Introduction

The core businesses of the Company and its subsidiaries and associates consist of property investment, property development, hospitality related activities and financial services. The Company is a subsidiary of Allied Group Limited ("Allied Group"), another publicly listed company in Hong Kong. The Company's interests in property investment and development and hospitality related activities in Hong Kong are mainly held through its wholly-owned subsidiaries or the 50% owned Allied Kajima Limited ("Allied Kajima"), and in respect of property investment and development and hospitality related activities in The People's Republic of China ("PRC"), through the 48.6% holding in Tian An China Investments Company Limited ("Tian An") held by Sun Hung Kai. The Company's financial services business is mainly conducted through its 74.99% holding in Sun Hung Kai.

Financial Review

The turnover of the Group for the year 2004 was approximately HK$1,128.2 million, an increase of 30.8% from the previous year due mainly to increase in income from investment, broking and financial services, increase in rental income and hotel revenue, partially offset by the decrease in interest income.

The Group's profit attributable to shareholders increased more than twofold by HK$357.5 million to HK$668.5 million from HK$311.0 million of 2003. The 115.0% increase in profit was primarily due to revaluation surpluses and a reversal of impairment losses in relation to the Group's Hong Kong properties totalling HK$158.0 million whilst in year 2003, the revaluation deficits and impairment losses charged to the income statement were HK$40.4 million, as well as the stronger performance of Sun Hung Kai, a listed subsidiary of the Group.

Segmental Information

Detailed segmental information in respect of the Group's turnover and contribution to profit from operations as well as other information is shown in note 4 to the financial statements.

Financial Resources, Liquidity and Capital Structure

The Group is principally financed by net cash inflow from operating activities and banking facilities granted by the banks. The banking facilities of the Group are reviewed from time to time and new banking facilities will be obtained or renewed to meet the funding requirements for capital commitments, investments and operations of the Group.

During the year, 47,767,684 warrants, representing approximately 97.6% of the total outstanding warrants, were converted into 47,767,684 ordinary shares at a subscription price of HK$2.5 per share. A proceed of HK$119.4 million was raised from the exercise of warrant subscription rights by warrantholders, and the Company's issued share capital increased from HK$978.8 million to HK$1,074.3 million accordingly. The remaining 1,157,975 warrants, representing 1,157,975 ordinary shares issuable lapsed at the close of business on 6th December, 2004.

At 31st December, 2004, the current ratio (current assets/current liabilities) of the Group was 1.70 times, which increased from the 1.41 times applicable at the end of the preceding year.

Financial Review (Cont'd)

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

At 31st December, 2004, the Group's net borrowings amounted to HK$1,179.9 million (2003: HK$1,602.3 million), representing bank borrowings and loan notes of HK$1,779.4 million (2003: HK$2,233.0 million) less bank deposits, bank balances and cash of HK$599.5 million (2003: HK$630.7 million) and the Group had net assets of HK$5,818.6 million (2003: HK$4,889.3 million). Accordingly, the Group's gearing ratio of net borrowings to net assets was 20.3% (2003: 32.8%).

	2004	2003
	HK$'000	HK$'000
Bank borrowings of the Group are repayable as follows:		
Within one year or on demand	**603,180**	1,059,908
More than one year but not exceeding two years	**226,738**	70,760
More than two years but not exceeding five years	**733,469**	759,110
More than five years	**86,362**	111,565
	1,649,749	2,001,343
Loan notes repayable within five years	**129,637**	231,637
	1,779,386	2,232,980

The bank borrowings of the Group were charged at floating interest rates. Finance costs decreased from HK$60.0 million in 2003 to HK$47.2 million during the year as a result of reduction of bank borrowings and continuing efforts made in reducing the interest rate margin payable, as well as a low interest rate environment in 2004.

Risk of Foreign Exchange Fluctuation

Other than the finance business (in regard to which, the foreign exchange risk will be mentioned later in this report), the Group's other operating activities are mainly denominated in Hong Kong dollars. Accordingly, the Group has no other significant exposure to foreign exchange fluctuations.

Acquisition of a Subsidiary

During the year, the Group acquired the entire issued share capital of and loans to Gilmore Limited ("Gilmore") for an aggregation consideration of HK$125.4 million. Gilmore is a property holding company and holds the whole of the 22nd Floor, No. 9 Queen's Road Central, Hong Kong.

Acquisition of Additional Interest in Tian An

During the year, Sun Hung Kai exercised warrants to subscribe for 44,000,000 shares and purchased 2,196,000 shares in Tian An for a total consideration of HK$92.8 million.

Financial Review (Cont'd)

Contingent Liabilities

Details of contingent liabilities are set out in note 35 to the financial statements.

Material Litigation Update

(a) On 28th February, 2005, by order of the High Court of Hong Kong, the claim by Shenzhen Building Materials Group Co. Limited against Sun Hung Kai Investment Services Limited ("SHKIS"), an indirect wholly-owned subsidiary of Sun Hung Kai, was dismissed with costs to SHKIS.

(b) By the Judgment of the High Court of Hong Kong on 1st April, 2004 ("Judgment") in HCA3191/1999 between New World Development Company Limited ("NWDC") and Stapleton Development Limited against Sun Hung Kai Securities Limited ("SHKS"), a wholly-owned subsidiary of Sun Hung Kai, SHKS was ordered to pay NWDC the sum of HK$105,534,018 together with interest on the principal sum of HK$80,117,653 at judgment rate from 16th December, 1998 until payment, pursuant to the terms of an oral agreement which the Court found ("Oral Agreement"). As at 17th June, 2004, the date when the Judgment sum was to be paid, the Judgment amounted to HK$150,115,682 (being HK$105,534,018 plus interest of HK$44,581,664). SHKS has paid the Judgment amounts. SHKS has filed an appeal against the Judgment both as to liability and quantum ("Appeal") to the Court of Appeal. The Appeal has been set down for hearing commencing 7th June, 2005. The decision of the Court of Appeal is likely to be delivered some months after the Appeal. Matters relating to the Judgment are further described in notes 6, 20 and 35(c) to the financial statements.

(c) Shun Loong Finance Limited and Shun Loong Holdings Limited (together the "Petitioners"), both wholly-owned subsidiaries of Sun Hung Kai, filed a winding-up petition on 19th February, 2004 in the British Virgin Islands ("B.V.I.") seeking an order that Shanghai Finance Holdings Limited be wound up by reason of its failure to pay debts owing to the Petitioners. The B.V.I. proceedings were stayed by order of the B.V.I. court. The Petitioners have appealed that decision but have agreed not to pursue the appeal during the stay of 200/2004.

(d) Sun Hung Kai, Sun Tai Cheung Credits Limited, an indirect wholly-owned subsidiary of Sun Hung Kai, and SHKIS filed a writ on 7th February, 2004 (230/2004) naming as defendants Shanghai Land Holdings Limited, Stephen Liu Yiu Keung, Yeo Boon Ann, The Standard Newspapers Publishing Limited and Hong Kong Economic Times Limited and claiming damages for libel, injunctive relief, interest and costs. The case remains at an early stage.

(e) SHKIS filed a notice of action on 8th June, 2004 in Canada naming as defendants Sung Chun ("Sung"), Song Lei ("Song") and the Bank of Montreal claiming from Sung and Song reimbursement for funds totalling US$1,300,000 transferred by them in addition to costs, and against the Bank of Montreal for an injunction freezing the subject funds or alternatively for payment of the funds into court. SHKIS discontinued the action in respect of the Bank of Montreal, and agreed to a dismissal of the action against Song. The funds are currently in the custody of the Superior Court of Justice. On 31st March, 2005, the Court granted summary judgment to SHKIS in the amount of Canadian currency sufficient to purchase HK$10,533,000 plus prejudgment and postjudgment interest thereon.

Financial Review (Cont'd)

Material Litigation Update (Cont'd)

(f) SHKIS filed a writ on 23rd July, 2004 in Hong Kong naming as defendants Sellon Enterprises Limited ("Sellon"), Sung and Song and seeking a declaration that Sellon holds property wholly or in part on trust for SHKIS.

Pledges of Assets

Details regarding pledges of assets are set out in note 39 to the financial statements.

Operational Review

PROPERTIES

Hong Kong

The Group's rental income increased moderately during the year under review. Major contributors of rental income included St. George Apartments, China Online Centre, Century Court and Allied Cargo Centre. Moreover, the Group completed the acquisition of the whole of the 22nd Floor of No. 9 Queen's Road Central in late 2004, thus adding a stable rental income stream to the Group's office portfolio. The Group will take advantage of the buoyant property market to review its Hong Kong rental property portfolio with a view to maximising yields.

Following the issuance of the occupation permit for phase two of Ibis North Point ("Ibis"), the hotel in Java Road, in December 2004 and the hotel licence, the hotel extension has been put into operation. After the completion of Ibis, all of the Group's development projects in Hong Kong have been completed. The Group will continue to assess opportunities for appropriate property investments should they arise.

Allied Kajima reported a 15.9% increase in profit attributable to its shareholders from the year 2003. Both the Novotel Century Hong Kong hotel and the Westin Philippine Plaza Hotel had improved performance from 2003 due to increased tourist arrivals in Hong Kong and the Philippines respectively, although the rental income from Allied Kajima Building decreased during the year resulting from lower occupancy rates and reduced rental rates.

Mainland PRC

Although total sales of gross floor area attributable to Tian An during the year under review decreased to 225,000 square metres from 291,000 square metres, profit attributable to its shareholders amounted to HK$200.6 million for the year, representing a significant growth of 95.9% compared to the previous year. The sharp improvement in the results for the year was mainly attributable to stronger contributions from property sales and the focus by Tian An on products of higher profit margin.

In the longer term, Tian An aims at becoming one of the premier real estate companies in Mainland China and hopes to improve its performance by adoption of the following policies, namely: (a) retaining developed commercial properties with long-term capital appreciation potential for rental yield thereby providing a stable recurrent income base, (b) disposing of inventories of properties and land in non-core cities and concentrating on the development of its very substantial land bank in the major cities of the PRC, and (c) continuing to streamline its management and cost structure.

Details of all major properties (other than those in Mainland China held by associates) are contained in the schedule headed "Particulars of Major Properties".

OPERATIONAL REVIEW (CONT'D)

FINANCIAL SERVICES

Sun Hung Kai achieved a profit attributable to its shareholders of HK$384.8 million, representing a 59.1% increase from the previous year.

Sun Hung Kai's broking commission income exceeded that of the previous year. Its experienced sales staff with their extensive client network capitalised on the buoyant stock market to expand its market share during the year. The income stream derived by Sun Hung Kai as a liquidity provider of derivative warrants and equity linked notes to warrant issuers continued to be strong.

SHK Online achieved significant growth during 2004. Continuing efforts to diversify its products, such as the new e-Option platform for locally listed HSI Options and additional e-Futures products should further provide growth momentum for the division.

In addition to the successful completion of the secondary placement of shares of two listed companies, the Corporate Finance division was involved in the placement of B shares of a PRC company which is listed on the Shenzhen Stock Exchange and a number of underwriting exercises for IPO issues.

Sun Hung Kai's margin loan book increased during the year. Net revenues were strongly positive through the substantial use of its shareholders' funds in a low interest rate environment.

With the continuing weakness in the U.S. dollar in 2004, Sun Hung Kai's foreign exchange volumes reflected a decline in investor interest. However, interest in commodities and precious metals increased significantly. Sun Hung Kai's business from Hang Seng Index Futures also rose substantially this year.

The Wealth Management division experienced strong growth in 2004. The "assets under management" and revenue almost doubled compared with 2003. For the Alternative Investments division, the second half of 2004 remained challenging because of the difficult environment in global financial markets. Nevertheless, all the funds experienced positive growth.

Despite the difficult environment, Sun Hung Kai's Insurance division performed well in 2004 and achieved slight profit growth compared to the preceding year. To meet the challenges ahead, the division continues to strengthen marketing activities, focus on the development of specialty products and markets, and pursue quality business partners and opportunities in the PRC.

After significant transformation of its business structure, management, compliance and control system following its acquisition by Sun Hung Kai in mid 2003, Shun Loong group is now positioning itself for growth with a range of marketing and promotional initiatives planned for Hong Kong and the PRC.

Sun Hung Kai International Bank [Brunei] Limited was officially opened in February 2004. The bank plans to develop international banking business including deposit taking from non-residents, extending credits, arranging money collections and transmissions, foreign exchange, issuance of guarantees as well as offering investment banking and other banking services.

Operational Review (Cont'd)

INVESTMENTS

Quality HealthCare Asia Limited ("QHA")

QHA, a 33.01% owned listed associate of Sun Hung Kai, is Hong Kong's largest listed healthcare company. It provides care for its private and corporate contract patients through a network of more than 560 Western and Chinese medical centres, and 44 dental and physiotherapy centres. In 2004, its network recorded more than 1.9 million healthcare visits. QHA operates eight elderly care homes and Hong Kong's longest-established international nursing service. QHA was awarded "Superbrands Hong Kong 2004" by an independent Superbrands Council during the year in recognition of its well respected brand name.

QHA continued to deliver a substantial improvement in its operating profit, with its turnover in 2004 exceeding HK$780 million. The encouraging results of QHA are a positive reflection of QHA's determination to focus on the consolidation and development of its core businesses.

QHA will continue to develop its specialist medical network and its relationship with private hospitals. It is well positioned to be one of the participants in the public-private partnership initiative to improve the healthcare industry in Hong Kong and also to support the government in any initiatives it may wish to pursue in both reducing costs and providing improved quality of service.

QHA's confidence in its future is reflected in a share repurchase offer which has recently been completed with 21,667,288 shares, representing 10% of its outstanding shares, repurchased and cancelled.

Yu Ming Investments Limited ("Yu Ming")

Yu Ming, a 22.43% owned listed associate of Sun Hung Kai, reported a profit of HK$39.4 million for the year 2004. At 31st December, 2004, the major investments of Yu Ming included a 37.85% owned joint venture which held 13.5% interest in AsiaWorld-Expo, being a 66,000 square metre exhibition centre located at the Hong Kong International Airport, Argyle Centre Shopping Mall in Mongkok, a bond portfolio amounting to HK$195 million and an investment in a Hong Kong based airline. Argyle Centre and the bond portfolio provided the bulk of recurrent income of Yu Ming in 2004. The AsiaWorld-Expo is scheduled to open in January 2006 and its bookings are well into 2008.

Shanghai Allied Cement Limited ("SAC")

For the year ended 31st December, 2004, SAC, a 54.77% owned listed subsidiary of Tian An, reported a net profit of HK$10.4 million, representing a decrease of 79.2% as compared to the year before. The decrease in profit resulted from: (a) the rising cost of raw materials, including coal, which is one of the major cost components of cement production, (b) with the Mainland government's austerity measures taking effect, the demand, and consequently prices, for cement in Mainland China have been falling, and (c) the construction of the new plant in Shandong with a daily clinker production capacity of 2,500 tonnes per day has been utilising substantial financial resources.

SAC's management is cautiously optimistic on the long-term prospects of the cement industry in the PRC and hopes to take advantage of the present competitive environment to improve efficiency and its cost structure so as to be in an improved position to take advantage of any significant upturn of the cement market.

Major Suppliers and Customers

The Group's five largest and top suppliers contributed 99.8% and 91.1% respectively of the total purchases in the year under review. The aggregate sales attributable to the Group's five largest customers accounted for less than 30% of the total turnover. No Directors, their associates, or shareholders of the Company who to the knowledge of the Directors own more than 5% of the Company's share capital, have an interest in any of the five largest suppliers or customers.

Employees

The total number of staff of the Group as at 31st December, 2004 was 1,774 (2003: 1,746). Total staff costs, including Directors' emoluments, amounted to HK$231.7 million (2003: HK$198.6 million). The Group reviews remuneration packages from time to time and normally annually. Besides salary payments, other staff benefits include contributions to employee provident funds, medical subsidies and a discretionary bonus scheme.

Management of Risks

The management of risks in respect of the Group's finance business is primarily conducted by Sun Hung Kai and described as follows:

Operational Risk

Operational risk has been defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

The Group places importance on ensuring that there is an effective operational risk management framework by maintaining strong risk and internal control cultures, including clear lines of responsibility and segregation of duties, effective internal reporting and contingency planning.

Line management is required to declare and submit annually its "responsibility statement for internal control procedures" for review by the internal audit and compliance department ("IAC").

Credit Risk

Credit risk arises from a number of areas. These include the possibility that a counter-party in a transaction may default during the settlement process. It also arises from lending, settlement, treasury, market making, derivatives, proprietary trading, and other activities undertaken by the Group.

The Group's credit manual sets out in detail the credit approval and monitoring procedures, which are established in accordance with sound business practices, the requirements and provisions of the relevant ordinances, and where applicable, the codes or guidelines issued by the Securities and Futures Commission.

Day-to-day credit management is performed by the credit department with reference to the aforementioned criteria including creditworthiness, collateral pledged, and risk concentration of the counter-parties. Decisions made daily by the credit department are reported and reviewed by the management and by the credit and risks management committee at its regular meetings.

Management of Risks (Cont'd)

Liquidity Risk

The Group manages its liquidity position to ensure it maintains a prudent and adequate liquidity ratio, in strict accordance with statutory requirements. This is achieved by the management monitoring the liquidity position of the Group on a daily basis to ensure the availability of sufficient liquid funds to meet all obligations and compliance with the statutory requirements such as the Financial Resources Rules applying to various licensed subsidiaries.

Capital Risk

The Group maintains a strong capital base to support the development of its finance business and to comply, where necessary, with at least the minimum statutory ratios.

Capital is allocated to the various activities of the Group depending on requirements and the degree of risk appropriate to various activities. Cost of capital, as determined from time to time, is allocated against its users.

Interest Rate Risk

Interest rate risk primarily results from timing differences in the re-pricing of interest bearing assets, liabilities and commitments. The Group's interest rate risk exposure arises mainly from margin financing and other lending activities undertaken. The Group has the legal capacity to quickly recall such loans or re-price its margin loans to an appropriate level. Its interest-sensitive positions can readily be identified. Interest rates paid by the Group are managed with the aim of maximising the spread of interest consistent with liquidity and funding obligations.

Foreign Exchange Risk

Foreign exchange risk is the risk to earnings or capital arising from movements of foreign exchange rates.

The Group's foreign exchange risk primarily arises from currency exposures originating from its leveraged foreign exchange business or purchases of foreign securities on behalf of clients. Foreign exchange risk is managed and monitored by the relevant department under the limits approved by the management. In relation to our leveraged foreign exchange activity, our position is that of a market-maker, and accordingly our risk is our open currency positions which are subject to management approved limits and are monitored and reported daily. The other possible risk is primarily a derivative foreign exchange risk for a client who does not or cannot meet margin calls following any period of substantial currency turbulence. The Group's principal lending operations are carried out in local currency to obviate foreign exchange risk. Accordingly, the Group has no significant exposure to foreign exchange fluctuations on loan assets.

Market Risk

Proprietary trading activities across the Group are subject to limits approved by management. In early 2004, the Group established the trading risk control unit ("TRCU") for the purposes of independently monitoring and reporting the positions, risks and profit and loss of its proprietary trading activities involving derivatives, foreign exchange and bullion. In addition to the TRCU, the Group's exposures are closely monitored by the credit department and senior management and are measured on both a "mark-to-market" and a "mark-to-fair" basis, and "maximum loss" limits are used. The Group's various proprietary trading activities are reported daily to senior management for review. The Group's IAC also performs audits to supplement the above controls to ensure compliance with the established market risk limits and guidelines.

Management of Risks (Cont'd)

Reputational Risk

A key factor for businesses in the financial services sector is their reputation for financial probity and prudence. In our case, with our important and valuable "brand", we manage these risks through our strong internal controls and risk management regime, by comprehensive employee training and operational manuals in key areas, and by the strength and independence of the IAC.

Business Outlook

Hong Kong saw improved property and financial markets in the year 2004, especially in the second half of 2004. The good performance of the economy was mainly due to the increased tourist arrivals and the improved market sentiments resulting from a series of economic co-operation measures with Mainland China. The management anticipates that the recovery of the local economy will continue in 2005, albeit at a reduced rate. The planned opening of the Hong Kong Disneyland in September 2005 will add more momentum to the tourist business. The management believes that it will further escalate economic activities in the hotel segment and benefit the Group's hotel operations. The further improvement in the residential and office property market brought by the robust economy is expected to be sustainable. However, the wild fluctuations of the crude oil prices and the rising trend of interest rates could adversely impact the market sentiment and activities. The Group will continue to monitor these factors closely and all other relevant factors, whilst aiming to maintain a good balance as between assets and earnings, for the benefit of all shareholders.

Patrick Lee Seng Wei
Chief Executive
Hong Kong, 14th April, 2005