## RESULTS AND DIVIDEND

Compared to the corresponding period of last year, we sold considerably more completed apartments. Consequently, turnover increased 35% to HK$4,457 million. Net profit attributable to shareholders rose 14% to HK$3,217 million and earnings per share similarly to HK72 cents. When excluding the effects of revaluation gains, the underlying net profit attributable to shareholders grew 29% to HK$2,484 million and earnings per share advanced correspondingly to HK55 cents.

The Board has declared an interim dividend of HK17 cents per share payable on September 30, 2014 to shareholders of record on September 17, 2014.

## OPERATIONS REVIEW

As the world's fastest growing major economy, China has seen much volatility over the past two to three decades. We are now in one of the down cycles but your Company has nevertheless performed acceptably. While I will report in greater detail at year end, here are some of the salient points.

Anti-corruption and anti-opulence policies of the new administration under President Xi Jinping continue to affect luxury retail sales. More recently, such policies also help depress housing prices especially in provincial capitals, as many apartments presumably owned by corrupt officials are for sale. This in turn harms the primary market. Administrative measures such as limiting second home purchases, credit tightening, together with a huge inventory in the hands of developers, have had serious effects. In recent months, prices have fallen whereas previously only transaction volume shrank. All these in turn affect retail sales. Negative wealth effect may have discouraged conspicuous consumption.

This is not all bad news for us. Financial weakness on the parts of home builders will curb their ability to buy land. This is evidenced by the withdrawal of land at many recent auctions. The result is that some municipal governments are in a weak financial position. This may give us the opportunity to buy commercial land at reasonable prices. When we bought the Wuhan piece in February 2013, that was exactly the scenario. As some say, Hang Lung always performs well in bear markets.

Of course we do not want to see the overall economy collapse. While some Western observers anticipate that, I do not share their pessimism. If we were to look at the country's public finances as a whole, serious challenges notwithstanding, the overall picture is not that bleak; the situation is quite manageable. The government is also more than capable of managing any liquidity needs or unusual market conditions. As I have noted in the past, there are many administrative measures that Beijing can employ. For example, cutting the present tight reserve requirement ratio for the nation's banks by one percentage point could unleash about RMB1 trillion (US$160 billion) into the banking system.

That said, Chinese leaders may choose not to do this in order to contain runaway credit expansion. If so, then the economy may remain relatively weak for some time to come. Thanks to improving export prospects and continued public investments, slower economic growth in China today still means an annual growth rate of some 7 to 7.5%. This is why the economic slowdown notwithstanding, your management is not overly concerned.

Overall turnover went up 35% to HK$4.4 billion. Rental income rose by 10% to HK$3.5 billion. In Hong Kong, we collected 7% more rent and on the Mainland 14%. If we take out the effect of Wuxi Center 66 which opened in mid-September last year, rental turnover on the Mainland was up 5%.

All of our shopping centers except one recorded higher rental turnover. The two in Shanghai saw an increase of 7% — 6% for Plaza 66 and 9% for Grand Gateway 66. The numbers for the two facilities in Shenyang respectively advanced by 7% for Palace 66 and 3% for Forum 66. Due to tenant remixing towards the end of the first lease term, turnover fell by 10% at Parc 66. The worst, however, should be behind us for this Jinan property.

In terms of occupancy rate, little change took place since a year ago for Plaza 66 and Grand Gateway 66 in Shanghai and Palace 66 in Shenyang. For the same reason noted previously, Parc 66 suffered the most but the situation should improve from here. Forum 66 has a little vacancy now which may persist for a year or so as many tenants are beginning to renew their tenancies for the first time.

An equally significant set of figures is the retail sales realized by our tenants. While Shanghai overall had a minor retreat of 2%, retail sales grew everywhere else. In line with what I wrote six months ago, the most significant improvement came in Palace 66 in Shenyang. With excellent management efforts, this mall has definitely turned the corner with retail sales up 15%. Footfall has also improved significantly. The other Shenyang project, Forum 66, saw tenants selling 8% more goods by value. Even Parc 66 in Jinan had an increase of 3% in spite of a higher vacancy rate.

As for Wuxi Center 66 which was only 9.5 months old by the middle of this fiscal year, we can only use per day rental for comparison. Compared to the 3.5 months of 2013, the first six months of 2014 recorded a growth of over 10%. One should bear in mind that sales during the opening period can be abnormally high, and July to December usually have higher sales than January to June.

Investment properties in our home market of Hong Kong remained healthy. Rental turnover and profit both advanced by 7%. Commercial rent moved up 9% and offices likewise by 6%. Both occupancy and unit rental rate for both product types rose. Retail sales were marginally better than the comparable period of a year ago, although the market has been weak in recent months. All measures relating to our serviced apartments — rents received, average room rate and occupancy — improved. Our residential units did not fare as well; only the average unit rent went up.

In Hong Kong, the market for residential sales was steady. We took advantage of this and sold 110 units of The Long Beach, 88 of which were recorded here because the transactions had been completed. The rest will be realized in the second half of the year. Total sales for the consummated deals were HK$901 million and operating profit therefrom, HK$540 million. They represent a jump of respectively almost 10 times and 8 times that of a year ago.

Revaluation gain showed a 0.5% rise in value of the assets concerned. The dollar amount was HK$748 million versus HK$1,014 million the year before. After deducting related deferred taxes and minority interests, the net gain was HK$733 million.

All told, profit attributable to shareholders went up 14% to HK$3,217 million for the 6 months under review and similarly earnings per share to HK72 cents. Excluding the net effect of revaluation, underlying net profit attributable to shareholders increased 29% to HK$2,484 million, and underlying earnings per share to HK55 cents, up 28%.

Our financial position remained very healthy. Net debt was HK$1.9 billion representing a net debt-to-equity ratio of 1.5%, which is very low by any standard.

## PROSPECTS

It is difficult to foresee a scenario where the Mainland economy will significantly improve during the rest of the calendar year. The present lethargy may in fact be extended to the first half of 2015. Consequently, it is perhaps unrealistic to expect a tail wind for our business there. This is different from what we had experienced in much of the past 15 years.

That said, there is nothing more certain than the continued growth of consumerism in China. Just as the main economic story of China in the past 30 years was manufacturing for export, it will be consumer spending in the next 30. As such, sooner or later a stronger market for our business will return. It is also likely that the high-end retail market will in future depend far less on corruption-related “gifting” than before. Such will be a much healthier market. A new level will be reached from which growth will resume.

Going forward, where will the demand for high-end retail goods come from? Whereas in the past it came from the business-wealthy and corruption, in the future the latter will be curtailed but the former can only grow. In place of "gifting" or buying lavish gifts for government officials, a new professional class is rising. Salary levels on the Mainland in the past decade have jumped tremendously. Previously, Mainland professionals would earn about half of what their counterparts with equal qualifications in Hong Kong earn, however, parity of pay has been achieved in the past few years. Because of a shortage of qualified individuals in certain professions, a person may in fact make more in mainland China than in Hong Kong. Just as the many young professionals, say above the age of 35, in other Asian cities would likely own several luxury items from clothing and handbags to jewelry and accessories, the same is happening on the Mainland. This group is beginning to come into its own and its size is not inconsequential.

Asians love branded luxury goods, especially those living in newly developed regions. Better quality and the associated status and prestige are two major motives. Over the past 50 years we have seen this phenomenon take place first in Japan, then in Hong Kong, Korea, Taiwan and Singapore. Now it is happening in mainland China. The only difference is that this time the size of the potential purchasing group is far larger. They are also concentrated in first- and second-tier Chinese cities, making them excellent targets for our type of malls. In the case of Japan and Korea, the demand for luxury products eventually spread to what the Japanese call "OLs" or office ladies. The same may be true in China, but perhaps it will not happen for another 15 to 20 years.

We will redouble our efforts in several areas during the present market lull. After opening four shopping centers in the past four years in three cities, we have learned a lot, both what to do and what not to do. In one case we misread the market; in another, our operational team made certain blunders. Fortunately, all of them can be fixed through management efforts, and they are all being remedied. We underwent similar challenges some 15 years ago when our Shanghai malls were first opened. Hopefully lessons learned will enable our coming projects to progress more smoothly.

A related issue is our management team. Although headcount has grown tremendously in recent years, there is always room for more experienced professionals. The fact is that given the extensive constructions everywhere, the entire industry is shorthanded. As before, we will recruit externally but we will also strengthen our Management Trainee Program which is now in its 10th year. The goal is to build up a first-class cadre. Given the seemingly endless opportunities, the Company can only expand over time and in-house trained personnel are preferred over outside hires in the long run.

As I have previously written, management is working hard to build our EST program which stands for Experience, Service and Technology. They represent the "software" of our leasing business. Few will dispute we have some of China's best hardware in the industry — best located, appropriately sizeable, superbly designed and well constructed commercial properties. These are what I coined "real estate genetics". Complementing them with the best software will solidify and extend our leadership position in the industry. This is especially critical today as the amount of retail space everywhere has ballooned. The use of technology and other means to differentiate ourselves is an area which deserves the attention of the Company's highest-level executives.

Previously I had written that the rapid growth of e-commerce could have a positive effect on our shopping centers. Brands may have fewer stores in each city resulting in concentration of sales. The better malls will benefit while the inferior ones will suffer. Consequently, the overall quality of a shopping center is now more critical than ever.

This explains a recent phenomenon in our Shanghai Plaza 66. At least four tenants, which are all global luxury or sub-luxury brands, have asked for much more space. Two of them want to double the size of their existing stores at that facility while the other two would like to enlarge their stores by 57-65%. This concentration of sales will doubtless benefit all of our other malls since they are invariably among the very best in their respective cities.

Almost 10 years after land acquisition, Tianjin Riverside 66 will finally open on September 26. This took much longer than what we had experienced in the past; the previous six projects (including the two in Shanghai) took 4.5 to 7 years. This time around we encountered far more difficulties from the local government. In the interim, a huge mall belonging to an entity related to the municipality had opened about two years ago. Due to first-mover advantage, most of the top global luxury brands have now settled there. (Tactics used to attract them to such a poorly located mall are worth studying but probably not emulating.) We will do our best to lure them over but it will take time. Ultimate success however is plausible due to our superior “genetics” as explained earlier.

But for now, there is no denying that Riverside 66 is “born” in a difficult time. Due to recent market weakness, international brands are for the time being not expanding. There is simply no budget for this year or next. At best, they will have to close a shop in a city before opening a new one cross-town. This was exactly our experience last year in Wuxi when we opened Center 66.

Adverse environment notwithstanding, I am pleased to report that 86% of the retail space at Riverside 66 has already been committed by reputable names. I expect 90% by the time of opening. As we have always targeted, initial gross yield will be between 4% and 5%, perhaps closer to 5%.

Constant improvement to our investment properties is key to sustainable rental growth. Consequently, an extensive asset enhancement program has been put in place in both Hong Kong and the Mainland. In Hong Kong, the potential for increased rent is considerable. We began with our extensive Mongkok District portfolio with very satisfactory outcomes. The program for the Causeway Bay District, which is the other major concentration of our buildings, has just started and the result should prove equally pleasing.

For our two Shanghai malls, major upgrades are being planned and will be introduced in phases to minimize disturbance to our tenants and shoppers. It will take about two years to complete and should keep the malls competitive for many years to come.

There is a reasonable chance that on a like-for-like basis, rental results of the second half of this year in both the Mainland and Hong Kong will improve from the period just reviewed. Coupled with the opening of Tianjin Riverside 66 in September, overall rental turnover will rise. The first office tower at Wuxi Center 66 is beginning to be leased and is not expected to significantly change the bottom line, at least not for now.

In the past few months, Hong Kong's residential market has become as healthy as ever in perhaps 20 years. Moreover, the chance of it remaining so is, in my opinion, fairly good. This means government actions in the past two years are beginning to work. Some are complaining that prices are still high, but imagine what the situation could have been if not for the government's intervention.

Given this, I am hopeful to part with more completed apartments while maintaining profit margins achieved previously.

In the past many years, I have taken pains to utilize this platform to communicate directly with our shareholders. Efforts have especially been exerted at year end, while the interim report has always been much shorter. With this format, I have long been troubled that only annually do I more adequately explain to shareholders our assessment of the market and management's views. There was also the problem that the year-end letter could become inordinately long — and it often did. Moreover, it may be hard for readers to absorb so much information at one reading, or the length may have discouraged some to even start reading.

For these reasons, I will henceforth spread out what I want to convey to shareholders by lengthening the mid-year report and slightly shortening the year-end one. It seems like a reasonable thing to do. As always, your comments are most welcome. Please send them to chairman@hanglung.com.

Ronnie C. Chan
*Chairman of the Board of Directors*
Hong Kong, July 31, 2014