

Leasing Performance by Business Sector

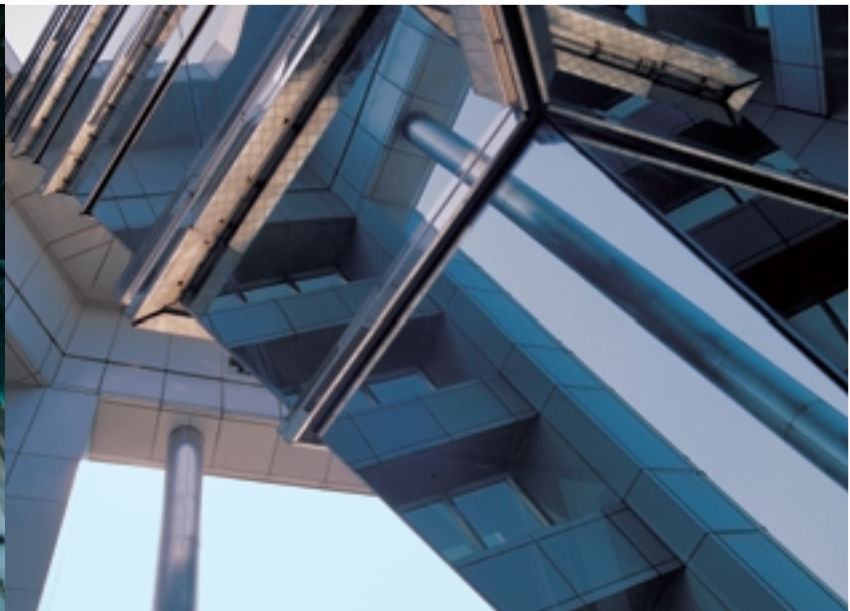
While many factors contribute to the success of our leasing activities, key drivers for assessment of our performance included those set out below:

- **Occupancy level** - retaining tenants, attracting new tenants
- **Rental level** - market rental and reversionary trend
- **Strategic level** - (for retail sector in particular) optimal tenant mix

Office Sector Performance

We continued to achieve high occupancy in the office sector throughout the year. The objective of meeting target tenant retention (ranging from 80 to 100% for different industries) was met. As at 31 December 2004, occupancy levels further improved to 97% (2003: 93%), reflecting a good balance of expansion activities of existing tenants as well as the securing of new tenants across a range of industries.

Taken as a whole, rental levels achieved for renewals in 2004 (including those concluded in 2003 under the normal lease renewal cycle) still fell short of levels under the original tenancy agreements. This was reflected in the drop in office sector rental income by 15%. There was, however, continued improvement in effective rental levels achieved and it is expected that negative rental reversion should enter its final phase in 2005.



Retail Sector Performance

As at 31 December 2004, our retail portfolio recorded an occupancy of 99% (2003: 95%; 99% excluding Lee Gardens Two). Rental income increased by 12%, which was attributable to full-year contribution from the re-launched Lee Gardens Two and better rents generated from the rest of the portfolio. These results reflect the premium location of our Causeway Bay portfolio and our Group efforts in asset enhancement and tenant mix management.

Our leasing team had an active year focusing on the following:

- pro-active retail leasing - occupancy rate achieved 99% before the grand opening of Lee Gardens Two;
- continuous refinement of tenant mix and improvement in the layout of our retail centres - including planning for a major re-tenanting programme for Lee Theatre Plaza;
- marketing campaign - the successful re-launch of Lee Gardens Two and image promotion for our retail centres.

Continuous refinement of our retail centres towards establishing a horizontally integrated shopping district that offers a broad appeal to the targeted consumer groups will continue.



Residential Sector Performance

Residential rental income increased by 50% and was largely driven by the improvement in Hong Kong's economic outlook and the resulting increase in expatriate arrivals, which in turn created a stronger demand for expatriate housing.

This was reflected in the significantly-improved occupancy of the Group's re-launched Bamboo Grove. Overall residential sector occupancy achieved was 84% as at 31 December 2004 (2003: 60%).



Property Expenses

Property expenses are costs of providing property services directly associated with daily operations of our investment properties. They are principally utilities costs, staff costs, recurring repairs and maintenance, and marketing.

2004 property expenses stood higher at HK\$259 million (2003: HK\$239 million), which was largely attributable to higher marketing and promotion expenses as well as extra property costs on the re-opening of Lee Gardens Two and higher occupancy in Bamboo Grove. Repairs and maintenance expenses were also higher.

Gain on Disposal of Investments in Securities

The Group's portfolio of listed securities continued to serve as a liquidity buffer to help finance capital expenditures and other market opportunities.

Disposal of listed securities during the year generated a gain of HK\$15 million (2003: HK\$48 million) and the sales proceeds were used to finance the Group's capital expenditure requirements.

Share of Results of Associates

The Group has associate-level interests in the following overseas joint venture development projects:

Development Property	Use	Total Gross Floor Area (million sq.ft.)	Group Percentage Ownership	Status
Shanghai, PRC				
The Grand Gateway	Phase I: Retail and Residential	1.4	23.7	Completed and leased (retail: 100%; residential: 96%)
	Phase II: Residential and Office	1.2		Construction works in progress
Singapore				
Amaryllis Ville	Residential	0.4	25.0	Over 70% sold and about half of the unsold units leased.

There was a HK\$58 million gain from the share of results of associates driven by contribution from Phase I of the Shanghai Grand Gateway project of HK\$71 million as a result of good leasing performance. This offset loss in the Singapore joint venture project

amidst the improved albeit slow Singapore residential property market. Consequent to the improved operating result of our associates, the Group's share of deferred tax also increased to HK\$20 million (2003 restated: HK\$8 million).



Reversal of Impairment Loss

The Group has interests in the following Singapore residential projects:

Development Property	Use	Total Gross Floor Area (million sq.ft.)	Group Percentage Ownership	Status
Singapore				
Sanctuary Green	Residential	0.7	10.0	Temporary occupancy permit issued and 59% sold
The Gardens at Bishan	Residential	0.9	10.0	Temporary occupancy permit issued. Sales launched with 95% sold.

Management has made impairment loss reversal of HK\$63 million (2003: Nil), taking into consideration the rate of sales and improved market conditions.

Administrative Expenses

Administrative expenses mainly comprised general office and corporate expenses as well as staff costs. These expenses increased marginally by 5.7% (HK\$5 million) to HK\$95 million (2003: HK\$90 million), which was principally attributable to human capital investment to support the Group's business objectives.

Finance Costs

In 2004, interest rates continued to remain low and resulted in lower finance costs (by 3.9%) to HK\$162 million (2003: HK\$168 million). The decrease in gross debt (2004: HK\$5.6 billion; 2003: HK\$5.9 billion) also contributed to the reduction in 2004.

Further discussions on financial management, including financing policy and risk management are set out in the "Financial Prudence and Managing Risks" section.

Taxation

The tax provision attributable to the Group for 2004 was lowered by HK\$25 million due to a higher base in 2003. This reflected a higher deferred tax in 2003 including a one-off charge as corporate tax rate rose from 16.0% to 17.5%.

Taxation for the year included an additional provision of HK\$55 million in respect of possible non-deductibility of certain interests claimed in prior years. This additional provision was made out of prudence during the first half of 2004.

Net Profit for the Year

Net profit for the year increased by 13.7% (HK\$73 million) to HK\$609 million (2003 restated: HK\$536 million).

Condensed Consolidated Balance Sheet as at 31 December

	2004 HK\$ million	2003 HK\$ million (restated)	Change HK\$ million	Change %
Investment properties	28,147	24,367	3,780	15.5
Investments in securities - listed	915	874	41	4.7
Investments in securities - unlisted	103	67	36	53.2
Interests in associates	855	850	5	0.7
Cash and bank balances	22	15	7	49.8
Other assets	199	160	39	23.1
Total assets	30,241	26,333	3,908	14.8
Debt borrowings	(5,603)	(5,914)	311	5.2
Taxation				
- current	(131)	(91)	(40)	-44.9
- deferred	(218)	(180)	(38)	-20.9
Other liabilities	(815)	(778)	(37)	-4.7
Total assets less liabilities	23,474	19,370	4,104	21.2
Shareholders' funds	22,493	18,616	3,877	20.8
Minority interests	981	754	227	30.2
	23,474	19,370	4,104	21.2

Assets

Total assets were HK\$30,241 million, increased 14.8% (HK\$3,908 million) from the 2003 level of HK\$26,333 million (restated). The main drivers were:

Investment Properties

The investment properties were HK\$28,147 million, up by 15.5% (HK\$3,780 million) from HK\$24,367 million in 2003. Adjusting for net additions, there was a 15.1% revaluation gain amounting to HK\$3,677 million (the Group's share after minority interests was HK\$3,453 million).

The Group continued to adhere to its strategy of enhancing and growing its investment property portfolio. Capital expenditure on investment properties in 2004 totalled HK\$104 million.

Investments in Securities

Investments in listed Hong Kong securities increased by 4.7% (HK\$41 million) to HK\$915 million (2003: HK\$874 million). Good stock market performance in 2004 led to an extra HK\$65 million unrealised gain from our listed securities portfolio. The net increase of HK\$41 million was arrived at after netting off the HK\$24 million being carrying value of securities disposed.

Investments in unlisted securities comprised principally minority interests in overseas property development projects. As discussed under the section "Condensed Consolidated Income Statement" above, impairment loss amounting to HK\$63 million was reversed from two Singapore development projects and was partially offset by cash receipts of HK\$27 million during the year.

Interests in Associates

The interests in associates comprised our associate-level interests in the Shanghai and Singapore development projects referred to above. After the Group's attributable share of current year profit (including negative goodwill) of HK\$60 million as well as revaluation reserve of HK\$57 million, netting off cash receipts (HK\$88 million), deferred tax provision (HK\$20 million) and exchange loss (HK\$4 million), the Group's interests in associates increased by 0.7% to HK\$855 million (2003 restated: HK\$850 million).

Debt Borrowings

The gross debt decreased by 5.2% (HK\$311 million) from HK\$5.9 billion at the end of 2003 to HK\$5.6 billion in 2004. The reduction was achieved as a result of higher cash flow from operations, cash receipts from overseas joint venture projects and disposal of listed securities, against a background of slightly lower capital expenditure for the review year.

Taxation Payable and Deferred Taxation

Provision for taxation increased from HK\$271 million in 2003 to HK\$349 million in 2004. The net increase was made up of a HK\$104 million charge for the year, HK\$38 million related to additional deferred tax, reduced by tax payments of HK\$64 million.

Management has been advised by the Group's tax consultants and believed adequate provisions have been made against current tax liabilities and deferred tax liabilities in accordance with relevant accounting standards.

Shareholders' Funds

Shareholders' funds increased by 20.8% from HK\$18,616 million (restated) in 2003 to HK\$22,493 million in 2004. These reflected the net profit after dividend payments in 2004 and revaluation gain from the investment properties and listed securities.

Minority Interests

The 2004 increase of HK\$227 million in minority interests was driven by revaluation surplus as well as increased profit contribution arising from Lee Gardens Two.

Contingent Liabilities

The Group has provided guarantees for banking facilities granted to associates and investee companies. As of 31 December 2004, the Group's share of guarantees and counter guarantees amounted to about HK\$61 million and HK\$89 million respectively.

The Group has also underwritten to the associates cash calls to finance their respective working capital requirements and no capital call request was outstanding as at 31 December 2004. Based on the degree of completion of the overseas projects and the currently available information, management does not anticipate any call for major cash contribution in the foreseeable future.

Critical Accounting Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as well as disclosure of contingent liabilities. The most significant estimate relates to the valuation of the Group's property investments.

For the purpose of preparing the 2004 financial statements, real estate properties were carried at market values determined by an independent professional valuer, Knight Frank Hong Kong Limited. The Group's investments in overseas property development projects were determined from management reports and audited financial statements. Due diligence was carried out on asset value, market information and estimated achievable sales proceeds. Due to the inherent uncertainties of valuation, the values reflected in the financial statements may differ from subsequent realisation.

The Group and its subsidiaries and associates may be subject to certain income and non-income-based taxes in their respective jurisdictions. As such, the management, upon advice from tax consultants where necessary, made reasonable estimates and necessary disclosures for tax exposures. Actual assessment amounts and results may differ from such estimates.

Changes in Significant Accounting Policies in 2005

The Hong Kong Institute of Certified Public Accountants ("HKICPA") has established the objective of harmonising Hong Kong Accounting Standards with International Financial Reporting Standards. The HKICPA has accordingly issued a number of new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards (the "HKFRS" and "HKAS"), which are effective for accounting periods beginning on or after 1 January 2005.

The Group has already commenced an assessment of the impact of these new HKFRS and HKAS and has so far concluded that adoption of the following new accounting standards will be of particular significance to the Group:

- HKAS 40 on Investment Property;
- HKAS 32 on Financial Instruments: Disclosures and Presentation;
- HKAS 39 on Financial Instruments: Recognition and Measurement; and
- HKFRS 3 on Business Combinations.

Overview

An important underlying concept of the HKAS 40, HKAS 32 and HKAS 39 is to move away from the "historical cost" principle to the concept of "fair value". Movements in balance sheet carrying values are charged to the income statement, which may introduce greater volatilities in earnings and financial ratios.

HKFRS 3 calls for revised accounting treatment for negative goodwill which is currently governed by Statement of Standard Accounting Practice 30.

HKFRS 3 essentially calls for negative goodwill to be recognised immediately instead of a systematic amortisation as a gain to the income statement.

HKAS 40

Companies are given an option to carry their long-term property interests at either cost (less amortisation) or "fair value". Consistency in treatment for subsequent accounting periods is required once the option is chosen.

The Group will account for its investment properties using the "fair value" approach. All revaluation surpluses and shortfalls will be taken through the income statement, affecting earnings directly. The current treatment of taking revaluation surpluses and shortfalls to reserves will cease. As a result, more volatility in our earnings figures is anticipated. The precise financial impact will depend on the prevailing real estate market conditions at reporting dates.

Deferred tax on all revaluation surpluses is likely to be provided. This will affect the net assets value per share figure.

In view of this significant change, management will adopt an appropriate communication plan to ensure that its shareholders and other stakeholders understand the changes and full implications so that they can make an informed assessment of the Group's financial performance. Management therefore intends to present additional information to the shareholders and stakeholders on earnings and net assets value per share, highlighting the impacts of the revaluation movements and their related deferred tax charges.

HKAS 32 and 39

The two standards seek to move away from "historical cost accounting" to "performance accounting" and require mark-to-market treatment and additional disclosure on financial

instruments. Hedging instruments do not need to be marked-to-market but can only be recognised under strict definitions and criteria stipulated in the standards. Appropriate disclosures are required.

As part of its treasury risk management activities, the Group enters into derivatives and forward contracts for differences. Typical contracts include interest rate swaps (converting a floating rate debt into fixed rate) and cross currency swaps (converting debts denominated in foreign currency back into our base currency in Hong Kong Dollars). Group treasury policy only permits the use of derivatives for hedging purposes, it is therefore likely that most of these contracts will continue to qualify as hedges under the new standards. However, the pricing and other market inefficiencies may cause timing differences in earnings over the life of the hedging instrument. We are not currently in a position to quantify its financial impact as it is dependent on market conditions prevailing at reporting dates.

HKFRS 3

Under the current accounting standards, negative goodwill, being excess of the acquirer's interest in the net assets values of the identifiable assets, liabilities and contingent liabilities bought over the costs of purchase, are deferred in the balance sheet. Such negative goodwill is systematically amortised with a corresponding gain credited to the income statement.

The new HKFRS 3, however, calls for an immediate recognition of such gains to the income statement. All outstanding negative goodwill (HK\$49 million) previously deferred shall be eliminated



and derecognised by way of an adjustment to the opening shareholders' funds. Starting from year 2005, the annual gain of HK\$2 million, being amortisation of negative goodwill previously acquired, shall no longer go through the income statement.

Capital Expenditure and Management

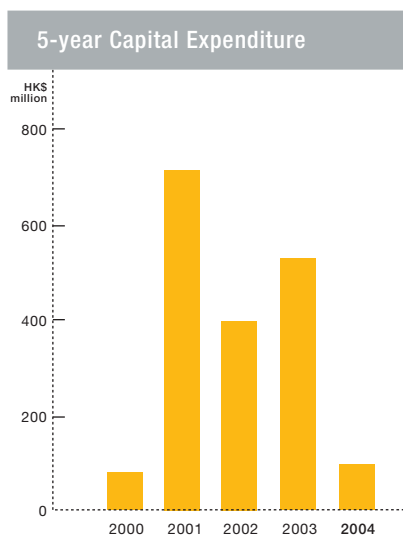
The Group is committed to enhancing the asset value of its investment property portfolio through selective re-tenanting, physical improvements, renovation and repositioning:

- re-tenanting** is particularly important for our retail properties in optimising tenant mix. In moving towards our goal of creating a horizontally integrated shopping district offering a broad appeal to different consumer groups, the Group has, over the past few years, continually seized opportunities to refine the tenant mix of its retail centres. These included The Lee Gardens and Lee Gardens Two (luxury retail); Lee Theatre Plaza and Leighton Centre (lifestyle and restaurants); Hennessy Centre (family-oriented retail); Sunning cluster comprising Sunning Plaza, AIA Plaza and 111 Leighton Road (specialty food and beverage);
- physical improvements** - the Group regularly reviews the need for, and implements physical improvements ranging from reconfiguration of building and shop space layout to improving building efficiency and rental potential;
- repositioning** completed in the last two years included the Bamboo Grove residential project and the Lee Gardens Two retail project. Both projects proved successful

as evidenced by the rental levels and occupancy contributions;

- renovations and whole life cycle maintenance programme** - the Group also has in place a portfolio-wide whole life cycle maintenance programme as part of its ongoing strategy to proactively review and implement maintenance activities. Works carried out in 2004 under the whole life cycle maintenance programme included improvement projects for Leighton Centre and Hennessy Centre.

Total cash outlay of capital expenditure (excluding purchase of plant and equipment) during the review year was HK\$104 million.



The Group has an internal control system for scrutinising capital expenditures. Detailed analysis on expected risks and returns are submitted to division heads, Executive Directors or the Board for consideration and approval, and depending on strategic importance, cost/benefit and the size of the projects. The criteria for assessment of financial feasibility are generally on net present value, payback period and internal rate of return from projected cash flow and residual value.

At year end, the Group had HK\$2.3 billion undrawn committed bank facilities. This availability, together with the Medium Term Note Programme, the Treasury securities portfolio and positive cash flows from operations, should be sufficient to cover the Group's refinancing and capital expenditure needs over the next few years.