## Introduction

The Company is primarily an investment holding company, with a stated strategy of focusing its management and financial resources on its core businesses of property investment and development together with financial services. The Company's interests in property investment and development in Hong Kong are mainly held through its 74.80% holding in Allied Properties and in respect of property investment and development in the People's Republic of China ("PRC"), through the 48.60% holding in Tian An China Investments Company Limited ("Tian An") held by Sun Hung Kai & Co. Limited ("Sun Hung Kai"). The Company's financial services business is mainly conducted through its 54.99% effective holding in United Asia Finance Limited ("UAF") as well as Allied Properties' 74.99% holding in Sun Hung Kai.

## Financial Review

The turnover of the Group for the year 2004 was approximately HK$1,911.0 million, an increase of 18.7% from the previous year due primarily to the increase in income from the Group's financial services divisions.

The Group reported a profit attributable to shareholders for the year of approximately HK$760.0 million, an increase of 56.2% compared to approximately HK$486.5 million for the preceding year. The increase was the result of a stronger performance from the Group's financial services divisions and, following the recovery of the Hong Kong property market, revaluation surpluses and a reversal of impairment losses were available from the Group's Hong Kong property portfolio. All in all, a stronger performance was recorded from all of the Group's core operations.

### *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*

An ordinary resolution for approving the consolidation of every ten shares of HK$0.20 each into one consolidated share of HK$2.00 each of the Company was duly passed at an extraordinary general meeting of the Company held on 22nd July, 2004.

At 31st December, 2004, the net assets of the Group amounted to HK$4,949.4 million, representing an increase of HK$793.5 million or approximately 19.1% from 2003. The Group maintained a strong cash and bank balance position and had cash and bank balances of approximately HK$767.0 million as at 31st December, 2004 (2003: HK$764.6 million). The Group's bank and other borrowings, together with loan notes, totalling HK$2,232.7 million (2003: HK$2,422.2 million) of which the portion due on demand or within one year decreased to HK$890.6 million (2003: HK$1,110.3 million) and the remaining long-term portion slightly increased to HK$1,342.1 million (2003: HK$1,311.9 million). The liquidity of the Group as evidenced by the current ratio (current assets/current liabilities) was 2.06 times (2003: 1.79 times). The Group's gearing ratio (net bank and other borrowings together with loan notes/net assets) decreased to 29.6% (2003: 39.9%).

The Group's capital expenditure, investments and repurchases of shares and loan notes were primarily funded by net cash inflow from operating activities and bank and other borrowings.

## Financial Review (Cont'd)

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

The bank borrowings of the Group were charged at floating interest rates. Other finance costs decreased from HK$61.3 million in 2003 to HK$49.4 million during the year as a result of reduction of bank borrowings and continuous efforts made in reducing the interest rates margin payable, as well as a lower interest rate environment in 2004.

### *Risk of Foreign Exchange Fluctuation*

Other than the Group's financial services businesses (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.

### *Additional Interest in Subsidiary*

The Group's equity interest in Allied Properties increased from 74.61% to 74.80% at the year end, mainly due to the conversion of 36,189,730 warrants into 36,189,730 shares at a total consideration of HK$90.5 million during the year.

### *Acquisition of a Subsidiary*

During the year, Allied Properties 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.

### *Contingent Liabilities*

Details of contingent liabilities are set out in note 38 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.

## Financial Review (Cont'd)

### *Material Litigation Update (Cont'd)*

(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 7, 22 and 38(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.

(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.

### *Pledge of Assets*

Details regarding pledging of assets are set out in note 42 to the financial statements.

## Operational Review

### *FINANCIAL SERVICES*

#### *Consumer finance*

The profit contribution from UAF increased substantially in 2004, with bad debt charges decreasing significantly in line with the lower number of personal bankruptcies.

UAF's loan portfolio grew substantially during the year. This was due to: (a) aggressive advertising and promotional campaigns, and (b) the acquisition from a credit card operator of its credit card loan portfolio together with the related customer database, which acquisition enabled UAF to substantially increase its customer base and provided opportunities for cross-selling of its products and services.


At 31st December, 2004, UAF maintained 28 branches, with a number of branches being relocated to better locations during the year in order to improve overall customer traffic and operating efficiency.

In view of the recovery of the Hong Kong economy, UAF will seek to expand its branch network and introduce new financial products to further improve its profit contributions.

#### *Broking and finance*

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.

## Operational Review (Cont'd)


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 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.

*Sun Hung Kai's signing ceremony with Sun Microsystems for a next-generation computerised dealing system*

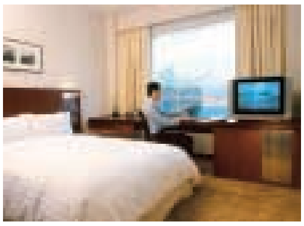
## Operational Review (Cont'd)

### *PROPERTIES*

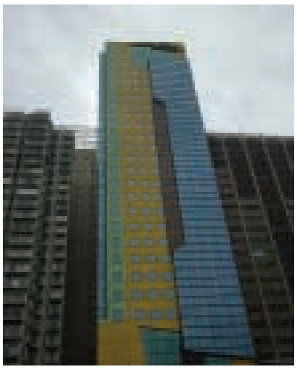
#### *Hong Kong*

Allied Properties recorded a profit of approximately HK$668.5 million, representing a 115.0% increase from its profit of approximately HK$311.0 million in the year 2003. The stronger performance of Allied Properties was largely due to revaluation surpluses and a reversal of impairment losses previously charged to the income statements following the recovery in the property market. Allied Properties' rental income also increased moderately during the year under review. Important contributors of rental income included St. George Apartments, China Online Centre, Century Court and Allied Cargo Centre. Allied Properties will take advantage of the buoyant property market to review its Hong Kong rental property portfolio with a view to maximising yields.

The properties of Allied Kajima group, which is 50% indirectly owned by Allied Properties, including Allied Kajima Building, Novotel Century Hong Kong hotel and the Westin Philippine Plaza Hotel, together contributed a 15.9% increase in profit compared to the previous year.



*Novotel Century Hong Kong hotel - Biz Room*



*Ibis North Point*

Phase two of Ibis North Point ("Ibis") was completed after the issuance of the occupation permit in December 2004. With this new 275-room hotel on Java Road fully operational, Allied Properties' recurrent income is expected to increase further. Following the completion of Ibis, all of Allied Properties' development projects in Hong Kong have been completed. Allied Properties will continue to assess opportunities for appropriate property investments should they arise. In this regard, Allied Properties purchased the whole of the 22nd floor, No.9 Queen's Road Central in late 2004.

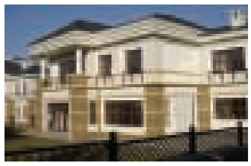
*Novotel Century Hong Kong hotel - Biz Lounge*

#### *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.

*Perspective of Shenzhen Tian An Golf Garden Phase III*

## Operational Review (Cont'd)


Changchun
Tian An City One


Perspective of Nantong
Tian An Garden


Wuxi Redhill Peninsula

In the longer term, Tian An 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".

### *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.


Quality HealthCare Medical Centre

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.

## Operational Review (Cont'd)

### *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.

*Factory buildings of new cement plant in Shandong under construction*

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 at 31st December, 2004 was 2,180 (2003: 2,150). Total staff costs, including Directors' emoluments, amounted to HK$341.9 million (2003: HK$299.8 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 in Respect of the Group's Consumer Finance Business

### *Credit Risk*

Credit risk is the risk that a customer of the Group will be unable or unwilling to meet a commitment when it falls due. It arises from any lending activities undertaken or credit facilities provided. The management implements lending guidelines and credit policies to keep credit exposure in check. In view of the current operating environment, the management continued to adopt strict lending guidelines and more credit reference checking procedures. Control systems including internal audit functions are in place to check and ensure compliance with such guidelines and policies. The executives review credit exposure reports and bad debt and doubtful debt provision policies periodically and adjustments to credit policies and guidelines are made where appropriate.

### *Foreign Exchange Risk*

The management adopts a conservative policy to limit its foreign exchange exposure to a certain percentage of its total assets. The Group also assesses the risk of exposure according to the fluctuation in foreign exchange rate of the currency concerned. When circumstances justify, the Group will hedge its exposure as appropriate.

### *Market Risk*

Market risk is the risk that interest rates, commodity or equity prices will move in a direction adversely affecting the Group's financial position. The Group will take positions on market risk related financial instruments as circumstances justify. However, the Group adopts a conservative view on exposure to market risk related financial instruments and it monitors its exposure to the market risk on a regular basis.

## Management of Risks in Respect of the Group's Broking and Finance Businesses

The management of risks in respect of the Group's broking and finance businesses (other than the consumer 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").

## Management of Risks in Respect of the Group's Broking and Finance Businesses (Cont'd)

### *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.

### *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.

## Management of Risks in Respect of the Group's Broking and Finance Businesses (Cont'd)

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.

### *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

The recovering Hong Kong economy is encouraging for the future performance of the Group. With deflation reversed and employment rate improving, the Board expects that the economy and the real estate market in Hong Kong should perform well in the near future. The Hong Kong tourist market is expected to improve with the planned opening of the Hong Kong Disneyland in September 2005. Nevertheless, recent upward price fluctuations of crude oil and the rising trend of interest rates are serious factors creating uncertainty for the future economic outlook. The management will make every effort to deliver a satisfactory set of results for 2005 and maximise returns for all shareholders.

**Lee Seng Hui**
*Chief Executive*
Hong Kong, 14th April, 2005