OPERATING AND FINANCIAL REVIEW

OPERATING REVIEW

Investment Properties

Office Leasing — The office leasing market continued its recovery path with generally improved rental levels. Activities were, however, principally relocation and upgrading to better locations and properties.

Against this, the Group achieved a 97% occupancy. It will take time to translate positive market developments into earnings.

Retail Leasing — The retail sector continued to be active during the first six months of the year. Further enhanced consumer sentiment and tourist arrivals continued to be the driving forces. Prime shopping locations witnessed particular increase in activities and rental levels achieved.

The Group's retail properties were virtually fully-let, and made increased contributions during the review period. These reflect the premium location of our retail portfolio and the re-opening of the upgraded Lee Gardens Two (which property was under renovation as from March 2003).

Our longer term objective is to position our hub in the prime retail district in Causeway Bay as a distinctive neighbourhood with a broad retail appeal, where shopping, leisure and service needs can be met. We aim to integrate retail offerings in a horizontal, streetscape setting. Shopping centres with different themes, food and beverage, and entertainment will provide the necessary anchors. These will be complemented by landscape and general environmental enhancements.

The completion of the upgraded Lee Gardens Two was the first major step in this direction. Plans to refine the tenant mix and positioning of Lee Theatre Plaza are in progress.

Residential Leasing — The luxury residential market saw increased activities, with a steady improvement in rentals achieved.

Our upgraded Bamboo Grove property successfully capitalised on such positive developments, as reflected in an occupancy of 80%.

Development Properties

Shanghai, PRC — Construction for Phase 2 of the Grand Gateway Project (in which the Group has an effective interest of 23.7%) made good progress. Leasing activities of the completed Phase 1 development performed well during the review period. The retail podium was virtually fully-let, and the residential tower achieved high occupancy.

Singapore — Construction of the Group's three joint-venture residential developments has been completed (Group interests: Amaryllis Ville: 25%, Sanctuary Green: 10% and Gardens at Bishan: 10%). Sales are in progress with a good part of the relevant residential units having been sold.

FINANCIAL REVIEW

Results

The comparative 2003 results have been restated to reflect a prior period adjustment on deferred tax arising from an associate, the impact and the details are set out in note 3 to the condensed financial statements.

Key drivers of the 2004 interim results were:

Gross rental income fell by HK$33.7 million (5.7%) to HK$559.8 million (2003: HK$593.5 million). Office rental income for the period lowered by 23.1%, largely offset by improved rentals from the retail and residential sectors (retail: 7.5%, residential: 55.6%). Retail rental levels were generally higher at the upgraded Lee Gardens Two (which property was under renovation as from March 2003). Upgraded residential Bamboo Grove development also achieved much-improved occupancy.

Investments in securities comprised principally of Hong Kong-listed securities held as long-term investment. This portfolio serves as a liquid buffer fund to help finance capital expenditure and other opportunities as they arise. Disposal during the period generated a gain of HK$14.6 million.

Property expenses went up in general, led mostly by revenue-driven expenditures such as decoration, promotional, marketing and agency fees. The Group continued to exercise tight control over administration expenses.

Net finance costs were down by HK$9.4 million, or 10.8% from corresponding period in 2003, taking advantage of lower prevailing interest rates.

Share of results of associates went up by HK$23.8 million compared to 2003, with profits from the Shanghai Grand Gateway project offsetting losses from a Singapore project (Group interest: 25%).

Impairment loss write-back related to two completed Singapore projects in which the Group has a 10% interest in each project. Based on the percentage of units sold and the expected revenue net of costs, the Group wrote back HK$41.0 million on impairment loss previously provided. The Group maintains a prudent policy in making sufficient provision against impairment losses.

Taxation for the period included an additional provision of HK$55.0 million in respect of non-deductibility of interests claimed in prior years. Having reviewed the basis of making such provision, the additional provision was made out of prudence.

Contingent liabilities — There were no significant changes since the publication of the Group's 2003 annual report in March 2004.

Shareholders' funds as at 30 June 2004 was HK$18,676.0 million (31 December 2003 restated: HK$18,616.4 million).

OPERATING AND FINANCIAL REVIEW

Capital Expenditure

The Group is committed to enhancing the quality of its investment properties portfolio. Expenditure on refurbishment, renovation and additions to the Group's investment properties amounted to HK$30.6 million during the review period.

Capital expenditures were primarily funded by internally generated funds from operations and proceeds from disposals of marketable securities. With substantial committed banking facilities in place and a solid base of recurrent income, the Group is in a strong liquidity position and has sufficient financial resources to meet its capital commitments and ongoing working capital requirements.

Financial Management

The key objective of the Group's financial management is to maintain prudent liquidity and financial risk management. This is achieved by way of an even spread of debt maturity to minimise funding and refinancing risks; diversified funding sources; and minimising interest rate and foreign exchange exposures.

Liquidity

The Group's total gross debt level was HK$5.83 billion as at 30 June 2004, little-changed from 31 December 2003. Weighted average borrowing costs (including taking into consideration the effect of hedging instruments) further lowered to 2.45 %, as interest rate remained favourable in the review period.

The Group's average debt maturity as at 30 June 2004 stood at 5.2 years (repayable within one year: 9%, two to five years: 40%, over five years: 51%, largely the same as at 2003 year-end). 66.4% of Group debts were from bank loans, almost the same level as at 2003 year-end. The Group has always maintained an appropriate level of debts raised from capital market to avoid over-dependence on a single source (as at 30 June 2004: 33.6%, largely the same as at 2003 year-end).

All Group debts are unsecured, with over 98% being on a committed basis. The Group has ample undrawn committed facilities, which stood at HK$2.79 billion as at 30 June 2004 (31 December 2003: HK$2.02 billion).

Risk Management

Interest rate risk was actively managed by the Group during the review period. As interest rate trended up, the Group took a higher percentage of fixed rate debts through the use of derivatives. The percentage of floating-rate debt decreased to about 50% as at 30 June 2004 (31 December 2003: 60%).

The Group's foreign exchange risk was minimal. All Group debts are either denominated in, or hedged back into, Hong Kong Dollars or the currency of the underlying assets. The Group's foreign exchange exposure relating to overseas joint ventures as at 30 June 2004 was HK$831.7 million (31 December 2003: HK$790.5 million), or 3% of the Group's assets. 88% of such exposure was denominated in Renminbi, with the balance being in Singapore dollars.

Financial Ratios and Credit Ratings

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 to 7.9 times as at 30 June 2004, reflecting lower interest expenses (31 December 2003: 6.5 times).

Net gearing (defined as gross debt less cash and cash equivalents and marketable securities at period-end market value, divided by shareholders' funds) as at 30 June 2004 was 26.5%, little-changed from 2003 year-end (31 December 2003: 27.0%).

Credit ratings as at 30 June 2004 remained unchanged, being Baa1 from Moody's and BBB from Standard and Poor's.

Michael T.H. Lee
Managing Director

Hong Kong, 18 August 2004