Fashion Walk,
Hong Kong

Olympia 66,
Dalian

Plaza 66, Shanghai

Insightful Vision

Upholding our business philosophy, We Do It Right, Hang Lung looks ahead in all of our areas of business. From market timing, location choice, architectural design, to daily operations and talent development, our pledge of excellence is to act with foresight to develop the Company into a highly admired national commercial developer in China.

Ronnie C. Chan
Chairman

RESULTS AND DIVIDEND

For the year ended December 31, 2015, turnover decreased 47% to HK$8,948 million as much fewer residential units were sold. With very limited amount of property revaluation gain, net profit attributable to shareholders retreated 56% to HK$5,092 million. Earnings per share fell similarly to HK$1.13.

Underlying net profit attributable to shareholders was down 56% to HK$4,387 million when excluding revaluation gain and related deferred taxes and non-controlling interests. Underlying earnings per share decreased correspondingly to HK98 cents.

The Board recommends a final dividend of HK58 cents per share payable on May 18, 2016 to shareholders of record on May 5, 2016. If approved by shareholders, total dividends per share will be HK75 cents for the year ended December 31, 2015.

BUSINESS REVIEW

For the past quarter century, I have personally penned this letter twice a year to shareholders. Beginning 15 years ago, I decided to go beyond the standard reporting of facts as previously practiced. Rather, the Chairman's Letter should be an appropriate platform to communicate with our shareholders and the market at large the views of the management on the economy, our industry, and our strategy. As much as possible, we should be transparent.

In the past few years, instead of a very long year-end letter and a much shorter mid-year one, I have beefed up the latter. This way, readers receive more timely information from management every six months. I trust this is well received by shareholders.

To our surprise, my last interim report, the longest that I have written at mid-year, went viral on the Mainland Internet as soon as it was released. The reason was unclear to me as it has always been my practice to comment on the Chinese economy. Naturally my views cannot be correct all the time but at least they were always honest, be they optimistic or pessimistic. Besides, I like to point out that my letters are primarily for our shareholders and potential shareholders and not the general public. We never lose sight of that.

What bears repeating here is the difference between the two letters respectively for this Company and for our parent Hang Lung Group (HLGL). Long-term readers of both should realize that for Hang Lung Properties, I devote more time to discussing the overall economy and our strategy. Analyses of the real estate industry of both Hong Kong and the Mainland are usually covered in the other letter.

This I again did six months ago. Whereas what I wrote here received much attention, the industry review in the other letter did not. Of late I happen to hold views on both Hong Kong and the Mainland's residential markets which are not shared by most in the market. Since they are important to our business, I will repeat some of them here. My opinion in this regard has not changed in the past six months.

This brings me to another point regarding this letter. When there are particularly critical developments in the economy, in our industry or our Company, more emphasis will of course be given to them. Beyond that, as much as possible, my practice is to pick an important aspect of the Company and give an in-depth review at year-end. Topics covered in recent years included corporate governance, sustainability, human resources and corporate culture.

In these areas, I have so far avoided repeating what have previously been covered. This is certainly my preference. However, new or potential shareholders may be unaware of these discussions. One way is to refer them to my former letters, which are available online. Nevertheless, management thinking progresses over time and it may be worthwhile to revisit some of these issues every so often.

Now let me turn to the year under review. When I first wrote in July 2012 that China was in for a prolonged economic winter, few were convinced like me. The same was true even as late as my last interim letter six months ago. Now I doubt if anyone will hold a contrary view, for things have gone from bad to worse. Will China recover? My answer is a most definite yes. However, given the structural causes of the downturn and how intransigent they are, recovery will be slow.

The crux of China's present economic challenge is the need to reform many of its systems. This is an evolutionary and not a revolutionary process, for reform has been ongoing for some 30 years. Just look at the country over that period and one cannot but marvel at the structural changes that had taken place. Nevertheless, Beijing is very aware of the need for further reform, but there are constraints. Spurred by necessity, nothing will focus the minds of top leaders more than urgent if not existential threats.

In this regard, I find proposals by certain Western pundits amusing. Whereas many of their diagnoses are correct, their prescriptions are often unrealistic. Some of them think that Chinese leaders are deaf or dumb, but these pundits are unaware of the internal difficulties confronting Beijing. Nothing is more certain than the fact that the country is more complicated than anyone can comprehend, and no one has ever faced such challenges in such a big country. One can only hope that officials are wise enough to adapt the needed reform policies to local situations.

To be sure, success in reform in the short run is by no means assured. But as is always the case in China and as Mr. Deng Xiaoping said some 30 years ago, the country will "cross the river by feeling the stones." To think that there is a silver bullet is frankly naive. What can be done is to draw on international as well as domestic experiences of the past 30 years and chart a course which will yield a higher probability of success.

Beijing will continue to use public investments to spur the economy, but there are serious limits. After years of fast growth, the economic base is much larger now such that the same amount of investment input will produce a smaller percentage of increase. Government debt is now higher than before, thus rendering massive new investments more difficult. Public-private partnership may be one way to go.

In some areas, infrastructure developments are already plentiful if not overbuilt. Nevertheless, there are still other projects which are sorely needed. For example, subway developments in many cities have been announced recently. Investments to improve the environment from air to water to soil will be good for both the short- and the long-term. Frankly the government will have to use all there is within its power to stimulate the economy.

In a recent conference session that I chaired in Hong Kong and was attended by some 2,800 people from around the world, all the speakers from both inside and outside of the Chinese government agreed that the best hope to lift the economy is to stimulate private consumption. I expect more policy initiatives in this regard. It was said that the stock market stimulation several months ago by the government was one such effort. The hope was presumably to create a wealth effect and so spur consumption. It was a wrong thing to do and it backfired. But it does not mean that there are no other ways to get the job done.

Room for increasing private consumption is considerable, and continued urbanization is but one way to achieve this. As a percentage of GDP, China's private consumption is much smaller than that of the United States. On the other hand, China's GDP growth is three times faster and salary growth is even more. Unlike developed economies such as North America, Europe and Japan where the size of the middle class is rather stable, China's middle class is expanding quickly. Whereas many in those countries already have basically all they need, the same cannot be said for China. For certain goods, the Chinese prefer to purchase overseas, hence to bring part of that market onshore will boost retail sales. The service sector is particularly underdeveloped and we expect to see explosive growth especially in first- and second-tier cities. That market is almost limitless.

Moreover, as everyone knows, Chinese people are compulsive savers. Policies can be introduced which will help turn some of the personal savings into consumption dollars. To be sure, the Chinese should not pick up the bad habits of the West – overspending and result in high personal debt. But neither should they remain at the other extreme. A sensible middle point should be found. Given structural problems in the society, from an unreasonable healthcare regime to an inadequate educational system, and from the lack of social security to the lack of personal credits, overspending by individuals is frankly unlikely for now.

Whatever the case, it seems certain that as reform progresses, no matter how slow it may be, a higher percentage of disposable income will go towards consumption. After all, as a result of 30 years of rapid economic development, many Mainland citizens have accumulated considerable wealth. A case in point: in one of our shopping centers in a second-tier city, a car dealer of expensive European brands is said to have sold over 200 units last year. Wealth is not an issue; Chinese city dwellers now accounting for about 54% of the population just need a little encouragement to spend.

Given today's terrible market conditions, it seems out of place to speak of anything but bad news. But objectively speaking, there are many positive societal developments which bode well for the economy. Some of them are of a short-term while others are of a long-term horizon. One of them is that the housing markets in the most important second-tier cities are by and large quite healthy. I will return to this point later.

Even without government encouragement, entrepreneurship especially in the high-tech sector is alive and well. As recent history shows, technology can create jobs and not just destroy them. During the "robber baron" days in the United States a century ago when regulations were lax, many businesses flourished, thus creating employment and raising the standard of living. Fortunately, its social culture, unlike that of Europe, ensures the enterprising spirit continues.

In China, such a spirit is alive and well. Its "robber baron" days might have been moderated as regulations are introduced, but they are far from being over. Compared to their predecessors, today's entrepreneurs are younger, better educated and more worldly. They are as sophisticated as I have seen anywhere in the world, and their learning curve is as steep as any. They travel the world and learn from the best. Herd instinct ensures that competition at home is severe, which will only lift the standard for all. It is an exciting scene to behold.

The legal environment is slowly improving, yet due to the size of the country, business opportunities remain plentiful. Like everywhere else, many startups will fail but a good number will not only survive but, to different degrees, thrive. Some will have international ambitions; there will be many more "Alibabas" to come. They will in time contribute greatly to the next phase of China's economic growth.

There are other positive factors. As a net energy importer, significantly lower oil price can only be favorable to China. The "One Belt, One Road" or "Belt and Road" initiative should also in time bear fruit. A drag to the present Chinese economy is the oversupply and overcapacity of many commodities like cement and steel. Infrastructural projects in the new Silk Road will digest some of the excesses. This should help position the country for the next phase of growth.

There are far more critical geo-economic and geo-political reasons to initiate the transcontinental effort. One is to secure long-term supply of energy and other natural resources. It also opens new markets for the country's massive manufacturing apparatus.

As I had written six months ago, frankly the new Silk Road is inevitable. It is a natural extension of globalization which started some 2,000 years ago in exactly the same place:

the original Silk Road. Yet today it is arguably the least globalized part of the world – between Western China and Eastern Europe. It matters little who raised the issue today. It merely completes a human experiment of two millennia which historically has brought prosperity to its participants. So no matter how one looks at Belt and Road, it seems that the upside outweighs the downside. This is true for China and for all other participants.

When history is written, all the geo-economic and even geo-political considerations will have retreated to the background. What may be remembered are two aspects: the embracing of the last bit of humanity into the globalized world, as well as the enrichment of cultures when different people interact. In the end, it may well be culture for which the Belt and Road initiative will be best remembered. This was certainly the case with the old Silk Road.

While enumerating some of the recent positive developments, let no one underestimate the immediate difficulties facing the economy. The global economy, with the exception of the United States, is not encouraging. Demand for Chinese goods is not as strong as before. Currency devaluation by many competitors will make China's exports more challenging.

More troubling however are domestic issues. While the anti-corruption campaign is necessary and is supported by the general populace, it has also crippled the government. Officials simply stop making decisions which is the safest posture to take – when you do nothing, no one can accuse you of corruption. As a result, the already slow economy will stall further. Equally troubling are legacy issues which I will address later.

Regarding the likely future of China's economy, let me first jump to the conclusion and then explain the reasons for it. My best guess is that it will muddle through for the next several years. Beijing leaders should have the tools to prevent a drastic fall, but its policy options to stimulate the economy are becoming limited. It is not easy to find a quick fix.

China began its long march to reform in 1978. The most dangerous period was before 1993 when the old ideology had to be overturned. Failure to do so would have scuttled the entire reform crafted by the then supreme leader Mr. Deng Xiaoping. It almost happened after the debacle of 1989, but Mr. Deng single-handedly rescued it.

Since the early 1990's, the economy has seen many ups and downs. There was no roadmap anywhere that leaders could follow. Laws were antiquated or outright missing; rules and regulations that were common in other countries were never seen before in China. Those were truly difficult years, but in my opinion not as precarious as the 1980's when ingrained ideology had to be radically altered.

When the new millennium arrived, China began a prolonged period of crisp rise. Just as the Asian Financial Crisis that began in 1997 did not hurt China, the country was also spared from serious trouble during the Global Great Recession of 2008-2009. The reason that China was spared from the earlier incident was that back then its economy was not that integrated with its neighbors. The more recent case was due to China's decisive actions. Nevertheless, a number of mostly international experts did point out that besides structural deficiencies, government actions taken to avert disaster in 2008 also sowed the seeds of economic problems. However, at the time they were considered manageable, and Beijing seemed capable of resolving most if not all difficulties.

Subsequent events showed that the cumulative side effects of less-than-ideal policies began to surface a few years ago. What China is facing today is a direct consequence of the excesses of the go-go years of the 2000's and of medicines taken in 2008. The problems were years in the making and it will take years to correct them.

Whereas it seemed that previously Beijing could do no wrong, now she can do nothing right. Undoubtedly the Western media in the past had inadvertently hyped up China's rise. While the present pessimistic reporting may be closer to the truth, it may be concerned about the wrong things. For example, what transpired a few months ago in the Shanghai stock market and later in the Renminbi currency movement made China a laughing stock of the world. Embarrassing as these incidents may be, they are not detrimental and do not have long-term consequences. China is like a farm girl thrust upon the global stage. Mistakes are inevitable but Chinese regulators will learn from them. As such, they are not my main concern. Instead, I am worried about something else.

Conceptually there are two main ways to manage any social system such as an economy. Briefly stated, they are laissez-faire versus control. The dominant practice of the free market in the world today is in the former category. Let the market comprised of many millions of individuals choose what it wants. The government is only responsible for maintaining order through rules and regulations supplemented by social norms. The other way is exemplified by the centrally controlled economy. Between the two, there is a continuum of many shades.

History of the 20th century has shown that the free market is more conducive to unleashing human productivity and hence wealth creation. But if taken to the extreme, chaos will inevitably result. Uneven wealth distribution may necessitate government actions to maintain societal order. The libertarian way must be somehow moderated.

And since almost all attempts at a centrally controlled economy ended in disaster, the ideal, if there is such a thing, must rest somewhere in the middle but much closer to the free market side.

After decades of experiment, China has discovered the above the hard way. The economic opening and reform since 1978 attested to that. The critical question now is how far and how fast it should go.

Beijing leaders are well aware that in order to pull China out of poverty, it must have a strong central government. The rise of other East Asian countries in the post-World War II era has amply demonstrated that, and there is no exception. In the first few decades of economic development, some form of government leadership is almost indispensable. This is true in Japan and in the Four Tigers – South Korea, Taiwan, Hong Kong and Singapore, with the then Colonial government of Hong Kong having the lightest touch. Beijing has followed that path and has so far been successful beyond imagination.

But as most people would agree, as the economy develops, involvement of the government must lighten up. Beijing understands it well and has already embarked on that direction. However, there are two unique challenges.

First, for over 4,000 years the Chinese have always lived under a hierarchical society where considerable control was exercised from the center. It is ingrained in the Chinese psyche and has become part of the Chinese culture. No other civilization has had so long a history of continued – and mostly successfully – rule under one governance principle. While it has its strengths such as efficiency and relative social harmony, it also has considerable weaknesses. The lack of legal infrastructure including the judiciary is one. Another is that mistakes made by the central government can be magnified and not easily corrected.

The other challenge is that China is a huge country like no other – it has almost 1.4 billion citizens. It also has one of the biggest peasant populations in the world of about 650 million. The wealth gap between cities and rural areas is huge. The reform needed in one place may not work in another; in fact, another place may require an opposite policy!

All these factors make reform complicated. Moreover, China is fast integrating with the global economy. What happens elsewhere in the world may impact the Chinese economy in profound ways. Increasing dependency on imported energy is just one often-cited example.

China today is no longer a centrally controlled economy like it once was; it is moving towards a government-guided one like Singapore. In fact, China's State-Owned Enterprises probably control a smaller percentage of the country's economy than their counterparts in the small island state. However, there is no denying that Beijing still plays a critical role in all important decisions that affect the economy. Herein lies my main concern for the country – the unintended consequences of government actions. As the system becomes exponentially more complicated, this risk similarly rises.

Since it is unlikely, if not impossible, and not necessarily desirable for the country to move quickly and become like the West, it will have to find a hybrid model which fits its own circumstances. Until a relative optimum is found and is somewhat tested, periodic blunders will seem inevitable. One can only hope that it does not happen too often and when it does, the effect is not too detrimental. Frankly it is quite amazing that the economy has risen to today's level without more disasters. The way ahead however will become even more operationally challenging as systemic complexities grow exponentially.

In the more immediate term, a question sometimes asked is whether the present downturn is systemic or cyclical in nature. The former means that there are structural problems in the economy which will take a long time to address, hence recovery, if it comes, will be very slow. The latter refers to normal market fluctuations where an upturn can be expected within a more or less predictable time frame.

While confident that China's economy will rise again, I fear that recovery will be lethargic, for there are so many structural issues which are not easily resolved. As I wrote as early as July 2012, unlike the sharp economic drop and quick recovery during the 2008-2009 financial crisis, the present downturn seems less severe but will take much longer to recover. Your management is certainly preparing for the worst.

Now let me turn to our real estate industry. I will begin with the residential sector on the Mainland. Although we do not build many apartment units and those that we do are only very high-end ones next to our malls, this area of the economy does affect our overall business. I wrote about it six months ago to HLGL shareholders and will summarize it here.

Contrary to almost everyone I know in the industry, I am of the opinion that China's housing market is quite healthy today. With a little hyperbole, it is the healthiest the country has seen in generations. This is particularly true in the most important tier-two cities. The predominant view, especially in the West, is that there will be a hard landing. I never believed that.

Consider the following: the prevailing problem of the past 20 some years was runaway prices. This called for drastic government actions which inevitably killed the market until the next cycle arrives. Seldom do we see a somewhat ideal condition: prices not rising or falling precipitously while transaction volume and land sales are both moderately robust. This is basically the case today in most tier-two cities. Developers are for the most part still highly geared but not particularly bad from a historical perspective. Many of them have tapped the bond market of late which provides stable and long-term funding.

Tier-one cities are still hot, but as I have previously written, those markets are the most desirable, and money tends to flow in from everywhere. And to be sure, tier-three and -four cities have serious oversupply which only time, perhaps in four to five years, can resolve. In monetary terms, however, by far the greatest sales amount comes from tier-two cities. Overall, their supply and demand are much more in balance. I know of developers who expect a pretty good year for 2016. Given this set of facts, I fail to see how there will be a hard landing.

Closer to our heart are retail properties. We have always maintained that while there are too many malls in certain cities, there are always too few good ones. The latter phenomenon is what gives us great opportunities.

A leading European bank recently published an extensive report which says that China is short of retail space rather than having an oversupply. Per capita square footage in the cities is only 70% that in the United States. Malls of equivalent quality in China have far higher footfall than their American and European counterparts but much lower spending per person. This implies that there is much room for better malls and more growth in per capita spending. While I am not convinced that the findings are correct in every respect, nevertheless the study deserves consideration.

Our experience so far tells us that the challenge does not come mainly from our so-called competitors but from a very weak market. This seems to agree with the above findings.

Now let me turn to our performance. On the Mainland, our two Shanghai properties performed well due mostly to management efforts. So far they are like two pillars that make up for the weak or negative growth elsewhere. However, Plaza 66 has embarked on a comprehensive asset enhancement initiative and Grand Gateway 66 is expected to follow suit later this year. While we will do our best to minimize the adverse effect, it cannot be eliminated altogether. A slow market is definitely the right time to undertake such an endeavor, but it will make growing revenue even harder.

There are other worrying signs. With the exception of Shanghai, negative reversion pressure is strong. We are even detecting some at Grand Gateway 66. With the exception of Shenyang Palace 66, all retail facilities collected less rent in the second half of 2015 than in the first. And with the exception of Forum 66, our tenants did less business in the later part of the year when compared to the earlier. Traditionally the last six months

of the year, with the summer vacation and more extended holidays like the National Day, perform better than the first six months. The latest numbers are a strong proof that the retail market is still weakening.

Looking at our malls in tier-two cities in order of their completion, Shenyang Palace 66 performed satisfactorily. Jinan Parc 66 held its own. If not for the extraordinarily difficult trading environment, this four-year-plus property should be well on its way to stabilizing. Shenyang Forum 66 and Wuxi Center 66 are facing strong challenges. Unlike Palace 66 or even Parc 66, these two newer additions have to deal with teething problems under the worst of all circumstances.

We are still observing Tianjin Riverside 66. The new property syndrome is likely unavoidable; we only hope that the hit will not be as severe as the previous two.

Dalian Olympia 66 had its soft opening in mid-December. Various vital signs are so far acceptable but it is way too early to jump to conclusions. Challenges do not come solely from the weak market but also from government actions or inactions. We will have a better idea by the time of its official inauguration in May.

Offices in our two Shanghai complexes were basically fully leased. The two towers in Plaza 66 were again weaker than that in Grand Gateway 66. We had to sacrifice a little rent to keep them fully let.

The high-rise office in Center 66 attained over 70% commitment by space and about 60% has been occupied. In Forum 66, we were only able to have 44% of the space leased and 40% of our tenants moved in. These numbers are below expectation. The main reason is of course the weak economy – we actually had tenants whose leases were voluntarily or involuntarily terminated soon after moving in. In other words, in a few cases we had to vacate tenants. Rental rate in both projects remained steady.

As expected, office tenant quality is not as high as that in our Shanghai facilities. Nevertheless, since we have invariably the best location, the best design and among the best constructed high-rise buildings in the respective cities, we should be able to attract the best possible tenants. We have not been aggressive in demanding rents because to us, tenant quality is as important as short-term unit rent.

Although the Hong Kong retail environment has deteriorated further, we have done well – rental revenue and like-for-like retail sales both rose. Recent efforts to upgrade premises have borne fruit in an otherwise difficult market. Results from offices were equally pleasing. Basically all properties remained fully let. The only exception was residential and serviced apartments which performed about the same as the year before.

Nevertheless, because we sold far fewer completed apartments than in the same period a year ago, revenue fell 88%. There was no way that the 7% overall increase in rents could have compensated for this. Moreover, with a very small revaluation gain, net profit attributable to shareholders was down 56%. Underlying net profit attributable to shareholders as well as underlying earnings per share likewise retreated by the same percentage.

It is only right that I should say a word about currency movement. For the past few years, we have held a lot of RMB, and in the second half of 2015, it fell by about 5%. Three points should be made here. First, we do not speculate in any currency. We bought RMB in the past because we have many projects under development on the Mainland. Construction, for example, has to be paid for in the local currency. In that sense, we are hedged. Since we report results in Hong Kong Dollars, translation gains and losses are recognized in the reserve account.

Second, as China seeks to increase convertibility of its currency, its range of movement will be broadened with concomitant increase in volatility. We will be prudent and will minimize risks to the extent possible.

Third, it is your Board and management's views that while the RMB has dropped quite a bit of late, we are not negative about its future in the longer run. It does not appear to us that it will fall significantly further. Relatively speaking, the Chinese economy is still much stronger than most major countries. Barring unforeseen circumstances, this should underpin the RMB.

PROSPECTS

It must have been a very wise investor who once said that no one should waste a bear market, but most people do. First and foremost, one must not only survive the bear attack but also be well prepared for it. If not, one will see opportunities go by without being able to capitalize on them. Only the disciplined will earn the right. As many in the West now know, the Chinese characters for "crisis" mean "danger" as well as "opportunities". The Chinese economy today is certainly in a crisis.

In the past 20 some years, your Company has thrived on numerous crises. Major ones included: the near collapse of China's reform in 1989 and its reversal in 1991; the Asian Financial Crisis that began in 1997; the tech bubble of 2000; and the Global Great Recession of 2008 brought on by global financial meltdown. The present slowdown is thus at least the fifth serious one in some 25 years. One commonality as far as Hang Lung is concerned is that we avoided danger and took advantage of market troubles each time.

In 1991 China was in serious turmoil and we began to study its economy. This led to our entrance into its market in 1992 and we formulated a strategy that is still in place today, namely that we shall build, own and manage world-class commercial properties in economically vibrant cities. In Hong Kong, we took advantage of the slow market conditions around that time and bought investment properties including our present headquarters, the Standard Chartered Bank Building. Beginning in 1994 we also bought land for residential developments in our home city but stopped a year later when we determined that the market would soon reach unsustainable heights. Instead, we put our finances in the best shape possible and then waited.

What we did not know then was how big the bear market would be. It turned out that the financial crisis that started in 1997 swept through much of East Asia. Then in the depth of that crisis, we bought land in Hong Kong in the absence of competition. Plots on which we built The HarbourSide, The Long Beach and more were all purchased within 21 months beginning April 1999. They have brought us over HK$26 billion of pre-tax profit.

Around the same time, a strong wind of high-tech startups blew our way from the United States. Many of our local competitors were caught up in it instead of buying land. We also experimented with it for a while but decided that the best opportunities then were to stick with what we knew best.

Then ahead of the Global Great Recession that hit in 2008, we quietly bought many plots on the Mainland in 2005-2006 when no one was looking at prime land in second-tier cities. Due to sound financial management, we avoided the troubles that followed and further acquired land amidst the market lull. The bear was thus kind to us.

Now the market is again weak. As I had written before, unlike in 2008 when the fall was steep and the recovery quick, this time it is a U-shaped experience which is much more painful. But as in all previous downturns, we are well prepared for it – in the past 10 years, we were basically debt-free. Net debt today is negligible.

Our preparation for the bear market was not limited to the area of finance. As the market was stalling, we undertook many asset enhancement initiatives – first in Hong Kong and now also in Shanghai. This was why we were able to maintain rental growth in our home market which was in an unfavorable environment. Some question how we can defy gravity. We do not; we just prepared ourselves well ahead of the market fall. Others predict a drop in our Mainland rental revenue like some of our competitors. I do not believe so, at least not this year.

How to capture opportunities presented in a bear market is something I had written about previously. Here I will only summarize.

As long as finances allow which certainly is in our case, a tough trading environment should be used for property upgrade. This we are doing in our two Shanghai properties. It will slightly hurt business but it is preferable to hurt at bad times than at good times. Most property owners hold back from spending money especially on capital expenditures when the market is down. We do the opposite. This will position us well for the next growth cycle.

In due course we may buy more land on the cheap. But because the downturn is expected to last for some time, we are not in a hurry. We will continue to monitor various cities, as we always do.

We will complete building our management team. Weaker players shed staff during market lulls; we try to attract the best that the marketplace can offer. The focus will mainly be on our leasing and commercial operations team. We will also continue rebuilding an appropriate corporate culture.

Under the leadership of the Board, my colleagues are completing a multi-year project on enterprise risk management. This is an area that we will revisit from time to time.

History shows that whenever our share price is low, our parent company HLGL will buy our scripts. I expect more of the same as long as conditions are right. We will also issue stock options to executives whose ranks have ballooned in numbers in recent years. We should keep our cadres motivated especially when the market is down.

There is one other critical area that we will attempt to build up during the slow market. Previously I have only alluded to it. Namely, in addition to our B2B (Business-to-Business) model, we will add a B2C (Business-to-Consumer) dimension to the way we conduct our business. This plan was recently affirmed at a Board retreat on risk and strategy.

Most landlords think of themselves as dealing only with brands and shop owners. After all, shoppers do not visit our malls to buy from Hang Lung; they transact directly with Chanel, Louis Vuitton, Apple or a restaurant. Our job is to build and manage the best environment, both physical and atmospheric, so that customers will continue to return to our malls, but our orientation is mostly towards our tenants. Our direct outreach to visitors is not robust.

However, consider the case when a female customer wants to buy an Hermès or a Prada product, she does not tell her driver to take her to those stores. Instead, she asks to be taken to Plaza 66 or Forum 66. We have always worked hard to attract the right kind of visitors to our malls but this effort will have to be deepened and broadened. Deepen in the sense that we must see ourselves as a marketing and customer-oriented company and not merely a property rental outfit. Our thinking must change. Broaden means that we must have much more direct interaction with shoppers. With the latest technology, what we can do directly and meaningfully with them has grown substantially. We will also have to work closer than ever with our tenants, especially the key ones, in a more symbiotic way.

This is why two years ago I wrote about an in-house initiative that we called EST, or Experience, Service and Technology. We apply technology of varying degrees of sophistication – from the very simple to the more complicated – in order to provide services that were previously not supported. The goal is to enhance and enrich a positive experience for our shoppers so as to foster long-term loyalty. In the short run, certain new services can be expected to directly increase sales to our tenants. In so doing we are not only luring shoppers to our malls but also bonding our tenants with us.

We already have some of the best hardware in the industry. We hope to also have the most effective software. To be sure, the number one critical success factor in our business is the hardware, or what I call "real estate genetics" of location, size, design and construction. It is almost impossible to win in the long-term without them. We already have them, and the superior software will further cement our leadership position in each of the markets we have chosen to play.

Many are concerned about the impact of e-commerce on physical stores, and I wrote extensively on the subject two years ago. Simply put, the former will definitely not replace the latter, and the few malls that have good "genes" like ours will continue to thrive.

What most people are less aware of are the changes that are quietly taking place in the physical facilities. The overall experience of a shopper at a mall will in say five years be very different from that of today. We want to position ourselves well for that revolution. When the market is hot, we may not have the capacity to focus on such changes. But now with a chilly winter upon us, it is the right time to put in place measures that will ensure our long-term competitiveness.

Given such changes and the role that technology will play, younger minds are needed. We do have some excellent executives in their 30's who should be able to lead the transformation and, one day, the Company. After all, the baby boomers are now at their retirement age or close to it. The bulk of the spending power is moving to a rising generation closer to the age of our younger colleagues. So from many perspectives, developing younger talent is critical to our continued success. This we are most conscious of and are taking steps to prepare for the future.

Six months ago I promised to report on the many awards that we have garnered. There are frankly too many to enunciate one by one. At one count, in 2015 alone we received over 20 prizes of many sorts from reputable international as well as local organizations. Here I will only summarize by roughly categorizing them into three broad groups: sustainability, corporate governance and design. Some honors may fall under more than one category.

On the issue of sustainability, we have been known for our excellent corporate social responsibility. This is a broad term that can include many aspects and we have been cited in many of them. Environmental sensitivity is one such area where we excel. For example, all of our completed Mainland malls have achieved the Gold Level of the LEED (Leadership in Energy and Environmental Design) certification from the U.S. Green Building Council. Not many commercial projects anywhere in the world can attain this but for us it is the minimum.

We have been singled out repeatedly for our efforts in human resources. Examples include: best employer award, best employee training and development program, high employee engagement, best knowledge management, and so forth. Marketing is yet another area for third party endorsement.

Regular readers of this letter will know why we are considered among the very best in corporate governance. For those who know anything about Hong Kong's public companies, especially in our industry, they will recognize that we absolutely stand out – we maintain the highest standard in terms of transparency and accountability. The prizes bestowed on us testified to this. We are also considered superb in investor relations. Even this Annual Report has garnered many awards.

In the area of design, no one should be surprised if he or she has visited our shopping centers on the Mainland. Every project has received high accolades from respectable international organizations. Each is a piece of art which adorns the cityscape. In a land populated with substandard building design, we see it our mission to raise the citizens' standards in appreciating good architecture. Needless to say, we always strive to balance aesthetics with functionality.

As we like to maintain, in all things "We Do It Right"!

Ronnie C. Chan
Chairman
Hong Kong, January 28, 2016