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 ("Allied Kajima"), and in respect of property investment and development and hospitality related activities in The People's Republic of China ("PRC"), through the 48.17% 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 74.95% holding in Sun Hung Kai.

Financial Review

The turnover of the Group for the year 2003 was approximately HK$862.8 million, a decrease of 4.5% from last year due mainly to the reduction in interest income and sale of properties, partially offset by an increase in income from other financial services.

The Group's profit attributable to shareholders was approximately HK$311.0 million, compared to the loss of approximately HK$400.9 million in 2002, representing a significant increase of 177.6%. The turnaround was primarily due to the major reduction in impairment losses and revaluation deficits in relation to the Group's Hong Kong properties from HK$564.5 million in 2002 to HK$40.4 million, as well as the remarkable performance of Sun Hung Kai, a listed subsidiary of the Group, and the increase of the Group's equity interest in Sun Hung Kai.

Segmental Information

Detailed segmental information in respect of the Group's turnover and contribution to profit 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 loan notes 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.

Loan notes with principal amount of HK$255.2 million were issued by Sun Hung Kai during the year as part of the consideration for repurchase of its own shares. Of the principal amount, HK$23.6 million was subsequently repurchased during the year. The loan notes bear interest at 4% per annum and are due on 7th March, 2008.

There was no material change to the issued share capital of the Company during the year.

At 31st December, 2003, the current ratio (current assets/current liabilities) of the Group was 1.41 times, which decreased from the 1.80 times applicable at the end of 2002.

Financial Review (Cont'd)

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

At 31st December, 2003, the Group's net borrowings amounted to HK$1,602.3 million (2002: HK$1,394.8 million), representing bank borrowings and loan notes of HK$2,233.0 million (2002: HK$1,774.1 million) less bank deposits, bank balances and cash of HK$630.7 million (2002: HK$379.3 million) and the Group had net assets of HK$4,889.3 million (2002: HK$4,497.1 million). Accordingly, the Group's gearing ratio of net borrowings to net assets was 32.8% (2002: 31.0%).

	2003	2002
	HK$'000	HK$'000
Bank borrowings of the Group are repayable as follows:		
Within one year or on demand	**1,059,908**	812,018
More than one year but not exceeding two years	**70,760**	259,669
More than two years but not exceeding five years	**759,110**	555,060
More than five years	**111,565**	147,310
	2,001,343	1,774,057
Loan notes repayable within five years	**231,637**	–
	2,232,980	1,774,057

The Group's bank borrowings were charged at floating rates. Finance costs decreased from HK$72.2 million in 2002 to HK$60.0 million during the year as a result of reduction in average bank loans being utilised during the year as compared to the year 2002 and continuing efforts made in reducing the interest rate margins payable.

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.

Additional Interest in Sun Hung Kai

The Group's equity interest in Sun Hung Kai increased from 61.67% to 74.95% at the year end mainly resulting from the completion of the repurchase by Sun Hung Kai of its own shares as announced by Sun Hung Kai on 27th February, 2003.

Acquisition of a Subsidiary

During the year, Sun Hung Kai acquired the entire issued share capital of Shun Loong Holdings Limited ("Shun Loong") for a consideration of HK$36.5 million subject to adjustments as detailed in an announcement of Sun Hung Kai dated 25th June, 2003. Shun Loong provides a full range of traditional and online brokerage services through its subsidiaries.

Financial Review (Cont'd)

Disposal of a Jointly Controlled Entity

During the year, the Group disposed of its 50% interest in a jointly controlled entity to a non wholly-owned subsidiary of the ultimate holding company at a consideration of HK$87.5 million. A loss of HK$5.5 million arose on disposal of the jointly controlled entity.

Contingent Liabilities

Details of contingent liabilities are set out in note 36 to the financial statements.

Pledges of Assets

Details regarding pledging of assets are set out in note 40 to the financial statements.

Operational Review

Hong Kong

The Group's rental income increased during the year under review mainly due to the contribution from St. George Apartments. Other important contributors of rental income included China Online Centre and Century Court, which achieved rentals for the year as a whole about the same as 2002, despite difficulties caused by SARS in the first half. Allied Kajima Building and China Online Centre had average occupancy rates for 2003 at 90% and 85% respectively.

Mainland PRC

Properties sold in the PRC with a total gross floor area of about 291,000 sq. m. compared to 250,000 sq.m. in the year before contributed significantly to the satisfactory performance of Tian An, with an increase in its net profit by 17.7% to approximately HK$102.4 million. During the year, Tian An has streamlined its operations and disposed of a number of non-core or non-strategic projects to concentrate its focus on the development of key projects in the major cities of the PRC. With a dynamic and proactive management team capable of taking advantage of the booming PRC economy, it is expected that Tian An's current development projects together with its significant landbank would substantially benefit the group in the years ahead.

Hospitality Related Activities

The performance of the Novotel Century Hong Kong hotel ("Century Hong Kong") was adversely affected by SARS in the first half of 2003. Benefiting from the implementation of the Individual Visit Scheme, Hong Kong's tourism related sector showed signs of recovery in the second half of 2003, especially in the later stages of the second half. The Westin Philippine Plaza Hotel ("Westin") became more competitive immediately after the completion of its renovation and refurbishment works. The Westin reported an increase in revenue notwithstanding the continued difficult tourism market conditions in the Philippines mainly attributable to the improvement of available rooms and effective cost control following the renovations.

Construction of the superstructure for phase two of Ibis North Point, the hotel in Java Road, has been completed. It is anticipated that this hotel extension will be operational before the end of this year.

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

Operational Review (Cont'd)

Financial Services

Sun Hung Kai recorded profit attributable to its shareholders of approximately HK$241.9 million, an increase of 31.5% compared to the previous year. However, having completed its own share repurchase exercise, the increase in its earnings per share was actually 53.3%. Continuing efforts to diversify its products and service range enabled Sun Hung Kai to capitalise on the market rebound. The performance of Sun Hung Kai also benefited from lower provisioning for doubtful debts, resulting from the improved capital market and stringent credit control, together with the write-back of some provisions from past years.

The market rebound in the second half of the year resulted in a satisfactory increase of Sun Hung Kai's margin loan book compared to the year of 2002. Net revenues were strongly positive through the substantial use of Sun Hung Kai's shareholders' funds in a low interest rate environment. Term lending levels trended downwards in 2003 as stronger capital markets provided potential borrowers with alternative funding opportunities. Net income levels, however, were still strongly positive.

New technologies such as IVRs, telephone order and inquiry systems, and online trading were added to the traditional account executive network in 2003 to enhance the services provided to securities clients. SHK Online Limited maintained its growth momentum from the previous year and captured significant increases in client base, volume, market share and revenue by the end of 2003. The launch of new online trading services for HSI futures contracts, and H-Share Index futures was well received by the clients.

Sun Hung Kai International Bank [Brunei] Limited, a newly incorporated wholly-owned subsidiary, was granted the first full international banking licence in Brunei under the International Banking Order 2000 issued by the Ministry of Finance, Brunei.

The acquisition of Shun Loong by Sun Hung Kai in June 2003 was a strategic move to further enhance Sun Hung Kai's competitiveness as a dominant financial services provider in Hong Kong.

Investments

The Group has taken the opportunity during recent years to invest in several listed investments. The Group believes these acquisitions should complement its core businesses. These investments have delivered pleasing results.

Quality HealthCare Asia Limited ("QHA")

QHA, a 28.85% associate of Sun Hung Kai, concentrated in 2003 on consolidation and focused its resources to the growth and development of its core healthcare businesses and achieved a profit of HK$24.4 million. QHA is the largest listed healthcare company in Hong Kong. The group provides care for its private and corporate contract patients through a total of approximately 600 QHA and associated western and Chinese medical centres, and 44 dental and physiotherapy centres. It also operates nine elderly care homes and Hong Kong's longest established international nursing service.

Operational Review (Cont'd)

Investments (Cont'd)

Yu Ming Investments Limited ("Yu Ming")

Yu Ming, a 21.53% associate of Sun Hung Kai, recorded a profit in 2003 of HK$143.4 million. Yu Ming's major investments were in Hong Kong equities, international debt instruments and the Argyle Centre, a fully leased shopping mall in a prime location in Mongkok. In August 2003, Yu Ming joined a private sector consortium to invest with the Hong Kong Government and the Airport Authority to develop and operate the Hong Kong International Exhibition Centre at the Hong Kong International Airport.

Shanghai Allied Cement Limited ("SAC")

For the year ended 31st December, 2003, the SAC group, a 54.77% subsidiary of Tian An, reported a net profit of HK$50.0 million. The principal activities of the SAC group are manufacturing and distribution of clinker, high-grade cement and natural stones, ceramic tiles, provision of engineering design and installation, and the distribution of other construction materials.

Major Suppliers and Customers

The Group's five largest and top suppliers contributed 92.7% and 87.4% 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, 2003 was 1,746 (2002: 1,463). Total staff costs, including Directors' emoluments, amounted to HK$198.6 million (2002: HK$174.3 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 a counter-party in a transaction may default during the settlement process. It also arises from lending, settlement, treasury, market making, derivatives, proprietary 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 ("CRM") at its regular 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 its results are reported to the CRM, management and the various committees at their 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 re-pricing 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 re-price 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 (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 of foreign securities on behalf of clients. 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 our open currency positions which are subject to management approved limits and are monitored and reported daily. The other possible 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 on loan assets.

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 infrastructure 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 years, appropriate insurance cover has been more difficult and more expensive than normal to obtain. 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 (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 management believes that, benefiting from the robust economic growth of Mainland China and better global economic prospects, the local economy should continue its current upswing. CEPA, the Individual Visit Scheme and commencement of restricted Renminbi banking services in Hong Kong all provide important impetus to our economic growth in the coming years. With the recent buoyancy of the real estate and stock markets, our established investment strategies and focus are expected to sustain the Group's growth in terms of property and financial services income. However, the fiscal budget deficit, the high unemployment rate and the potential for a rise in interest rates are factors which should be closely watched. The management will continue to monitor these and other relevant factors as well as the market situation with a view to maintaining a stable and satisfactory return for the Group.

Patrick S. W. Lee
Chief Executive
Hong Kong, 15th April, 2004