Executive Directors, ensures that effective accountability mechanisms are in place and good reporting practices and internal control systems are implemented and followed.

In November 2003, the Hong Kong Society of Accountants presented the Company with the Gold Award in the Non Hang Seng Index category under its Best Corporate Governance Disclosure Awards Program. This is the fourth consecutive year that the Company has received an award in this program, which highlights the Group's continuing commitment to maintaining high standards of transparency and good corporate governance.

(K) COMMUNITY RELATIONS

In November 2003, The Hong Kong Council of Social Services awarded the Company with the Caring Company Logo 2003/04 in recognition of the Company's enduring efforts in caring for the community and commitment to good corporate citizenship.

(L) STAFF

As at 31 December 2003, the Company and its subsidiaries had 3,368 employees. Salaries of employees are maintained at competitive levels while bonuses are granted on a discretionary basis. Other employee benefits include provident fund, insurance, medical cover, subsidized educational and training programs as well as a share option scheme.

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Share Option Schemes

On 17 April 2002, the shareholders of the Company approved the termination (to the effect that no further options shall be offered) of the executive share option scheme adopted by the Company on 27 March 1997 (the "1997 Share Option Scheme") and the adoption of a new share option scheme (the "2002 Share Option Scheme"). The 2002 Share Option Scheme is designed to motivate executives and key employees and other persons who may make a contribution to the Group and enable the Group to attract and retain individuals with experience and ability and to reward them for their contributions.

As at 31 December 2003, options to subscribe for a total of 26,303,507 option shares were still outstanding under the 1997 Share Option Scheme. No options have been granted under the 2002 Share Option Scheme.

(M) CLOSURE OF REGISTERS OF MEMBERS

The registers of members of the Company will be closed from Friday, 16 April 2004 to Tuesday, 20 April 2004, both days inclusive, during which period no transfer of shares will be effected. In order to qualify for the proposed final dividend, all share transfers accompanied by the relevant share certificates must be lodged with the Company's branch share registrar in Hong Kong, Abacus Share Registrars Limited of G/F, Bank of East Asia Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong, for registration not later than 4:00 pm on Thursday, 15 April 2004. Subject to shareholders' approval of the payment of the final dividend with a scrip alternative at the Annual General Meeting of the Company, the dividend warrants and certificates for the new shares to be issued pursuant to the 2003 Final Scrip Dividend Scheme will be distributed on or about Friday, 28 May 2004.

(N) ANNUAL GENERAL MEETING

The Annual General Meeting of the Company will be held at 10:30 am on Tuesday, 20 April 2004 at Island Ballroom, Level 5, Island Shangri-La Hotel, Pacific Place, Supreme Court Road, Central, Hong Kong.

(O) PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

Neither the Company nor any of its subsidiaries had purchased, sold or redeemed any of the Company's listed securities during the year.