Ronnie C. Chan
Chair

Results and Dividend

For the year ended December 31, 2022, overall revenue remained stable at HK$10,347 million. Rental revenue decreased slightly by 3% to HK$10,031 million. The drop owed primarily to the depreciation of the Renminbi (RMB) since the second quarter of 2022.

When excluding all the effects of property revaluation, underlying net profit attributable to shareholders retreated by 4% to HK$4,199 million. Underlying earnings per share decreased likewise to HK$0.93.

Net profit attributable to shareholders, after considering all the effects of property revaluation, fell by less than 1% to HK$3,836 million. Earnings per share stood at HK$0.85.

The Board recommends a final dividend of HK60 cents per share payable on May 19, 2023 to shareholders of record on May 5, 2023. If approved by shareholders, total dividends per share for the year ended December 31, 2022 will be HK78 cents.

Business Review

2022 was one of the most peculiar years in over three decades of my doing business in mainland China. It was fraught with unforeseen challenges. In light of this, I consider the results presented here rather satisfactory.

I refer particularly to the way the pandemic was managed in mainland China. It was set against the backdrop of two monumental events: deteriorating China-U.S. relations and the Ukraine War. I have written extensively on both before, the former in recent years and the latter six months ago, so I will not belabor the two points here. I will merely give an update on each.

Employing time-honored methods in combating any pandemic, no one can deny that China had been hugely successful in preserving lives as well as the economy in the first two years of the three-year public health threat. Compare it to other major countries in the world, and one will readily see that the per capita pandemic death rate in the most populous nation in the world is a fraction of other countries. The Chinese have every reason to be rightfully proud.

There are, however, two troubling issues. First, what is the economic cost to the country when her people were essentially cut off from the international community? Second, as seen in previous pandemics, the virus has become significantly less deadly, yet this time much more contagious. Frankly, it has become uncontainable. In the end, it was precisely these two factors and their derivative social consequences that forced the country to abruptly reopen towards the end of last year.

To remind my readers, the first half of 2022 saw varying periods of complete closure of six of our ten malls on the Mainland. The most devastating impacts were in Shanghai, where our two facilities could not do any business for two months, and no dine-in services were allowed for three and a half months. Compared to the same period in 2021, the second quarter footfall and sales both fell by over 70%. Shenyang, where we also have two retail properties, saw a month of complete closure. All our malls experienced either restrictions to dine-in services and/or shuttering of entertainment and education outlets.

Given such ruinous circumstances, it was quite remarkable that our total retail rents received for the first half of the year hardly dropped compared to the same period in 2021. Total Mainland rental revenue actually rose, thanks to the strong performance of our luxury malls outside Shanghai, as well as our portfolio of offices across the board.

While counting ourselves fortunate, we were hopeful that the worst might have been behind us, as I wrote you six months ago. Well, it was not. The second half of the year managed to outdo the first in terms of troubling news. While Shanghai improved, Shenyang and Wuhan worsened. Our Dalian mall experienced almost a month of complete closedown, while Wuhan fared only slightly better. Tianjin, on the other hand, was plagued by the virus year-round.

In usual times, the second half of a year is typically stronger in sales than the first. There are the summer vacations, the early October long National Day holidays, commonly called the "Golden Week", as well as Christmas. (While Christmas is not officially celebrated on the Mainland, it is an occasion for gifting, and hence a good time for retail business.) By the time the government suddenly lifted pandemic restrictions on December 7, the virus had already spread everywhere, more so in certain cities.

As our staff infection records showed, the climb in new cases was very steep during the second and third weeks of December. By Christmas, it had peaked. Nevertheless, people dared not leave their homes for another week or so, hence footfall remained low. Around New Year's Day, things were already on the mend. Within a week, almost all our staff were back at work. By January 14, it was all over. Fortunately, we did not have any deaths.

All told, about 81% of our Mainland staff caught COVID-19 in a matter of about five to six weeks. Different cities ranged between 71% and 94%. If our sample is somewhat representative of the country, then it is truly amazing how fast the virus spread and how quickly herd immunity was achieved. Needless to say, Management remains vigilant of any further adverse developments.

Heartland 66, Wuhan

The downside is that we did not have a Christmas season. Together with the unpredictable restrictions on business across our portfolio in the second half of the year, those six months became even more difficult than the previous six. For the full year, our portfolio was fully open for business for only a little more than half of the time.

For our business, footfall in the first quarter of 2022 already demonstrated weaknesses. By the second quarter, all ten malls noted diminishing number of shoppers compared to a year before. In the third quarter, only Heartland 66 in Wuhan recorded growth from the previous year. However, during the fourth quarter, that city was hit hard by the virus, and our mall joined other properties and recorded less footfall.

Compared to 2021, overall we had 21% fewer shoppers across all ten malls. However, total tenant sales fell by only 9%. Expectedly, where market disruption was more severe, we had less footfall and sales. Besides Shanghai, Shenyang and Tianjin were hit the hardest. In Shenyang, for example, dine-in services were prohibited for almost eight months of the year. In Tianjin, entertainment and educational facilities were shuttered for almost nine months.

Olympia 66, Dalian

Center 66, Wuxi

An interesting phenomenon was observed: a drop in footfall had less of a negative impact on sales in luxury malls. This was the case in Shanghai and even more so elsewhere. For example, Center 66 in Wuxi, which was hit hard by the pandemic, had 21% fewer shoppers, but sales still rose by 1%. Olympia 66 in Dalian saw a 6% drop in footfall, but sales jumped by 67%. The two numbers for Spring City 66 in Kunming, a tourist destination, were minus 6% and minus 4%, respectively.

A special case was our newest property Heartland 66 in Wuhan which was inaugurated in late March 2021. Many top fashion brands only opened towards the end of 2021 and into 2022. As such, the mall started the year powerfully. However, the pandemic began to affect the city in the second quarter. The number of visitors fell by 11%, but sales rose by a whopping 300%. In the third quarter, footfall recovered and climbed 12% higher than the year before. Sales skyrocketed some 240%. The fourth quarter then took a beating, when the number of shoppers dropped by 39% and tenant sales by 24%. For the full year, footfall was 2% less than in 2021, but tenant sales still rose by a remarkable 158%.

As I had predicted previously, the other bright spot among our luxury malls was Olympia 66 in Dalian. It was our only facility that had a consistent increase in tenant sales in all four quarters, even though footfall fell in three of the four quarters, all pandemic-related. Only the first quarter saw more visitors than the year before.

Center 66 in Wuxi and Spring City 66 in Kunming both performed relatively well. Of the three sub-luxury kind, Parc 66 in Jinan did the best.

The above results clearly show that, while COVID-19 had spooked many citizens from venturing out to shop, tenant sales were less affected. For example, during the Golden Week of National Day holidays in early October, our entire portfolio experienced a drop in footfall of 24% compared to the year before, but the total sales achieved were 2% higher. Our luxury malls attracted 16% fewer shoppers, but total sales were up 5%. The two numbers for the sub-luxury malls were minus 34% and minus 19%, respectively.

Given all the restrictions imposed throughout 2022, any comparison in performance with 2021 would not be meaningful. Last year should be considered an anomaly. If some stability returns in 2023, then its performance should be compared to that of 2021.

Whatever the case, and troubling environment notwithstanding, mainland China's rental revenue for the year increased by 1% in RMB terms. Because the RMB depreciated 3.1% during the year against the Hong Kong Dollar, Mainland rentals fell by about 3% overall in our reporting currency. When excluding the mall of Heartland 66 in Wuhan, the like-for-like comparison showed a decline of 1% in RMB terms relative to 2021, or a 4% drop in the Hong Kong Dollar.

Revenue from our seven luxury malls fell by only 1% in RMB terms. If Heartland 66 in Wuhan (which opened in March 2021) is excluded, revenue retreated by 3%. Sub-luxury malls collected 4% less rents than a year ago.

Due to government enforced closedown for two months last spring, our two Shanghai properties suffered significantly. Rental revenue was down by 10% at Plaza 66 and 1% at Grand Gateway 66. The strong performance in our luxury malls outside Shanghai, and a continued rise in office rents, made up much of the loss.

Rental margin of all our Mainland retail properties generally held up. For the luxury kind, all improved except Plaza 66 in Shanghai which retreated by two points. Given the two-month business suspension with effectively zero tenant sales, this is understandable. Nevertheless, it still stood at 90%. Grand Gateway 66 remained unchanged, while Olympia 66 in Dalian did superbly with a 24-point improvement. Occupancy rates everywhere held steady. Their sub-luxury cousins performed less satisfactorily.

As reported before, our offices have become a significant and steady source of revenue. Primarily due to increased occupancy and also some organic growth, total office rental was 11% higher than the year before. Rental margin rose by six points. Occupancy was healthy everywhere. Understandably, the newer the property, the faster the take-up rate and hence the improvement in rental margin. For example, our latest addition, Heartland 66 in Wuhan, saw a 16-point increase in occupancy and an 82-point margin advancement.

The Hong Kong commercial property rental market remained sluggish, primarily due to the pandemic and a lethargic economy. Retail and office rents were down

Grand Gateway 66, Shanghai

by 3% and 5% for the year, respectively. However, both sectors improved in the second half, with retail up by 3% and office by 1%, respectively.

Retail space recorded a two-point drop in rental margin to 81%, while occupancy improved by one point to 98%. Office occupancy rose three points to 90%, but rental margin slipped three points to 82%.

A minor revaluation loss, some rent relief, and weakness of the RMB vis-à-vis the HKD, all adversely affected our final results for the full year. Rental revenue declined by 3% overall. Total revenue was marginally higher than in 2021 because we sold a house on Blue Pool Road and recorded a good profit.

The net after-tax profit attributable to shareholders as well as earnings per share both decreased by 1%. When the effects of revaluation were excluded, total underlying net profit attributable to shareholders retreated by 4%. Underlying earnings per share similarly fell.

Prospects

In writing to shareholders regarding the future, it is customary to add "barring unforeseen circumstances." Never has this phrase been more applicable than today. In our 30 years of investing in mainland China, there have been many ups and downs. However, not until now have we encountered so many externalities that were totally beyond our control.

Deteriorating China-U.S. relations has resulted in "a war without a war," at least for now. The significance of the conflict in Ukraine is that it is a proxy war between the West, led by the U.S., and Russia. COVID-19 is a war of nature in the form of a fast-mutating virus versus humankind. In recent years, I have written considerably on all three issues, so will only provide updates here, especially for the first two. However, the way in which Beijing handled the public health threat in the past year was a new development. It deserves some explanation as it has had a tremendous impact on the economy and our business.

But let me first give my conclusion on what may happen to our Mainland operations in 2023. Provided there are no drastic and unexpected external factors, our Mainland business should do well. I base this assessment on the following observations. First, even without certain government stimuli for the economy in general, and consumption in particular, tremendous pent-up demand is being unleashed. Second, I anticipate there will be a powerful push from the government to revive the economy. Consumption may not be the only sector covered, but will nevertheless be a beneficiary of such actions. Later, I will explain the rationale for my optimism but will need to first lay the groundwork for it. Suffice to say that 2023 has the potential to be a very good year for our Mainland rental business.

The Hong Kong economy might have already peaked for many years to come. I will comment on the fundamental changes in our home city. Over the past decade, our Mainland business has grown nicely. As a result, our profit has depended less on Hong Kong, which now accounts for barely a third of our rental income, and will likely diminish further over time due to anticipated faster growth up north. Nevertheless, Hong Kong is still our headquarters, and we have no intention of giving it up.

The groundwork to be laid here is to better understand the geopolitical scene as well as key happenings in mainland China. Like it or not, such assessments are no longer dispensable. The world around us has become a lot more complicated than the Cold War days, or the decade or two that followed. These changes have sparked a series of responses from Beijing that will affect not only China but also everywhere else.

Of the three critical issues, I will only add one remark each on the first two, namely China-U.S. conflict and the Ukraine War. Readers can read online my previous letters for my basic analyses. Mainland China, being our primary market, deserves a fuller discussion, especially in light of the extraordinary events in the year under review. Adequately understanding them is the only way to possibly predict the future.

Latest starting in the early 1990's, some in the U.S. such as the neocons already targeted China as the future prime enemy. They were the minority then, but barely 10 years later under the George W. Bush administration, they took center stage. During that period, there were repeated military encounters between the U.S. and China which were played down by the media. Consider the Yinhe incident in the Indian Ocean in 1993, the two U.S. aircraft carriers just outside the Taiwan Strait in 1996, the 1999 bombing of the Chinese Embassy in Belgrade, and the EP-3 spy plane collision around Hainan Island in 2001.

Once the 911 distractions to the Middle East were over, Obama declared the Pivot to Asia policy soon after assuming the U.S. presidency. No doubt the U.S. was targeting China. Since joining the WTO in 2001, her economy was greatly strengthened with concomitant advancements in technology. Such developments worried the U.S., a country not accustomed to coexist with others as equals, especially after World War II (WWII). The GDP gap between the two countries continued to narrow, and America's anxiety continued to rise.

All along, China has tried to avoid conflict with the U.S. Everyone in Beijing knew that no one who got on the wrong side of America ended well. Yet economic development has been hardwired into the Chinese minds since the economic opening in 1978. In 1980, the size of the Chinese economy was less than 7% that of the U.S. A decade later, China was still only 6% of America. In 2000, China was less than 12%, but by 2010, her economy was over 40% that of the U.S. Ten years later, China had caught up to 70%. The number for 2021 was 76%. With economic growth came political influence.

This set of figures clearly illustrates why the U.S. has been doing her best to contain China's growth. Since George W. Bush, who won the U.S. presidential election in 2000, there has been four presidents, two each of the two leading political parties. None had wavered in his policies to limit this rising power. In fact, the dial has only turned up. The attack has been bipartisan. Some were rough like Trump; others were more subtle.

Within two months after U.S. President Biden took office, Beijing was eager to learn if there was any possibility under the new U.S. administration of easing the tension, thus the March 2021 meeting in Alaska. The acrimonious first session told Beijing that all hopes were dashed. Nothing will stop the U.S., so China had better prepare for the worst. Since that time, every major decision taken by Beijing, domestic or international, must have that in view. It may get ugly.

In the past few months, some pundits have observed a slight thawing of this relationship. The reason is simple. While the U.S. is still by far the most powerful country on earth, she is not without constraints. Unlike right after WWII, no one is all-powerful today. Witness the U.S. who had to ask her nemeses Venezuela and Iran to increase energy production as the Ukraine War wore on was a case in point. In an already inflationary environment, Washington, D.C. would not like to see any holder of U.S. treasury bonds, let alone the number one or number two biggest holders like China, to sell or cease to buy more. To see the present apparent warming up as a sign of the conflict ending is wishful thinking. It is a misunderstanding of the cause and nature of the conflict in the first place.

This leads me to the one point I want to raise regarding the Ukraine War, which will circle back to China. Even before this conflict started, the U.S. declared that she would not send soldiers to fight. Besides assuring her own citizens back home that no American lives would be at risk, it also tells the world that the conflict between Russia and Ukraine is a proxy war.

At a time when the U.S. is provoking China, how the Americans handle Ukraine can be seen as a message to Beijing. Just as after the Alaska meeting mentioned above, everything that Beijing does would have the U.S. looming in the worst possible outcomes. After all, American body politics has long decided that the real threat to her hegemony is China, not Russia.

Now let me turn to China, as it affects our business. Besides geopolitical challenges, several domestic issues of recent years have led to a highly unusual 2022. The problems with residential real estate have long been in the making. Having written about them before, I shall not repeat myself here. Suffice to say that the debacle has left not only many private sector developers, and their contractors and suppliers, technically bankrupt, but a great number of home buyers financially and emotionally troubled. There was a pervasive sense of uncertainty among the corporates and disappointment for many citizens, resulting in a loss of confidence in the economy on the parts of many. This is, of course, in addition to the gigantic financial hole in public debt and private debt, as well as equity markets.

Then came the restrictions on Internet platform companies such as Ant Financial as well as educational institutions. From what I can tell, the rationale behind these restrictions was sound and reasonable. However, the way these policies were executed left much to be desired.

Several years ago, I asked a friend, a founder of one of the biggest Internet platform companies in China, if he and his fellow founders had thought of voluntarily splitting the company into several separate entities. Frankly, every responsible government would take antitrust action when circumstances demand it. Remember the cases of Standard Oil and AT&T of the last century in the U.S.

Certain sectors in China today are undoubtedly ripe for similar measures. By voluntarily splitting the company, the process would still be in the hands of management, who can better control the execution as well as the outcome. Eventually, my friend told me that he and his fellow founders had contemplated it but decided not to act. Sadly for them, my fear came to pass.

Consider how huge and powerful some of those business enterprises have become. They have the financial wherewithal to easily buy up almost anything. This makes it extremely difficult for newer and smaller firms to grow big. Competition is stifled.

Huge, commercially driven educational enterprises have added social dimensions to their challenges. In the somewhat unique Chinese context, such institutions can affect social equality, which is a sensitive issue everywhere.

While recognizing the need for change, the execution in short successions may be particularly tricky. As we all know, policy execution can be as important as policy formulation. The combined effects of such measures have created a tremendous amount of uncertainty in the business community, resulting in a loss of confidence in the future. To make things worse, it took place at a time when the economy was already buffeted by the problematic housing sector. Given that, turning conservative is all but a natural defensive reaction. No one dares to make new investments, for fear of what the next wave of policies, real or imagined, might be.

Then, three years ago, COVID-19 hit. To be fair, Beijing did a superb job in the first two years in containing the spread and the loss of lives. Compared to most other countries, the Chinese economy was strong. They did it the time-tested way. The hierarchical society characteristic of the Chinese for millennia helped.

However, the economic costs gradually piled up directly and indirectly. Directly, the running of the containment machine became exorbitantly expensive. Indirectly, it siphoned off resources from more productive commercial activities, thus depressing the economy. When 2022 rolled in, the virus became more contagious and containment measures heightened. There began a serious interruption of normal economic activities such as manufacturing and transportation. The closure of shopping centers was only a minor side distraction.

By that time, most parts of the world had basically achieved herd immunity. Economies had recovered, and the public health threat was increasingly considered an endemic and no longer a pandemic. After all, newer variants of the virus, such as the dominant Omicron, while highly contagious, were not as deadly as the earlier ones. Widespread vaccination helped minimize severe symptoms and deaths. Normalcy had returned.

Meanwhile in China, some virus outbreaks were experienced in early 2022. When the leading commercial center of Shanghai was affected, the city was practically closed down for two months. Less drastic but nonetheless stringent measures continued on and off throughout the year until December. Multiple cities throughout the country experienced varying degrees of impositions. Uncertainty was rife everywhere, which extracted a psychological toll on citizens.

By December, at the latest, three issues became clear. First, fresh outbreaks almost everywhere seemed inevitable. Fortunately, these were not too lethal. Second, the economic cost to the country was becoming unbearable. Third, social pressure was building up. So, instead of the gradual opening-up planned for early 2023 as reported, it was abruptly brought forward to early December of last year. The haphazardness was thus understandable. Frankly, the country can count herself fortunate. If she did not open up in time when the virus was becoming uncontainable amid increasingly stringent control measures, the social consequences might have been serious.

Over the past year, whenever the pandemic was less severe and government policies were relaxed, tenant sales of our luxury malls shot up. The pent-up demand was conspicuous. This was the case when we held our annual "Home to Luxury" Party at Plaza 66 in Shanghai in late November. Mall-wide tenant sales were 23% higher than that of a year ago, which was then a record high. Given stringent government regulations at the time, similar but less spectacular results were recorded at Grand Gateway 66 in Shanghai, Center 66 in Wuxi, and Spring City 66 in Kunming. The events at Heartland 66 in Wuhan and Olympia 66 in Dalian had to be cancelled due to quarantine issues. So far, footfall as well as sales this month have been strong. This has also been true for our sub-luxury malls. Office enquiries have been healthy.

All this is positive news even without government economic stimulus. As long as there are no serious adverse externalities that cannot be foreseen or managed, it is a good omen for the year. Moreover, in recent weeks, Beijing is putting forth programs to vigorously spur the economy. They are pushing for a strong recovery in manufacturing and exports, and are also seeking inbound investments. Together with the government actions earlier to stabilize the housing market, all these efforts should gradually restore confidence to businesses and citizens alike. The economy should slowly pick up, which can only bode well for personal consumption. We would be able to benefit therefrom.

In my two letters to shareholders, both a year ago as well as six months ago, I wrote why I do not expect there would be much post-pandemic leakage of luxury sales dollars once the wealthy Chinese can travel overseas. Instead, I believe that, for the most part, consumers will continue to shop within mainland China rather than in the likes of London, Paris, New York City, Tokyo, or Hong Kong. I encourage my readers to review those two letters.

Now let me turn to Hong Kong, our home market. The geopolitical analyses above, if correct, cannot but lead to an external environment that is fundamentally different from what it was like in the 75 years after WWII. In those days, ours was a city at the confluence of the East and West, and our economy exploited those advantages to great benefit. We were seen as both East and West, yet neither solely East nor West. We could be whatever the circumstance required us to be. We were flexible. When China was closed to much of the world before 1979, we profited. When China opened her doors, she and the world both needed us to understand the other side, and we profited more. When the Berlin Wall came down and globalization took off, we were a huge beneficiary. All these have now changed.

Today, by fighting China on multiple fronts, the U.S. is bifurcating the world. Everyone eventually has to choose sides. You either side with the U.S. or with China. There is no middle ground. Very few countries like to choose, but almost all may feel compelled to oblige. Everyone will seek ways to circumvent it. Such consequences may last for many years to come. In the interim, everyone will suffer, including China and the U.S.

The first place to feel this coercion outside mainland China is Hong Kong. Since 1997, the West has said that Hong Kong should not be like the rest of China, and they wrongly accused Hong Kong of moving too close to Beijing. Today, with intent, they lump us as part of the Mainland, which inadvertently drive us closer to Beijing. Facts do not matter; this is politics.

Consequently, the game that Hong Kong played so well for over a century until a few years ago is now over. The U.S. wants to wreck the One-Country-Two-Systems construct. As the saying goes, it is not what you are; it is what they say you are, and you will be treated as such. International media is not in China's hands.

Another global phenomenon that will affect Hong Kong is deglobalization. This is a corollary to the point above. As a small but powerful entrepôt for over a century, Hong Kong thrived on globalization. But when the number one economy in the world wants to tear itself away from the number two, a considerable amount of deglobalization is inevitable. Whereas wholesale economic decoupling will not and cannot take place, it will still be painful. The resulting increase in economic friction will raise the cost of doing business and will be hugely inflationary. Hong Kong's middleman role, which we have skillfully performed for so long, will have to be modified.

I suspect that wholesale globalization will, to some extent, be replaced by regionalism. Some of Hong Kong's old tricks will remain useful, but the counterparties may be different. Our business community will need to adapt. Trade links will change; cargo and passenger flight routes will be different from before; Hong Kong people may even have to learn new languages. Some of our former major trading partners may mean less to us going forward. Previously unfamiliar players will emerge. Capital flow always follows trade flow. This means that our role as a major international financial center will also have to adapt.

To Hong Kong — or anywhere else — this is not all bad. The economies who first adjust appropriately will be the winners. Others who fail to adapt properly for whatever reason, such as not recognizing the changing environment, being complacent or otherwise, will be left behind. These are the days of monumental change. At such times, risks are exceptionally high but, at least theoretically, so are the potential rewards.

Over the past century, Hong Kong has had to endure many pivotal changes. Such a time has again arrived. We can no longer expect to perform the same acts as before, even if we do them better, to be assured of success. We need fresh thinking that aligns with the new global reality. Relying on the same industries that had made us wealthy in the past may now be a sure recipe for disaster. At the very least, we have to adapt in order to thrive in the new environment. We need new growth models and new industries that befit the time.

There are a few other dark clouds that may or may not disperse. The likelihood of their occurrence is low, but if they happen, the consequences could be humongous. One is the disruption of peace in the Taiwan Strait. Another is the weakening of the U.S. dollar's supremacy. A third is the further evolution of the energy security framework around the world, including in our region. And as the Ukraine War shows, even food security can easily become an issue, not just in poor countries.

Nevertheless, I do see some silver linings. Hong Kong should be able to turn some of the challenges outlined above to our own advantage. There are, however, two prerequisites. First, our metropolis must return to our roots of being primarily an economic city. For 20-some years until the enactment of the National Security Law (NSL) in June 2020, we have been hijacked by politics. Like everywhere else in the world, politics is an elixir that can get a community drunk or high. Under the British, this was strictly prohibited. But before their departure in 1997, they paved the way for this heady substance to flow freely in our streets. The result was a steady progression of social unrest that culminated in the riots of 2019.

The second prerequisite is that the people of Hong Kong must learn to acknowledge China and her people north of our border. The reality is that, with or without interference from the West, Hong Kong's economic future rests with the Mainland. Fortunately, our motherland is no longer the poor neighbor of the pre-economic opening past. Rather, it is a massive and relatively fast-growing economy, which is the second largest in the world and soon to become the largest.

To be sure, like everywhere else, China has tremendous and deep-seated problems that will take time to resolve. But none can deny the successes already scored, such as lifting hundreds of millions of people out of abject poverty in record time. It is just like saying that one should focus only on America's high violent gun crime rate and conclude that she is not an amazing country. After all, she is by far the strongest nation ever to have existed on earth. To me, both countries are wonderful.

As long as Hong Kong can overcome these two obstacles, our future should still be quite encouraging. There are still good things in our favor. Consider the following economic and social progression in three stages.

A few hundred years ago, the way for a nation to become wealthy was by owning land and natural resources with a sizeable population. Food production and extractive activities were key. After the Industrial Revolution, these traditional assets were gradually shadowed by knowledge, in particular science and engineering, as well as organizational skills. The production of manufactured goods became critical. Then, in the past few decades, another revolution took place. Advanced basic sciences, high technology (derived primarily from top-notch universities), and an abundance of capital are now essential to economic leadership in the world. For corporates and individuals alike, the best way in recent times to make a lot of money was with high tech or with other people's money, hence investment banking and funds management. We live in a digitalized world.

This begs the question: what is next? The above progression was for the most part enabled by globalization. A critical precondition for it was a relatively peaceful world. For example, globalization sped up at a furious pace after the fall of the U.S.S.R. But if, as described above, the world is rapidly reverting to turbulence and instability, some decoupling would become inevitable. Certain manufacturing will reshore. Regionalism will increasingly share the world stage with globalism.

Henceforth, the obtaining of critical resources like energy, food, and minerals, which were almost taken for granted in a globalized world, can no longer be counted upon. As such, a winner in tomorrow's world may have to possess most, if not all, factors of the above three stages — from natural resources to manufacturing to digitalization. Countries that have a large land mass, have access to natural resources, and have a sizable and well-educated population, will have a much greater chance of success.

In this regard, Hong Kong is fortunate to have big China next door, of which the city is a part. Sharing a common history, culture, and language helps reduce friction when the two sides work together. The same advantage does not exist in most other smaller, standalone economies. If all the resources at our disposal are wisely employed, Hong Kong can remain thriving for decades to come.

There are other silver linings that are of a shorter-term nature. Ever since the end of WWII, many people from the Mainland have enjoyed living in Hong Kong. Such new immigrants have always been an impetus for our economic growth. Because of the strict quarantine requirements in Shanghai and elsewhere on the Mainland, now even more are keen to move here. Of all my Hong Kong friends, the group that is the most bullish about our city's future is the "new Hongkongers" — those from the Mainland who have made Hong Kong their adopted home in the recent past.

Needless to say, Hong Kong must make many domestic adjustments properly, one of which is improving its working relationship with Beijing. For that, strong local leadership and time are both necessary. Provided that we can accomplish all that reasonably well, then our economy would not wane. There are still unique and meaningful roles that Hong Kong can play for our own benefit, as well as for our motherland. Conversely, the Mainland can offer Hong Kong many resources and opportunities.

Under this scenario, Hong Kong's real estate market would not be too weak. The best performing sector should be luxury housing. The market size is not large, but the profit margins, if well managed, can be lucrative. Mass residential market will become even more commoditized. Perpetual land shortages since the city's economic takeoff in the 1970's will soon become a thing of the past. This will inevitably keep housing prices in check. Since your Company did not play much in this sector for the past 20 years, I see little reason to jump in now. Only the luxury sector is of interest to us, but opportunities are rare.

The fortune of commercial real estate will reflect the overall economy. In particular, it will depend on our financial services industry. Opportunities to develop from scratch are limited, so companies add to their portfolio primarily through acquisition. Because the overall market is quite mature, and quality buildings in desirable locations are already concentrated in a few hands, I do not see this as a growth market for us.

As to our most immediate future, I believe that the worst should be behind us as far as our Hong Kong commercial property rental business is concerned.

This brings me back to our primary business of developing, managing, and owning world-class commercial real estate on the Mainland. There are still many opportunities to be embraced, and we will, in due course, add to our portfolio. Six months ago, I voiced caution. I still do, but I am feeling a little bit more relaxed though not yet enough to act. Risk everywhere is still too high, and I prefer much more clarity before we buy.

For our near-term performance, please allow me to repeat: barring unforeseen circumstances, 2023 should prove to be a very good year for us.

I want to thank Professor H.K. Chang for his almost eight years of faithful and diligent service on the Board. He will be leaving us by virtue of age.

Ronnie C. Chan
Chair
Hong Kong, January 31, 2023