To Our Shareholders

RESULTS AND DIVIDENDS

In the past fiscal year, turnover increased by $3,001.6 million to $5,823.4 million. Net profit attributable to shareholders was $744.5 million which was 14.7% lower than the year before. Earnings per share was 56.3 cents per share, a decrease of 14.3% over previous year's figure.

The Board recommends a final dividend of 32 cents per share and together with the interim dividend paid earlier on this year, full year dividends would be 44 cents per share, representing a decrease of 16.2% from that of last year.

BUSINESS REVIEW

The real estate slump which started at the end of 1997 and in early 1998 must be one of the worst in the post-war era both in terms of nature and duration. All pronouncements of the market bottoming out have so far proven premature.

The industry downturn in the early 1980's, for example, was due to the very high prices of 1980-1981 and the subsequent political uncertainty surrounding Hong Kong's return to Chinese rule. Once the Joint Declaration between the Chinese and the British was signed in 1984, the market began to slowly but surely recover. In fact, because of the limited land supply and continued negative interest rate environment, the price hike accelerated into what was the biggest property boom in decades. Not only were the two principal structural elements underpinning the industry, i.e. insufficient land supply and untransparent market, not broken, they were exacerbated.

The present bear market is primarily caused by structural changes in the industry. The SAR government wants to bring prices down by granting sufficient land and making the market transparent. This new policy announced on July 1,1997 called for the construction of 85,000 residential units per year. At the time, Hong Kong citizens including all political parties cheered the decision. To be fair, there was nothing wrong with the policy, if not for the Asian economic crisis which arrived on July 2,1997. Knowing Mr. Tung Chee Hwa and the Hong Kong government, I do not believe that the target was cast in stone. Instead, it represents roughly the steady housing demand of the previous decade and could be adjusted as the market expands or contracts. This was why I supported the new policy from day one, for Hong Kong was pricing itself out of competition vis-à-vis our neighbors. What none of us knew at the time was the onslaught and severity of the economic crisis which swept the region. The expected soft landing turned into a hard one.

Another structural change was that the negative interest rate which had started in mid-1985 and persisted for 12$^1/_2$ years, finally ended in early-1998. The property market was driven to its heights and developers were loaded with expensive land banks. Now that the situation is reversed, they are forced to unload to generate cash. Potential homebuyers see the abundant supply and have decided to wait.

Among other reasons for continued market weakness is deflation which has existed since the last quarter of 1998. As we all know, deflation is the worst enemy of real estate. The recent terrorist attack in the U.S. coming on the heel of an already slowing global economy will ensure that Hong Kong's recovery will be postponed.

Moreover, for the past three years unemployment has stayed at a high level relative to the past. Although absolute numbers have moderated from the worst of 6.2% in the first quarter of 1999 to the 4.9% of today, there are signs that the present plight may be nastier for the housing sector. A few years ago, it was mainly the low skilled laborers who lost their jobs; now financial and other service firms are beginning to seriously cut staff. The tens of thousands of laid-off professionals are either homeowners or potential homeowners. Those who are already suffering from negative equity but do not have a cash flow problem because their jobs are secure, may now be in trouble. Mortgage defaults which have been on the rise may worsen.

In private discussions with top government officials, I am convinced that all along they are well aware of the housing problem and its serious effects on the overall economy. However, having to pander to various constituents of society, they do not want to appear as favoring developers. The result is that the government's real estate policy appears to be wavering. In the end, economic realities prevail and the government (which controls land supply and through quasi-governmental bodies like the Housing Authority is the biggest builder of housing units) has to take repeated actions to prevent a further price slide. Afterall, about half of our citizens own their apartments and continued deterioration will destroy whatever remaining confidence they have. The situation is dire indeed. Even when the government two weeks ago requested the Housing Authority to stop selling Home Ownership Scheme units for nine months, the market did not respond.

In view of this very weak and uncertain market, land acquisition must be carried out with extreme caution. To illustrate how treacherous is the situation, there is strong evidence that ten months after we bought Kowloon Station Package 4 in March 1999, our neighboring lot went for an estimated 40-50% more in accommodation value. On the other hand, twelve months prior to our December 2000 acquisition of a piece not far from the Olympic Station in West Kowloon, a developer paid over 50% more for the adjacent piece. In both cases, our plots are bigger and better situated than those of our neighbors'.

Given that, we should be pleased with our land purchases. Indeed we are, but I should caution that the market may yet mock anyone who celebrates prematurely. Prices paid seem reasonable enough, but only time will tell how much profit these projects will bring.

In the past fiscal year, there were two brief periods when sentiment was relatively better — August 2000 after Hong Kong's Chief Executive announced that the annual housing target of 85,000 units was no longer valid, and February 2001 after several successive interest rate cuts and moderation of government imposed anti-speculation measures. We took advantage of both and sold 99% of Baycrest in Ma On Shan and about two-thirds of Garden Terrace in Mid-Levels. 92% of 2,158 units of Phase I of the joint venture project Tung Chung Crescent are now sold.

On the rental front, again any note of optimism in the past year now seems inappropriate. Offices and high end residential are particularly weak. Not only is there no new demand for offices, companies are cutting staff such that excess space will be released back to the market at the next rent renewal. Secondary locations are especially hard hit, but even core Central will be hurt since there will be several new buildings coming up in the next two to three years.

Retail space has suffered less but there is a great discrepancy between prime and secondary locations. Ground floor shops may lease well but those upstairs will have a hard time finding tenants. One problem is that Hong Kong people today are no longer eager to start businesses. In the past when their residential units were worth something, many borrowed against them and struck out on new ventures. Now, such activities are financially more difficult and psychologically less propitious.

Overall occupancy rate for our entire rental portfolio stood at 93% at fiscal year end but the trend is in the wrong direction. I expect the situation to deteriorate in the coming months. Besides the insignificant industrial sector, residential also saw a double digit vacancy rate. This number, however, was affected by Garden Terrace where we had purposely kept certain units empty to facilitate their sales.

In April, Plaza 66 on Nanjing Xilu in Shanghai had its soft opening and official opening was on July 14. It is possible that more of the world's top fashion brands are found there than anywhere else in China. To many people's surprise, most of them are trading well from day one. Some are even asking for more space. As can be expected, however, shops on the higher floors do less satisfactorily and will undergo a certain turnover over time. The office tower, which is for now the tallest in Puxi, the older and densely populated part of the city, is practically fully leased. Most of the tenants are well known corporate names.

The bigger shopping mall The Grand Gateway in Shanghai's Xujiahui District has performed acceptably. Since opening less than two years ago, traffic has increased steadily.

The apparently good results of Grand Hotel Holdings belie extremely difficult times in the hospitality industry. This year's bottom line will not be as pleasing as the one under review.

Non-real estate investments are progressing. As stated six months ago, I hoped to have more to report before next March. That seemed reasonable until the terrorist attack of two weeks ago. It has forced the delay of one of our projects. Nevertheless I am hopeful that it will be put back on track before long.

PROSPECTS

For those of us in the real estate industry, times are not only difficult but fraught with danger. Prices, profit margins (if there are profits at all) and transaction volumes are all falling and will likely stay low for the foreseeable future. Given that, a major mistake in land purchase may prove fatal to a weaker or smaller player. It will be knocked out of competition for several years at least.

The financing environment has also changed considerably. Banks are less willing to lend to anything less than blue-chip names. Due to our financial strength and size, we (including our property subsidiary Amoy) are high on the preferred client list of banks and can easily raise funds from the capital market.

All these indicate that the industry will consolidate further. The few stronger players including ourselves will get even stronger while some weaker ones will gradually fade. This has always been a cruel game and it will be even more so in the future.

Amidst these perilous times, your management team is, while extremely cautious, in fact invigorated. Our relative position in the marketplace has been strengthened in the past two to three years. Having made less mistakes during the go-go days of 1995-1997 compared to our competitors, and having taken every opportunity to strengthen our balance sheet for the past decade, we have emerged stronger and healthier. Shrewd acquisitions of the past 30 months have further put us in a favorable position. Now Amoy ranks among the top land bank holders in terms of in-town residential sites. More significantly, they probably have the lowest per unit land cost and are all very well located.

Yet there are many challenges ahead. Foremost is to achieve one of the best profit margins in the industry. There is now that possibility. The days which favored companies with cheap Land Exchange Entitlements are gone; they have all been exhausted. Now all compete on a level playing field. This should, at least in theory, favor those of us who are used to fighting uphill battles. Ultimately, it will be those who buy the best land at the lowest price that will win. Here we cannot afford to be careless and will always use our best judgement.

Another challenge is to strengthen our management team in all areas but especially in project management and property management. To be able to produce the best product within budget and in the shortest time possible will be another key to future success.

If we achieve the above, then along the way we may even pick up market share in mass residential developments. Ultimately, my goal is to build Hang Lung into one of the top two or three real estate companies in Hong Kong as measured by profitability, product quality and management excellence. For that, I count on the support of our loyal shareholders.

Ronnie C. Chan
Chairman

Hong Kong, 24 September 2001

The foundation is the source.
It is the seed from which all things grow.
It is a pure idea, a true desire,
that moves intention into reality.