

# Vision



We share a common vision  
and uphold the We Do It Right  
business philosophy to strive  
for excellence and achieve  
new heights for the Company.



Hangzhou Project





Spring City 66, Kunming





Heartland 66, Wuhan





# Chairman's Letter to Shareholders



**Ronnie C. Chan**  
Chairman

## Results and Dividend

Revenue decreased 16% to HK\$9,408 million for the year ended December 31, 2018, as far fewer residential units were sold. The net profit attributable to shareholders fell by less than 1% to HK\$8,078 million. Earnings per share retreated similarly to HK\$1.80.

Underlying net profit attributable to shareholders declined 26% to HK\$4,093 million when excluding property revaluation gain and all related effects.

The Board recommends a final dividend of HK58 cents per share. If approved by shareholders, total dividends per share for the year ended December 31, 2018 will be HK75 cents. Final dividend will be payable on May 21, 2019 to shareholders of record on May 7, 2019.

## Business Review

What is the chance of success for a chairman to convince his readers that his company is doing very well in the midst of a troubled geopolitical environment, a full-fledged trade war, and deteriorating industry sentiment? Well, every phenomenon described in the above sentence is correct, including the positive outlook for our business. Let me begin with a review of both our industry and business before turning to the thorny external environment.

Statistics show that private consumption in China is indeed slowing. The growth rate last year was probably not much more than 8%, the most sluggish in 15 years. There are many reasons for this, including the present trade war with the U.S., and the resulting slowdown in China's GDP growth. While this is in no way detrimental to the economy, it may temporarily blunt job growth. Lack of consumer confidence will likely result.

It is unrealistic to expect that private consumption will never slow down. In the 14 years between 2004 and 2017, the average annual growth rate was 13%. How can it be sustainable?! Or consider car sales, which came down last year after having risen for almost three decades. Sooner or later, the demand curve will flatten, or even dip a little. Given how bad traffic is nowadays in many big cities, having fewer cars on roads may in fact be desirable. After all, a growth rate of over 8% in private consumption is still respectable.



## GRAND GATEWAY 66, SHANGHAI

Set against this background, our malls have performed satisfactorily, not only in Shanghai but also elsewhere. Following a rental revenue growth of over 20% in 2017 upon completion of a major refurbishment, rents at Plaza 66 in Shanghai rose a further 12% last year. Tenant sales increased 13%. A major AEI (Asset Enhancement Initiative) is still ongoing at Grand Gateway 66, where 19% of prime space is closed for business. Works should be completed by the end of this year, and I expect a similar increase in revenue as experienced in Plaza 66. Indeed, a comparable rise in rent was recorded for the portion of Grand Gateway 66 that reopened last September when Phase One of the AEI was completed.

Our shopping centers outside of Shanghai also performed well. With the exception of Forum 66 in Shenyang where rents fell, and Riverside 66 in Tianjin which held steady, the average rent increase at the other four properties was 13%. Olympia 66 in Dalian saw the highest growth rate at 20%, followed by Center 66 in Wuxi at 19%. All cases except Riverside 66 performed better in the second half of 2018 than in the first half; Riverside 66 received about the same amount in the two consecutive six-month periods.

The same trend is observed in our tenant retail sales figures. Comparing to the year before, 2018 recorded an increase in all our malls except Riverside 66, while Forum 66 held steady. The average growth in sales in the four stronger facilities averaged over 20%. Again, with the exception of Riverside 66 whose numbers stayed about the same, the results in the second half of 2018 were better than those in the first half.

All this tells us that for both our luxury and sub-luxury malls, business is basically on the rise. This conclusion is supported by the fact that, with few exceptions, occupancy rate, average unit rent, and daily footfall all increased nicely. This is also the case with Plaza 66. Grand Gateway 66 is temporarily an exception due to its AEI.

Consider another phenomenon. In the past few months, we have signed many leases with top luxury brands and more are forthcoming. Of the total of 30-some new contracts, about two-thirds are outside Shanghai. Those in Shanghai are primarily in Grand Gateway 66, which will be transformed from a sub-luxury mall to a luxury one. Forum 66 is expected to gain a few more top brands, while Center 66 will very soon become the “Plaza 66 of Wuxi”. Spring City 66 in Kunming will be the city’s “Home to Luxury” from the day it opens its doors later this year.



PLAZA 66,  
SHANGHAI





This development tells us several things. First, top fashion brands are expanding again in mainland China. Second, we are one of their preferred landlords in Shanghai as well as in other key cities. Third, Beijing's recent policies to stimulate private consumption are working, even for high-end goods — perhaps particularly well for high-end goods. Government measures include: lowering import duties, discouraging the purchase of luxury items overseas, decreasing effective personal income tax rates by increasing exemptions, etc. On average, tariffs dropped by 9% which has led to a cut of a few percentage points in prices. All this is good news for us.

These prestigious fashion groups must have conducted careful research before deciding to expand in China. Many of them have been operating in the country for two decades or more and are therefore experienced. Most of them over-expanded in the 2000's and suffered the consequences during the bear market of 2012 to 2017. They must now be extra cautious, yet they are all opening new stores again. They know well the statistics that showed a weakening in personal consumption growth but are undeterred. All these trends are reassuring to us; they confirm what we already believe to be the case.

An interesting anecdote is that when my team recently met with the senior management of several European fashion companies, the issue of the China-U.S. trade war was never once brought up. They must believe what we do — that the trade dispute will spur China's personal consumption partly through government actions.

It is worth mentioning that, recognizing now the comprehensive quality of all our malls and not just the two in Shanghai, top luxury brands are signing up in our properties: besides Grand Gateway 66, Forum 66 in Shenyang, Olympia 66 in Dalian, Center 66 in Wuxi, Spring City 66 in Kunming, and Heartland 66 in Wuhan are all benefitting. Only our sub-luxury properties — Palace 66 in Shenyang, Parc 66 in Jinan, and Riverside 66 in Tianjin — have so far not seen such new tenants. That said, I expect Parc 66 to migrate upward over time. This is not unlike the experience of Grand Gateway 66 in Shanghai. It is not easy to get the process moving but, once it does, the speed may surprise many. For tactical reasons, it is understandable when brands act by herd instinct.



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Recognizing the comprehensive quality of all Hang Lung malls, top luxury brands are signing up in our properties

For now, there seems to be a divergence in the market place between ordinary spending and that for luxury items. While the former may be weakening, we have seen the opposite in the latter. This view is confirmed by the experience of selective high-end facilities owned by others. Like us, they are also faring well. The recent results of certain European fashion houses spoke to the same.

There are certain things that management can do to improve long-term performance, such as AEI. We opened our first rental property on the Mainland — Grand Gateway 66 — in 1999, followed by Plaza 66 the next year. Some 15 years into their existence, we spent time and money to undertake a major uplift. Our tenants, especially the high-end ones, were impressed. Not every landlord is willing to devote so many resources and be able to do such a good job as us. This further enhances our brand equity in the minds of our tenants and potential tenants. Those who are already in our facilities will want to stay and are willing to pay more rent. Many more who aspire to rent from us are courting us even more earnestly.





## Chairman's Letter to Shareholders

While enjoying an advantageous industry environment, we do not forget that there are many worrying developments in the geopolitical and geo-economic spheres. Consequently, we constantly take precautionary measures to mitigate any possible negative effect. Currency fluctuation is one example.

Between mid-2010 and the end of 2014, the RMB strengthened almost incessantly. It nearly touched RMB6.0 to one U.S. dollar. Then it quickly fell until the end of 2016 when it almost reached RMB7.0. Thereafter it appreciated again until this past spring when it broke through RMB6.3. The ensuing fall in value was almost a straight line until early November 2018 when it came close to RMB7.0. Of late, it stands at around RMB6.75.

A case in point: when we won the Hangzhou land auction in late May of 2018, the RMB stood at 6.37 to one U.S. dollar. The first 50% of the land premium was settled when the exchange rate was at RMB6.95, almost the weakest level in a decade. The remaining 50% is to be paid no later than February 9, 2019. Not knowing where the currency will go, we locked in the rate at RMB6.85 and settled the balance before the deadline. In so doing we saved almost a billion Hong Kong dollars. This time we were lucky but luck cannot be with anyone all the time. This illustrates how treacherous the game is. As we always say, we are in the business of real estate, not currency speculation. We can only use our best judgement and employ market instruments to hopefully mitigate the risk.

In general, when the RMB is strong, Chinese people travel abroad more to shop for expensive items like high fashion products. At one point, it was said that overseas purchases accounted for some three quarters of the total sales of such goods. As I wrote last year, there are indications that many of the overseas purchases have yet to be domesticated.

With new government policies mentioned above, Beijing now seems more serious about bringing this money home. Recent social unrest in Paris may have further discouraged such leakage. Even though the total amount is not big compared to the size of China's economy, it is significant to our industry. From this source alone, the domestic market can easily double without adding one new client. Since these wealthy shoppers are heavily concentrated in dozens of major Chinese cities, including every one where we have a presence, we can only benefit.

As anticipated six, indeed 12, months ago, our Hong Kong retail property rents grew at low single-digit rates. For a mature market, this is not surprising. That said, with our city being a small place next to a giant, anything happening on the Mainland can have tremendous impact on us. So far, most if not all Beijing's policies that affect Hong Kong have intentionally or unintentionally been beneficial to us. This should continue to be the case in the foreseeable future.



23-39 BLUE POOL ROAD

Our offices everywhere have performed satisfactorily. Rental revenue rose both in Hong Kong and on the Mainland. Occupancy and rental margins remain high in our home town, and are improving in Mainland cities.

Except for the 12 semi-detached houses at the Blue Pool Road development and one apartment at The Long Beach, we have sold out all Hong Kong residential units. Profit margins were all healthy. The lack of more units to sell is the sole reason for the fall in overall top and bottom lines in the past year.

It is fortuitous that we have parted with all high-rise apartments, for the Hong Kong residential market has finally retreated. Since the summer of 2016, prices went up almost non-stop for two years. That was the time when we sold a lot. From July of last year, prices began to ease, and so did transaction volume. The prices of ultra-high-end products like our Blue Pool Road houses are driven mostly by different factors and so should not be as affected.

All projects under development are progressing well. The second office tower of Center 66 in Wuxi should open in the second half of this year. We are applying to the government to build two towers of luxury serviced apartments and a small boutique hotel in Phase Two. The land is right behind Phase One, separated only by a beautiful tree-lined street. The two phases will be linked by an underground car park.

The Conrad Hotel atop the office tower at Forum 66 in Shenyang will also be inaugurated before 2019 is over.





## Chairman's Letter to Shareholders

Both the mall and the office tower at Spring City 66 in Kunming will open in the last few months of this year. They are, respectively, 160,000 square meters and 180,000 square meters. Almost 80% of the retail space has already been leased, and we are expecting many more top fashion names to join. Like Plaza 66 in Shanghai and Center 66 in Wuxi, Spring City 66 will from its inauguration be a “Home to Luxury” for this biggest and most significant city in southwest China. The negotiated rents so far are quite satisfactory. The office tower with 64 stories will be 350 meters tall. Preleasing will commence next month once the show floor is ready.

Next year should see the inauguration of both the mall and the office tower at Heartland 66 in Wuhan. Both were topped out last year. The main contract for the serviced apartment blocks was awarded a few months ago. Opening of the entire project in phases should begin next year.

After a global competition, we appointed Kohn Pedersen Fox Associates as the design architect for our Hangzhou project. Groundbreaking will take place soon after site possession next month. Completion in phases is scheduled for 2024 and onward.

Previously I have reported on a residential project in the Ngau Tau Kok district in Hong Kong, not far from the old airport. We have commenced the process to unify the titles for the existing industrial building. The site is well-located and we expect to construct almost 16,000 square meters of apartments for sale.

Land assembly for an office development in the North Point district is coming to a close. We should be able to announce it once final technical details are ironed out. We anticipate a tower of about 9,300 square meters.



HEARTLAND 66,  
WUHAN

On the thorny issue of the present China-U.S. relations, it would be irresponsible if management is not keenly aware of its possible effects, although so far the conflict has not negatively affected our business. In the last interim letter to shareholders, I have set out my basic views. As far as I am concerned, the conclusions are still valid today although the overall situation has gotten worse.

If I am correct that the present China-U.S. trade dispute is a mere manifestation of a much more serious political contest — namely, that American hegemony is perceived to be under attack — then solving the trade issue will only give rise to disputes in other areas. If the source of the problem is political, then the solution must also be political. Trade is but one tool used in the long-term political fight. Today it is difficult if not impossible to predict what that political solution may be.

That said, nothing is impossible in politics. It is not like religious animosities which can last much longer. Nevertheless, no one should expect the present problem to be behind us anytime soon. Trade disputes may be settled but there will be other issues. We should all be prepared for a prolonged period of uncertainties and difficulties. Later I will present what the consequences would be to us and how we should respond.

## Prospects

By now I trust that my readers would agree with me on the following statements: the environment in which we are operating is very challenging, yet our Company is doing well with an encouraging future. Most stock market players would probably not buy our scrip anytime soon because of the former. However, some value investors — plus our majority shareholder Hang Lung Group — may.

Why do I believe that the China-U.S. trade war would not get out of hand? Primarily it is because Beijing is rational. At least so far she has not yet been forced to behave otherwise. As I wrote six months ago, the Chinese will be willing to yield on tariffs in return for other benefits, such as those that are political and/or financial in nature. Trump will be able to claim victory over tariffs in headline news, while China will keep quiet on all the gains they receive. As always, it is a quid pro quo.

Recently I met a Mexican friend who was a key trade negotiator in consummating his country's latest agreement with the U.S. He was a former senior official at WTO, and has lived in Asia for over a decade until he was recalled by his government for the negotiations. He is now quite a hero back home because Mexico did not have to give in much while allowing Trump to claim victory. He tells me that the same is true of Canada's new deal with the U.S.





## Chairman's Letter to Shareholders

I believe that a similar scenario will be played out between China and the U.S. Admittedly, China is far more complicated and some of the negotiation terms can be rather opaque. But the outcome should essentially be the same.

If I am correct, then there seems to be cause for optimism on the trade front. Our business, even in the longer term should do well because we are in a sweet spot in the Chinese economy. However, the geopolitical and geo-economic picture at large may well turn quite ugly.

Why then am I not more troubled nowadays? First, our business is unlikely to be adversely affected. In fact, the trouble may help, as I shall explain later. Second, I take a very realistic stance. For the past 30 years, as a global citizen I have devoted considerable time and effort to bettering U.S.-China relations. Yet all of us must recognize that what any of us can do is very limited.

There are nevertheless two dark clouds looming nearby, one on either side of the Pacific. I would be remiss if I do not point them out.

As President Trump's personal legal troubles brew at home, China-bashing will become the handy tactic to divert attention. It will not be the first time when international relations are sacrificed for domestic reasons, and it can get out of hand. China may be forced to react and things can spiral out of control. On Beijing's side, any plans, even peaceful ones, to take back Taiwan soon will worsen U.S.-China relations.

We, as a commercial enterprise, like others, will have to understand the consequences to our business. Frankly, some of these developments are so new that time will be required to study and digest its impact.

Leaving this aside for the time being, I believe that the trade war is not only not detrimental to our industry; it may in fact help, at least in the near term. Concerned that the country's GDP growth will be adversely affected, Beijing has been taking measures to stimulate its slowing economy. Examples include: removing home purchase restrictions; injecting more liquidity into the system; facilitating small- and medium-sized enterprises (SMEs) to borrow money for expansion; enlarging personal tax exemptions, etc. All these measures will help boost consumer spending. This should be music to our ears.

Hong Kong may also benefit from the trade dispute. As I wrote in my last letter, America's credibility and moral standing in the world have taken a beating. Political interference increasingly makes the U.S. a dangerous place to invest in

or do business with. Some will look for alternatives, and Hong Kong is one of the better choices. Consider the public listing of companies. In the past decade, Hong Kong several times topped the list of raising the most money annually — more than New York City or London. 2018 was no exception.

I will not be surprised if many Chinese companies listed on the New York exchanges will decide to relocate. In fact, I have warned a number of friends in the past before they chose the U.S. to list their companies. Few have listened, but perhaps more will now heed my words. Given the tight listing rules in mainland China, Hong Kong becomes almost the only alternative.

While we enjoy auspicious markets, one should also prepare for the worst. For example Washington, D.C., while attacking Beijing, may make Hong Kong suffer collateral damage. The U.S. may choose to ignore our successful practice of “One Country, Two Systems” and simply lump us with the Mainland. It is not the facts; it is politics. One may call America dishonest, ignorant, or unfair, but in the face of cruel and naked geopolitics, facts do not matter.

While being optimistic about our business especially on the Mainland, we should also play defense. After all, our analyses may be wrong, and unexpected global events may yet adversely affect our market. So what can we do and what have we done?

First, we have become quite cautious in our expansion plans. We have been more selective than ever in land acquisitions. Unless it is strategic and financially reasonable like the latest Hangzhou piece, we do not act. What is unknown to the public are the auctions from which we have abstained, or have bid conservatively.

Second, we are conscientious about our financial position. While still very strong by any standard, we want to be prudent. In the recent past, we have further enlarged our standing facilities. We may also sell some of our mature investment properties in Hong Kong, as we have periodically done before. We will not be overly generous in our dividend payout, although I certainly do not expect any lowering from the present level.

While implementing these precautionary measures, I cannot help but also be pleased with how things are developing, especially in our Mainland rental business. Whereas we should be able to grow rent somewhat this year, the big break should begin in 2020. New revenue will come from four sources: the completion of AEI, newly built properties, tenant upgrades, and normal rent reversions.





## Chairman's Letter to Shareholders

As reported, Plaza 66 has witnessed two years of rental jump after refurbishment. The recently concluded Phase One of the AEI in Grand Gateway 66 has produced similar results. When the entirely renewed property opens to the public at the end of this year, rents should leap. Grand Gateway 66 will have transformed itself from a sub-luxury mall to a luxury one, more akin to Plaza 66 in the same city. The full-year effect will be felt in 2020.

For about 18 months starting from the third quarter of this year, we will be adding a lot of new rental space: the second office tower at Center 66 in Wuxi including a cinema, a mall and an office skyscraper at Spring City 66 in Kunming, the Conrad Hotel at Forum 66 in Shenyang, all within this year. In 2020, we will celebrate the opening of the mall and high-rise office at Heartland 66 in Wuhan. Soon thereafter, the serviced apartments at Heartland 66 should be ready for sale. Not counting the hotel and serviced apartments, there will be a combined new rental space of over 710,000 square meters. What makes this number special is that all these spaces are in truly world-class retail malls and Grade A offices, the likes of which are seen only in a few countries around the world.

A third source of rental growth is the upgrading of tenants. As mentioned, over 30 new leases with top luxury brands have been signed or are about to be signed. Having much higher profit margins, they should be able to generate much more rents for us. What is particularly encouraging is that two-thirds of these new leases are with our properties outside of Shanghai. Center 66, Olympia 66, Forum 66, and Spring City 66 will share the spoils. Even Heartland 66 has its first luxury brand committed, with more to follow.

CENTER 66,  
WUXI





OLYMPIA 66,  
DALIAN

Finally, periodic tenant remixing is improving our malls' overall attractiveness. Palace 66 in Shenyang is a case in point. As long as retail sales are rising, the ability of tenants to pay higher rents will be the obvious result.

For years, we had only two truly luxury malls — Plaza 66 in Shanghai and Forum 66 in Shenyang. The former has been hugely successful while the latter has been struggling. Now, with more tier-one brands signing up at Forum 66, things are changing for the better. The property is not out of the woods yet, but will be soon.

Two previous sub-luxury properties will now join the ranks of true "Home to Luxury" — Grand Gateway 66 in Shanghai and Center 66 in Wuxi. The upgrading of tenants we envisioned years ago is now taking place.

The next two malls to similarly move up should be Olympia 66 in Dalian and Parc 66 in Jinan. A number of top brands have recently committed to the former, and more will follow. We are still working on the latter, and when the top brands start to come, they may well flood in. When we finally made a breakthrough at Center 66, many brands rushed to sign up with us. Almost all of them migrated from the two neighbors of ours. This may happen one day to Parc 66 as well.

Palace 66 in Shenyang and Riverside 66 in Tianjin are sub-luxury facilities. Given the cities and the districts in which they are located, tenant upgrading is less likely. Of the two, the chance of Riverside 66 achieving it one day is higher than that of Palace 66.





## Chairman's Letter to Shareholders

Six months before its inauguration, we have started to market the second office tower at Center 66 in Wuxi. The quality of tenants and unit rent achieved so far are both satisfactory. Like the first office block, it will contribute decent profit.

The same cannot be expected from the hotel in Forum 66. For such a huge development, the presence of a hotel is almost a must. Its direct contribution to profit would be mild. We will do our best so that it will not become a major drag on bottom line growth.

Hangzhou is progressing as planned. Having appointed the design architect, we now have a better idea of what the project will eventually look like. It is architecturally a challenging project, but I believe that we have found a reasonable solution. As always, we will balance aesthetics with pragmatism. The present plan calls for a mall, five mid- to high-rise office towers and a hotel. Considering how vibrant the city's economy and consumer market are, I am confident that we will score another success. After all, our excellent location is an edge.

As our shareholders know, we have hundreds of thousands of square meters of apartments or serviced apartments in five of our Mainland projects: Grand Gateway 66 in Shanghai, Forum 66 in Shenyang, Center 66 in Wuxi, Spring City 66 in Kunming, and Heartland 66 in Wuhan. According to their land acquisition documents, all these apartments can be sold. We have completed them at Grand Gateway 66, are constructing at Heartland 66 and Center 66, and are drawing up plans for Forum 66 and Spring City 66. They should bring cash flow and profit in the not too distant future.



**SPRING CITY 66,  
KUNMING**

For the coming year, my assessment of the various Mainland properties is as follows. Plaza 66 will continue to perform well, especially its retail space. Grand Gateway 66 will still be affected by AEI disruptions. Of the malls outside of Shanghai, the fastest rental growth will come from Center 66 and Olympia 66. Parc 66 and Palace 66 will also advance in their performance, but not as robustly as the previous two. Forum 66 will continue to improve, and Riverside 66 may hold steady. All offices should fare acceptably, with the less mature markets like Wuxi and Shenyang performing better in terms of percentage growth.

In Hong Kong, I do not foresee our rental performance to differ too much from that of 2018. In other words, the most likely scenario is low single-digit growth.

How many houses at Blue Pool Road we would sell is hard to predict. It is easy to lower prices and move the products but this may not be in the best interest of our shareholders. After all, this will be our last development available for sale until the two new projects mentioned earlier are ready.

This year I expect the overall rental revenue and profit to both increase mildly, followed by a jump in 2020, and again in 2021. The top line will grow faster at the beginning. There will be a lag effect for the bottom line, given the extra expenses associated with the opening of new properties. Finance costs in the near future will increase as interest expenses can no longer be capitalized but will be expensed. Nevertheless, barring unforeseen circumstances, the bottom line should catch up.

Geopolitically and geo-economically, the whole world is entering an even more uncertain phase. Being deeply interlocked with the global system, China cannot be spared. Nevertheless, your management believes that betting on China's consumption growth is still relatively safe. With this caveat, I do believe that better days should be ahead for us. We are entering a harvesting phase. If anyone would do well in our business, we should be one of them. Management will as always do its best to avoid economic troubles that may arise, while striving to maximize medium-term profit.

Our CEO Mr. Weber Lo has joined us now for eight months and has been in his present position for the last six. He has settled in well in this role and has built a harmonious working relationship with the team, and is well liked. For that I am gratified.

**Ronnie C. Chan**

*Chairman*

Hong Kong, January 30, 2019