VISION

At Hang Lung, we are driven by a shared vision: to always strive for excellence and scale new heights.

Chairman's Letter to Shareholders

Ronnie C. Chan
Chairman

Results and Dividend

For the year ended December 31, 2017, revenue decreased 14% to HK$11,199 million because fewer residential apartments were sold over the previous year. Net profit attributable to shareholders increased 31% to HK$8,124 million. Earnings per share likewise grew to HK$1.81.

When excluding all the effects of property revaluation gain, the underlying net profit attributable to shareholders fell 13% to HK$5,530 million.

The Board recommends a final dividend of HK58 cents per share payable on May 16, 2018 to shareholders of record on May 3, 2018. If approved by shareholders, total dividends per share for the year ended December 31, 2017 will be HK75 cents which is the same as the year before.

Business Review

Retail sales continued to recover in both mainland China and Hong Kong. This has yet to be translated into higher rents due to the lagging effect of lease contracts. It will likely take another 12 to 18 months after which our results should be positively impacted.

On the Mainland, the recovery of retail sales of luxury products is particularly strong. On a year-on-year and like-for-like basis, all our malls saw improvements, ranging from 1% in the case of Shenyang Forum 66 to 99% for Dalian Olympia 66. Most of the others increased by 10% to 12%, with Shanghai Plaza 66 climbing 26%. Occupancy rate also advanced in almost all properties, with the biggest rise in Wuxi Center 66 and Tianjin Riverside 66.

Overall, there were far fewer instances of lease terminations and negative rent reversions than in the past few years. In the cases of Shanghai Grand Gateway 66 and Wuxi Center 66, the fall in rental revenue was entirely due to the renovation and construction works that took some retail space out of the market. In the former, on average 20% of the retail space was under renovation, with 30% affected at one stage. On a like-for-like basis, the rents collected were 7% higher than the year before. In Wuxi, not counting the 9% retail space taken out by the construction of the second office tower, the revenues received were flat. Comparing the second half of 2017 to the first six months of the year, the rents were up 9%.

Offices in Shanghai remained under pressure. Rental income retreated by 8% due primarily to the lead time required to replace a major tenant at Plaza 66. A new long lease is now signed at an attractive rate. The incoming tenant is of a much higher quality than the outgoing one. The office towers in Wuxi Center 66 and Shenyang Forum 66 have done well, with occupancy rates reaching 80% or above, in fact close to 90% for Center 66.

All this tells us that the six-year winter is now behind us. Even Forum 66, the most challenging property, is gradually improving. The new on-site management team is delivering positive results. Everywhere, I expect our operating numbers to further advance in the coming year or two.

The recovery of Hong Kong retail sales was stronger in the second half of the year. Excluding certain properties that were undergoing major renovations, our rental revenue rose 3% while retail sales increased 8%. However, as explained six months ago, years of outperformance when the market contracted has left our rents with a much higher basis. Consequently, I do not expect them to grow as much as in the past few years. Low single-digit increases should be achievable.

Hong Kong residential sales remained strong. Since the minor correction in the second quarter of 2016, the market has been rising. Growth rate has moderated somewhat in the second half of 2017 but there are signs that the upward trend may resume.

Taking advantage of such market movements, we further sold down our inventory at good profits. Having parted in 2016 with much that was remaining, we did not have as much to sell in 2017. Consequently, total sales and profit both fell. Whereas we sold 436 units of The Long Beach in 2016, the number for the year under review was 226, with only 10 remaining unsold at year-end. As of today, only six apartments are left. In the case of The HarbourSide, we parted with the very last of the 1,122 luxury units in the first half of 2017. In both projects, profit margin kept rising until the very end. It was around 65% for The Long Beach and 85% for The HarbourSide.

Last year we sold another semi-detached house at 23-39 Blue Pool Road. This month alone we parted with two others, leaving 13 units unsold. We may be able to do more for the rest of this year. Interestingly, only one of the five houses sold so far was to a mainland Chinese buyer. Profit margin has been satisfactory.

Taking all of the above together, rental income both on the Mainland and in Hong Kong did not change much from the year before. Because far fewer Hong Kong residences were sold, revenue therefrom fell 36%. Net profit attributed to shareholders advanced 31% due to revaluation gains. Taking them out, the underlying net profit attributable to shareholders retreated 13%.

Such a set of results should not surprise anyone, at least not the regular readers of this letter and of that to the shareholders of Hang Lung Group Limited (HLGL), our majority shareholder. The numbers basically reflected our view of the market and our own condition as I had presented six months ago. The retail environment everywhere has definitely improved which will soon favorably impact our bottom line. There is little doubt in my mind that better days are ahead.

There are two reasons for my optimism. First, under our CEO Mr. Philip Chen, we have in the past seven years greatly transformed our management. Ours is a much better company today, and one which is more prepared to cope with the ever-changing market conditions. We will continue to make improvements.

The second is that China's economy is undergoing desirable changes. Private consumption is fast becoming a major pillar. Not long ago it accounted for about one-third of the economy; now it is over 40% with the economic pie being much bigger. By comparison, the same number in the U.S. is around 69%. Over time, China will move closer to the American level, although it is doubtful if it would ever get as high as that of the U.S. With their propensity for a high savings rate, it is hard to see the Chinese consume that much. But for the number to grow from today's level to say 50% to 55% is possible. All along, the total economy is expanding, for it is conceivable that the annual GDP growth will remain above 6% or even over 6.5% for the coming several years. This is good news for us.

In 2017, China's exports have also risen nicely. The growth rate for public investment has however moderated. Conceptually the latter can be used as a buffer to adjust the rate of economic growth. Of the three horses pulling the economy — exports, public investment, and consumption — public investment is the only one that is basically under the control of the government, and Beijing certainly has the financial resources to do more of it if they want to.

Whatever the case, from all indications, it seems that for now the Central Government is happy that private consumption is playing a bigger role than ever. This, I assume, is part of what Beijing leaders call quality growth. Many economists in the West would agree.

Another way of comparing China's private consumption with that of other major nations is to look at the average per capita square meter of retail space. The U.S. is the most "over-malled" — for every citizen, there are over 2.2 square meters. No one comes close; the next is Canada with 1.5 square meters per capita. Hong Kong, Singapore, and Australia each has about 1.1 square meters per person. Then the numbers drop off. In Europe, the U.K. has the most at 0.5, France is below 0.4, Italy and Spain each has less than 0.3, and Germany, not even 0.2.

The number for China is similar to Italy and Spain at 0.3 square meters per person. This is less than one-seventh of that in the U.S. Taking out China's huge rural population — approximately 43% of 1.38 billion — with less consumption power, and allocate all retail space just to city dwellers, the number would still be only around 0.5 square meters.

So why do some investors complain that China has too many malls? First, most of the new facilities are concentrated in tier-one and tier-two cities. Second, the rate of space addition can be mind-boggling. Although the per capita retail space numbers are favorable for China, the impression to the casual observer is a different story. This "oversupply" together with the onslaught of e-commerce have caused some investors to shy away from Chinese retail real estate. It is amazing how some analysts observing the oversupply in the U.S. market have assumed that China has the same problem.

That said, it is nonetheless correct that many shopping centers in China will, like some of their American counterparts, close down in the coming years. As I have previously written, many of these properties, while relatively new, are of inferior if not pathetic quality. They are located at undesirable places, wrongly designed, and poorly constructed. Frankly they do not deserve to survive. Eventually, consumer sales dollars will concentrate on the better malls including those in our portfolio. While competition is cruel to the weak players, they can in fact make the strong ones stronger. Such is the market economy.

Compared to anywhere else in the world, we count ourselves fortunate to be operating in markets such as those of tier-one and tier-two cities in China. The country's economy is growing at 6% to 7% per annum. Middle class salaries and private consumption are both rising faster than GDP. Many citizens have only in the past decade or two become purchasers of goods beyond the basic daily necessities. This makes them motivated shoppers.

The physical environment of tier-one and tier-two cities in China is also conducive to good business for retail shops and mall owners. Population density is inevitably high which provides a large catchment area for well-located and well-built malls. Whether through e-commerce or physical store visitation, shopping is convenient.

In my 2011 year-end letter to shareholders, I contrasted what I considered to be the three markets with the best shopping centers — Las Vegas in the U.S., Dubai in the United Arab Emirates, and China. Whereas new ideas and novel designs often begin in Las Vegas, Dubai mall developers improve upon them and make their facilities bigger and better. Their Chinese counterparts, like us, come later and so can learn from everyone.

The three places however have significant dissimilarities; their market dynamics are totally different. As explained before, shopping in Las Vegas plays third fiddle to gambling and various forms of entertainments such as shows and concerts of all sorts. In Dubai, a city where I have regularly visited in the past two decades, many shoppers are actually not from the Emirate. After all, the local population is not that big. Their malls draw shoppers from neighboring emirates and countries, from Sharjah to Ras Al Khaimah, and from Saudi Arabia to Oman. The question is how often does the same shopper return — quarterly or half yearly? In China, population density ensures that within a short distance, there are hundreds of thousands of regular customers. They can easily come every day if they want to and if a mall is good enough to attract them.

While comparing China's malls with those in other countries, I should add that like nowhere else, our properties are by far the most spectacular architecture-wise. Every shopping center of ours can rightfully be considered as quality public art. Beyond just placing say nice sculptures inside or outside the building, our entire structure, always sizable, is a design masterpiece. Not many people I believe will dispute this statement. There are very few, if any, mall developers who pay so much attention to the shape and elevation of their buildings.

Although it may cost us a little more to design and construct, it is good business in the long run. First, many municipal leaders from around the country want us in their city. We help beautify their environment. The image thus created helps them raise the profile of their city and differentiate them from others in front of their political bosses in Beijing. It will not hurt their personal chance of career advancement. Their desire to have a Hang Lung 66 project in their city has given us a slight edge in winning land.

On a more altruistic and less personal level, we believe that designing and erecting exceptionally beautiful buildings in a city helps fulfill our determination to be a responsible enterprise that gives back to society. It is a service we provide to all citizens irrespective of whether they are our customers or not. As society becomes more prosperous, people begin to seek aesthetics which is innate to all mankind. We try to help in this regard and, in the process, help foster a more harmonious society.

We recognize that in many countries, the opportunity to design and construct architecturally significant malls in city centers may not exist. This is certainly the case in most major European cities. Because of their history, it is almost impossible to have a piece of sizeable land in the town center. This is why the entire continent hardly has such big shopping centers. In the past decade or so, London finally saw a few rather large malls, situated more or less in-town, that are quite nice inside. Yet, little attention is given to the exterior. Their proximity to many neighboring buildings makes it superfluous to spend money on it, for there is not sufficient surrounding space for shoppers and other citizens to appreciate it.

The same is not true in China. In the past two to three decades, the downtown of all major municipalities went through tremendous transformation. Old and shabby structures were almost always pulled down to make way for newer buildings. The sad thing is that many of the latter are also of inferior design and construction. Nevertheless, it allows conscientious developers like us, who invariably own our complexes for the long term, to put up large and beautiful architectural pieces. No wonder every one of our malls has won international as well as national design awards.

Obviously biased, I as a lover of architecture have yet to build a commercial project in mainland China that I do not like. Aesthetics is a very personal matter, so I cannot expect every individual to like every one of our developments. Nevertheless, few will disagree that every one of them is an architectural statement.

Needless to say, we must balance aesthetics with practicality. We never forget that we are a commercial enterprise in a free market economy with competition. As such, our design must yield highly functional space where our tenants can sell products well and we can collect good rents. Our experience has proven that a balance can be struck, and we do not need to sacrifice revenue for beauty. We are proud of what we have developed. I know of no other mall owner who has a portfolio like ours.

Paying attention to a building's exterior does not mean that we neglect the interior. But we never forget that inside the malls, the stars are our tenants. We do not compete with them; our job is to create a comfortable and conducive environment for shops and shoppers alike. Over the years, we have made mistakes in design and have learned from them. Some errors are impossible to be completely reversed. We will have to live with some imperfections. Nevertheless, lessons learned will help make our future projects better.

Prospects

Earlier I stated that both the recovery of mainland Chinese retail sales and the improvements in our management team should prove auspicious for our future. Here I may add that perhaps the results of the recently concluded 19th Party Congress may point to a continued stability on the social front. If this is correct, then the stars would seem to be all aligned for a few promising years ahead.

However, it is hard to believe that life can be always favorable and peaceful. After all, a dose of caution is always healthy for anyone in management. It keeps the mind alert and sharp.

To be sure, the Chinese system is prone to black swan events. From the 1950's to the 1980's, there were serious troubles in every decade, some of which lasted more than 10 years. The fact that now for almost 30 years, China has been relatively peaceful socially and economically is in itself a miracle. We can only hope that good days will continue. Recent developments seem to be encouraging.

What then can keep me awake at night? Government policy mishaps. In China, many of the macroeconomic — including finance-related — policy decisions are highly concentrated in a few top officials of the Central Government. As the economy grows in size and complexity, and is increasingly integrated with the global system, such policy decisions can become extraordinarily treacherous. There are simply too many moving parts. To be able to understand all possible serious consequences becomes almost impossible. This is not to mention all the unintended consequences.

Chairman's Letter to Shareholders

Two to three years ago, Beijing's certain actions related to the RMB and the stock market greatly surprised the system and became a laughing stock of the world. Fortunately the damage that they had inflicted on and beyond its reputation was manageable. Could other mistakes be made that would have much graver consequences? It seems inevitable. To have this happen is to be expected; to successfully avoid such mistakes is to be lucky. This is in no way an indictment of the intention or ability of top leaders. The system is just way too complicated for anyone.

When biased foreigners read this, some may jump to the conclusion that the Chinese system is inferior and unsustainable. In the West, market forces have a much bigger say and decision-making is far more diffused. They think their mechanism is safer but hardly so! Such people forget that only a decade ago, the financial market operating under free market principles brought the global economy to the brink of total collapse. Just as in the Asian Financial Crisis of 1997-2002, Malaysia refused to open its market to the world and was thus preserved, so in the Global Financial Crisis of 2007-2008, China was then not as integrated with the global financial market as it is today and so was spared.

The epicenter of this latest catastrophe was squarely in the "capital" of free market — Wall Street in New York City. The damage that it caused on the global economy was far more severe than the Asian problem of a decade earlier. Some experts say that parts of the global economy, such as Europe, are still suffering from the aftermath. Could it happen in the West again? Absolutely! When it does, will we be as fortunate as the last time and not go over the cliff? No one at this stage can tell, but total economic collapse is a distinct possibility.

At the height of the crisis, I was invited to the home of a good friend, the late Mr. John Whitehead, for dinner. That must have been in the summer of 2008. As many of my readers know, he was a former co-chair of Goldman Sachs, and later Deputy Secretary of State under U.S. President Ronald Reagan. All would agree that he was one of the most honorable and respected investment bankers of the past several decades. Over dinner he expressed his worry of a total economic collapse. If only I were to repeat his words here!

A basic element which gives rise to a potentially dangerous environment for the global economy today is the over-abundance of capital. World War II ended some 70 years ago and we have witnessed a relatively peaceful period when wealth could be accumulated in great quantities. So much so that capital has increasingly overtaken other factors of production such as labor and natural resources. Making money with money has become a necessity. It is not that people do not want to invest this money in productive industries like manufacturing or services. There is simply too much capital around, and making money with money becomes not only necessary but also most profitable.

Some may say that technology has been the main driver of wealth creation. This is to some extent true especially in the past decade or two. It is the only sector that can perhaps rival financial services in generating personal wealth. However, the two have a fundamental difference. Whereas technology companies usually add real economic value to society, financial services do much less so. Many of the transactions that made lots of money for those executing them do not create much value for the wider community. They are purely driven by greed. While greed itself is not useless in that to a good extent it drives the capitalistic system, the problem is that it knows no bounds. Regulations are needed but as we shall see, they cannot be effective. The only other means to check greed is through ethics or religion, but human history has amply shown their utter ineffectiveness.

Chairman's Letter to Shareholders

At least in one respect, financial services are similar to technology. Just as the former can hardly be controlled, so is the latter, especially in the biotechnology area. It raises troubling moral issues which have never been faced by mankind before; it directly calls into question what is the human race. We can try to regulate it and must do so, but I worry that it will not be effective. For certain of these technologies to fall into evil hands is like having the latter control nuclear bombs and worse. Both are distinctly possible.

Technology has also greatly exacerbated the danger of many financial services. Machines, i.e. computers, even super computers, have enabled money or capital to churn much faster. It is like lightning striking from one end of the sky to the other and can destroy everything in its way. During the Asian Financial Crisis of the late 1990's, we saw how smaller economies can be utterly devastated by the size and velocity of fund flow. This can happen at no fault of the economies involved. Hong Kong was a perfect example. If not for the boldness with which then Chief Executive Mr. C.H. Tung acted to counter the capital attack, our economy would have been all but destroyed.

Ironically, after the Global Financial Crisis of 2007-2008, which as I explained was caused partly by having too much capital in the economy, the solution devised by central banks was to issue more money. While meeting an immediate need, it also further exacerbates the original problem. It may set the stage for the next big financial crisis from which we may not be so lucky to escape unscathed. All the QE1 (Quantitative Easing), QE2, etc. by the U.S., Europe, and Japan create the conditions for future problems. In this regard, although China was not that affected by the Asian Financial Crisis of the 1990's and the Global Financial Crisis a decade later, it nonetheless is equally guilty of printing too much money.

Accompanying the rise of capital is the rise of investment banking which makes money with money. When I first started to do business some four decades ago, the word "banker" was a venerable term reserved for those in commercial banking. Investment bankers were considered to be a different breed who were not that respected, rather like a real estate developer. In fact many would not consider investment bankers as bankers. Those were the days when investment or merchant banking firms were run as partnerships where individual partners had unlimited personal liabilities for whatever happened to the firm. Consequently, the players had to be very cautious for fear of losing all they had.

Eventually investment bankers, who are invariably very smart, figured out that if their partnership goes public as a corporation with limited liability, their own unlimited personal liabilities will go away. That they successfully did. With personal wealth no longer at risk, they could cast off all constraints and expand their companies through leverage to unimaginable sizes. After all, capital was abundant and should not be left idle. That was how the Global Financial Crisis was developed.

In the process, these newly minted "bankers" amass for themselves huge fortunes. Armed with such wealth, they can now rightfully call themselves "bankers." The table has turned and every commercial banker now wants to be an investment banker, a profession which they not that long ago disdained.

Another group of "losers" was the earlier and more honorable old-fashioned investment bankers, like the late Mr. John Whitehead mentioned above. I suspect that his personal net worth was not up to one tenth that of his successors at his previous firm. The unrestrained greed displayed by some of John's former colleagues has brought certain disgrace on their heads. Sadly, the profession has become rather disrespectful in the eyes of the general public.

No one can deny that investment banking fills a necessary role in the economy. In fact, as global money supply increased, these operators in the capital market became extraordinarily significant. The sheer size of the pool of money as well as the velocity of capital flow have made them extremely powerful. Recognizing this new reality, several U.S. presidents have appointed investment bankers as Secretary of the Treasury. From 1981, six out of 12 men who filled that post came from this industry. The supremacy of the capital market over the traditional banking system, and of investment bankers over commercial bankers has thus been sealed. The beast is now the king.

In China, for the past 20 years or so, many of the brightest young people aspired to become an investment banker. That included sons and daughters of powerful officials or wealthy business families. Recognizing that such bankers personally add little value to society, I always discourage my younger friends from pursuing such a career. Most of them are not learning anything solid. (To a good extent, the value of the profession lies in the global distribution network for financial instruments they create, many of which are problematic.) Seldom was I heeded, for the money earned in investment banking was far more than in almost any other job.

One of my few successes was with my son Adriel, who is now a capable executive of this Company. After university and further Chinese language training in Beijing, followed by a short stint at a not-for-profit organization in New York City, he joined a top accounting firm in Shanghai and later, a global commercial bank. Both industries offer solid business training for young aspiring executives. When he first entered the business world, an entrance level job at investment banks was paid four to five times more than that at an accounting firm.

In order to create or justify the super high salaries and especially bonuses, such bankers have to create bigger and bigger transactions. Given the size and the speed of capital flow, they can wreak havoc on the entire economy. Today, financial assets with leveraging are much bigger in size than the real economy. This was exactly how the 2007 Global Financial Crisis developed.

The remedy that was almost universally advocated or adopted was more regulation. I certainly see the need for it. Yet I am at the same time suspicious of its efficacy if deployed on its own. There is a timing gap and perhaps also an intelligence gap. First, until there is a financial product, there is nothing to regulate. Unless all such instruments must be pre-approved by the regulatory body which may not work, there will be a lagging effect. Many such instruments may seem benign on the surface, and only when tested by time and usage will their true colors — including unintended consequences — be known. By that time, considerable damage might already have been caused.

Moreover, investment banking often offers the highest paid jobs and recruits the best graduates from top universities. Once hired, competition and work pressure will further sharpen their minds. On the other hand, government positions or those of quasi-governmental agencies cannot pay as much. Consequently, with few exceptions, second-class brains become regulators. It is not difficult to predict the outcome when a Premier League team plays a B-league team. This is not to mention that once the two sides have to engage in a legal dispute, the party with more money will have an edge by engaging the best lawyers.

If so, regulation alone cannot do the job. What then shall we do? We must first discover the philosophical roots of the problem. I have long considered that the fundamental problem is the ever-increasing demand for more freedom in society, especially in Western societies. Almost no one in the West, and very few in the East, dare say publicly that society already has too much freedom. It is against the prevailing ethos of the time in which we live. Anyone who ventures to utter the unutterable, i.e. that we already have sufficient or even too much freedom, will be publicly condemned. On this issue, it seems that no one has the freedom to freely think and speak. Social norms dictate what one can think or speak. One must be totally politically correct. Few have the moral courage to speak up even when something commonly accepted to be true is actually patently false.

This is modern slavery of the mind. The East, like China, certainly does not have the monopoly for political correctness. In fact, it is much more subtle in the West yet no less powerful. The difference is that many people in the East usually know that they are wrong when they go along with what is commonly accepted, perhaps perpetrated by the government. In the West, most people do not know that they are wrong. In fact, the government, the academics and the media often reinforces each other to obscure the truth. The truth is no longer important; political correctness is.

When this philosophy is applied to the already powerful capital market, it takes on the form of demanding ever-increasing market efficiency. More efficiency is better, more freedom is better, bigger is better, and faster is better — and as much as possible, operating in the absence of restraints. The employment of super computers in trading transactions has helped to push the market in that "correct" direction. It seems that no one is asking the question — or dare to ask the question — of whether we are being too free, too efficient, too big, or too fast. A computer cannot ask that question. Only human beings with a sound mind, an objective and unbiased attitude, and plenty of common sense laced with moral fortitude can. If the collective humankind cannot ask the sensible questions, then our financial market will sooner or later get us into big trouble. I do fear that the next crisis may be more severe than the last one of 2007, from which it may take decades to recover.

So far not only have I not discovered enough sensible voices in the West, in fact, self-righteous America has been condemning some Asian nations like China for neither improving nor reforming according to the Western standard. What hubris, especially given their own Global Financial Crisis of 2007.

Fortunately China seems to have a certain awareness of the danger mentioned above. As a result, it only selectively accepts certain advice from the West. For example, many pressure China to open its capital account and allow the RMB to be freely convertible, but China has so far not agreed. In my opinion, there is a good possibility that the next time when the West is in yet another systemic financial crisis, China with its vast economy and ready liquidity will be looked upon as a beacon of stability. They may even help bail out the West. Perhaps that will be what it takes to convince the Anglo-Saxon world, especially the U.S. that it does not have the monopoly of a reasonably good system. Every system has its own strengths and weaknesses.

That said, China is subjected to its own unique dangers. Just as the Western market may fail, so can China's policy pronouncements. I am quite sure that the former will happen again and from which recovery may be more difficult than before. Equally it is far easier for me to believe that some Chinese policy mishaps will sooner or later hit us. My hope is that top leaders in Beijing will be able to catch their own mistakes before it is too late and immediately take corrective actions. In recent years, China has several times done exactly that, and the system usually has the flexibility to reverse course. The political will as well as operational means are so far present.

Having said all that, as a businessman, I together with my colleagues must decide whether to continue to invest in mainland China. So far our decision is a very definite yes. Of less concern to us than policy blunders is the cyclical fluctuation of the market such as the winter of the past six years. We knew that spring would sooner or later return, and it did.

On a more immediate business front, I truly believe that in time, in fact quite soon, all of our properties will perform satisfactorily. This includes the two projects that are being built: Kunming Spring City 66 and Wuhan Heartland 66. Frankly there are few reasons to believe otherwise.

What is less clear is our ability to acquire good pieces of land at reasonable prices. While this is in no way detrimental to our near-to-medium-term, for we have many square meters of land on the Mainland yet to be developed, our long-term future could be capped. Doubtless we will buy land some time but the uncertainty of timing and outcome will be a test to our nerves. While sticking to our time-proven strategy, we may also explore new ideas.

A more immediate challenge to the Company is internal, that of management succession. To be sure, much effort has been expended in recent years to ensure that almost every middle and senior management position now has someone who can step in on short notice if necessary. After all, illnesses and accidents are beyond one's control. All the more reason we should have a succession plan for the top few posts.

On this score, your Board is closely monitoring the situation. In fact, our Nomination and Remuneration Committee (NRC) comprising only independent non-executive directors is directly participating in the process of candidate identification and appointment. In the past, I reported on how our NRC solely determines the compensation packages for all executive directors, including their salaries, bonuses, and stock options. This of course includes the chairman who is also an executive director. It should be pointed out that the Committee's nominating function is no less onerous. In fact, the impact of its actions in this regard is more far-reaching than remuneration determination.

A case in point took place about eight years ago when our then Managing Director Mr. Nelson Yuen, now an independent non-executive director of the Company, retired. He gave us plenty of notice. Subsequently, he and I worked closely together with the NRC — and that of our majority shareholder given the joint appointment of the Managing Director in both Companies — to identify a successor. In fact, all non-executive directors were involved in the process, with some in an intimate way.

While the best process cannot guarantee the best outcome, it does enhance the chance of success. Eventually the then Board of Directors unanimously appointed Mr. Philip Chen who was once the CEO of a highly successful airline.

As longtime shareholders and observers of Hang Lung know, it was Nelson who helped put the Company on the strategic path that we now enjoy. We built two fabulous commercial complexes in Shanghai that are the envy of many. We deftly prepared our balance sheet for the 1997 market downturn, and then bought superb pieces of land in Hong Kong at the market trough and made great profits. Then in the six years before his retirement in mid-2010, we acquired on the Mainland several excellent plots of land at very reasonable prices. We have yet to complete construction on some of them.

Nelson chose to retire right before the completion of the first of these Mainland projects outside of Shanghai. Those were the days when we were frantically constructing many complexes all at once, and the development of our management team was falling seriously behind. At that juncture, Philip joined us. His managerial and operational expertise was exactly what we needed at that time. Since his appointment, the Company has been completely transformed to suit the needs of today.

Suffice to say here that the Board is always monitoring the situation to ensure the smooth and uninterrupted operation of the Company.

A related issue is board composition. This is especially crucial for us. Unlike many other Hong Kong listed companies, our Board is a truly well-functioning body. It does what a board of directors is supposed to do. This is why for many years running, we have been picked by reputable industry bodies as having the best corporate governance.

Besides succession planning and remuneration of top management, the Board is actively involved in all key decisions of the Company, such as risk management, capital structure, cost control, and organizational structure. With this in mind, we have gathered a group of individuals with diverse backgrounds that are germane to our business. We have some of the city's top economists, accountants, lawyers, engineers, bankers, investors, as well as civic leaders. They are knowledgeable about Hong Kong, mainland China and indeed all major economies of the world. There are still a few industries and professions from which we would like to draw. I will report again as we score successes in identifying and appointing new board members.

In time we will need younger blood. Years ago we instituted age and term limits, but this is not enough. The retail business is fast-evolving and the use of technology is nowadays prevalent. It makes sense to have more younger and tech-savvy people on the Board.

A balance between experience and fresh thinking needs to be struck. I believe that certain institutional memory and wisdom derived therefrom are critical to the success of any company, and certainly in our industry. Our assets are long-dated, and the market is highly cyclical often with long amplitude. It takes time to experience a full cycle, which traditionally spans six to eight years. Anyone new to the industry will most likely be short of the necessary exposure. This argues for keeping some of the long-serving members while adding younger people. It takes time for the latter to gain the necessary experience while contributing their expertise.

On dividend, I have explained six months ago to shareholders why the Board was careful not to be overly optimistic. Quite a number of analysts have chosen to neglect my words, and there was nothing we can do about that. While we do listen to investors in general, we are not led solely by them. Sometimes their interests and that of the Company do not align. Management is not prepared to make recommendations to the Board to assuage certain short-term desires of some investors. In this case, the Board sides with management.

Since I have written much regarding corporate governance, let me make one final point here. Long-term followers of this Company know that Hang Lung is among the most transparent of companies. This is why I write letters to shareholders twice a year, the length of which is far greater than most, if not all, of my peers. While the quality of a piece is not judged exclusively by its length, few will dispute the fact that we are among the most open and forthright in our industry. Not only do we not intentionally or unintentionally mislead our readers — a practice not uncommon elsewhere — I always do my best to put forward the key thinking, and not just actions, of management whenever I write, or in public meetings with analysts or the press. If some people choose not to believe my words, that is their prerogative, but no one can say that I have not told them what is on our minds on key issues.

In penning this letter to shareholders once every six months, I try each time to cover one or two topics of significance to our business. This is beyond the usual reporting on performance and analyses of our business, the industry, and the economy. From time to time, I may also comment on national or regional developments that may affect us. The same is true for my piece to the shareholders of our major shareholder HLGL.

For example, in this writing I touch upon succession planning, board composition, and of less significance, architecture. Six months ago in the letter to HLGL shareholders, I dissected the Belt and Road Initiative. In recent years, I have at different times covered topics such as e-commerce (HLPL Annual 2016), models for boards of directors (HLGL Annual 2016), enterprise risk management (HLPL Annual 2015), sustainability issues (HLPL Annual 2015 and 2006-2007), real estate "genetics" (HLPL Annual 2014), corporate culture (HLPL Annual 2014), Enterprise Resource Planning System (ERP) (HLGL Annual 2013), and many more.

Obviously, I cannot expect all my readers to know what I have expounded in the past, and I cannot touch upon every topic in each piece of writing. As such, I either periodically repeat certain critical issues or refer my readers to a previous letter either of this Company or that of HLGL.

For this reason, we have published a collection of my 25 years HLPL Chairman's letters in summary form. It is entitled "25 Years In Retrospect" and can be downloaded at our website at http://www.hanglung.com/en-US/media-center/publications/25-retrospect.

Back to our immediate prospects: I do not expect the rental income of 2018 to be substantially different from that of the past year. A mild increase is the most likely outcome. The positive effects of the recovering retail market should soon come through thereafter. Total profit will again depend on how much of the Blue Pool Road project we sell.

In Hong Kong, the major renovation of The Peak Galleria should finish by the end of 2019. We now own about 85% of Amoycan Industrial Centre. Plans for redeveloping the site are being drafted.

The second office tower of Wuxi Center 66 should be completed in mid-2019. Plans for the second site just south of the mall and offices are being drawn up. Trial pile and soil testing are proceeding.

Ongoing construction works are all progressing as planned with minor delays. The mall of Kunming Spring City 66 is expected to open in mid-2019. So far slightly over 30% of the space is committed or close to being so. Response from retailers is quite encouraging. The office tower is expecting to open three to six months after the shopping center.

Wuhan Heartland 66 should see the opening of both the mall and the office tower towards the end of 2019 or the beginning of 2020.

The completion of the refurbishment of Shanghai Grand Gateway 66 should take place in mid-2019. I expect an upgrading of tenants which will include more top fashion brands.

All of the above projects will significantly enlarge and improve our investment portfolio on the Mainland. Starting from 2020 and continuing for many years thereafter, rental revenue should climb, followed by the rise in profit. Another growth phase of the Company should soon be upon us.

Ronnie C. Chan
Chairman
Hong Kong, January 30, 2018