恒隆地產
HANG LUNG PROPERTIES

2019
Interim Report

Hang Lung Properties Limited
Stock Code: 00101

WE DO IT RIGHT

CONTENTS

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RESULTS AND DIVIDEND

Compared to the last corresponding period, revenue decreased 18% to HK$4,204 million, which was due primarily to the lack of property sales. Net profit attributable to shareholders fell 25% to HK$3,516 million. Earnings per share retreated similarly to HK78 cents.

Underlying net profit attributable to shareholders fell 4% to HK$2,229 million when excluding property revaluation gain and all related effects. The corresponding earnings per share moderated similarly to HK50 cents.

The Board has declared an interim dividend of HK17 cents per share payable on September 26, 2019 to shareholders of record on September 13, 2019.

BUSINESS REVIEW

Six months ago I wrote about the dichotomy that exists between the troubled world around us and our Company's bright future. The irony continues: our core business is performing rather well and, in some cases, very well, yet the external environment has gone from bad to worse. Six months ago, we had one problem – the China-U.S. trade war. Now we have two – the added social turmoil in Hong Kong. This means that in both of our markets – mainland China and Hong Kong – there are causes for concern. Yet we seem to have defied gravity. Our Hong Kong business is steady; our Mainland operation has traded strongly, and is projected to continue to do so for at least a further two to three years.

To be sure, the social unrest of recent weeks on Hong Kong streets will impact many businesses sooner rather than later. Tourist arrivals are already negatively affected, which will translate into slower retail activities. For luxury products, sales may even retreat. Unlike our Mainland business, our retail tenants in Hong Kong mainly deal with local people's daily necessities. As such, we are expected to be less affected.

Like six months ago, I will begin with a review of our business before addressing the external environment in the next section on "Prospects."

After the initial success in the early 2000's in Shanghai with our two malls at Plaza 66 and Grand Gateway 66, in 2005 we embarked on the second phase of our Mainland strategy. Believing that luxury sales will sooner or later overflow from Shanghai and Beijing into many wealthy tier-two cities, we began to buy land in the latter in a deliberate and highly selective manner. We picked only what we believed to be economically vibrant cities, and in them, we focused only on large tracts of land that were centrally located for retail purposes. We were disciplined, even religious, about this approach. We designed and constructed buildings to the highest standards, and will hold these properties for a long period.

So far we have not seen any other company having the same strategy. We will pass up the best located piece of land if we do not deem the city to be attractive enough. A few years back, we worked on such a piece of land that was ultimately offered to us at a reasonable price. The local government ardently courted us, but we eventually turned it down because we decided at the time that there was a fair chance to buy in more prosperous cities. We did not want to be financially or psychologically burdened by an inferior plot in case a superior one comes along. The result was the Hangzhou Westlake 66 piece acquired last year. Unless a city is among the top one-third or even top quartile of all tier-two cities, we shy away. And in those cities that pass our stringent requirements, we still do not purchase unless we believe that the land being considered is among the best in the city – not merely the best that we can find in the city.

For this strategy to work, strict discipline and much patience are required. We will wait and are willing to pay more for the best piece in town. If not, we may be stuck with a substandard piece of land. Earlier I cited the land in Hangzhou. We first visited the city in the early 1990's but decided to go to Shanghai instead. In 2004, we began to look outside Shanghai in earnest and the city again appeared on our radar. From that time onward, we had plenty of opportunities to acquire, but waited until 2018 before we acted. We believe we now have a plot that has the potential to be the number one in the city for luxury retail and Grade A offices. In fact, we have a decent chance to create a commercial hub in the very center of this highly prosperous city. A downtown, if you will.

Those who have followed these writings in the past would know what I call the "real estate genetics" for luxury malls and high-rise offices. (I first wrote about it in the Chairman's Letter of 2013 Annual Report. Readers can find this piece and other previous letters on our website.) There are five "genes", and location is the first of them.

Second, the land must be big enough.

Third, it must have a government-stipulated development brief that is conducive to building a world-class complex. A person who does not know what a true luxury mall looks like, let alone built one, will unlikely be able to recognize or negotiate the requisite development terms for a particular lot. I cannot emphasize enough its importance, for this can make or break a project. The last two “genes” are that a commercial complex must be designed right, and constructed well.

These five genes in high-end commercial real estate – location, size, development brief, design, and construction – are the key determinants for success. I call them “genetics” because once a project is “born” with them, rightly or wrongly they cannot be changed. Just as a short man can never play top-league basketball, a commercial complex with defective genetics cannot compete. In this business, hardware is more critical than software. When there is no competition, a development with defective genes may do fine, but once a project with the right genes appears, the inferior one will suffer, if not die.

For three reasons I deem it necessary to repeat this concept of high-end commercial real estate genetics. First, we have many new and potential shareholders who have never read what was written many years ago. Second, our experience in the past few years makes me even more convinced than ever that our approach is correct. Third, it is always safe to remind my colleagues, old and new, about this. Although not perfect, all of our Mainland projects nevertheless possess strong real estate genes. This was why our total rental income hardly suffered a down year in local currency terms during the bear market of 2012–2017, and when good days return, like now, we can outperform. Our prospects in the coming few years are quite encouraging.

Once I took a potential American investor to visit Plaza 66 in Shanghai. At that time the property was almost 15 years old, yet he thought that we had just opened it two or three years ago. Now that the complex has been in business for close to 20 years, we have spent over HK$700 million for its upgrade. Anyone visiting it today may well think that it is brand new. This is possible because we designed the mall and office towers correctly in the 1990’s, and constructed them well. It remains the city’s most prestigious address.

Consider Center 66 in Wuxi, which opened in 2013. Recognizing in late 2011 that the bear market was approaching, we did our best to woo as many luxury brands as we could. We succeeded, but before some of them moved in, everyone realized how serious the downturn was. A few of the top brands who had committed to us later withdrew unilaterally. The mall became half-baked as the bear market lingered for four more years. When sentiments reversed in 2018, all those who had turned their backs on us have returned. Of course, we welcomed them with open arms.

The question is: why did they come back? Because no other mall in the city has the proper hardware, i.e., good genetics. We knew it all along and so did the brands. Today, there is no doubt in anyone’s mind that Center 66 is the only five-star mall in Wuxi.

The same will be true for Parc 66 in Jinan and Olympia 66 in Dalian. Both properties were “born” in difficult times – 2011 and 2015, respectively – especially the latter. Consequently, the top brands already in other malls would not move over to us, for their headquarters froze all store movements. Now that the market has turned, it is just a matter of time for these two facilities to become their respective city’s prominent luxury retail hub. We are convinced about this, because our properties were designed and built correctly. They have the right genes, while no one else in those cities has.

Compared to the last three malls mentioned above, Spring City 66 in Kunming is much more fortunate – it is being completed amid a strong recovering market. It will open its doors to shoppers next month, and the official inauguration will take place in mid-2020 when all the luxury brands have moved in. So far there is little competition in that city and so, like Plaza 66 in Shanghai, it will be born a “Home to Luxury”.

Unlike tier-one metropolises, which can each support multiple stores for a fashion name, most tier-two cities at present can only support one. Our real estate genetics ensure that we are the home to that one store. If a brand is already present elsewhere in the city, as long as our competitor lacks at least two of the five real estate genes, we have a good chance of luring the brand to our place.

What if there is a competitor that also has good genes? Then we had better be the first in the market. The experience of Forum 66 in Shenyang is a good reminder of what to avoid. Playing second fiddle to another strong player is not pleasant. We do not want to be in that position; that is where we want our competitors to be.

Good genetics have other benefits. For the first 15 some years, Grand Gateway 66 in Shanghai was a four-star mall. But because it was well-located, and was designed and built right, i.e., we had the correct hardware, eventually the top brands began to move in. Once the mall fully reopens later this year after undergoing its Asset Enhancement Initiative (AEI), it will be transformed into a five-star facility commanding commensurately higher rents. If faulty genetics were hardwired in the mall back in the 1990's when we first built it, such an upgrade could not have been successful.

So far, Riverside 66 in Tianjin and Palace 66 in Shenyang are solid sub-luxury shopping centers. However, both were designed and built to a specification that will allow them to migrate upward. For the time being, we are pleased with having four-star content (i.e., the tenants and products sold) in a five-star building. This may change one day.

In the case of Tianjin, the great majority of luxury brands were already in a huge facility that predated us. It is a mall with a department store attached. Our performance has been lackluster since inauguration, mainly due to the city's weak economic performance in recent years. The other place fared worse: the department store has long since closed down and, together with the mall, was sold recently. Given the differential in genetics, can we one day lure top names to Riverside 66? I think so, although it will take some time.

As for Palace 66, the district in which it is situated has been a two- to three-star location. With our arrival and that of three or four other sizable facilities, now the area is more like three- to four-star standard. It may take a decade or two to move up, if it moves up at all. This is fine since we already have a luxury mall – Forum 66 – in the same city. When we bought the land for Palace 66, we targeted the sub-luxury market, or four-star, if you will. We have achieved that, and the retail sales figures as well as rental revenue have increased strongly of late. In the past six months, they grew 29% and 23%, respectively, compared to the same period a year ago. The mall is doing what it was designed to do.

Another conviction we had in the mid-2000's has also worked out nicely in recent years. We believed then that, although the Grade A office market in tier-two cities will never be as vibrant or as profitable as that in Shanghai or Beijing, nevertheless some demand will exist. Before we built ours, there were no such quality skyscrapers in those metropolises. Once we are there, we can easily become the market leader. Top Mainland banks, insurance companies, and professional firms, as well as many foreign enterprises, will always choose to rent from us. This was a reasonable prospect then, and it is today a reality for us.

Investments in such office towers should yield a reasonable return, although they can never match that of luxury retail space. For us, the former is always part of a bigger complex that centers around the mall below. The two product types complement each other. White collar footfall will fuel retail sales, and the convenience of shopping will help attract better office tenants. The ecosystem thus created should make us competitive overall. This is not to mention that offices are a lot easier to manage, and their rent much steadier.

Our experiences at Forum 66 in Shenyang and Center 66 in Wuxi have proven that our idea of almost 15 years ago was sound. Seven of our 11 locations on the Mainland have this product type, and we are happy to do more.

Beyond retail and office space, five of the 11 complexes also have a residential element. Besides Grand Gateway 66 in Shanghai which was long completed, two are under development (Heartland 66 in Wuhan and Center 66 in Wuxi), and plans are being drawn up for a further two (Forum 66 in Shenyang and Spring City 66 in Kunming). We should begin to pre-sell those in Heartland 66 in 2021. It is likely that for a few years thereafter, we will have something to sell each year. How much profit therefrom is hard to predict at this point, but I do expect at least some from each of the projects. An added benefit for this product class is that cash inflow is much faster than that from investment properties. We welcome that.

As we open Conrad Shenyang at Forum 66 late next month, it is likely that at least three other complexes – Center 66 in Wuxi, Spring City 66 in Kunming, and Westlake 66 in Hangzhou – will also have a hotel element. They are not expected to be big money makers, but will mainly support the offices and the shopping centers.

All in all, we are pleased that the strategy we put in place in 2003–2004 is finally bearing tangible fruits. Believing that it will remain relevant in the coming decades, we will keep refining it as well as expanding it. Our properties outside Shanghai will increasingly contribute a higher percentage of total profit. I am convinced that what we have seen is merely the first fruit; the full harvest has yet to come, and when it does, it will continue for some time. Both rent and profit therefrom will grow.

Moreover, our Mainland strategy is quite resilient. During the very tough years of 2012–2017, our top and bottom lines from retail space, both inside and outside Shanghai, hardly had a down year. What brought about this resilience and what gives us the confidence now for a bright future, as long as the Chinese society remains calm? Why are we relatively sanguine in the face of a trade war between China and the U.S.? In the past, I presented on and off the many positive features of our strategy in a somewhat unique industry. Here I would like to present them in a more systematic fashion. It is not easy to find another business like investing in high-end commercial real estate for the long term.

This should not surprise long-term readers of this letter, but let me once again state in one sentence what our strategy is: TO DEVELOP IN ECONOMICALLY VIBRANT CHINESE CITIES, AND TO OWN AND MANAGE FOR LONG-TERM RENTAL WORLD-CLASS COMMERCIAL COMPLEXES, ANCHORED AROUND A LUXURY OR SUB-LUXURY MALL THAT IS THE NUMBER ONE IN ITS MARKET SEGMENT. The phrase “world-class” implies possessing all five real estate genes mentioned above. Namely, the location must be among the best in the city, the complex must be sizable, the development brief for the piece must be acceptable, and the design and construction are both good and reasonable.

With this in mind, we can consider the strategy that we have adopted from two perspectives: the external markets that we have chosen, and the business model that we have devised. I will move from the macro to the micro, that is, from the market to the company. They are first presented in an outline form, and then I will comment on each point. This is critical to the understanding of our Company.

A. Market Factors

1. The Chinese retail market is huge, and its future is relatively certain

2. The overall Chinese consumer spending is advancing much faster than her GDP

3. Our chosen market segment is rising particularly fast

4. Competition is light

5. Growth in our market niche should last for at least another 30 to 40 years

B. Business Model Factors

1. Our business model is unlikely replaceable by technology or other business models

2. We have long-dated hard assets with little obsolescence and flexible usage

3. We are only capital intensive, not labor, technology or regulation intensive, nor single commodity dependent

4. We enjoy quality recurrent income which is dependable and growing steadily

5. Our profitability is quite predictable

6. We can have relatively high investment returns

7. Considerable capital appreciation is possible but usually goes unnoticed

8. Our market position is defendable

9. Management is not dependent on any individual, but on a team within an ecosystem buttressed by corporate culture

10. Our business model is conceptually simple but extremely difficult to execute

Each of these 15 points needs some explanation. In the past, I have expounded on many, some at considerable length, but not on all of them. I refer readers to my previous Letters to Shareholders of this Company and those of our majority shareholder Hang Lung Group Limited. They can be found on our websites. As such, I will be somewhat succinct here.

It is superfluous to repeat how big the consumer market in China is. With a middle-class population estimated to be about 300 million and growing fast, it is, or soon will be, the world's single largest group of shoppers. Even in absolute dollar terms, the amount available for spending is among the highest on earth.

Today it seems that nothing is certain in the world anymore, and this includes the economy. Hardly any business anywhere can be spared from uncertainty. If anything is relatively sure, it is the continuous rise in China's consumer spending. Even the present trade war between the U.S. and China cannot stop it. In fact, it will help. As the country's exports slow down, Beijing must put in more effort to stimulate its domestic market. This is exactly what we have witnessed since Donald Trump moved into the White House.

This is why I have said in the past that our Company can be considered a retail-related company as much as a real estate concern. Providing physical space for retail transactions to take place is a critical step in the entire merchandising chain.

Since we are in the most hard assets intensive part of that chain, the number of malls we can own is of necessity limited. This is why we can hardly afford to have a failed mall, or even a weak one. We also must stay at the higher value-added end of the market spectrum. To put it in colloquial terms, we want our malls to be selling expensive goods with rich profit margins, so that our retailers are able to pay us higher rents. We certainly do not like to be at the other end: building big boxes that house the likes of hypermarkets where the profit margins are extremely thin. They can hardly pay a reasonable rent, let alone a high one.

Moreover, there are many people who know how to construct such unimaginative matchboxes. Their game is basically a financial one. But to build sophisticated malls that sell luxury products to discerning shoppers is another story. It is a complicated endeavor which requires a tremendous amount of knowledge and experience.

For the past 20 some years, several Mainland companies have tried but very few succeeded. The reasons are simple: they are unaware of the real estate genetics needed for such properties, not recognizing their significance, or incapable of abiding by them. Anyone who respects and adheres to the five genes in real estate genetics cannot help but win, as long as he or she is the first in the market. Frankly, most cities are eagerly waiting for the arrival of such quality malls.

The luxury and sub-luxury segments in the mall business in which we play are not a particularly big part in the overall Chinese consumer real estate market, but are particularly fast-growing. If the past 30 years saw a tremendous increase in the sheer quantity of goods consumed, the next 30 will see the improvement in the quality of products. The question today for most Chinese city dwellers is no longer whether or not you own, but what you own. Many will migrate from how much you own to how superior the things you own. The latter is related to our business.

Now we come to a point that is surprising to many: Competition is light (A4 in the Outline above). Careless analysts complain that China is overbuilt with shopping centers. Not exactly. Admittedly there is a glut of low-end or nondescript malls in many cities, but that is not what we build. As Mr. Deng Xiaoping, the architect of China's economic reform, once said: it is glorious for some to become wealthy first. We tailor our malls only to those who become wealthy first; we specialize in four- or five-star retail centers. How many cities in all of China have at least one luxury mall that is akin to those that we develop? I doubt if the number is larger than 20, and we are in nine of them.

Yet, there are 121 metropolises in China that have a population of over a million (the equivalent number in the U.S. is nine), 92 with over 3 million, 78 with over 5 million, and 13 with more than 10 million. The purchasing power in tier-one cities – Beijing, Shanghai, Guangzhou, and Shenzhen – is very strong indeed, and the best tier-two cities, like Hangzhou and Wuhan, are growing fast. We have been doing business in the Mainland for 28 years and are only in nine today. I estimate that given our present strategy, there are at least 20 more metropolises where we will consider developing.

On the supply side, from what I can tell, so far only a few companies have a track record of being capable of developing luxury malls like ours. Most of them, including ourselves, are from Hong Kong. Many of the other firms who build cheaper products are not a direct concern to us, for we play in different market segments.

The reality in the marketplace is, whereas there is an overbuilding of two- or three-star malls in certain tier-two cities, there is a dearth of high-end ones in most of them. This is not unlike the difference between a 50-square-meter apartment (which is larger than the median size dwelling in Hong Kong) and a 500-square-meter house. Both are residential, but the oversupply in one category can never meet or replace the demand for the other. The rationale is simple and obvious, yet one may be surprised by how many analysts have told me that they worry about the abundance of retail space in China somehow affecting our business. This is simply foolishness.

One final point on market factors: some researchers believe that, due to China's extraordinary population size and her relationship, geographic or otherwise, between various regions therein, the country's continuous growth and development should last three times that of smaller economies. But for the sake of conservatism, let us just treat China like everyone else.

In almost all Asian countries, after achieving certain wealth, their citizens begin to seek luxury fashion items like those sold in our malls. Japan was the first, and the Tokyo Olympic Games in 1964 was usually taken as a symbol of the country joining the ranks of developed nations. From around that time, the Japanese began to consume high-end goods. The market has remained strong for over 50 years, and so far there are no signs of waning. Many top brands today still single out Japan as a separate region, while the rest of Asia is combined as the other Asian region.

Hong Kong became affluent in the mid-1970's, so its luxury goods market has been growing for 40 some years. Similarly, such products have been selling well in Singapore, South Korea, and Thailand for over 30 years. The markets in all these places are still growing strongly.

The question at hand is: what about mainland China? Plaza 66 in Shanghai was one of the earliest luxury malls that sell expensive items in the entire country. It has been in business just shy of 20 years. It is thus reasonable to expect that under normal circumstances, the market still has at least 30 to 40 years to go, if not much longer. This should mean that our malls will be kept busy for many decades to come.

Now let me turn from market factors to those relating to our chosen business model, i.e., the 10 points under B in the Outline. First, good physical retail space will not be replaced by technology such as e-commerce. In previous years, I wrote at length about this so will only summarize here.

Everyone knows what a souk is – it is a marketplace common in the Middle East and North Africa. Some of them have existed for over a millennium, and are still with us today. They may have been modernized somewhat, but the concept is exactly the same today as they once were. Recently I revisited one in Istanbul which has been there for hundreds of years. Generations of new technology and related business models have not displaced the souks – mail order, catalog sales, telephone ordering, and now, the Internet. Instead, most of those once new sales channels have all but disappeared, but the souks are still with us. After all, human beings are social animals who need to and want to physically interact with each other. The souk of the old days was not just a place to buy and sell but also a place for social interactions. Today, the modern souk is called a mall.

In the past few years, the market has discovered that e-commerce and physical stores actually complement each other. For each product class in a particular market, sooner or later a dynamic equilibrium will be reached between the two channels of sales. Although e-commerce started in the West, it has grown a lot faster in China. The annual sales volume of Alibaba or even JD.com far exceeds that of their Western counterparts. The phenomenon is particularly acute in tier-three and tier-four Chinese cities where traditional distribution and sales channels are not as well-developed.

On the other hand, there has been an overbuilding of retail space in the U.S. with a per capita square meter of over 2.2, whereas in Asia, the number is around 1.0, and in Europe, between 0.2 and 0.5. So in the past few years when e-commerce finally hit the American market big time, many shopping centers had to close down. Some analysts still believe that everything in the West is more advanced, and therefore think that this is the end of physical stores everywhere in the world. One even suggested that one should sell all the stocks of companies that own physical retail assets anywhere. What hubris and what ignorance!

The reality is that Chinese mall operators like us have had to live in the past two decades with powerful e-commerce companies like Alibaba and JD.com. In most product categories, an equilibrium has been reached for some years. In fact, many retailers who started their businesses selling on the Internet learned that they need to have a physical presence. Because of the lingering mistrust by the general public on many products sold electronically, having a physical store can help boost the brand's credibility. The result is that the unit price of its goods can be as much as 20% higher if it has prominent shops in well-located and widely respected malls.

Needless to say, such brands will not open too many physical stores. They only want to be where their brand value can be enhanced by the prestige of the address, and the association with respectable neighboring retailers within a mall. More often than not, Hang Lung's properties become their first choice. This is another reason, albeit a minor one, to always position our facilities as the number one in a particular market.

That said, obviously we are very respectful of e-commerce. It is a serious phenomenon that will change the way we live, if not just the way we shop. Some products are more vulnerable than others to the threats from this new sales channel. Fortunately, another decision we made as early as the 1990's has protected us well even in this regard. We decided long ago that we do not want to be in the low-end of the retail business. Luxury retail properties are far less affected by e-commerce.

To be fair, there was no e-commerce in the 1990's, so we could not have known about this added benefit. All we knew then was that the sellers of goods that command richer profit margins have a better ability to pay higher rent. Now everyone understands that in general, the higher the price point of an item, the less likely it is for people to buy it through the Internet. High-end fashion, exquisite jewelry, and expensive watches, for example, would hardly be sold on the Internet. Potential buyers may first study them electronically, but transactions are physically carried out after careful product inspection in tastefully crafted stores in luxury malls like ours.

Having established that our business model can hardly be upended by technological advances, a corollary is that there is little obsolescence in our malls as long as they are designed wisely and built adequately. They are also long-dated assets: once constructed, they will continue to produce income for decades to come (Point B2 on the Outline). Only regular maintenance and periodic freshen up are required.

The latter was exactly what we have done with our two Shanghai complexes. Approximately 17 to 18 years after inauguration, we spent a total of over HK$1.5 billion to upgrade them. This included the employment of the latest technologies to both enhance revenue and reduce operating cost. In the case of the mall at Plaza 66, we saw two successful years of double-digit growth in rental revenue after its AEI. The "new" property should go on strongly for another two decades before it needs another new lease on life. The cost of such an AEI is minor compared to the building's original cost.

One characteristic of our developments that is not of immediate value, but should nevertheless be mentioned, is that they are flexible. They are invariably built to the highest standards. If for whatever reason the high-end retail market for which these developments were originally built somehow diminishes, we can always adapt them for less prestigious purposes. A five-star mall can be converted into a two- or three-star one but not vice versa. Similarly, a mall design can be easily adjusted to fit a department store, but a structure built for a department store can never be used as a mall. Many in China have tried the latter and failed. All our properties have this versatility, although I do not foresee a time when this flexibility would be called upon.

Another beauty of our business model is that it is only capital intensive, a point to which I will return (Point B3 in the Outline). Other than this, it is not labor intensive, technology intensive or regulation intensive. Moreover, it is not beholden to any single commodity whose price may fluctuate greatly, like oil or gas. In this respect, if the airline business is one of the worst in the world (which I believe it is), ours must be among the best. I always believe in parsimony – all else being equal, the simpler the better and the fewer moving parts the better. There is less chance of things going wrong. I am happy to work in a business that is intensive in only one dimension, i.e., capital. Hang Lung can handle this and has handled it well.

There are many other virtues of our business model that are, one way or another, finance-related. They affect profitability (see B4 to B7 in the Outline). Apart from the periodic sales of expensive serviced apartments in certain projects of ours, we basically rely on quality recurrent income. Since we are invariably the best or among the best commercial complexes in a city, our tenants, both for the mall and for the offices (if the project has the latter), are among the most prestigious that can be had. For example, our office tenants read like the Who's Who of Chinese and international businesses. Their ability to pay rent even in tough economic environment is far better than the less solid renters. Such companies are also less likely to disappear overnight.

Since our revenue is rather dependable once the buildings are leased up, and since expenses are not difficult to estimate, profitability becomes quite predictable. Putting aside new projects where land acquisition done in our way can be sporadic, the steady-state condition of our Company should be transparent to anyone who cares to study us. With this as a base, one can make reasonable assumptions about the addition of new developments, and the future of our Company's profitability can be approximated.

Having completed eight complexes on the Mainland, and with three more on the way, we have a pretty good idea of the life cycle of large new projects in terms of profit growth from inception to steady-state, adjusting for the stage of the economic cycle as well as the local competitive landscape. Such "predictability" cannot be said for most other industries or businesses.

To add to all these favorable elements is perhaps the ultimate attraction: our business model is capable of producing reasonably high investment returns to those who respect the five real estate genes. We accomplished this in Shanghai, and are now emulating it elsewhere.

Ten years after completing the two Shanghai projects, we have achieved a blended unleveraged gross rental return on the original cost at slightly over 30%. The number is much higher for the retail space, but that for the offices is also very rewarding. By the time we did the AEI, it has reached over 45%. The cost of the AEI has brought it down by a few points, but approximately three years after the onset of AEI, the gross return has recovered its high watermark. Its 19 years in business included the six-year severe downturn of 2012–2017. It was certainly not a straight upward line; neither can we expect it in the coming decades.

When will the rental return stop growing and what is the limit? Due to the characteristics of the market, office yield can be capped. But for the mall, one can say the sky is the limit. Since our rental margin is at or close to 90%, net return is also very high. Moreover, this does not take into consideration the tremendous capital appreciation we already enjoy and will enjoy.

Obviously the same cannot be expected elsewhere. In Shanghai, we caught the opening of the entire country to quality goods in the early 2000's; outside Shanghai, we are only benefitting from the economic rise of the metropolitan area plus the surrounding region, which can include the entire province. In other words, the catchment area of Shanghai in the past was much bigger than that enjoyed by tier-two cities today.

There is another reason why our properties outside Shanghai will grow more slowly. Our six existing facilities all opened immediately before or during the six-year bear market of 2012–2017, where negative growth was the industry norm. For practical purposes, we might as well reset the clock to begin in 2018. Our next two complexes – Spring City 66 in Kunming and Heartland 66 in Wuhan – do not have this problem. They will open in the next 12 months in a bull market.

Here, several related points are worth mentioning. They all affect the return calculations.

First, the rental margin of Plaza 66 in Shanghai today stands at 90%. This figure converts the gross rental return to a net rental yield, which is still amazingly high. Although we probably can further improve the margin somewhat, it may not be wise to do so. Maintaining the facility in tip-top condition for our tenants and shoppers is much more important than shaving a point or two in rental margin. Grand Gateway 66 can achieve a similar figure, but is for now in a temporarily lull due to its AEI.

Outside Shanghai, various market and regulatory dynamics will render it unlikely for us to achieve such high margins. But can we reach 70%-75%? I think so. Compared to most other businesses, this number is already very attractive. Needless to say, the earlier we get there, the more profitable a project will be.

A second point is that the rental return figures above are on an unleveraged basis. I can hardly believe that any commercial real estate concern, no matter how small, would use no debt, let alone one of our size. Indeed, for over a decade beginning in the mid-2000's, Hang Lung was basically debt-free. It was a unique situation which is not easily replicable. Before the Asian Financial Crisis of 1997–2002, we prepared ourselves well for it, and afterwards wisely bought land in Hong Kong in the absence of competition. We also timed our sales well to maximize profit. Consequently, we were cash-rich. We began to buy land outside Shanghai in 2005, which coincided with the beginning of a period of zero debt for more than a decade. About three years ago we started to have some debt, although our gearing today is still rather low by the industry standard. Even with moderate leverage, our investment return can rise further.

A third point is that the rental return figures are calculated based on the original cost. The land price however is not all paid on day one, and the total cost including construction is usually expended over six to seven years, starting with the first land payment until soon after the opening of the building.

By now, my readers may agree with me that our business can generate attractive returns. At steady-state, each development is like an annuity where income usually grows over time. The rate of increase should more or less reflect the rise of consumer spending in the country. After two to three decades of double-digit growth, today the Chinese still spend 8%-9% more each year. Unlike in developed economies where private consumption accounts for over 60% of GDP, this number in China is only in the low to mid-40's. There is much room to grow, and so our "annuity" will become even more valuable over time.

Finally, there are two financial gains that are not captured by the rental return numbers. First, although not the mainstay of our strategy, for those developments that have serviced apartments, the sales of these units will bring extra profit and faster cash flow. In the order of their time to market, the four complexes in this category are Heartland 66 in Wuhan, Center 66 in Wuxi, Forum 66 in Shenyang, and Spring City 66 in Kunming. All these units are for sale and are projected to be profitable. The only exception is Grand Gateway 66 in Shanghai with two residential towers and one block of serviced apartments. There is no present plan to sell them.

Another somewhat hidden financial gain is capital appreciation, which is also my next point in the Outline (B7). Seldom has any analyst focused on this. The fact is that, compared to our competitors, our land cost is cheap and our developments command the highest unit rent in their respective markets. Our properties are considered the most prestigious in their respective city with a bright future. Yet the cap rates used to revaluate our assets semi-annually are among the highest in the industry. The fact of the matter is: give me a 2% cap rate and I will not sell our commercial properties, yet some inferior buildings in our neighborhood are transacting at not much more than that level.

Many investors probably do not pay much attention to revaluation gain, or deem it unimportant. What should be pointed out is that such asset appreciation is as much the fruits of our labor as it is windfalls from a rising market. When evaluating the worth of this Company, such factors should be taken into consideration.

Point B8 says that once a luxury mall achieves market leadership, that position is quite defendable. There are at least two reasons why a high-end retail facility must be the number one in its market. First, as I have written in years past, the investment return for the market leader usually far exceeds that of the runner-up. Tier-one metropolises can afford multiple stores, as can some tier-two ones such as Wuhan, Hangzhou, and possibly Shenyang. In other places, prestigious brands will congregate in one best mall. They do not want to be the odd one out – stuck somewhere alone in an inferior property.

There is, however, another reason to be number one. Once a top luxury mall has achieved the top spot in the market, it is very difficult for others to dislodge it. In other words, its preeminence is relatively easy to defend. Of course, this assumes that such a facility has good genes. If it does not but has gained market prominence merely because it was the first in the market, or because all competitors are also weak genetically, then its position is still vulnerable. When someone like us with strong genes comes along, the former leader can be displaced. We have seen this in Palace 66 in Shenyang, Center 66 in Wuxi, and Spring City 66 in Kunming. We are also beginning to witness it in several of our other developments.

The penultimate point (B9 in the Outline) relates to management. What makes our business model work is not because of any single leader, nor is it dependent on any individual. It is teamwork within a particular ecosystem that entails a certain corporate culture. Before the mid-2010's, our Chief Executive Officer was Mr. Nelson Yuen, now an Independent Non-Executive Director of the Company. He and I together conceived this model in the 2000's and gradually developed it. His successor Mr. Philip Chen, now a Non-Executive Director, quickly recognized its virtues and fully embraced it. We refined the model and built the organizational infrastructure that brought us to where we are today. A year ago, Mr. Weber Lo, our present Chief Executive Officer, took over. Just like Philip before him, he understood the model's value and is now executing it. Like Nelson, Philip or Weber, any intelligent person with good general management experience and a controlled ego can do the job. Before joining Hang Lung, Nelson was an accountant, Philip was the head of two airlines, and Weber came from a consumer products background followed by banking. All of them are good leaders of this Company, past or present.

The second half of the 2000's and the first few years of the 2010's was the time when this business model began to take shape. A number of our then senior colleagues could not adapt to the new organizational changes. For example, some could not get used to the teamwork that was required of them and left. Because our Company was then a darling among local real estate counters on the stock exchange – we outperformed almost everyone between 2002 and 2012 – our former senior staff became desirable commodities in the job market. Companies in Hong Kong and the Mainland quickly snapped them up. They thought that our former colleagues could replicate for them our business model. On the one hand, we were gratified that they were apparently being held in high regard by our competitors. On the other hand, we gradually observed that none of them was able to replicate our success.

This brings me to the last point in the Outline (B10) – conceptually, this business model is very simple, but in practice, it is extraordinarily difficult to execute. I like its simplicity – what is so challenging to develop, own, and manage large and high-end commercial complexes? It seems a lot easier than many manufacturing operations. If so, simple economic principles would dictate that there must be many competitors, especially in light of the relatively high investment returns and other attractive characteristics. Why then are there only so very few that are successful in this fast-growing niche market?

As mentioned above, this model works only under a particular mindset or mental ecosystem that is supported by a certain culture. One must be able to consistently focus on the long term. While recognizing the need to report semi-annual profits as a public company and pay dividends, management must avoid making critical decisions that may produce immediate results at the expense of our long-term prospects. We respect every shareholder, but we are not here to please every one of them. We particularly like those who share our long-term horizon in doing business.

The more senior a person becomes in this Company, the more patience is required of him or her. At the operational level, of course our staff must meet short-term deadlines. For example, we cannot let construction drag on for it costs money – higher interest payments and delayed rental inflow. A project staff of managerial grade must also be able to deliver timely results. But this is different at the senior level. For example, a senior person must not make design decisions that will quickly render our buildings obsolete, or choose construction materials that are not durable or not easily maintained in the long run.

Then at the top level, our executives must be prepared to wait, not just for months, but at times for years. For example, I first visited Hangzhou for business in the early 1990's. After choosing Shanghai instead, we stopped looking at Hangzhou until 2004. For the ensuing 14 years, we studied most of the better land pieces and rejected all until last year. We finally found a plot that possesses the five real estate genes. During almost the entire 14-year wait, we were cash-rich. With money on hand, it became even more difficult not to buy, but we resisted the temptation.

What if our waiting was in vain, namely no suitable land surfaces? My answer is: at least we would not be stuck with substandard land. China is big and there will always be opportunities, if not in one city, then in another.

Having a long-term outlook also implies the necessity of persistence. For example, it does take us longer to finalize a design scheme. No one is smart enough to quickly come up with an optimal solution that takes nearly all things, including those that may happen many years down the road, into account. It is an iterative process where each edition improves upon the last one. There are always issues that have not been considered before, so persistence is required to find them and keep improving on them. When to stop? When the marginal utility becomes smaller than the marginal input.

We do not build to sell, for once sold, the building with all its present and future defects will be someone else's worry. We build to hold for the long term. This means we have to live with the problems we have created for ourselves for not being careful and thorough in the design phase. For our strategy to work well, everyone on the team must be long-term minded and quality conscious.

Teamwork, as mentioned earlier, is also required. When architects and engineers design something, the user must also be brought in from the beginning. The leasing team, who will have to live with the building for decades to come, must have valuable input. The perspectives of the user can often be diametrically opposite to those of the planner.

Because of the long cycle in real estate which usually lasts six to eight years, waiting becomes inevitable. Only then can one always do the right thing at the right point in the cycle. The history of our industry, in both the East and the West, teaches us the same thing: investors must learn to wait to be successful. Those who do not will sooner or later get caught by the bear market. Cash flow problems will follow and bankruptcy is highly probable.

In order to wait, discipline is also required. These two are severe tests for a developer (or investor). Without them, one can never adhere to the five real estate genes. Waiting can be frustrating, but one must learn to sit on his or her itchy hands. It is easy to pay lip service to these cardinal principles of the industry but lip service means little. A friendly competitor once announced publicly that he would adopt the Hang Lung model. I could have told you the outcome that day.

Obviously we do not have the only winning model. We have one – and a very good one at that – which no one has been able to replicate successfully, and we know why. The past 27 years (counting from the time we bought land in Shanghai for Grand Gateway 66 in December 1992) have shown us that this model works and should continue to do so. We are far from perfect; we are still learning every day.

That said, no business model is free of problems. Neither is ours. It has a serious flaw which also serves as a huge barrier to entry. It requires a massive amount of capital, most of which upfront. Anyone who does not already possess a solid financial base should not even begin. And of those with a strategy similar to ours – building large commercial complexes for long-term hold – and which have been successful, all have strong financial wherewithal before venturing into this business.

In our case, our Hong Kong development projects brought in a lot of cash in the 2000's, which launched us onto this path. Our initial rental success in Shanghai in the early part of that decade provided confidence as well as cash flow for dividend payments. This enabled us to use the Hong Kong development profit to venture outside Shanghai. The rest is history.

An interesting and meaningful point here is that such a strategy is particularly suited to business groups controlled by a family, even when the company is publicly traded on a stock exchange. This is indeed the case with all our successful competitors. In each case, the company is in the hands of a family, and the Mainland entity is an SOE (State-Owned Enterprise) where the government plays that role. Although all of us are publicly listed, the security of having a controlling shareholder enables management to look at the long term.

Not only is this business heavy upfront in capital deployment, payback also comes slowly. Each development usually takes slightly over a decade from land acquisition to maturity. Adding new projects will continue to consume capital and push back the date of achieving full harvest. It takes time for an income stream to build up, but once steady-state is achieved (assuming that there are no more new projects, which is unrealistic in China), it is very consistent.

After having observed the Asian stock markets for decades, and having been a participant therein, I think I know the pitfalls of family-controlled entities. The Hong Kong Stock Exchange has many such companies. In spite of the rather stringent regulations, including stock exchange rules, a few of them may have mistreated minority shareholders. These activities should be minimized. However, let us not throw out the baby with the bath water. This genre of publicly listed entities has definite advantages and unique strengths. Whether run by family members directly, or by professional managers with the oversight of the controlling shareholder, management is basically free from the possibility of being replaced. This enables the top executives to take a real long-term view and create something meaningful for society. Hang Lung is one in this category.

What if Hang Lung were not controlled by a family, and what if I were just a hired gun? I took over the chairmanship in 1991 after the Company had underperformed for two decades. It was not until 2001 or 2002 that we began to outperform, and the winning streak ended in 2012. Would the investment public have given me 10 years to turn the Company around if I did not represent the controlling shareholder? I doubt it.

Of the major local real estate firms, we were among the earlier ones to invest in the Mainland beginning in 1992. Our strategy was unique then: we acquired land much larger than that of our fellow Hong Kong developers at that point. It was a big bet, and we bought two huge pieces in the same city, Shanghai. Signs of success did not begin to surface until approximately 2001 or 2002, a full decade since we began. Would shareholders have waited that long, or would they have kicked me out? Perhaps the latter, but I will never know.

Then, before the Asian Financial Crisis which began in 1997, Hang Lung did in Hong Kong the exact opposite of the prevailing beliefs of that time. Everyone was rushing to expand their land banks. Instead, we sold investment properties and hoarded cash. We raised it in every way we knew how. That took place before our Shanghai venture had any signs of success. Again, what did the investors think?

As noted earlier, our shares performed superbly between 2002 and 2012 relative to our competitors. But when Beijing's anti-corruption campaign began, the market turned south and so did our stocks. We had a cold winter for six years. Our scrip only recovered when 2019 approached. During those few years, we had to fix many internal issues caused mainly by rapid expansion. Without a controlling family, shareholders might have pushed management to take short-term measures purely for the sake of the share price, but would have diminished the long-term prospects of the Company. We might not have the opportunity to reap the benefits as we are now beginning to do. I might even have been fired!

Now let me turn to the performance of the immediate past. We turned in a set of satisfactory results for the first six months of this year. The most encouraging aspect is that the prospects of the Company are rather favorable. Signs that are pointing in that direction are now clearly seen.

Plaza 66 in Shanghai continued to trade well after its AEI. In RMB terms, retail sales increased 15%, and mall rental income 11%. These were accomplished following two years of strong growth, which established a high base. Since Grand Gateway 66 is undergoing an extensive upgrade, I will exclude it from the following discussion. Suffice it to say here that once its AEI is completed, I expect the same pleasing results as that experienced in Plaza 66.

Compared to the same period a year ago, all Mainland retail properties outside Shanghai advanced in retail sales and rental revenue. For tenant sales, the following malls saw their numbers jumped: Palace 66 in Shenyang, Olympia 66 in Dalian, and Center 66 in Wuxi rose 29%, 27%, and 25%, respectively. Rental increases for the three properties were 23%, 30%, and 26%, respectively. Parc 66 in Jinan, which has always performed steadily, advanced 11% and 12% on these two measures. Even the two weaker complexes, Forum 66 in Shenyang and Riverside 66 in Tianjin, recorded positive growth of 2%-3% each. Rental margin and occupancy everywhere improved, except at Riverside 66 which is undergoing a major tenant remixing.

All our offices on the Mainland performed satisfactorily. The two latest towers, one each at Forum 66 in Shenyang and Center 66 in Wuxi, achieved about 90% occupancy. Unit rents remain steady.

All the numbers above are in local RMB terms. Its value however fell 6% against our reporting currency, the Hong Kong Dollar, in the six-month period under review. So whereas our Mainland total rental rose 7% – 4% in Shanghai and 14% outside – in Hong Kong Dollar terms, it only advanced by 1%.

It is worthy to note the fact that rental growth outside Shanghai is now faster than that in Shanghai. When Grand Gateway 66 reopens fully next year, the situation may change. If Plaza 66 after its AEI is any indication, then a double-digit growth may last for at least two to three years. Whatever the case, I will not be surprised if in the next, say, five years, organic percentage growth outside Shanghai will be stronger than that in Shanghai. Coupled with new space opening – the second office tower of Center 66 in Wuxi next month, the mall and office of Spring City 66 in Kunming in the next month or two, and of Heartland 66 in Wuhan early next year – the rents arising from outside Shanghai will become more significant.

There were no surprises in Hong Kong: rents increased 3%. Together with the rise in Mainland leasing revenue (which was greatly affected by the devaluation of the RMB), overall rental growth was 2%.

We only sold one house at Blue Pool Road, but completion will not occur until the second half of the year. We also parted with 100 car parking spaces in Hong Kong. The transaction will not close until later, so no profit is recognized in this reporting period. The sale is in line with our policy to recycle our assets – selling older mature properties and deploying the cash in higher potential ones, be they in Hong Kong or on the Mainland.

Interest expenses would have been not much less than the year before. However, due to a change in accounting rules, it has all but disappeared. Gross revaluation gain was about a billion dollars less than the prior year.

The combined effect of the above is that net profit attributable to shareholders was 25% lower than last year at HK$3,516 million. The lack of development profit and the modest revaluation gain were the primary reasons. When the latter is taken out, the underlying number is down 4% to HK$2,229 million. The underlying net profit attributable to shareholders from property leasing alone was up 25%.

PROSPECTS

The China-U.S. trade dispute continues with no end in sight. As I have said from the beginning, the day there will be a deal is the day when U.S. President Trump needs one. Apparently he has not gotten to that point.

To a careful observer of the process, one cannot help but come to the conclusion that it is somewhat of a farce. With the press hanging on to every tweet of President Trump, he is pulling strings at whim, while blaming the Chinese every step of the way. One day he would announce that the two sides are close to a deal, only to say a few days later that the Chinese have pulled away. A month or two later, he would repeat the game while dragging the global stock markets with his antics. Frankly, he is fooling everyone – the Chinese, the U.S. public, the world, the media, and the stock market.

On May 8, the famed columnist Martin Wolf wrote in the Financial Times that the American offer on the table then was nothing less than an unequal treaty à la those of the 19th century imposed on China by the Western powers. There was no way that Beijing could have accepted it, and Washington, D.C. knew it. Another renowned European journalist friend told me recently that Steve Bannon, although out of office, admitted that fact to him. This meant Washington, D.C. had no intention at this stage to conclude a deal. Trump was merely using the process to gain political points at home for his upcoming re-election, while his cronies like Bannon got what they wanted – to give Beijing hell in order to contain China.

Is China that desperate for a deal, such that she does not mind being played in the international arena? Will history not show this to be a kind of humiliation, not unlike the unequal treaties of years past? Given that, it is possible that Beijing will wake up one day and harden her position. If the U.S. continues to overplay her hand, China may even walk away. Trump, I assume, understands that. Since he too sooner or later needs a deal for his re-election, the earlier Beijing is willing to walk away, the sooner we may see a deal.

Will the ultimate treaty be substantially better than what the U.S. is getting before? I have my doubts. Perhaps marginally better, just like the fact that the latest trade agreements with Canada and Mexico were not much better for the U.S. than the original NAFTA. Trump gained political kudos, and a few other trading partners elsewhere in the world lost some, while the three parties involved (the U.S., Canada, and Mexico) reshuffled slightly their relative positions to each other. What the U.S. really gained was a strengthened image as a bully; what she lost was the reputation as a credible partner.

For China, I have long stated that Beijing is quite willing to trade something away. This way Trump can claim victory in front of the media. Will China be able to withstand the pain? No problem, but let us not forget that there are real costs to the Americans as well. Their consumers may be the first to be hit, but the pain will not stop there. U.S. companies, and therefore the economy, will also suffer. There are usually no winners in trade wars, but there may be one this time – Trump, apparently.

I wrote six months ago that the Chinese are much more prepared for the worst. The U.S. was not so at that time, and neither is she today. The huge increase in subsidies to American farmers is just the beginning. Other short-term measures to ease the pain may well create much more serious long-term problems.

The bottom line is that China will speed up the diversification of her markets as well as her technology sources away from the U.S. She will also upgrade her industries faster. These moves are actually advantageous to the country's long-term competitiveness, and exactly what America does not like to see. The U.S., on the other hand, will isolate herself more from the global market. Her credibility and moral leadership in the world will be greatly eroded further. This is the price of Trump's personal victory. To me, this is sad!

How will this affect our business? On balance, not bad. What I wrote before will soon come to pass. Beijing has redoubled her efforts to stimulate domestic spending. In April, private consumption dipped a little, but by June, it has rebounded strongly. We will see what the coming months will hold.

But one thing is certain: luxury products are at present selling well. Our own experience is substantiated by pronouncements as well as sales figures of the world's top fashion companies. China now accounts for some 30% to 40% of their global sales. Whereas I am sure that this market, like those of most other products, is cyclical, the impetus is for now on the rise. I will not be surprised if in the next five to 10 years or longer, the overall trend continues to go up. This will be good news for us.

Here, we will all do well to remember one thing. There is a fundamental difference between a small- or medium-sized country and a very big one. Whereas smaller ones need to sell to or service others overseas in order to survive, large economies can be far more self-sufficient because of their huge domestic markets. Just like the U.S., China is one such. Internal economic dynamics can keep the country going for some time even in the absence of external involvement. The only commodity that China absolutely needs from the rest of the world is energy.

In fact, the U.S. and China are the world's only two continental economies. They are so big that they can accommodate almost all industries – upstream and downstream, heavy and light manufacturing, primary, secondary, and tertiary industries, and high-tech, mid-tech and low-tech. (Because of high salaries, low-tech manufacturing has disappeared in the U.S., but it may return one day given robotics.) This notwithstanding, I am quite sure that China will for decades become even more engaged in the global economy as a major player. My worry is that the U.S. will increasingly move in the opposite direction. More so than any other country, including China, the U.S. has the ability to isolate itself and still survive. For example, it now pumps more oil and gas everyday than Saudi Arabia! America's withdrawal cannot be good for the world – nor herself.

Now to a sad development that was not present when I last wrote to you six months ago. At that time, Hong Kong was relatively calm. In the past month and a half, the city has erupted into a tumultuous place. It was the result of unwise policies made locally and not initiated by Beijing, which has since basically kept quiet. But the trouble on the streets today are not just directed at the local government but also at the central government in Beijing.

Such social disturbances cannot but negatively affect business. Visitor arrivals will definitely slow down as we have observed during the Occupy Central movement of 2014. Retail will be hurt. If trouble persists, then confidence among the international business community will be affected. Whether or not there will be any long-term effect will depend on how the situation resolves itself. But for now, no one can predict how this will pan out.

The local residential market will no doubt slow down. We will see if prices will fall alongside with volume. More likely than not, they will. Nevertheless, as long as Hong Kong gets back on its feet after the trouble is over – and over it will be, most probably with the help of Beijing – our residential market should be fine in the long run. There is real demand locally and from the Mainland.

The present disturbances will force Beijing to change its tack regarding Hong Kong. From "no governance is good governance" of 1997 to whatever it is tomorrow, one thing is certain. Beijing has been too lax about enforcing the Basic Law in the past 22 years. If the present turmoil forces all parties to embrace the Basic Law, this may not be a bad outcome. In this eventuality, Hong Kong's residential market and indeed the entire economy may well gain a second wind.

But for now, turbulence will be with us. We are fortunate to have sold out all our development projects, except for the 11 semi-detached houses on Blue Pool Road, one duplex in The Long Beach, and some car parks. We still hold out hope to sell these luxury units at good prices, but if we have to wait a bit, it is not the end of the world. The timing is beyond us anyway.

As for our Hong Kong investment properties, we will do our best to maintain the growth rate of the past two years at about 3% per annum. If social unrest persists, it may prove to be difficult. Nevertheless, we should still be able to produce some growth in the second half of this year. After all, in the very tough years of 2013–2016 when local retail properties all over Hong Kong suffered severely, we never had a down year.

How bad can this get? During the Asian Financial Crisis of 1997–2002, we had four consecutive years of negative growth followed by two more that went sideways. Then it took another almost five years to return to the total rent levels of 1998. It was a terrible journey of 10 to 11 lost years. The bear market was doubtless exacerbated by the dot-com bubble of 2000 and the SARS epidemic of 2003, but those effects were short-lived. For us, fortunately, our Shanghai properties began to contribute in 2000, which blunted the fall.

What will be the effects of the present trouble? I do not yet know. The nature of the problem this time is different; it is political rather than economic. My guess is that it will take more time to recover.

On the Mainland, I believe that the coming few years should be auspicious for us. In Shanghai, organic growth in Plaza 66 should continue, although a post-AEI jump in rent has already created a much higher base. To slow down a little is inevitable one day. Fortunately, Grand Gateway 66 will see its AEI completed in the coming year. The North Building reopened recently and is enjoying a double-digit growth. This may last for a while. The same should happen when the South Building, which is the main part of the mall, is ready. Tenant upgrading is impressive, which should translate to considerably higher rents. It is now a five-star mall.

Outside Shanghai, organic growth is proving exciting. Three of our six malls have seen an increase in retail sales and rental revenue of 23%-30%. I believe that there is still much more room for further advancement. Four of the six properties are at the threshold of a growth phase which should last many years. When things begin to slow, say, in the second half of the 2020's, AEI will be needed as we have done in Shanghai. The rejuvenation will hopefully launch these facilities onto a new upward trajectory, like what is happening now with our two Shanghai properties.

Impetus for growth outside Shanghai will also come from the new space that we will complete between 2019 and 2025. By way of comparison, in the seven years between 2010 and 2016, both years inclusive, we built over 1,900,000 square meters in total, or on average more than 271,000 square meters per year. (Stripping out the car park, we still completed about 1,100,000 square meters in all, or some 156,000 square meters annually.)

However, between 2019 and 2025, also a seven-year span, we expect to deliver 2,660,000 square meters in total, or almost 380,000 square meters per year. This is some 40% more than the earlier seven-year period! No wonder many investors agree with me that Hang Lung is truly a growth stock! It is doubtful if many – or any – real estate concern anywhere in the world has this magnitude of a pipeline.

Equally significant is the fact that the experience of the next seven years should be far better than the previous period. First, our management team today is much stronger than before. Back then, staffing needs was a real problem, but it is no longer the case today. Second, last time we were heading into a prolonged and severe downturn from 2012 to 2017. Today, the luxury goods market is thriving. It started last year and will hopefully continue for a few more to come.

Beyond rental income-producing properties, we also have over 400,000 square meters of high-end residential units in four of our Mainland cities. They will be ready for sale in the coming few years. How much profit can be derived therefrom cannot be determined with any certainty at present, since Chinese home prices can fluctuate greatly, depending partly on the government policies at the time. One thing however is sure: the successful sales of these serviced apartments will be beneficial to our mall business next door.

By now, I trust that my readers are as excited as I am about Hang Lung for the coming few years. Barring unseen circumstances, our future should be bright.

There is one more question that needs to be answered: will we buy more land in the next few years? Yes, we are looking, our not insubstantial land bank notwithstanding. The industry is healthy and growing, so of course we should expand. The fact of the matter is, we have never stopped searching in the past 15 years. As always, we will only act when we find something that has the five real estate genes. This cardinal principle must not be compromised.

Nevertheless, recognizing the turbulent geopolitical and geo-economic situations around us, and the impact that they may have on China, we should not overextend ourselves financially. As always, we will adhere to fiscal conservatism as stringently as we will to real estate genetics. These two are the cornerstones of our business.

With this in mind, we will nevertheless not hesitate to strike when the stars are aligned. Given how strict we are in land acquisition, we cannot afford to let too many good opportunities go to waste, for they do not come along too often. Once missed, they may likely never return, and those cities may be forever lost to us. As such, prudence is required to know when to act and when not to. Our track record of the past almost three decades on mainland China stands us in good stead for the future.

Ronnie C. Chan
Chairman
Hong Kong, July 30, 2019

Financial Highlights

In HK$ Million (unless otherwise stated)

RESULTS

	For the Six Months Ended June 30		
	2019	2018	Change
Revenue	**4,204**	5,150	–18%
Property Leasing	**4,204**	4,118	2%
Property Sales	**–**	1,032	–100%
Operating Profit	**3,217**	3,682	–13%
Property Leasing	**3,217**	3,117	3%
Property Sales	**–**	565	–100%
Net Profit Attributable to Shareholders	**3,516**	4,689	–25%
Earnings Per Share (HK$)	**$0.78**	$1.04	–25%
Interim Dividend Per Share (HK$)	**$0.17**	$0.17	–

UNDERLYING RESULTS

	For the Six Months Ended June 30		
	2019	2018	Change
Underlying Net Profit Attributable to Shareholders	**2,229**	2,319	–4%
Property Leasing	**2,229**	1,777	25%
Property Sales	**–**	542	–100%
Underlying Earnings Per Share (HK$)	**$0.50**	$0.52	–4%

FINANCIAL POSITION

	At June 30 2019	At December 31 2018	Change
Shareholders' Equity	**138,191**	137,561	–
Net Assets	**144,243**	143,594	–
Net Debt	**25,407**	14,890	71%
Financial Ratio			
Net Debt to Equity Ratio	**17.6%**	10.4%	7.2 pts
Debt to Equity Ratio	**21.9%**	19.0%	2.9 pts
Shareholders' Equity Per Share (HK$)	**$30.7**	$30.6	–
Net Assets Per Share (HK$)	**$32.1**	$31.9	1%

CONSOLIDATED RESULTS

The core property leasing business sustained its growth with a 2% period-on-period increase in leasing revenue in spite of a 6% Renminbi depreciation against the Hong Kong Dollar. As no property sales were recognized during the period, total revenue of Hang Lung Properties (the Company) and its subsidiaries (collectively known as "Hang Lung Properties") for the six months ended June 30, 2019 decreased 18% to HK$4,204 million, and operating profit fell 13% to HK$3,217 million. With a smaller valuation gain when compared with the same period last year, net profit attributable to shareholders dropped 25% to HK$3,516 million. Earnings per share decreased correspondingly to HK$0.78.

When excluding the property revaluation gain and all related effects, underlying net profit attributable to shareholders retreated by 4% to HK$2,229 million.

Revenue and Operating Profit for the Six Months Ended June 30

	Revenue			Operating Profit		
	2019 HK$ Million	2018 HK$ Million	Change	**2019 HK$ Million**	2018 HK$ Million	Change
Property Leasing	**4,204**	4,118	2%	**3,217**	3,117	3%
Mainland China	**2,190**	2,171	1%	**1,487**	1,447	3%
Hong Kong	**2,014**	1,947	3%	**1,730**	1,670	4%
Property Sales	**–**	1,032	–100%	**–**	565	–100%
Total	**4,204**	5,150	–18%	**3,217**	3,682	–13%

DIVIDEND

The Board of Directors has declared an interim dividend of HK17 cents per share for 2019 (2018: HK17 cents) to be paid by cash on September 26, 2019, to shareholders whose names appeared on the register of members on September 13, 2019.

PROPERTY LEASING

In the first half of 2019, our property leasing performance sustained the solid growth momentum built up since the second half of last year. Both the tenant retail sales and our rental turnover were resilient and on a sustainable trend. Total revenue of our leasing properties grew to HK$4,204 million. Revenue from our Mainland portfolio increased 7% in RMB terms and that of our Hong Kong portfolio rose 3% period-on-period. The performance was promising amid the US-China trade dispute and other global uncertainties.

Mainland China

Growth momentum of our mainland China leasing portfolio continued. All our mainland properties, except Shanghai Grand Gateway 66 mall which is under a major upgrading program and Wuxi Center 66 office tower, recorded revenue growth during the period. Revenue of the entire portfolio advanced 7% to RMB1,894 million. Operating profit increased 9% to RMB1,286 million. Average margin improved to 68%.

Revenue of our Shanghai properties advanced 4% period-on-period despite the short-term rental interruption caused by the major renovation at Grand Gateway 66. Properties outside Shanghai achieved a remarkable 14% revenue growth period-on-period and continued the growth momentum with a 7% increment comparing to the second half of last year.

Mainland China Property Leasing Portfolio for the Six Months Ended June 30

City and Name of the Property	Revenue (RMB Million) 2019	2018	Change	Occupancy Rate* Mall	Office
Shanghai Plaza 66	**827**	763	8%	98%	93%
Shanghai Grand Gateway 66	**394**	410	–4%	86%	N/A
Shenyang Palace 66	**95**	77	23%	91%	N/A
Shenyang Forum 66	**113**	105	8%	94%	89%
Jinan Parc 66	**158**	141	12%	95%	N/A
Wuxi Center 66	**140**	121	16%	93%	90%
Tianjin Riverside 66	**93**	90	3%	83%	N/A
Dalian Olympia 66	**74**	57	30%	79%	N/A
Total	**1,894**	1,764	7%		
Total in HK$ Million equivalent	***2,190***	*2,171*	*1%*		

* All occupancy rates stated therein were as of June 30, 2019.

- *Malls*

Total revenue of our eight malls in mainland China increased 8% to RMB1,479 million. In Shanghai, our investments in asset enhancement are paying off. Plaza 66 continued to report strong growth in both sales and rental revenue, two years after its renovation. Grand Gateway 66 is expected to follow the successful footsteps of Plaza 66 to achieve strong revenue growth and enhanced tenant mix after completion of the upgrading program. Outside Shanghai, all malls achieved growth in both revenue and sales, most in double-digit.

The Shanghai **Plaza 66** mall reported double-digit increases in revenue and retail sales at 11% and 15%, respectively. The mall has firmly established its positioning as the Home to Luxury, and continues to add new and renowned luxury labels and high-end restaurants to its tenant portfolio. In addition, after the debut launch of HOUSE 66, our nationwide Customer Relationship Management (CRM) program, in September 2018, we have seen more quality tenant collaborations and direct engagements with our customers. Our investment and focus on deploying the CRM program will further cultivate customer loyalty and drive both tenant sales and boost leasing performance over time.

Revenue of the Shanghai **Grand Gateway 66** mall retreated 4% to RMB394 million due to the short-term interruption caused by a major upgrading program commenced in 2017. The first phase of the upgrade works was completed with the North Building re-opened in September 2018. The renovated area was fully let, with higher rental income, comprising a good mix of young and trend-setting brands, food & beverage tenants, and the refurbished cinema. The second phase, covering the bulk of the South Building and its basement, is in full swing and the progress made is on track. The basement has partially re-opened and a variety of new cosmetics brands will be introduced. The works of the second phase are expected to be completed in stages from late 2019.

The Shenyang **Palace 66** mall collected 23% more in rents to RMB95 million resulting from increases in both turnover rent and occupancy. Retail sales jumped 29%. Our efforts to introduce more sporting and popular lifestyle fashion brands are bearing fruit. It further strengthens our leading trendy lifestyle mall positioning in Zhongjie and Shenyang city. Occupancy also rose four points to 91%. To inject more family and children’s content into the mall, the kids’ zone on the third floor was revamped.

Revenue of the Shenyang **Forum 66** mall rose 3%, with our efforts to reshuffle tenants and diversify trade mix continuing. Occupancy rate further jumped seven points to 94%. Retail sales also advanced 3%. More quality food & beverage tenants were introduced, drawing a good reception from shoppers. Some luxury brands making their first landing in Shenyang were also enrolled to set up kiosks on the first floor.

Income of the Jinan **Parc 66** mall increased 12% to RMB158 million mainly driven by the increase in occupancy rate and positive rental reversions. Occupancy rate edged up one point to 95%. Retail sales rose 11%. The mall achieved a higher unit rent through upgrading its tenant portfolio, including the introduction of some international brands to Jinan for the first time. These brands delivered a good sales performance by successfully satisfying the younger generation's spending appetite. Following its successful debut in Shanghai Plaza 66, HOUSE 66 was launched in Parc 66 in December 2018, and the responses from both customers and tenants have been enthusiastic.

The Wuxi **Center 66** mall achieved a remarkable 26% growth in revenue mainly attributable to increased turnover rent and favorable rental reversions. Retail sales surged 25%. Occupancy rate improved six points to 93%. Part of the area temporarily closed for construction of the second office tower re-opened in May 2019, housing a brand new premium cinema complex which will help to enrich the tenant mix and attract footfall. Hang Lung's CRM program HOUSE 66 was also launched at Center 66 in May 2019. We are experiencing a promising trend of brand migration from other venues in Wuxi to Center 66 and expect to see the opening of more luxury brands in our mall in the near future.

Revenue of the Tianjin **Riverside 66** mall rose 3%. Occupancy rate dropped three points to 83% as the efforts on tenant reshuffling and trade mix enhancement continued. Part of the fourth floor is being converted into a theme zone to attract the younger generation and will open this year. Retail sales increased by 2%.

The Dalian **Olympia 66** mall delivered a strong performance in the first half of 2019. Revenue and retail sales jumped 30% and 27%, respectively, riding on the business growth of trendy lifestyle and food & beverage tenants. Occupancy rate increased four points to 79%. The Phase 2 area of the mall is planned to open by phases from the second quarter of 2020.

- *Offices*

During the period, our four office towers at Shanghai Plaza 66, Shenyang Forum 66 and Wuxi Center 66 recorded a revenue growth of 5% to RMB415 million. Revenue from all the office towers accounted for 22% of our mainland China leasing revenue. It proved to be a solid and stable income stream.

Income of **Plaza 66** offices grew 4% to RMB312 million because of higher occupancy. Average occupancy rate advanced three points to 94% as a result of the effort made on new lettings and the expansion by long-term quality tenants.

The office tower at **Forum 66** collected 11% more revenue to RMB63 million. Occupancy rate advanced four points to 89% as the six floors in the high zone of the tower were completed in July 2018. Conrad Shenyang, residing on the top 19 floors of the office tower, is expected to open later this year.

Revenue of the office tower at **Center 66** decreased 3% to RMB40 million. Occupancy rate slipped one point to 90%. The second tower will be ready for handing over to tenants in the second half of 2019. Pre-leasing activities are underway.

Hong Kong

The performance of our Hong Kong leasing properties was stable. Total revenue and operating profit recorded growth of 3% and 4% to HK$2,014 million and HK$1,730 million, respectively. Overall rental margin was 86%.

Hong Kong Property Leasing Portfolio for the Six Months Ended June 30

	Revenue (HK$ Million)			Occupancy Rate*
	2019	2018	Change	
Commercial	**1,198**	1,155	4%	96%
Office and Industrial/Offices	**655**	638	3%	93%
Residential & Serviced Apartments	**161**	154	5%	78%
Total	**2,014**	1,947	3%	

* All occupancy rates stated therein were as of June 30, 2019.

- *Commercial*

Revenue of our Hong Kong commercial portfolio increased 4% to HK$1,198 million, mainly driven by positive rental reversions of our major tenants. Total retail sales advanced 7% period-on-period. Occupancy fell one point to 96%.

Revenue of the **Causeway Bay portfolio** increased 3%. Retail sales grew 4%. We are further refining the tenant mix to strengthen Fashion Walk's positioning as a vibrant integrated hub for fashion and lifestyle shopping and experiences. The pop-up store of a luxury beauty brand introduced during the period was well received. We will introduce more beauty and make-up shops, building an appealing beauty cluster at Fashion Walk.

Kornhill Plaza in Hong Kong East collected 4% more in rents mainly contributed by the anchor tenants. Retail sales decreased 2%. The property was fully let.

Revenues of **Grand Plaza and Gala Place in Mongkok** rose 6% supported by the good sales performance of the tenants. Both properties were fully let. The Mongkok portfolio continues its efforts to add new healthcare, beauty and lifestyle tenants and enrich its gourmet options to attract style-seekers and the younger generation among locals and tourists. Total retail sales increased 36%.

Amoy Plaza in Kowloon East achieved revenue growth of 5%, benefitting from favorable rental reversions and the opening of the UA Amoy cinema in August 2018. Retail sales rose 2%.

The major renovation at **Peak Galleria** continued. The mall has been closed since October 2018 except two restaurants commenced business in the first half of 2019. This iconic property as well as a destination for tourists and local people at The Peak is expected to fully re-open by phases from the summer of 2019.

- *Offices*

Revenue from our Hong Kong office portfolio grew 3% to HK$655 million mainly driven by positive rental reversions. Overall occupancy rate declined one point to 93%. Our offices in Central and Mongkok recorded income growth of 5% and 6%, respectively, while revenue from those in Causeway Bay dropped 5%. The Hong Kong office rental amount accounted for 33% of our total leasing income in Hong Kong.

- *Residential and Serviced Apartments*

Income from our residential and serviced apartments increased 5% to HK$161 million due to higher occupancy at The Summit and Burnside Villa.

PROPERTY SALES

During the first six months, one semi-detached house at 23-39 Blue Pool Road (2018: three houses) was sold. As the sale will be recognized upon completion of legal assignment later this year, no revenue or profit in respect of property sales was recorded in the first half of 2019.

During the period, 111 car parking spaces held as investment properties at Laichikok Bay Garden were disposed of. The transaction will be completed in the second half of 2019. These properties were reclassified as assets held for sale as of June 30, 2019, at valuation with reference to the selling price. A gain of HK$69 million was included as part of the fair value gain of properties. Meanwhile, the sale made in 2018 regarding the remaining apartment and car parking spaces at Garden Terrace was completed in April 2019.

PROPERTY REVALUATION

The total value of our investment properties amounted to HK$136,970 million as of June 30, 2019, comprising the value of the Hong Kong portfolio and the mainland China portfolio of HK$66,382 million and HK$70,588 million, respectively. Our investment properties were revalued by Savills, an independent valuer, as of June 30, 2019.

An overall revaluation gain of HK$1,438 million, representing a 1% growth in valuation as compared to the value as of December 31, 2018, was recorded in the first half of 2019 (2018: HK$2,456 million), mostly attributable to the gains of our Hong Kong portfolio.

PROPERTY DEVELOPMENT AND CAPITAL COMMITMENT

The aggregated value of investment properties under development was HK$40,335 million. They comprised mainland China projects in Kunming, Wuhan, Hangzhou and the remaining phases of the developments in Shenyang and Wuxi. The portfolio consists of malls, office towers, hotels and serviced apartments.

The construction work at Kunming **Spring City 66** is progressing as planned. Testing and commissioning works are in progress. This mixed-use development, covering a total gross floor area of 432,000 square meters, comprises a world-class mall, a Grade A office tower, serviced apartments, a hotel and car parking spaces. Both the mall and the office tower are expected to open in the second half of this year. About 85% of the mall's area has been leased, and the pre-leasing of the office tower has also made good progress.

The construction of Wuhan **Heartland 66**, a mixed-use commercial project with a total gross floor area of 460,000 square meters, is progressing as planned. This project will house a premier mall, a Grade A office tower, serviced apartments and car parking spaces, and is expected to be completed in stages starting from 2020. Leasing activities for both the mall and office tower have commenced.

The conversion of the top 19 floors of the office tower at Shenyang Forum 66 into **Conrad Shenyang** is close to completion. The hotel is planned to commence operation in the second half of this year. This five-star hotel will have 315 guest rooms and a grand ballroom which can accommodate more than 500 guests. The addition of this hotel will complement the positioning of Forum 66 as the destination of choice for those seeking high-end shopping, entertainment, business and hospitality experiences.

The construction work for the second office tower at Wuxi **Center 66** is almost completed. This Grade A office tower, built above the southeastern section of the Center 66 mall, will add 52,000 square meters in gross floor area available for leasing. Leasing activity has commenced and the tower will be ready for handing over to tenants in the second half of 2019.

The master layout plan for the Wuxi Phase Two development was approved by the government in March 2019. The project includes luxury serviced apartments and a boutique hotel.

The development of Hangzhou **Westlake 66**, a high-end commercial mixed-use complex with a total above-ground gross floor area of 194,100 square meters comprising a world-class mall, office towers and a hotel, has started. The land was fully paid for and handed over to us during the period. The project is planned for completion in phases from 2024.

The projects mentioned above represented the majority of our capital commitments at the reporting date, amounting to HK$32 billion. They will be completed in phases over a number of years.

In Hong Kong, we have consolidated the entire interests in the Amoycan Industrial Centre in Ngau Tau Kok through the Compulsory Sale for Redevelopment Order. With its proximity to Mass Transit Railway the site is also well located near the future East Kowloon Cultural Centre and is planned to be re-developed into residential properties for sale. In addition, jointly with our parent company, Hang Lung Group Limited, we are embarking on a re-development project at Electric Road in North Point. The project will encompass the clearance of the site for construction of a commercial and office tower with a gross floor area of 105,000 square feet.

LIQUIDITY AND FINANCIAL RESOURCES

Our major financial management objective is to maintain an appropriate capital structure with a high degree of agility. This is to ensure access to sufficient financial resources for meeting operational needs and capital commitments, and to seize investment opportunities when they arise for sustaining long-term growth. We also strive to establish multiple channels of debt financing for risk mitigation. All financial risk management, including debt re-financing, foreign exchange exposure and interest rate volatility, etc., are centrally managed and controlled at the corporate level.

- *Liquidity and Financing Management*

The cash flow position and funding needs are closely reviewed and monitored to ensure that Hang Lung Properties has a good degree of financial flexibility and liquidity while optimizing net financial costs.

As of June 30, 2019, Hang Lung Properties had total cash and bank balances of HK$6,208 million (December 31, 2018: HK$12,363 million). All the deposits are placed with banks with strong credit ratings and the counterparty risk is monitored on a regular basis.

For debt portfolio management, Hang Lung Properties focuses on mitigating the re-financing, interest rate and foreign exchange risks. An appropriate mix of RMB/HKD/USD borrowings, fixed/floating rate debts, a staggered debt repayment profile and a diversified source of funding are maintained.

As of June 30, 2019, total borrowings of Hang Lung Properties amounted to HK$31,615 million (December 31, 2018: HK$27,253 million), of which about 43% was denominated in RMB. The higher debt balance against last year-end was due to payments for the various projects under development in mainland China and Hong Kong, including the final payment for the remaining 50% land cost of Hangzhou Westlake 66. The following table shows the composition of our debt portfolio:

	At June 30, 2019		At December 31, 2018	
	HK$ Million	*% of Total*	HK$ Million	*% of Total*
Floating rate HKD bank loans	**5,735**	*18.1%*	255	*0.9%*
Floating rate RMB bank loans	**12,379**	*39.2%*	13,490	*49.5%*
Fixed rate bonds	**13,501**	*42.7%*	13,508	*49.6%*
Denominated in USD	**7,815**	*24.7%*	7,832	*28.7%*
Denominated in HKD	**4,552**	*14.4%*	4,540	*16.7%*
Denominated in RMB	**1,134**	*3.6%*	1,136	*4.2%*
Total borrowings	**31,615**	*100%*	27,253	*100%*

At the reporting date, the average tenor of the entire loan portfolio was 3.3 years (December 31, 2018: 3.3 years). The maturity profile was well staggered and spread over a period of 7 years. Around 69% of the loans was repayable after 2 years.

	At June 30, 2019		At December 31, 2018	
	HK$ Million	*% of Total*	HK$ Million	*% of Total*
Repayable:				
Within 1 year	**3,079**	*9.7%*	2,414	*8.8%*
After 1 but within 2 years	**6,806**	*21.6%*	3,514	*12.9%*
After 2 but within 5 years	**19,790**	*62.6%*	17,900	*65.7%*
Over 5 years	**1,940**	*6.1%*	3,425	*12.6%*
Total borrowings	**31,615**	*100%*	27,253	*100%*

As of June 30, 2019, Hang Lung Properties' undrawn committed banking facilities amounted to HK$11,283 million (December 31, 2018: HK$16,224 million). The available balances of the USD3 billion Medium Term Note Program and the RMB10 billion Green Panda Bond Program amounted to USD1,410 million and RMB9,000 million, respectively, equivalent to HK$21,247 million in total (December 31, 2018: HK$21,297 million).

- *Gearing Ratios & Interest Cover*

As of June 30, 2019, the net debt balance of Hang Lung Properties amounted to HK$25,407 million (December 31, 2018: HK$14,890 million). Net debt to equity ratio was 17.6% (December 31, 2018: 10.4%) and debt to equity ratio was 21.9% (December 31, 2018: 19.0%).

For the six months ended June 30, 2019, the total amount of borrowing costs incurred increased by HK$113 million to HK$755 million. The net amount charged to the statement of profit or loss for the first half of 2019 decreased by HK$534 million to HK$8 million because more borrowing costs were capitalized to the projects under development with additions of construction costs for projects under development, full payment of land premium of Hangzhou Westlake 66 and the adoption of an amendment to the accounting standard on the capitalization of borrowing costs effective on January 1, 2019.

Interest income for the period dropped to HK$96 million (2018: HK$256 million). The decrease was mainly due to the reduction of average deposit balance after settling payments on capital expenditures and the Hangzhou land premium.

The amount of net interest income for the first half of 2019, i.e. the excess of interest income over finance costs, was HK$88 million (2018: net interest expense of HK$286 million). The average effective cost of borrowings during the period was 4.8% (2018: 4.9%) given a portfolio of debts comprising 39% in RMB bank loan, 18% in HKD bank loan, 39% in HKD and USD bonds and 4% in RMB bond.

Interest cover for the first six months of 2019 was 4 times (2018: 9 times).

- *Foreign Exchange Management*

The activities of Hang Lung Properties are exposed to foreign currency risks mainly arising from its operations in mainland China and certain bank deposits denominated in RMB held in and relating to mainland China entities. There is also exposure in USD arising from the two USD500 million bonds issued. Appropriate measures have been taken to mitigate the foreign exchange risk exposure.

The currencies of cash and bank balances at the reporting date were as follows:

	At June 30, 2019		At December 31, 2018	
	HK$ Million	*% of Total*	HK$ Million	*% of Total*
Denominated in:				
HKD	**3,484**	*56.1%*	4,673	*37.8%*
RMB	**2,715**	*43.7%*	7,681	*62.1%*
USD	**9**	*0.2%*	9	*0.1%*
Total cash and bank balances	**6,208**	*100%*	12,363	*100%*

(a) RMB Exposure

The RMB exposure of Hang Lung Properties is mainly derived from two aspects of the operations: firstly, currency translation risk arising from the net assets of our Mainland subsidiaries; secondly, the RMB deposits held in and relating to mainland China entities which are primarily for the purpose of settling future construction payments in RMB.

As of June 30, 2019, net assets denominated in RMB accounted for about 60% of Hang Lung Properties' total net assets. The re-translation of these net assets denominated in RMB into HKD using the exchange rate as of the reporting date resulted in a re-translation loss of HK$402 million (2018: HK$759 million), as RMB depreciated by about 0.4% against HKD compared to December 31, 2018. The re-translation loss was recognized in other comprehensive income/exchange reserve.

Hang Lung Properties' business operations and projects under development in mainland China are funded by cash inflows from Mainland operations and RMB borrowings, in addition to capital injections from Hong Kong. We have adopted an enterprise risk management approach to mitigate the currency risks and practiced good discipline of not taking any speculative position on the movement of RMB against HKD. Regular business reviews were made to assess the level of funding needs for our Mainland projects after taking account of various factors such as regulatory constraints, project development timelines and the business environment. Appropriate modifications to our funding plan will be conducted in light of the outcome of the periodic reviews.

(b) USD Exposure

The USD foreign exchange exposure is related to the two USD500 million fixed rate bonds issued, equivalent to HK$7,815 million at the reporting date. The related currency exchange risk was covered back-to-back by two USD/HKD cross currency swap contracts. The swap contracts were entered into in order to effectively fix the exchange rate between USD and HKD for future interest payments and principal repayments.

The changes in the fair value of both swap contracts did not impact on the cash flows and the profit or loss materially as they qualified for cash flow hedge accounting.

- *Charge of Assets*

Assets of Hang Lung Properties were not charged to any third parties as of June 30, 2019.

- *Contingent Liabilities*

Hang Lung Properties did not have any material contingent liabilities as of June 30, 2019.

OUTLOOK

While the US-China trade dispute shows no sign of abating, we are cautiously optimistic that our business would continue to deliver sustainable growth in both Hong Kong and the Mainland. The growth will be fueled by a number of key drivers.

Our established properties are expected to continue delivering solid organic growth and will sustain the momentum. With the implementation of various customer-centric initiatives, including the roll-out of the HOUSE 66 CRM program and adoption of new technologies, we will build stronger engagement with both our tenants and customers and offer a unique Hang Lung Brand experience, boosting sales and leasing revenue.

In addition, our investment in asset upgrading programs will also pay off. The progressive completion of the major renovation at Shanghai Grand Gateway 66 mall later this year is expected to deliver a similar increase in revenue as experienced in Plaza 66.

In the second half of 2019, a number of new properties will commence business, including the mall and office tower of Kunming Spring City 66, the second office tower of Wuxi Center 66, and Conrad Shenyang at Forum 66. They will provide another impetus for business growth.

Depending on market conditions, we will continue to sell down residential units on hand in Hong Kong. At the same time, we will extract more value from our property portfolio through disposal of non-core properties.

On the property development side, in Hong Kong, we have started two re-development projects, and will continue to look for opportunities. On the Mainland, four mixed-use projects have serviced apartment element and are intended for sale. We have started the construction work of luxurious serviced apartments at Wuhan Heartland 66. Similar development at projects in Wuxi, Kunming and Shenyang would also start by phases.

CORPORATE GOVERNANCE

We are committed to maintaining the highest standards of corporate governance. During the six months ended June 30, 2019, we adopted corporate governance principles that emphasize a qualified Board of Directors (the "Board"), sound internal controls, and effective risk management to enhance transparency and accountability towards our stakeholders. The general framework of our corporate governance practices is set out in our corporate governance report in the 2018 annual report, which is available on our website under Financial Report of Financial Information of the Investor Relations section.

The Board

The Board currently consists of eleven members: comprising four Executive Directors; one Non-Executive Director; and six Independent Non-Executive Directors. There is a clear division of responsibilities between the Chairman and the Chief Executive Officer to ensure a balance of power and authority. The Board continues to review its practices from time to time, constantly seeking to improve the Group's corporate governance procedures in accordance with international best practices. An updated list of Board members identifying their roles and functions and whether they are Independent Non-Executive Directors is maintained on our website and the website of Hong Kong Exchanges and Clearing Limited ("HKEx"). The biographical details of Board members are also maintained on our website under Board of Directors of Corporate Governance of the Investor Relations section.

Nomination and Remuneration Committee

Our Nomination and Remuneration Committee, which is chaired by an Independent Non-Executive Director, currently consists of three Independent Non-Executive Directors. The Committee members meet at least once a year. Its duties include reviewing significant changes to the salary structure of the Group and the terms and conditions affecting Executive Directors of the Board and senior management. The Committee members also conduct regular reviews of the Board's structure, size and diversity, and make recommendations to the Board on the appointment, re-appointment and succession planning of Directors of the Board. The terms of reference of the Committee can be accessed on both our website and the website of HKEx.

Audit Committee

Our Audit Committee, which is chaired by an Independent Non-Executive Director, currently consists of four Independent Non-Executive Directors. The Committee members meet at least four times a year. Meetings are normally attended by external and internal auditors, the Chief Financial Officer and the Company Secretary for the purposes of, inter alia, discussing the nature and scope of internal audit work and assessing the Company's internal controls. The terms of reference of the Committee, which include duties pertaining to corporate governance functions and the oversight of risk management, are available on both our website and the website of HKEx. The Audit Committee has reviewed this interim report, including the unaudited interim financial report for the six months ended June 30, 2019, and has recommended their adoption by the Board.

This interim financial report is unaudited but has been reviewed by KPMG, our auditor, in accordance with the Hong Kong Standard on Review Engagements 2410 "Review of interim financial information performed by the independent auditor of the entity" issued by the Hong Kong Institute of Certified Public Accountants. The Independent Auditor's Review Report is set out on pages 58 and 59 of this interim report.

Compliance with Corporate Governance Code

During the six months ended June 30, 2019, we complied with the code provisions set out in the Corporate Governance Code as stated in Appendix 14 of the Rules Governing the Listing of Securities (the "Listing Rules") on The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

Compliance with Model Code contained in Appendix 10 to the Listing Rules

We have adopted a code of conduct with regard to securities transactions by Directors of the Board (the "Code of Conduct") on terms that are no less exacting than the required standard set out in the Model Code for Securities Transactions by Directors of Listed Issuers contained in Appendix 10 to the Listing Rules (the "Model Code"). The Company has made specific enquiries with all Directors of the Board and confirmed that they have complied with the required standard set out in the Model Code and the Code of Conduct regarding securities transactions by Directors of the Board throughout the six months ended June 30, 2019.

DIRECTORS' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at June 30, 2019, the interests or short positions of each of the Directors of the Board in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of the Securities and Futures Ordinance (the "SFO")) which were required to be notified to the Company and the Stock Exchange pursuant to Part XV of the SFO or pursuant to the Model Code or which were recorded in the register required to be kept by the Company under section 352 of the SFO are as follows:

		The Company (Long Position)			*Hang Lung Group Limited (Long Position)*	
Name	**Capacity**	**Number of Shares**	**% of Number of Issued Shares**	**Number of Shares under Option** *(Note 2)*	**Number of Shares**	**% of Number of Issued Shares**
Ronnie C. Chan	Personal	16,330,000	0.36	24,025,000	11,790,000	0.87
Weber W.P. Lo	Personal	–	–	12,750,000	–	–
Ronald J. Arculli	Personal & Corporate	724,346	0.02	–	1,089,975	0.08
Nelson W.L. Yuen	Personal	8,000,000	0.18	6,500,000	–	–
Dominic C.F. Ho	–	–	–	–	–	–
Philip N.L. Chen	Personal	–	–	24,000,000	–	–
Andrew K.C. Chan	–	–	–	–	–	–
H.K. Chang	–	–	–	–	–	–
Anita Y.M. Fung	–	–	–	–	–	–
H.C. Ho	Personal	–	–	13,600,000	–	–
Adriel W. Chan	Personal & Other *(Note 1)*	2,619,719,340	58.25	4,400,000	501,340,580	36.82

Notes

1. Other interests included 2,619,719,340 shares of the Company and 501,340,580 shares of Hang Lung Group Limited ("HLG") held/deemed to be held by a trust of which Mr. Adriel W. Chan was a discretionary beneficiary. Accordingly, Mr. Adriel W. Chan was deemed to be interested in such shares under the SFO.

2. Movement of Options under the Share Option Schemes of the Company

(i) Share Option Scheme adopted on November 22, 2002

Date Granted (mm/dd/yyyy)	Name	Number of Shares under Option: As at Jan 1, 2019	Exercised during the Period	As at Jun 30, 2019	Exercise Price per Share (HK$)	Vested Dates (mm/dd/yyyy)	Expiry Date (mm/dd/yyyy)
02/08/2010	Ronnie C. Chan	6,500,000	–	6,500,000	$26.46	02/08/2012: 10%	02/07/2020
	Nelson W.L. Yuen	6,500,000	–	6,500,000		02/08/2013: 20%	
						02/08/2014: 30%	
						02/08/2015: 40%	
07/29/2010	Philip N.L. Chen	10,000,000	–	10,000,000	$33.05	07/29/2012: 10%	07/28/2020
						07/29/2013: 20%	
						07/29/2014: 30%	
						07/29/2015: 40%	
09/29/2010	H.C. Ho	2,000,000	–	2,000,000	$36.90	09/29/2012: 10%	09/28/2020
						09/29/2013: 20%	
						09/29/2014: 30%	
						09/29/2015: 40%	
06/13/2011	Ronnie C. Chan	4,500,000	–	4,500,000	$30.79	06/13/2013: 10%	06/12/2021
	Philip N.L. Chen	4,500,000	–	4,500,000		06/13/2014: 20%	
	H.C. Ho	3,000,000	–	3,000,000		06/13/2015: 30%	
						06/13/2016: 40%	

2. Movement of Options under the Share Option Schemes of the Company (continued)

(ii) Share Option Scheme adopted on April 18, 2012

Date Granted (mm/dd/yyyy)	Name	Number of Shares under Option As at Jan 1, 2019	Granted during the Period	As at Jun 30, 2019	Exercise Price per Share (HK$)	Vested Dates (mm/dd/yyyy)	Expiry Date (mm/dd/yyyy)
06/04/2013	Ronnie C. Chan	4,500,000	–	4,500,000	$28.20	06/04/2015: 10%	06/03/2023
	Philip N.L. Chen	4,500,000	–	4,500,000		06/04/2016: 20%	
	H.C. Ho	3,000,000	–	3,000,000		06/04/2017: 30%	
	Adriel W. Chan	200,000	–	200,000		06/04/2018: 40%	
12/05/2014	Ronnie C. Chan	2,750,000	–	2,750,000	$22.60	12/05/2016: 10%	12/04/2024
	Philip N.L. Chen	2,500,000	–	2,500,000		12/05/2017: 20%	
	H.C. Ho	1,850,000	–	1,850,000		12/05/2018: 30%	
	Adriel W. Chan	150,000	–	150,000		12/05/2019: 40%	
08/10/2017	Ronnie C. Chan	2,750,000	–	2,750,000	$19.98	08/10/2019: 10%	08/09/2027
	Philip N.L. Chen	2,500,000	–	2,500,000		08/10/2020: 20%	
	H.C. Ho	1,850,000	–	1,850,000		08/10/2021: 30%	
	Adriel W. Chan	1,850,000	–	1,850,000		08/10/2022: 40%	
05/16/2018	Weber W.P. Lo	10,000,000	–	10,000,000	$18.98	05/16/2020: 10%	05/15/2028
						05/16/2021: 20%	
						05/16/2022: 30%	
						05/16/2023: 40%	
06/28/2019	Ronnie C. Chan	–	3,025,000	3,025,000	$18.58	06/28/2021: 10%	06/27/2029
	Weber W.P. Lo	–	2,750,000	2,750,000		06/28/2022: 20%	
	H.C. Ho	–	1,900,000	1,900,000		06/28/2023: 30%	
	Adriel W. Chan	–	2,200,000	2,200,000		06/28/2024: 40%	

Save as disclosed above, none of the Directors of the Board had, as at June 30, 2019, any interests or short positions in the shares, underlying shares or debentures of the Company or any associated corporations.

Other than as stated above, at no time during the six months ended June 30, 2019 was the Company, its holding company or any of their respective subsidiaries a party to any arrangement to enable the Directors of the Board to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

SUBSTANTIAL SHAREHOLDERS' AND OTHER PERSONS' INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES

As at June 30, 2019, details of substantial shareholders' and other persons' (who are required to disclose their interests pursuant to Part XV of the SFO) interests and short positions in the shares and underlying shares of the Company as recorded in the register required to be kept under section 336 of the SFO are as follows:

Name	*Note*	Number of Shares or Underlying Shares Held *(Long Position)*	% of Number of Issued Shares *(Long Position)*
Chan Tan Ching Fen	*1*	2,619,719,340	58.25
Cole Enterprises Holdings (PTC) Limited	*1*	2,619,719,340	58.25
Merssion Limited	*1*	2,619,719,340	58.25
Adriel W. Chan	*1*	2,619,719,340	58.25
Hang Lung Group Limited	*2*	2,591,386,240	57.62
Prosperland Housing Limited	*3*	1,267,608,690	30.60
Purotat Limited	*3*	354,227,500	8.55

Notes

1. These shares were the same parcel of shares held by controlled corporations of Merssion Limited which was held under a trust. As Ms. Chan Tan Ching Fen was the founder, Cole Enterprises Holdings (PTC) Limited was the trustee and Mr. Adriel W. Chan was a discretionary beneficiary of the trust, they were deemed to be interested in such shares under the SFO.

   The controlled corporations included HLG in which Merssion Limited had 36.82% interests. Accordingly, the 2,591,386,240 shares held by HLG through its subsidiaries were included in the 2,619,719,340 shares.

2. These shares were held by the wholly-owned subsidiaries of HLG.

3. These companies were wholly-owned subsidiaries of HLG. Their interests were included in the 2,591,386,240 shares held by HLG.

Save as disclosed above, as at June 30, 2019, no other interests or short positions in the shares or underlying shares of the Company required to be recorded in the register kept under section 336 of the SFO has been notified to the Company.

CHANGES IN INFORMATION OF DIRECTORS PURSUANT TO LISTING RULES

The changes in information of the Directors of the Board are set out below:

Mr. Philip N.L. Chen

– ceased to be Adviser to Chairman of the Company

Dr. Andrew K.C. Chan

– ceased to be the chairman of the trustees' board, and became a member of the trustees' board and senior consultant of the global Arup Group

Prof. H.K. Chang

– resigned as an independent non-executive director of Brightoil Petroleum (Holdings) Limited

Ms. Anita Y.M. Fung

– ceased to be an independent non-executive member of the board of Airport Authority Hong Kong

Save as disclosed above, there is no other information to be disclosed pursuant to rule 13.51B(1) of the Listing Rules.

PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES

During the six months ended June 30, 2019, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of its listed securities.

EMPLOYEES

As at June 30, 2019, the number of employees was 4,530 (comprising 1,128 Hong Kong employees and 3,402 mainland China employees). The total employee costs for the six months ended June 30, 2019 amounted to HK$813 million. We provide competitive remuneration packages for all employees including discretionary bonuses payable based on individual performance. We regularly review the remuneration packages to ensure that they comply with relevant regulatory requirements and market conditions. The Company has share option schemes for the employees and provides professional and high-quality training for all employees.

Review report to the Board of Directors of Hang Lung Properties Limited

(Incorporated in the Hong Kong with limited liability)

INTRODUCTION

We have reviewed the interim financial report set out on pages 60 to 90 which comprises the consolidated statement of financial position of Hang Lung Properties Limited ("the Company") as at June 30, 2019 and the related consolidated statement of profit or loss, consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and condensed consolidated cash flow statement for the six month period then ended and explanatory notes. The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of an interim financial report to be in compliance with the relevant provisions thereof and Hong Kong Accounting Standard 34, *Interim financial reporting*, issued by the Hong Kong Institute of Certified Public Accountants. The directors are responsible for the preparation and presentation of the interim financial report in accordance with Hong Kong Accounting Standard 34.

Our responsibility is to form a conclusion, based on our review, on the interim financial report and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

SCOPE OF REVIEW

We conducted our review in accordance with Hong Kong Standard on Review Engagements 2410, *Review of interim financial information performed by the independent auditor of the entity*, issued by the Hong Kong Institute of Certified Public Accountants. A review of the interim financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

CONCLUSION

Based on our review, nothing has come to our attention that causes us to believe that the interim financial report as at June 30, 2019 is not prepared, in all material respects, in accordance with Hong Kong Accounting Standard 34, *Interim financial reporting*.

KPMG
Certified Public Accountants
8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

July 30, 2019

Consolidated Statement of Profit or Loss

For the six months ended June 30, 2019 (Unaudited)

	Note	2019 HK$ Million	2018 HK$ Million	*For information purpose only* 2019 RMB Million	2018 RMB Million
Revenue	3(a)	**4,204**	5,150	**3,639**	4,187
Direct costs and operating expenses		**(987)**	(1,468)	**(854)**	(1,193)
Gross profit		**3,217**	3,682	**2,785**	2,994
Other net income	4	**4**	70	**3**	58
Administrative expenses		**(317)**	(292)	**(275)**	(237)
Operating profit before changes in fair value of properties		**2,904**	3,460	**2,513**	2,815
Net increase in fair value of properties		**1,438**	2,456	**1,259**	2,021
Operating profit after changes in fair value of properties		**4,342**	5,916	**3,772**	4,836
Interest income		**96**	256	**83**	208
Finance costs		**(8)**	(542)	**(7)**	(441)
Net interest income/(expense)	5	**88**	(286)	**76**	(233)
Share of profits of joint ventures		**38**	54	**33**	44
Profit before taxation	3(b) & 6	**4,468**	5,684	**3,881**	4,647
Taxation	7(a)	**(698)**	(736)	**(604)**	(599)
Profit for the period		**3,770**	4,948	**3,277**	4,048
Attributable to:					
Shareholders		**3,516**	4,689	**3,057**	3,837
Non-controlling interests		**254**	259	**220**	211
		3,770	4,948	**3,277**	4,048
Earnings per share	9(a)				
Basic		**HK$0.78**	HK$1.04	**RMB0.68**	RMB0.85
Diluted		**HK$0.78**	HK$1.04	**RMB0.68**	RMB0.85

The accompanying notes form part of the interim financial report.

Consolidated Statement of Profit or Loss and Other Comprehensive Income

For the six months ended June 30, 2019 (Unaudited)

	Note	2019 HK$ Million	2018 HK$ Million	2019 RMB Million (For information purpose only)	2018 RMB Million (For information purpose only)
Profit for the period		**3,770**	4,948	**3,277**	4,048
Other comprehensive income	7(b)				
Items that are or may be reclassified subsequently to profit or loss:					
Exchange difference arising from translation to presentation currency		**(402)**	(759)	**46**	552
Movement in hedging reserve:					
Effective portion of changes in fair value		**48**	38	**41**	30
Net amount transferred to profit or loss		**22**	(27)	**20**	(22)
Item that will not be reclassified to profit or loss:					
Net change in fair value of equity investments		**–**	2	**–**	1
		(332)	(746)	**107**	561
Total comprehensive income for the period		**3,438**	4,202	**3,384**	4,609
Total comprehensive income attributable to:					
Shareholders		**3,213**	4,007	**3,165**	4,404
Non-controlling interests		**225**	195	**219**	205
		3,438	4,202	**3,384**	4,609

The accompanying notes form part of the interim financial report.

Consolidated Statement of Financial Position

At June 30, 2019

	Note	(Unaudited) June 30, 2019 HK$ Million	(Audited) December 31, 2018 HK$ Million	*For information purpose only* June 30, 2019 RMB Million	*For information purpose only* December 31, 2018 RMB Million
Non-current assets					
Property, plant and equipment					
Investment properties	10	**136,970**	136,676	**120,492**	119,895
Investment properties under development	10	**40,335**	31,186	**35,481**	27,325
Other property, plant and equipment		**209**	216	**184**	189
		177,514	168,078	**156,157**	147,409
Interest in joint ventures		**1,346**	1,330	**1,184**	1,168
Other assets		**93**	93	**82**	82
Deposits with banks	11	**1,853**	1,853	**1,630**	1,628
		180,806	171,354	**159,053**	150,287
Current assets					
Cash and deposits with banks	11	**4,355**	10,510	**3,831**	9,222
Trade and other receivables	12	**2,309**	2,046	**2,031**	1,794
Properties for sale		**4,336**	2,442	**3,815**	2,145
Assets held for sale	15	**110**	101	**97**	89
		11,110	15,099	**9,774**	13,250
Current liabilities					
Bank loans and other borrowings	13	**3,079**	2,414	**2,709**	2,116
Trade and other payables	14	**6,288**	5,974	**5,533**	5,236
Lease liabilities	21	**24**	22	**21**	19
Current tax payable		**599**	533	**527**	470
Liabilities directly associated with assets held for sale	15	**-**	3	**-**	3
		9,990	8,946	**8,790**	7,844
Net current assets		**1,120**	6,153	**984**	5,406
Total assets less current liabilities		**181,926**	177,507	**160,037**	155,693

	Note	(Unaudited) June 30, 2019 HK$ Million	(Audited) December 31, 2018 HK$ Million	*For information purpose only* June 30, 2019 RMB Million	*For information purpose only* December 31, 2018 RMB Million
Non-current liabilities					
Bank loans and other borrowings	13	**28,536**	24,839	**25,103**	21,792
Lease liabilities	21	**302**	298	**266**	261
Deferred tax liabilities		**8,845**	8,776	**7,781**	7,690
		37,683	33,913	**33,150**	29,743
NET ASSETS		**144,243**	143,594	**126,887**	125,950
Capital and reserves					
Share capital	16	**39,915**	39,915	**37,433**	37,433
Reserves		**98,276**	97,646	**84,130**	83,231
Shareholders' equity		**138,191**	137,561	**121,563**	120,664
Non-controlling interests		**6,052**	6,033	**5,324**	5,286
TOTAL EQUITY		**144,243**	143,594	**126,887**	125,950

The accompanying notes form part of the interim financial report.

Consolidated Statement of Changes in Equity

For the six months ended June 30, 2019 (Unaudited)

HK$ Million	Shareholders' equity					
	Share capital (Note 16)	Other reserves (Note 18)	Retained profits (Note 18)	Total	Non-controlling interests	Total equity
At January 1, 2019	**39,915**	**(1,117)**	**98,763**	**137,561**	**6,033**	**143,594**
Profit for the period	**–**	**–**	**3,516**	**3,516**	**254**	**3,770**
Exchange difference arising from translation to presentation currency	**–**	**(373)**	**–**	**(373)**	**(29)**	**(402)**
Cash flow hedges: net movement in hedging reserve	**–**	**70**	**–**	**70**	**–**	**70**
Total comprehensive income for the period	**–**	**(303)**	**3,516**	**3,213**	**225**	**3,438**
Final dividend in respect of previous financial year	**–**	**–**	**(2,609)**	**(2,609)**	**–**	**(2,609)**
Employee share-based payments	**–**	**10**	**16**	**26**	**–**	**26**
Dividends paid to non-controlling interests	**–**	**–**	**–**	**–**	**(206)**	**(206)**
At June 30, 2019	**39,915**	**(1,410)**	**99,686**	**138,191**	**6,052**	**144,243**
At January 1, 2018	39,912	2,251	93,995	136,158	6,087	142,245
Profit for the period	–	–	4,689	4,689	259	4,948
Exchange difference arising from translation to presentation currency	–	(695)	–	(695)	(64)	(759)
Cash flow hedges: net movement in hedging reserve	–	11	–	11	–	11
Net change in fair value of equity investments	–	2	–	2	–	2
Total comprehensive income for the period	–	(682)	4,689	4,007	195	4,202
Final dividend in respect of previous financial year	–	–	(2,609)	(2,609)	–	(2,609)
Issue of shares	3	–	–	3	–	3
Employee share-based payments	–	22	12	34	–	34
Dividends paid to non-controlling interests	–	–	–	–	(344)	(344)
At June 30, 2018	39,915	1,591	96,087	137,593	5,938	143,531

The accompanying notes form part of the interim financial report.

For information purpose only

RMB Million	Shareholders' equity					
	Share capital	Other reserves	Retained profits	Total	Non-controlling interests	Total equity
At January 1, 2019	37,433	498	82,733	120,664	5,286	125,950
Profit for the period	–	–	3,057	3,057	220	3,277
Exchange difference arising from translation to presentation currency	–	47	–	47	(1)	46
Cash flow hedges: net movement in hedging reserve	–	61	–	61	–	61
Total comprehensive income for the period	–	108	3,057	3,165	219	3,384
Final dividend in respect of previous financial year	–	–	(2,288)	(2,288)	–	(2,288)
Employee share-based payments	–	8	14	22	–	22
Dividends paid to non-controlling interests	–	–	–	–	(181)	(181)
At June 30, 2019	37,433	614	83,516	121,563	5,324	126,887
At January 1, 2018	37,431	(2,308)	78,698	113,821	5,088	118,909
Profit for the period	–	–	3,837	3,837	211	4,048
Exchange difference arising from translation to presentation currency	–	558	–	558	(6)	552
Cash flow hedges: net movement in hedging reserve	–	8	–	8	–	8
Net change in fair value of equity investments	–	1	–	1	–	1
Total comprehensive income for the period	–	567	3,837	4,404	205	4,609
Final dividend in respect of previous financial year	–	–	(2,115)	(2,115)	–	(2,115)
Issue of shares	2	–	–	2	–	2
Employee share-based payments	–	18	10	28	–	28
Dividends paid to non-controlling interests	–	–	–	–	(287)	(287)
At June 30, 2018	37,433	(1,723)	80,430	116,140	5,006	121,146

Condensed Consolidated Cash Flow Statement

For the six months ended June 30, 2019 (Unaudited)

	Note	2019 HK$ Million	2018 HK$ Million	2019 RMB Million (For information purpose only)	2018 RMB Million (For information purpose only)
Operating activities					
Cash generated from operations		**2,808**	3,929	**2,407**	3,202
Income tax paid		**(529)**	(626)	**(460)**	(511)
Net cash generated from operating activities		**2,279**	3,303	**1,947**	2,691
Investing activities					
Payment for property, plant and equipment		**(9,478)**	(5,331)	**(8,155)**	(4,356)
Decrease in bank deposits with maturity greater than three months		**659**	3,934	**570**	3,199
Other cash flows arising from investing activities		**123**	555	**106**	450
Net cash used in investing activities		**(8,696)**	(842)	**(7,479)**	(707)
Financing activities					
Proceeds from new bank loans and other borrowings		**9,671**	3,235	**8,375**	2,629
Repayment of bank loans and other borrowings		**(5,276)**	(2,423)	**(4,565)**	(1,970)
Capital element of lease rentals paid		**(4)**	–	**(3)**	–
Interest and other borrowing costs paid		**(704)**	(652)	**(610)**	(531)
Interest element of lease rentals paid	21	**(8)**	(8)	**(7)**	(7)
Dividend paid		**(2,609)**	(2,609)	**(2,288)**	(2,115)
Dividends paid to non-controlling interests		**(206)**	(344)	**(181)**	(287)
Other cash flows arising from financing activities		**-**	3	**-**	2
Net cash generated from/(used in) financing activities		**864**	(2,798)	**721**	(2,279)
Decrease in cash and cash equivalents		**(5,553)**	(337)	**(4,811)**	(295)
Effect of foreign exchange rate changes		**57**	(81)	**(5)**	32
Cash and cash equivalents at January 1		**8,556**	10,373	**7,507**	8,670
Cash and cash equivalents at June 30		**3,060**	9,955	**2,691**	8,407
Analysis of the balance of cash and cash equivalents:					
Cash and deposits with banks		**6,208**	17,786	**5,461**	15,025
Less: Bank deposits with maturity greater than three months		**(3,148)**	(7,831)	**(2,770)**	(6,618)
Cash and cash equivalents		**3,060**	9,955	**2,691**	8,407

The accompanying notes form part of the interim financial report.

1. BASIS OF PREPARATION

The unaudited interim financial report has been prepared in accordance with Hong Kong Accounting Standard (HKAS) 34, *Interim Financial Reporting*, issued by the Hong Kong Institute of Certified Public Accountants (HKICPA) and the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

The preparation of interim financial report in conformity with HKAS 34 requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses on a year-to-date basis. Actual results may differ from these estimates.

The interim financial report is unaudited, but has been reviewed by KPMG in accordance with Hong Kong Standard on Review Engagements 2410, *Review of interim financial information performed by the independent auditor of the entity*, issued by the HKICPA. KPMG's independent review report to the Board of Directors is included on pages 58 to 59.

The HKICPA has issued a number of new or amended Hong Kong Financial Reporting Standards (HKFRSs) that are first effective for the current accounting period of the Company and its subsidiaries (collectively the "Group"). Except for HKFRS 16, *Leases*, and Amendments to HKAS 23, *Borrowing costs*, the adoption of these new or amended HKFRSs does not have significant impact on the Group's interim financial report.

The interim financial report has been prepared in accordance with the same accounting policies adopted in the 2018 annual financial statements, except for the changes in accounting policies that are described in note 2.

1. BASIS OF PREPARATION (Continued)

The presentation currency of these consolidated financial statements is Hong Kong dollar. In view of the Group's significant business operations in mainland China, management has included additional financial information prepared in Renminbi in the consolidated financial statements. Such supplementary information is prepared on the same basis as 2018 as if the presentation currency is Renminbi.

The financial information relating to the financial year ended December 31, 2018 included in the interim financial report as comparative information does not constitute the Company's statutory annual consolidated financial statements for that financial year but is derived from those financial statements. Further information relating to these statutory financial statements disclosed in accordance with section 436 of the Hong Kong Companies Ordinance (Cap. 622) is as follows:

The Company has delivered the financial statements for the year ended December 31, 2018 to the Registrar of Companies as required by section 662(3) of, and Part 3 of Schedule 6 to, the Hong Kong Companies Ordinance.

The Company's auditor has reported on those financial statements. The auditor's report was unqualified; did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying its report; and did not contain a statement under sections 406(2), 407(2) or 407(3) of the Hong Kong Companies Ordinance.

2. CHANGES IN ACCOUNTING POLICIES

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period.

HKFRS 16

HKFRS 16 replaces HKAS 17, *Leases*, and the related interpretations, HK(IFRIC) 4, *Determining whether an arrangement contains a lease*, HK(SIC) 15, *Operating leases – incentives*, and HK(SIC) 27, *Evaluating the substance of transactions involving the legal form of a lease.*

The key changes to the Group's accounting policies resulting from the adoption of HKFRS 16 are summarized below.

As a lessee

As a lessee, the Group previously classified leases as operating or finance leases under HKAS 17 based on its assessment of whether the lease transferred significantly all of the risks and rewards incidental to ownership of the underlying asset to the Group. Under HKFRS 16, the Group is required to capitalize all leases when it is the lessee, including leases previously classified as operating leases under HKAS 17.

The Group decided to apply recognition exemptions to short-term leases that have a lease term of 12 months or less and leases of low-value assets. For leases of other assets, the Group recognized right-of-use assets and lease liabilities.

As a lessor

HKFRS 16 does not substantially change how a lessor accounts for leases under HKAS 17.

2. CHANGES IN ACCOUNTING POLICIES (Continued)

Transition

The Group applied HKFRS 16 with a date of initial application of January 1, 2019 using the modified retrospective approach, under which the cumulative effect of initial application is recognized in the opening balances at January 1, 2019.

(a) Leases previously classified as operating leases under HKAS 17

At transition, lease liabilities were measured at the present value of the remaining lease payments, discounted at the Group's incremental borrowing rate as of January 1, 2019. Right-of-use assets are measured at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments.

The Group used the following practical expedients when applying HKFRS 16 to leases previously classified as operating leases under HKAS 17:

– applied the exemption not to recognize right-of-use assets and liabilities for leases with a remaining lease term of less than 12 months as of January 1, 2019; and

– excluded initial direct costs from measuring the right-of-use asset at the date of initial application.

(b) Leases previously classified as finance leases under HKAS 17

For leases that were previously classified as finance leases under HKAS 17, the carrying amount of the right-of-use asset and the lease liability at January 1, 2019 are determined at the carrying amount of the lease asset and lease liability under HKAS 17 immediately before that date. The accounting caption of "finance lease obligations" is changed to "lease liabilities".

2. CHANGES IN ACCOUNTING POLICIES (Continued)

Impacts on the consolidated financial statements

On transition to HKFRS 16, HK$320 million were reclassified from finance lease obligations to lease liabilities, and the Group recognized an additional HK$11 million of right-of-use assets and HK$11 million of lease liabilities. Such right-of-use assets are presented within investment properties. There was no impact on the opening balance of equity.

Annual Improvement to HKFRSs 2015–2017 cycles: Amendments to HKAS 23

The Amendments to HKAS 23 clarify that the general borrowings pool used to calculate eligible borrowing costs excludes only borrowings that specifically finance qualifying assets that are still under development or construction. Borrowings that were intended to specifically finance qualifying assets that are now ready for their intended use or sale, or any non-qualifying assets, are included in that general pool.

Impacts on the consolidated financial statements

In accordance with the transitional provisions, the Group has applied those amendments to borrowing costs incurred on or after January 1, 2019, the date of initial application. Consequently, additional borrowing costs of HK$323 million were capitalized to properties under development for the six months ended June 30, 2019.

However, the additional capitalization neither impacted the overall profit for the period nor carrying value of properties under development which are stated at fair value.

3. REVENUE AND SEGMENT INFORMATION

The Group manages its businesses according to the nature of services and products provided. Management has determined three reportable operating segments for the measurement of performance and the allocation of resources. The segments are property leasing in mainland China, property leasing in Hong Kong and property sales in Hong Kong.

Property leasing segments include property leasing operation. The Group's investment properties portfolio, which mainly consists of retail, office, residential, serviced apartments and carparks, are primarily located in mainland China and Hong Kong. Property sales segment includes development and sale of the Group's trading properties in Hong Kong.

Management evaluates performance primarily based on profit before taxation.

Segment assets principally comprise all non-current assets and current assets directly attributable to each segment with the exception of interest in joint ventures, other assets, cash and deposits with banks and assets held for sale. The investment properties of the Group are included in segment assets at their fair values whilst the changes in fair value of properties are not included in segment profits. No segment liabilities analysis is presented as the Group monitors and manages its liabilities on a group basis.

(a) Disaggregation of revenue

Revenue for the six months ended June 30, 2019 is analyzed as follows:

HK$ Million	**2019**	2018
Under the scope of HKFRS 16 (2018: HKAS 17), *Leases:*		
Rental income	**3,808**	3,700
Under the scope of HKFRS 15, *Revenue from contracts with customers:*		
Sales of completed properties	**–**	1,032
Building management fees and other rental related income	**396**	418
	396	1,450
	4,204	5,150

3. REVENUE AND SEGMENT INFORMATION (Continued)

(b) Revenue and results by segments

HK$ Million	Revenue		Profit before taxation	
	2019	2018	**2019**	2018
Segment				
Property leasing				
– Mainland China	**2,190**	2,171	**1,487**	1,447
– Hong Kong	**2,014**	1,947	**1,730**	1,670
	4,204	4,118	**3,217**	3,117
Property sales				
– Hong Kong	**–**	1,032	**–**	565
Segment total	**4,204**	5,150	**3,217**	3,682
Other net income			**4**	70
Administrative expenses			**(317)**	(292)
Operating profit before changes in fair value of properties			**2,904**	3,460
Net increase in fair value of properties			**1,438**	2,456
– property leasing in Hong Kong			**1,334**	2,216
– property leasing in mainland China			**(362)**	240
– upon transfer from completed properties for sale in Hong Kong to investment properties			**466**	–
Net interest income/(expense)			**88**	(286)
– interest income			**96**	256
– finance costs			**(8)**	(542)
Share of profits of joint ventures			**38**	54
Profit before taxation			**4,468**	5,684

3. REVENUE AND SEGMENT INFORMATION (Continued)

(c) Total assets by segments

HK$ Million	Total assets	
	June 30, 2019	December 31, 2018
Segment		
Property leasing		
– Mainland China	**112,166**	103,489
– Hong Kong	**67,656**	66,634
	179,822	170,123
Property sales		
– Hong Kong	**4,337**	2,443
Segment total	**184,159**	172,566
Interest in joint ventures	**1,346**	1,330
Other assets	**93**	93
Cash and deposits with banks	**6,208**	12,363
Assets held for sale	**110**	101
Total assets	**191,916**	186,453

4. OTHER NET INCOME

HK$ Million	**2019**	2018
Ineffectiveness on cash flow hedges	**1**	–
Gain on disposal of investment properties	**–**	45
Gain on disposal of assets held for sale	**–**	25
Others	**3**	–
	4	70

5. NET INTEREST INCOME/(EXPENSE)

HK$ Million	2019	2018
Interest income on bank deposits	96	256
Interest expense on bank loans and other borrowings	724	619
Interest expense on lease liabilities (Note 21)	8	8
Other borrowing costs	23	15
Total borrowing costs	755	642
Less: Borrowing costs capitalized	(747)	(100)
Finance costs	8	542
Net interest income/(expense)	88	(286)

6. PROFIT BEFORE TAXATION

HK$ Million	2019	2018
Profit before taxation is arrived at after charging:		
Cost of properties sold	–	350
Staff costs (Note)	652	633
Depreciation	22	22

Note: The staff costs included employee share-based payments of HK$26 million (2018: HK$34 million). If the amounts not recognized in the statement of profit or loss, such as amounts capitalized to investment properties under development, were accounted for, staff costs would have been HK$813 million (2018: HK$755 million).

7. TAXATION

(a) Provision for Hong Kong Profits Tax is calculated at 16.5% (2018: 16.5%) of the estimated assessable profits for the period. Mainland China Income Tax mainly represents mainland China Corporate Income Tax calculated at 25% (2018: 25%) and mainland China withholding income tax calculated at the applicable rates. A withholding tax of 5% is levied on the Hong Kong companies in respect of dividend distributions arising from profits of foreign investment enterprises in mainland China earned after January 1, 2008.

HK$ Million	**2019**	2018
Current tax		
Hong Kong Profits Tax	**269**	283
Mainland China Income Tax	**327**	379
Total current tax	**596**	662
Deferred tax		
Changes in fair value of properties	**40**	66
Other origination and reversal of temporary differences	**62**	8
Total deferred tax	**102**	74
Total income tax expense	**698**	736

(b) There is no tax effect relating to the components of the other comprehensive income for the period.

8. DIVIDENDS

(a) Interim dividend

HK$ Million	**2019**	2018
Proposed after the end of the reporting period:		
HK17 cents (2018: HK17 cents) per share	**765**	765

The dividend proposed after the end of the reporting period has not been recognized as a liability at the end of the reporting period.

(b) Final dividend approved and paid during the six months ended June 30, 2019

HK$ Million	**2019**	2018
2018 Final dividend of HK58 cents		
(2017: HK58 cents) per share	**2,609**	2,609

9. EARNINGS PER SHARE

(a) The calculation of basic and diluted earnings per share is based on the following data:

HK$ Million	2019	2018
Earnings used in calculating basic and diluted earnings per share (net profit attributable to shareholders)	**3,516**	4,689

	Number of shares	
	2019	2018
Weighted average number of shares used in calculating basic earnings per share	**4,497,718,670**	4,497,645,393
Effect of dilutive potential shares – share options	**–**	754,332
Weighted average number of shares used in calculating diluted earnings per share	**4,497,718,670**	4,498,399,725

Note: Diluted earnings per share were the same as the basic earnings per share for the period as there was no dilutive effect on the potential ordinary shares during the six months ended June 30, 2019.

9. EARNINGS PER SHARE (Continued)

(b) The underlying net profit attributable to shareholders, which excluded changes in fair value of properties net of related income tax and non-controlling interests, is calculated as follows:

HK$ Million	**2019**	2018
Net profit attributable to shareholders	**3,516**	4,689
Effect of changes in fair value of properties	**(1,438)**	(2,456)
Effect of corresponding income tax	**107**	66
Effect of changes in fair value of investment properties of joint ventures	**(13)**	(28)
	(1,344)	(2,418)
Non-controlling interests	**57**	48
	(1,287)	(2,370)
Underlying net profit attributable to shareholders	**2,229**	2,319

The earnings per share based on underlying net profit attributable to shareholders were:

	2019	2018
Basic	**HK$0.50**	HK$0.52
Diluted	**HK$0.50**	HK$0.52

10. INVESTMENT PROPERTIES AND INVESTMENT PROPERTIES UNDER DEVELOPMENT

(a) Additions

During the six months ended June 30, 2019, additions to investment properties and investment properties under development amounted to HK$9,929 million (2018: HK$4,936 million). The additions included the final payment to Hangzhou Land Resources Bureau for acquiring the land in Xiacheng District, Hangzhou, Zhejiang Province, PRC.

(b) Valuation

The investment properties and investment properties under development of the Group were revalued as of June 30, 2019 by Mr. Charles C.K. Chan, Registered Professional Surveyor (General Practice), of Savills Valuation and Professional Services Limited, on a market value basis.

11. CASH AND DEPOSITS WITH BANKS

At the end of the reporting period, the Group had cash and deposits with banks with currencies denominated in:

HK$ Million	**June 30, 2019**	December 31, 2018
Hong Kong Dollars	**3,484**	4,673
Hong Kong Dollars equivalent of:		
Renminbi	**2,715**	7,681
United States Dollars	**9**	9
	6,208	12,363

After deducting cash and deposits from bank loans and other borrowings, the net debt position of the Group at the end of the reporting period was as follows:

HK$ Million	**June 30, 2019**	December 31, 2018
Bank loans and other borrowings	**31,615**	27,253
Less: Cash and deposits	**(6,208)**	(12,363)
Net debt	**25,407**	14,890

12. TRADE AND OTHER RECEIVABLES

(a) Included in trade and other receivables are trade receivables (based on the due date) with the following aging analysis:

HK$ Million	**June 30, 2019**	December 31, 2018
Not past due or less than 1 month past due	**16**	13
1–3 months past due	**3**	4
More than 3 months past due	**2**	2
	21	19

The Group maintains a defined credit policy including stringent credit evaluation on and payment of a rental deposit from tenants. In addition to the payment of rental deposits, tenants are required to pay monthly rents in respect of leased properties in advance. Receivables are regularly reviewed and closely monitored to minimize any associated credit risk. Given the Group has not experienced any significant credit losses in the past and holds sufficient rental deposits from tenants to cover the potential exposure to credit risk, the allowance for expected credit losses is therefore insignificant.

(b) Included in other receivables of the Group is a deposit of land acquisition in mainland China of HK$284 million (December 31, 2018: HK$285 million).

13. BANK LOANS AND OTHER BORROWINGS

At the end of the reporting period, the Group had HK$11,283 million (December 31, 2018: HK$16,224 million) of committed undrawn banking facilities.

In addition, the Group has a USD3 billion (December 31, 2018: USD3 billion) Medium Term Note Program and a RMB10 billion (December 31, 2018: RMB10 billion) green bond program. At the end of the reporting period, the Group issued in total an equivalent of HK$13,501 million (December 31, 2018: HK$13,508 million) of bonds with coupon rates ranging from 2.95% to 5.00% (December 31, 2018: 2.95% to 5.00%) per annum.

14. TRADE AND OTHER PAYABLES

(a) Included in trade and other payables are trade creditors with the following aging analysis:

HK$ Million	**June 30, 2019**	December 31, 2018
Due within 3 months	**1,787**	1,737
Due after 3 months	**665**	850
	2,452	2,587

(b) Included in trade and other payables is an amount of HK$601 million (December 31, 2018: Nil) due to a fellow subsidiary, which is the joint developer of a project at Electric Road in which the Group and the fellow subsidiary hold respective interests of 66.67% and 33.33%. The amount represents the contribution by the fellow subsidiary in proportion to its interest to finance the above project, and is unsecured, non-interest bearing and has no fixed terms of repayment.

15. ASSETS HELD FOR SALE

On June 26, 2019, the Group entered into a sale and purchase agreement with an independent third party to dispose of all the car parking spaces held at Laichikok Bay Garden in Hong Kong. Accordingly, the relevant assets are presented as assets held for sale. The completion of the transaction is scheduled to take place in September 2019.

HK$ Million	**June 30, 2019**	December 31, 2018
Investment properties	**110**	101
Deferred tax liabilities	**–**	3

The balance at December 31, 2018 represented:

- a disposal group relating to the residential unit and several car parking spaces at Garden Terrace in Hong Kong which were disposed of in April 2019; and
- an investment property of a car parking space at The Long Beach in Hong Kong which was disposed of in February 2019.

16. SHARE CAPITAL

Movements of the Company's ordinary shares are set out below:

	June 30, 2019		December 31, 2018	
	Number of shares Million	**Amount of share capital HK$ Million**	Number of shares Million	Amount of share capital HK$ Million
Ordinary shares, issued and fully paid:				
At January 1	**4,498**	**39,915**	4,498	39,912
Shares issued under share option scheme	**–**	**–**	–	3
At June 30/December 31	**4,498**	**39,915**	4,498	39,915

17. SHARE OPTION SCHEMES

The share option scheme adopted by the Company on November 22, 2002 (the "2002 Share Option Scheme") was terminated upon the adoption of a new share option scheme on April 18, 2012 (the "2012 Share Option Scheme"). No further options shall be offered under the 2002 Share Option Scheme, but all options granted prior to such termination and not exercised at the date of termination shall remain valid. The share options granted under the above two share option schemes to the directors and employees are at nominal consideration and each share option gives the holder the right to subscribe for one share.

The movements of share options of the Company during the six months ended June 30, 2019 were as follows:

(a) 2002 Share Option Scheme

	Number of share options					
Date granted	Outstanding on January 1, 2019	Exercised	Forfeited/ Lapsed	**Outstanding on June 30, 2019**	Period during which options are exercisable	Exercise price (HK$)
February 8, 2010 to June 1, 2010	13,380,000	–	–	**13,380,000**	February 8, 2012 to May 31, 2020	26.46 – 27.27
July 29, 2010 to June 13, 2011	30,990,000	–	(300,000)	**30,690,000**	July 29, 2012 to June 12, 2021	30.79 – 36.90
Total	44,370,000	–	(300,000)	**44,070,000**		

All the above options may vest after two to five years of the grant date and are exercisable up to the tenth anniversary of the date of grant, after which they will lapse. No options were exercised or cancelled during the six months ended June 30, 2019.

During the six months ended June 30, 2019, 300,000 options (2018: Nil) were forfeited upon cessations of the grantees' employments and no option (2018: 200,000 options) lapsed due to the expiry of the period for exercising the options.

17. SHARE OPTION SCHEMES (Continued)

(b) 2012 Share Option Scheme

	Number of share options					
Date granted	Outstanding on January 1, 2019	Granted	Forfeited/ Lapsed	**Outstanding on June 30, 2019**	Period during which options are exercisable	Exercise price (HK$)
June 4, 2013	27,350,000	–	(760,000)	**26,590,000**	June 4, 2015 to June 3, 2023	28.20
December 5, 2014	23,622,000	–	(692,000)	**22,930,000**	December 5, 2016 to December 4, 2024	22.60
August 10, 2017	39,495,000	–	(1,695,000)	**37,800,000**	August 10, 2019 to August 9, 2027	19.98
May 16, 2018	10,000,000	–	–	**10,000,000**	May 16, 2020 to May 15, 2028	18.98
June 28, 2019	–	55,492,000	–	**55,492,000**	June 28, 2021 to June 27, 2029	18.58
Total	100,467,000	55,492,000	(3,147,000)	**152,812,000**		

All the above options may vest after two to five years of the grant date and are exercisable up to the tenth anniversary of the date of grant, after which they will lapse. No options were exercised or cancelled during the six months ended June 30, 2019.

In respect of options granted during the six months ended June 30, 2019, the closing price of the shares immediately before the date of grant was HK$18.52.

17. SHARE OPTION SCHEMES (Continued)

(b) 2012 Share Option Scheme (Continued)

During the six months ended June 30, 2019, 3,147,000 (2018: 2,708,000) options were forfeited upon cessations of the grantees' employments.

The fair value of share options granted was estimated at the date of grant using the Black-Scholes pricing model taking into account the terms and conditions upon which the options were granted. In respect of the share options granted during the six months ended June 30, 2019, the fair value, terms and conditions, and assumptions were as follows:

Fair value at grant date	HK$2.45
Share price at grant date	HK$18.58
Exercise price	HK$18.58
Risk-free interest rate	1.39%
Expected life (in years)	6
Expected volatility	23.38%
Expected dividends per share	HK$0.75

The expected volatility is based on the historical volatility and the expected dividends per share are based on historical dividends. Changes in the above assumptions could materially affect the fair value estimate.

18. RESERVES

HK$ Million	Other reserves						
	Exchange reserve	Hedging reserve	Investment revaluation reserve	Employee share-based compensation reserve	Total	Retained profits	Total reserves
At January 1, 2019	(1,801)	(143)	93	734	(1,117)	98,763	97,646
Profit for the period	–	–	–	–	–	3,516	3,516
Exchange difference arising from translation to presentation currency	(373)	–	–	–	(373)	–	(373)
Cash flow hedges: net movement in hedging reserve	–	70	–	–	70	–	70
Total comprehensive income for the period	(373)	70	–	–	(303)	3,516	3,213
Final dividend in respect of previous financial year	–	–	–	–	–	(2,609)	(2,609)
Employee share-based payments	–	–	–	10	10	16	26
At June 30, 2019	(2,174)	(73)	93	744	(1,410)	99,686	98,276
At January 1, 2018	1,573	(134)	85	727	2,251	93,995	96,246
Profit for the period	–	–	–	–	–	4,689	4,689
Exchange difference arising from translation to presentation currency	(695)	–	–	–	(695)	–	(695)
Cash flow hedges: net movement in hedging reserve	–	11	–	–	11	–	11
Net change in fair value of equity investments	–	–	2	–	2	–	2
Total comprehensive income for the period	(695)	11	2	–	(682)	4,689	4,007
Final dividend in respect of previous financial year	–	–	–	–	–	(2,609)	(2,609)
Employee share-based payments	–	–	–	22	22	12	34
At June 30, 2018	878	(123)	87	749	1,591	96,087	97,678

19. FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS

The fair value of the Group's financial instruments are measured at the end of the reporting period on a recurring basis, categorized into the three-level fair value hierarchy as defined in HKFRS 13, *Fair value measurement*. The level into which a fair value measurement is classified and determined with reference to the observability and significance of the inputs used in the valuation technique is as follows:

- Level 1 valuations: Fair value measured using only level 1 inputs i.e. unadjusted quoted prices in active markets for identical assets or liabilities at the measurement date

- Level 2 valuations: Fair value measured using level 2 inputs i.e. observable inputs which fail to meet level 1, and not using significant unobservable inputs. Unobservable inputs are inputs for which market data are not available.

- Level 3 valuations: Fair value measured using significant unobservable inputs

(a) Financial assets and liabilities carried at fair value

i) *Derivative financial instruments – cross currency swaps*

The fair value of cross currency swaps as of June 30, 2019 of HK$36 million recorded under "Trade and other receivables" (December 31, 2018: HK$1 million recorded under "Trade and other receivables" and HK$10 million recorded under "Trade and other payables") in Level 2 is determined based on the amount that the Group would receive or pay to terminate the swaps at the end of the reporting period taking into account current interest rates and current creditworthiness of the swap counter-parties.

ii) *Investment in equity instruments*

The fair value of non-publicly traded equity investments as of June 30, 2019 of HK$93 million (December 31, 2018: HK$93 million) in Level 3 is determined by reference to the net asset value of these investments.

19. FAIR VALUE MEASUREMENT OF FINANCIAL INSTRUMENTS (Continued)

(a) Financial assets and liabilities carried at fair value (Continued)

iii) Transfers of instruments between the three-level fair value hierarchy

During the six months ended June 30, 2019, there was no transfer of instruments between Level 1 and Level 2, or transfer into or out of Level 3 (2018: Nil). The Group's policy is to recognize transfers between levels of fair value hierarchy as of the end of the reporting period in which they occur.

(b) Financial assets and liabilities carried at other than fair value

The carrying amounts of the Group's financial instruments carried at cost or amortized cost were not materially different from their fair values as of December 31, 2018 and June 30, 2019.

20. COMMITMENTS

At the end of the reporting period, capital commitments not provided for in the interim financial report were as follows:

HK$ Million	**June 30, 2019**	December 31, 2018
Contracted for	**6,898**	14,255
Authorized but not contracted for	**25,509**	20,556
	32,407	34,811

The above commitments include mainly the land costs and construction related costs to be incurred in respect of the Group's development of its investment properties in various cities in mainland China.

21. COMPARATIVE FIGURES

The Group applied HKFRS 16 at January 1, 2019 using the modified retrospective method. Under this method, comparative information is not restated. As a result, the balance of lease liabilities as of December 31, 2018 in the consolidated statement of financial position and the amount of interest element of lease rentals paid for the six months ended June 30, 2018 in the condensed consolidated cash flow statement represent the amounts in respect of finance leases under HKAS 17 only.

The Group applied Amendments to HKAS 23 at January 1, 2019 using a prospective approach according to the transitional provisions. Comparative information is not restated.

Further details of the changes in accounting policies are disclosed in note 2.

22. REVIEW AND APPROVAL OF INTERIM FINANCIAL REPORT

The interim financial report is unaudited, but has been reviewed by the Audit Committee. It was authorized for issue by the Board of Directors on July 30, 2019.

FINANCIAL TERMS

Finance costs: Total of interest expense on total borrowings and other borrowing costs, net of amount capitalized

Total borrowings: Total of bank loans and other borrowings, net of unamortized other borrowing costs

Net debt: Total borrowings net of cash and deposits with banks

Net profit attributable to shareholders: Profit for the period (after tax) less amounts attributable to non-controlling interests

Underlying net profit attributable to shareholders: Net profit attributable to shareholders excluding changes in fair value of properties net of related income tax and non-controlling interests

FINANCIAL RATIOS

$$\text{Basic earnings per share} = \frac{\text{Profit attributable to shareholders}}{\text{Weighted average number of shares in issue during the period}}$$

$$\text{Debt to equity} = \frac{\text{Total borrowings}}{\text{Total equity}}$$

$$\text{Net assets per share} = \frac{\text{Net assets}}{\text{Weighted average number of shares in issue during the period}}$$

$$\text{Net debt to equity} = \frac{\text{Net debt}}{\text{Total equity}}$$

$$\text{Interest cover} = \frac{\text{Operating profit before changes in fair value of properties}}{\text{Finance costs before capitalization less interest income}}$$

FINANCIAL CALENDAR

Financial period	January 1, 2019 to June 30, 2019
Announcement of interim results	July 30, 2019
Latest time for lodging transfers	4:30 p.m. on September 11, 2019
Closure of share register	September 12 to 13, 2019 (both days inclusive)
Record date for interim dividend	September 13, 2019
Payment date for interim dividend	September 26, 2019

SHARE LISTING

As at June 30, 2019, 4,497,718,670 shares are listed on The Stock Exchange of Hong Kong Limited. It has a sponsored American Depositary Receipt (ADR) Program in the New York market.

STOCK CODE

Hong Kong Stock Exchange: 00101
Reuters: 0101.HK
Bloomberg: 101 HK
CUSIP Number/Ticker Symbol for ADR Code: 41043M104/HLPPY

SHARE INFORMATION

Share price as at June 30, 2019: HK$18.58
Market capitalization as at June 30, 2019: HK$83.57 billion

SHARE REGISTRAR

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