CHAIR'S LETTER TO SHAREHOLDERS

Ronnie C. Chan
Chair

Results and Dividend

Despite the depreciation of the Renminbi (RMB) and the absence of any contribution from property sales, overall revenue held up when compared to 2022 at HK$10,316 million for the year ended December 31, 2023. The entire amount came from rental revenue, which represented an increase of 3% from last year.

The reported underlying leasing profit attributable to shareholders slightly increased by 1% to HK$4,177 million. However, without any contribution from property sales, the underlying net profit attributable to shareholders, when excluding all the effects of property revaluation, declined only by 1% to HK$4,137 million. Underlying earnings per share likewise fell to HK$0.92.

Net profit attributable to shareholders, after considering all the effects of property revaluation, increased by 3% to HK$3,970 million. Earnings per share rose correspondingly to HK$0.88.

The Board recommends a final dividend of HK60 cents per share, payable on or about June 14, 2024, to shareholders of record on May 10, 2024. If approved by shareholders, total dividends per share for the year ended December 31, 2023 will be HK78 cents.

Business Review

For most Mainland businesses, ours included, 2023 opened with much promise. The strict measures against COVID-19 were suddenly lifted in December 2022, and nationwide herd immunity was achieved in five to six weeks. By early January, normalcy appeared to have returned. The government was expected to take strong measures to stimulate the economy. Everything was looking upbeat.

During the first four months of the year, the market did perform well, but the momentum began to wane. Apparently, the government's economic stimuli were unable to sustain growth. Weakening sentiment gradually set in, with few encouraging signs as the year progressed.

When comparing the same period in 2023 to 2022, the rise in tenant sales during the first half was powerful but slowed in the second half. A similar pattern was observed in rental growth. Of late, the government seemed to have dialed up its stimulation, but whether this is sufficient to reverse the economic slowdown remains to be seen. As I have written in my recent letters, this is not only a financial or economic issue; it is also a structural one. It involves the loss of confidence from individuals to consume and enterprises to reinvest. Until that is restored, temporary upward movements can hardly be sustained. This is why I believe that, this time, the arrival of a full recovery will be measured in years and not months. When that happens, the economic structure will hopefully be healthier than before, thus assuring more sustainable growth.

As previously reported, for the 23 years since we opened our first commercial property on the Mainland in December 1999 until 2022, our Mainland rental portfolio in RMB terms has grown consistently year after year. We achieved this through a combination of organic growth as well as the addition of new properties. I am happy to report that we broke the record again in 2023 — in spite of not having new square footage added, we collected more commercial rents on the Mainland than ever before. Looking ahead, it will be a challenge to replicate this in 2024, but we will certainly do our best. We are operating under a very weak economy.

During and after the pandemic, luxury retail was one of the few sectors that was still growing nicely. But in the past several months, it too has slowed. This phenomenon is not unique to China; it is ubiquitous. In fact, relatively speaking, China is probably performing acceptably compared to most major markets around the world. Yet, her annual increase cannot be compared to the many years past. As one expert wrote, we must adapt to the new normal of a slower market. There may come a time when rapid growth will return, but I do not expect it in 2024.

A year ago, I stated my belief that 2023 might be a good year. I was correct since our Mainland rentals did reach new heights in our history. However, the results were not as pleasing as I had hoped because the economy continued to lose momentum throughout the year. Considering a quick recovery cannot be expected, I should comment on our net debt level, which has been creeping upward. After all, for about two years we have been operating under a rising interest rate environment.

To be sure, at the present 31.9% net debt-to-equity ratio, with a net debt balance of some HK$45 billion at year-end, our financial position is quite comfortable. This is particularly so given the nature of our business where we receive over HK$10 billion of quality recurrent rental revenue each year. Moreover, our net debt is expected to peak sometime in the next year or two. Management is therefore quite sanguine about our financial position. That said, we are taking many prudential measures to strengthen our finances, such as offering all eligible shareholders the opportunity to take scrip dividend rather than cash. This will allow us to retain more cash as working capital.

The point I want to make here, however, is not financial but strategic. A major reason why our debt level is where it is today is that, in 2018, we acquired land in Hangzhou and began construction as soon as we could. To me, this was an important strategic move, whose rationale I will explain later. There is obviously the need to balance financial stability, especially cash flow prudence, with strategic necessities. Nothing is free in business. To gain a longer-term strategic advantage, one must pay a shorter-term financial price.

As I have written many years ago, in the mainland Chinese luxury retail mall business, it is imperative that a company occupies as much as possible the following competitive positions. First, it should only be in very vibrant economic cities. Second, it must be the best in each city, although, in the biggest Mainland markets of Shanghai and Beijing, one can afford to be number two. Both sales and profitability are usually the highest in such properties which I call champions.

Plaza 66, Shanghai

Heartland 66, Wuhan

Not counting Hong Kong, I categorize Chinese cities into three groups. Only Shanghai and Beijing are in the top echelon. Each city can sustain multiple stores, say five to six, for each of the top fashion houses, such as the "Big Six" of Louis Vuitton, Dior, Chanel, Hermès, Cartier, and Gucci. Of those stores, the top two of each brand would garner the lion's share of the market.

The second group of cities comprises the six metropolises of Guangzhou, Hangzhou, Chengdu, Shenzhen, Nanjing, and Wuhan. Their economies are enormous, and each city can boast say three to four locations of each luxury brand, but the best one tends to outdistance the rest in terms of sales dollars. The runner-up may or may not be that lucrative. In other words, there will only be one or at most two champions in a city.

Group 3 consists of the better of the so-called tier-two cities. Each can manage only one — or, at most, two — stores for such brands, and the second best usually will not be particularly profitable. There can only be one champion.

For the first group of cities, our Plaza 66 is one of the two top-selling malls in Shanghai. (We do not have a presence in Beijing.) In fact, Plaza 66 is believed to have unrivaled efficiency nationwide, i.e., achieving the highest sales per square meter among all luxury malls in mainland China. We are only limited by size, so we are doing our best to expand its footprint, as I shall report later.

For the second group, we are only in Wuhan so far, which is not the strongest of its peers. Despite being a new property, Heartland 66 in Wuhan has already made considerable achievements. It is still gaining market share and has a fair chance of assuming the number one position in the city soon.

Spring City 66, Kunming

Olympia 66, Dalian

This is where Hangzhou comes in. Our Westlake 66 development certainly has the potential to become the strongest in that city. In each of the other four cities of Guangzhou, Chengdu, Nanjing, and Shenzhen, there are already one or two dominant players. It would not be easy to dislodge them. Such is the strategic significance of Hangzhou to us. We could not afford to miss the opportunity to acquire the land back in 2018. Fortunately, we won the auction. The price was well within our budget, and we are confident that we can build the best luxury mall in Hangzhou.

Group 3 cities are economically smaller but can still be highly profitable if you are the best in class, such as our Center 66 in Wuxi. The city is not large in population, but in terms of per capita household disposable income, it ranks as number one in the country. Consequently, the total tenant sales of Center 66 are only next to that of our two malls in Shanghai. I should mention that we also dominate in two other group 3 cities — Olympia 66 in Dalian and Spring City 66 in Kunming.

So far, we have four champions — Plaza 66 in Shanghai, Center 66 in Wuxi, Olympia 66 in Dalian, and Spring City 66 in Kunming. Very few developers have achieved that, but the situation may change over time. Frankly, any company that can produce one or more champions deserves our respect.

Given this landscape, the significance of Westlake 66 in Hangzhou is self-evident. It is strategically critical, albeit it has raised our debt-equity ratio for a few years. Once it opens, I expect tenant sales to be high, leading soon to pleasing rental revenue. That, in turn, will help bring down our gearing, which is reasonable even at its peak.

Prospects

In recent years, geopolitical and geo-economic issues have increasingly become significant to any sizable business, ours included. Traditional risks like strategic, financial, marketing, and technology risks, remain. Some of these were even exacerbated by developments of late. For example, the rapid advancement of science and technology appears to have reached the very steep part of a J-curve. Every new technology brings positive as well as negative consequences to society. I worry that the latter has finally caught up with the former. The speed of such inventions is beyond the ability of individuals and communities to cope. It is frankly alarming.

Consider the unprecedented ethical issues some technologies now present. Humankind has never before been confronted with anything like it. Or witness the prevalence of mental illnesses, such as on university campuses everywhere, to almost pandemic levels. A Harvard medical school professor recently told me that a significant majority of their students need some form of psychological counseling. Five or six years ago, I learned that, at Yale, such percentage was only slightly lower.

Today, the geopolitical problems we face are more grave than in recent memory. When the world's most powerful nation (the U.S.) wants to take on the second biggest economy (China) in a comprehensive contest, it is bad news for all. It will impact global businesses everywhere, especially those operating in China, like us. Trouble can strike anywhere. One place that is unexpected by many is the U.S. As I shared with a top thinker and practitioner of international affairs in mid-July last year, four months before his passing, the biggest risk in international affairs today is domestic troubles in the U.S. They will have severe consequences for the rest of the world.

Today, America is a country at war with herself. To some degree, she always has been, but it has never been this serious since the end of the Civil War in 1865. Party politics has become toxic, wealth gap is wide, and racial divide is rampant. Somewhat unique to America are the issue-based schisms in society, such as gender, immigration, guns, drugs, and many others.

Imagine Donald Trump returning to the White House, an outcome that appears increasingly possible. If this happens, three phenomena will surely occur: further splintering within the U.S., further fragmentation of the world, and further diminishing of America's global standing, resulting in her faster retreat to isolationism.

I fail to see how this is good for the U.S., or, indeed, the world. Since World War II (WWII), America has assumed the role of the global police. Like it or not, to some extent the U.S. has kept the world peaceful. Once that felt or unfelt force diminishes, the world will be a mess. It will be a world adrift in a stormy sea with no possible safe haven.

In my opinion, China does not have the intention nor the ability to replace the U.S. in this regard. At the same time, multiple non-state actors are rising, whose power and ability may rival or exceed that of many nations. Who will be there to contain them? Perhaps one day, a certain convergence of events would compel the U.S. and China to work together to resolve some global security issues.

Such is the prospect of the troubled world in which we now live. This is why I have publicly stated that, in today's environment, the objective of most companies should be to survive, not thrive. There are simply too many risks, known and unknown, to take an aggressive stance on expansion. Get through the next few years, then see how the world has evolved around us. It is better to pass up an opportunity than to lose an entire business. This is why, at Hang Lung, we have maintained a cautious stand in the past few years.

In these troubled waters, China may actually be a relatively peaceful place after she successfully resolves two issues: the contest with the U.S. and her own domestic economic malaise. In the past, I have written about the former and why I am not overly pessimistic about it; here, let me briefly address the latter.

As we all know, the Chinese economy is facing numerous challenges. When forced to change, the country will. With appropriate structural reforms, I believe Beijing should be able to overcome them one day and resume growth. In the past 45 years of opening and reform, she has faced difficulties of all kinds and has always found a way out. As the proverb goes, necessity is the mother of all inventions.

Besides new impetus from an improved economic system, technological advancements will be another key driver of recovery. Unlike years past that saw a proliferation of software giants, making the country one of the most advanced in the world, the next phase will likely be propelled by breakthroughs in hardware. Thanks to the U.S., which is depriving China of advanced chips and other sophisticated products whose imports she previously relied on, the country is left with no choice but to innovate and develop them domestically. Today, tech startups led by hungry young entrepreneurs abound. Endowed with the largest cohort of engineers in the world, China will sooner or later catch up, or at least narrow the gap with the West. Just look at recent examples like Huawei's Mate 60 smartphone.

When the Chinese economy eventually recovers, likely in the coming few years, it will be quite different from that of the past. For example, the former model of local governments selling land to fund infrastructure and other public goods is no longer possible. A healthier model must be found, for not changing is no longer an option.

The Chinese government does have a useful tradition of "drawing conclusions from previous experiences" (總結經驗). However, its usefulness will altogether hinge on the correct understanding of past mistakes. Drawing wrong conclusions is a distinct possibility.

For example, I have heard some officials say that the cause of today's housing problem was the greediness of private sector developers. As such, moving forward, they proposed that residential real estate should primarily be handled by State Owned Enterprises, or SOEs.

On the surface, it makes sense. Almost all the developers who are bankrupt today are from the private sector. Because SOEs were wisely controlled by the government from overborrowing, they never had the excesses of private developers. However, the greediness of business people is not the problem; not putting proper regulations in place is. After all, greed is human nature and is at the heart of the market economy. Without it, there is no market economy. It is precisely the function of the government to institute proper rules and rein in excess greediness

without killing the market. Hong Kong and Singapore developers, for example, are equally greedy, but because local rules and statutes are more adequate, their markets are much less problematic. This was not the case in decades past before appropriate laws were introduced.

Over time, these laws tend to undulate — being too tight or too loose, leading to market contraction or expansion. Every society needs to learn over time to adjust these rules so that the market does not overreact. A good government is one that has learned to do this relatively better. Like everywhere else, Beijing must learn, and is learning. This principle cannot change, although it should be customized to local conditions.

Take, for example, the mechanism for money borrowing. If banks and other providers of funds are better regulated, developers cannot overborrow. This was not the case on the Mainland, thus leading to sky-high leverage. Anyone with experience in the market economy could have easily foreseen troubles ahead. For years, I, for one, have been publicly telling Mainland home developers that their business model, indeed the entire industry, was unsustainable.

Another example relates to bankruptcy. For reasons mostly ill-founded, Mainland developers were for decades prevented from going bust. As I had observed years ago, the Chinese market must hold the longest record of not having any real estate company fail. But this was for the wrong reason — the government did not allow them to, even when they were already technically insolvent. Wrongly saving them led to a moral dilemma that emboldened companies to overborrow. Why be cautious if the government would always bail you out of financial troubles? This also encouraged unhealthy competition with each other on size and speed, rather than profitability and quality.

As I have long argued, bankruptcy of property companies is in general the least disruptive to society. Land will not disappear, and building obsolescence is very slow-moving. A developer going bankrupt does not necessarily entail a loss of jobs. The only real change is that of ownership. If a proper regulatory regime is in place, company failures would mostly be isolated incidents with little contagion effect.

Like in any economy, from time to time some developers will inevitably fail. Given market cyclicality, such bankruptcies are usually due to over-expansion at the wrong time. Let the balloon burst; it is an essential part of the market economy. Instead, mainland China has, in recent decades, gradually allowed many small balloons to become a big industry-wide one that could no longer be contained. The consequences are now grave.

Today, the trouble is not only financial but structural. As I wrote six months ago, local governments have sold land in recent years that will be sufficient for a long time to come. Moreover, the total stock of completed, or soon-to-be completed, housing units is truly enormous. The surplus will depress land and home prices for quite a while. Consequently, local governments must find new sources of revenue to keep up with the production of public goods. It will not be easy, but it will provide much room for structural experimentation. When there is a need, there will come a solution. Such is the resilience and ingenuity of the Chinese people — government officials included — which has been amply demonstrated since the economic opening in 1978.

Allow me to cite another case of learning from previous mistakes. There is now a belief in certain quarters that, soon after the beginning of the Global Financial Crisis (GFC) of 2008, China should not have pumped so much liquidity into the market. The money printed, for the most part, did not help the real economy. Instead, it fueled asset inflation and led to worsening corruption. As a result, now again facing economic malaise, money creation is very timid.

From my understanding, what went wrong in 2008-2009 was not the priming of the monetary pump per se, but the lack of regulation to guide the money printed. As a result, it did not bring the desired effect. By wisely directing the flow of money, the economy can be revived. Many countries have in the past done so effectively. Why not China?! A free economy does not mean freedom from regulations. Rather, proper regulations are absolutely necessary to preserve the free market. Just do not overdo it.

If the analyses above are correct, many short-term concerns notwithstanding, a longer-term optimism of the Chinese economy should be justifiable. Nevertheless, since the transition will take time, we will adopt precautions for the present winter. With prudent management decisions, we should be able to position the Company to take advantage of the spring that lies ahead.

In principle, this is similar to what we did in the mid-1990's. Foreseeing trouble on the horizon latest in 1995, we took steps to prepare ourselves, such as refraining from buying land, selling investment properties, issuing stocks for cash, and exchanging shorter-term debts with longer-dated ones. When the Asian Financial Crisis (AFC) began on July 2, 1997, we were prepared to seize opportunities when the timing was right. Judging that market recovery might not immediately occur, we waited another 21 months before striking out to buy land. In retrospect, those were among the most profitable projects anyone has ever done. From the perspective of a business operator, we may be at one of those rare points in time that occurs once every two to three decades.

A few days ago, I spoke with a friend from Guangzhou who has extensive knowledge of major Mainland developers. I have been seeking her advice for well over a decade. She shared with me how negative the sentiments among her friends are. To them, the sun will never rise over China's economy again. This is understandable, for I am quite aware of how dark the days are. But given my own analyses as presented above, I am not too unhappy with the sentiments of those developers. History always tells us that those who were once wildly optimistic will have their share of total despair. Perhaps that time has come.

Here is an interesting anecdote. Exactly 17 years ago, a group of more than 20 Mainland developers visited me in Hong Kong. I told them that, in 20 years or so, perhaps 60% of them would make money, of which 5%-10% would become super wealthy. In the remaining 40%, maybe 20% would face struggles or exit the industry. The rest would be bankrupt. Those were the early and happier days for Mainland real estate, and no one was concerned about my prediction. None would have imagined that they belonged to the bottom 20%. Sadly, history proved that I was way too optimistic, for most, if not all, are bankrupt today.

Yet another incident worth sharing: In the summer of 2017, I attended what may be mainland China's largest annual real estate forum. Among the ten or so developers on stage with me during one session, all except myself were from the Mainland. When asked if Hong Kong's

property market would in five years' time be dominated by companies north of the border, everyone said yes. I was the lone dissenting voice. This is a reminder of how overconfident one can be in a bull market.

As I have explained before, the present downturn is not a cyclical but a structural one. This bear is not those bears of the past. As such, one cannot expect things to turn around quickly, but turn they will. We will not commit significant amounts of capital at these times. Instead, with local governments in need of funding, and with most competitors running short of cash or courage, there must be opportunities. We should be able to use limited capital in exchange for lucrative potential gains. This we are already seeing. Beyond it, there will come a time when we will be more willing to commit larger sums of money for our next phase of growth.

For now, let me report on one recently committed project. There are others in the pipeline.

Highly profitable as it may be, one imperfection of our Plaza 66 in Shanghai is its small size — about 55,000 square meters. Over the years, we have done all we could to expand it, and each expansion brought in increased total rent. Last summer, we received planning permission from the government to add 13% of retail space in a low-rise standalone building beside the existing Office Tower 2. The price of the addition is reasonable, and we can immediately start work.

As my readers know, Plaza 66 has had a long waiting list of potential tenants for a considerable period of time. Every brand, it seems, wants to be a tenant of ours. As such, leasing the space should not be a problem. In fact, we already have a good idea of what the future new tenants may be, and what rent they will likely pay. By knowing fairly well both the costs and possible income, the investment return is somewhat assured. When other similar significant opportunities materialize, Management will, of course, inform shareholders.

For now, I will only observe that, just as the first decade of the 2000s was an auspicious time for us in Hong Kong, when we acquired much land given the aftermath of the AFC of 1997-2002, we may be entering a similar period on the Mainland. During much of that decade (specifically, between 2002 and 2011), our stock price performance was among the very best of Hong Kong property counters. Whether this will happen again remains to be seen, but it is always a possibility.

The underlying causes of the trouble then and now are, however, quite different. The AFC originated in the capital market and led to a severe economic fallout. It was the biggest Asian bear market that I have seen since WWII. Its lingering effects lasted at least four to five years. Being well prepared for it, we greatly benefited.

First and foremost, today's trouble everywhere (and not just in China) is to a good extent politically instigated. The resulting deglobalization was exacerbated by the three-year pandemic. The economic effects are more fundamental in nature, more subtle, and slower to surface than traditional market downturns. When they do emerge, they will change the global economy in a systemic way. The future rise and fall of economies will be greatly affected by the political developments around the world. Of particular consequence will be the U.S., the EU, and China. As such, a certain understanding of geopolitics is indispensable today. All along, businesses will still be subjected to traditional economic forces, such as another financial crisis, which seems inevitable.

A main theme in the world today is deglobalization. It is driven to a good extent by the U.S.-China conflict. While the Trans-Pacific contest is in the short run dangerous, I have come to the conclusion that it should not lead to serious kinetic trouble. (Of course, I can be wrong.) Instead, what is happening domestically in the U.S. and the EU, as well as long-standing disputes in the Middle East, are greater sources of concern to me. As a result, I expect that once the present challenges from the U.S. subside, China will resume some reasonable level of economic growth. After all, America has many other problems, domestic and international, to contend with. Assuming that China can keep its society relatively calm, it will not surprise me if, in the coming years, the country will become a relatively peaceful haven in this troubled world.

If correct, our business on the Mainland may actually enjoy a somewhat stable environment with a gently rising economy. My regular readers should know by now that my guarded optimism is not based on some wide-eyed wishful thinking, but on half a century of observations and analyses.

I count myself fortunate to be in this business — primarily, luxury commercial space rental on the Mainland. If, over the next decade or so, China's economy expands annually by say 3.5% to 5%, and our sector outperforms it by two to three points, the future of the Company should be quite bright. After all, I expect that we would be able to outdo our direct competitors by some margin. The shareholder value accretion should be satisfactory.

Let me end with a few thoughts on our share price. We can divide the past 33 years broadly into three periods: 1991-1997, 1998-2008, and 2009-2022. In the first period ending with the return of Hong Kong to her Motherland, both the British and the Chinese had their own different reasons to keep the economy look good. As such, the stock market had to be strong. It was a period of high growth. The second period of 1998 to 2008 began with the AFC that began on July 2, 1997, the day after Hong Kong's return, but most people were unaware of its impact until the end of that year. The 11 years in this period were quite turbulent. In the middle we had the bursting of the Dotcom bubble in 2000, SARS in 2003 and, towards the end, the GFC. One may call it a phase of consolidation. Finally, the 14 years since 2009 were the post-GFC time of slow growth until the market fell during COVID-19.

Our shares only outperformed in the middle 11 years, i.e. the second period. Being a laggard in the seven years since 1991 was a legacy issue. We underperformed our peers in much of the 1970's and 1980's. By the early 1990's, the investment community had basically forgotten us. Many major brokerage houses had stopped covering us. Rightly so, for our performance did not particularly shine.

By the mid- to late 1990's, we were one of the very few companies that had foreseen the looming crisis of Hong Kong real estate price fall. We prepared ourselves well and then adroitly entered the market right before the market recovered around 2002. Also, no one paid attention to our Mainland strategy at that time, until soon after we opened our two Shanghai malls around 2000. Market analysts began to take notice of our stocks.

By the early 2000's, investors realized that the land in Hong Kong we bought could reap rich profits, and our Mainland rental business was taking off. That was when our share price began to outperform. For that decade taken as a whole, and among the 12 property counters active in Hong Kong and the Mainland like us, we were the best performing stock in terms of average

annual share price increase and dividend yield. All along, we quietly bought up top commercial land on the cheap in major cities outside Shanghai beginning in 2004.

By late 2011, the Central Government began to crack down on corruption. There was no denying that, at the time, black money was one reason for the thriving luxury retail business. Our sector fell into a six- to seven-year bear market and was shunned by investors. Top fashion houses froze all expansion plans. In the same period, we annually completed one big shopping center beginning in 2010. Initial growth pains were inevitable, and tangible results to encourage investors were still scarce. Facilities designed as luxury malls had to be downgraded to mass retail. It was the only way to fill up the huge space with tenants. Being the purest play on Mainland retail of all Hong Kong companies, investors stayed away from us.

By the end of 2017, it was evident that warmth had returned to the luxury retail sector. Our shares showed a temporary recovery, but the 2019 Hong Kong riots had dampened the enthusiasm for all local counters, ours included. This was followed by the three-year pandemic when almost all stock prices declined.

If we examine only the underlying growth of the same dozen of Hong Kong property counters over the past 33 years in terms of total return of book value increase and dividend yield, it turns out that they all fall within a somewhat narrow range. Over the three time periods defined above, corresponding to more or less three decades from 1991, no company performed well under all market conditions. Different strategies did better in one period but not in the others. Over the entire 33 years, we and our parent company Hang Lung Group (HLG) both performed somewhere in the middle of the pack.

The question then becomes: What may happen to our share price moving forward? Provided that my optimism about the Chinese market and our performance are not too farfetched, our stock price should enjoy another period of outperformance. A precondition is that the sentiment of the global investment community must once again accept China's continued economic rise.

Inasmuch as I expect our luxury retail properties on the Mainland would continue to perform nicely in the coming many years, the same cannot be said of Hong Kong's residential and commercial real estate. In Hong Kong, the decade-long artificial shortage of land for home building is on its way to being broken. With expected ample supply, apartment prices cannot repeat the leaps and bounds of yesteryears. In the long haul, it will help Hong Kong's competitiveness. On this point, I encourage my readers to also read my letter to HLG shareholders of today's date.

Hong Kong's commercial properties may undergo a downward adjustment in rents because our economy has nor been vibrant. Given increasing physical connectivity with the Greater Bay Area (GBA) north of the border, many of our citizens will not hesitate to take the short train ride there to spend money, say, on weekends. Price differential for services and products alike between Hong Kong and GBA can be significant, and their quality has improved tremendously in recent years. Since the end of the pandemic, I have several times taken the train or traveled by car to Shenzhen just across the Shenzhen River. I can testify that the food, both at the averagely priced eateries and Michelin quality restaurants, has great value for money compared to Hong

Kong. As more consumer dollars migrate north, sales transacted in Hong Kong will decline. Our rents will fall, leading to lower asset value and even an expansion of the cap rate. Hong Kong property prices and those of the GBA will, over time, converge somewhat. It is inevitable, and is not necessarily bad for Hong Kong's longer-term competitiveness.

Given an overall weaker economy together with geopolitical and geo-economic attacks from the West, such as on our financial service industry, Hong Kong's office rents can hardly rise. This is not to mention that there is an overbuilt of supply.

The only subsegment of our industry that will be relatively healthy will be luxury homes. It is the only kind of land that we have been buying in Hong Kong in recent years. It is a niche business whose volume cannot be big.

Given this overall industry landscape, Hong Kong developers who have for decades rely only on developing mass residential will have a difficult time generating former levels of profit. Those who have not built up a decent rental portfolio, locally or on the Mainland, will find it challenging to survive. The only exception is that a few of our peers have, in recent decades, diversified into other businesses that are doing well.

After having ventured into the Mainland market for 33 years, we are fortunate to be in the right sector. The assets that we have developed are not inconsequential. They bring some of the highest rents in the industry. We also have built an experienced management team that is competent and stable. Increasingly, senior management is led by bright younger talents from our Management Trainee program, which is highly sought after by recent university graduates.

We have also successfully created and nurtured a top brand for top-end commercial properties. It may be easier to develop a hotel brand that is by nature B2C (Business-to-Customers). As a result, a few Hong Kong hospitality groups have, over the decades, built globally recognizable brands of value. Fewer are those who manage to create brand equity for commercial buildings that are at once B2B (Business-to-Business) and B2C — we rent to retail operators but also directly interact with shoppers. Our "66" name is certainly among the most valuable brands in the whole of mainland China.

All these assets, tangible or intangible, will put us in good stead for a sustainable and prosperous future.

Farewell

This is the last time I am writing this *Chair's Letter to Shareholders*. Last year, I notified the Board of my intention to retire from the chairmanship at our next Annual General Meeting (AGM), which falls on April 26, 2024. It is also my desire not to be a Non-Executive Director. Your Board and that of our majority shareholder HLG have kindly bestowed upon me the title of Honorary Chair, which I am proud to accept. I am permitted to attend Board meetings but will no longer have voting rights.

The Board has chosen Mr. Adriel Chan, now 41 years of age, to succeed me on April 26. This is the culmination of a succession plan that has lasted over a decade. After growing up in Hong Kong and attending university in the U.S., Adriel decided to move to Beijing to brush up his

Putonghua at Peking University, or Beida, until he was offered the opportunity to work for a year at a New York City-based not-for-profit that was related to Asia. Upon successfully completing that assignment, he returned to mainland China, this time to Shanghai. He spent around three years with the audit and consulting firm KPMG, followed by not quite two years at HSBC. Being entrepreneurial from a young age, Adriel joined Hang Lung in Shanghai in 2010 when he was 28 years old. Two years later, in 2012, he was transferred to the headquarters in Hong Kong where he has worked since.

Adriel's increased responsibilities over the years have enabled him to oversee all aspects of our business. He is particularly keen on sustainability issues. After being promoted to be an Executive Director in 2016, thus joining the board of directors, he was tasked by the Board to identify a new CEO to succeed the then-retiring Mr. Philip Chen. The search was an evident success. Adriel has been working closely and well with our present CEO, Mr. Weber Lo, since 2018, and has essentially assumed overall responsibility for the entire operation led by Weber. In 2020, Adriel became Vice Chair. Thereupon, I have asked him to write a *Vice Chair's Notes* to supplement my semi-annual *Chair's Letter to Shareholders*.

Throughout this process of succession planning, the entire Board has been fully engaged. Nevertheless, I would like to single out four members for their leadership — Professor Pak Wai Liu, Mr. Dominic Ho, Mr. Philip Chen, and my brother Dr. Gerald Chan. If Adriel's chairmanship is a success, as we expect it to be, they should each take some credit for it.

Our founder and my late father, Mr. T.H. Chan, was 35 years of age when he established his first company Tai Lung Construction & Investment Co. Soon after turning 41, he founded Hang Lung on September 13, 1960. In 1991, when I took over the chairmanship from my uncle Mr. Thomas Chen, I too had just turned 41. Serendipitously, Adriel is now 41 years of age.

Over the years, there has been much speculation in the market surrounding what happened to Hang Lung leadership upon the passing of our founder. Here is what transpired.

Following my father's untimely passing in 1986, someone needed to tend to the non-public side of his business. The responsibility fell on me. I encouraged my brother Gerald, who is a scientist, to join me in sorting out the family assets, which we successfully did. As my uncle Mr. Thomas Chen had assisted my father since Hang Lung's founding, it was only natural that he should assume the chairmanship of the public company.

Upon taking up the leadership at Hang Lung, Uncle Thomas, who is a true gentleman in every sense of the word, informed me of his decision to pass the chairmanship to me in January 1990. Due to further reorganization of the non-public side of the business, I asked Uncle Thomas in mid-1989 if he could stay on for another year, and I was grateful that he consented. Hence, I assumed the Hang Lung chairmanship on January 1, 1991 when I was the age of 41.

In one form or another, I have been involved with this Company since it went public in 1972, almost 52 years ago. In 1980, I took up executive functions. With the exception of a short interlude, I have been in company management for over 40 years. Through thick and thin, we have created acceptable shareholder value.

Equally satisfying is that we have built a reputation for being among the most ethical real estate developers in Hong Kong, and now also in mainland China. As illustrated by this semi-annual letter to shareholders, we are likely the most transparent with shareholders in the industry. I like to think that our corporate governance, or more broadly, our ESG (Environmental, Social, and Governance), is among the best. As our motto says: **We Do It Right**, and more recently, **We Do It Well**! This, I trust, is our legacy.

There is little doubt in my mind that, in Hong Kong, we have one of the most engaged and diligent operating board of directors in the industry. Their stewardship of all aspects of risk management is something I am most appreciative. The Company has been professionally managed for almost 40 years, with four successive CEOs who are all non-family members. Only the Executive Chair among all Executive Directors is a Chan.

Our management team is competent, and our corporate culture is healthy. We are financially sound and cautious. Our reputation in the marketplace, including our company name and product branding, is highly recognizable, respectable, and valuable. The quality of our recurrent rental income on the Mainland is unmatched. Consequently, I have every confidence that Hang Lung will continue to thrive for many years to come.

That said, of all people, I know there is much room for improvement. Our team under Adriel and Weber will surely do that. To steer the Company through the present economic uncertainty, and to position ourselves for the upcoming market recovery, will require mental agility and operational skill. We must learn from experience, yet not be bound by it. I have full confidence in our top management team to navigate such treacherous waters. After all, our Executive Directors are guided and supported by a highly experienced Board, with members of diverse expertise. Once the present economic malaise passes, and it undoubtedly will, we will return to a growth mode, and will be presented with many new opportunities.

Considering all that, I am convinced that this is a good time for me to retire from the Board. The ship is in good shape and in highly capable hands. I trust that our shareholders and potential shareholders will share my confidence. As long as the Chinese economy and our market do not collapse, which I do not foresee, this Company should do very well indeed.

Before putting down my pen, I want to thank my many colleagues over the decades. You are the ones who make Hang Lung successful. In particular, I am blessed to have worked with four different CEOs over the past 30-some years: the late Mr. S.S. Yin (for only a short time), Mr. Nelson Yuen, Mr. Philip Chen, and now Mr. Weber Lo. Each of them, at different stages of the Company, has made unique contributions. Much credit accorded to me actually belonged to them. Thank you!

However, a management team is more than a few of its top people. Many others have also become my comrades-in-arms, personal friends, as well as wonderful teachers, like Mr. Norman Chan (former head of leasing), Mr. H.C. Ho (former CFO), and Mr. C.F. Kwan (former head of corporate communications and investor relations). All have retired in the past three years, and each has, in his own way, enriched my professional career. I thank you, and I am proud of you.

I also express my appreciation to the many loyal readers of this letter spread far and wide. The phenomenon surprised me, for I wrote merely out of duty — I have a strong sense of the

need to be transparent with shareholders. While traveling with colleagues in a major city in western China right before COVID-19, a well-groomed man perhaps in his late 30's approached me while we were having coffee at Starbucks. He thanked me for having regularly written this letter. The same thing happened just 12 days ago, when I was having coffee with one of our Independent Non-Executive Directors at the airport hotel in Houston. This time, the person had to be well into his 40's. Even Chinese government officials have told me that they regularly read this letter. As I write my last letter, I would like to thank them all. I can assure you that for the past 33 years, much time and effort have been exerted to pen these letters. In total, I have produced 144 of them.

One may ask: do you plan to continue writing as the Honorary Chair? I do not have plans to do so. Over the past 20 years or so, I have voluntarily left the chairmanship of many not-for-profits, some of which I founded and/or built over long years, such as, the Asia Society, the Asia Business Council, and the One Country Two Systems Research Institute. My perfect track record is that I have never meddled in their businesses since. Once retired, I let my successor have a free hand to lead the organization. I intend to do exactly that at Hang Lung.

That notwithstanding, as Honorary Chair, I will retain a relatively small office at Hang Lung headquarters to facilitate the many community-related activities that the Board deems beneficial to the Company. No doubt, I will be watching out for the best interest of the Company and communicate as appropriate my views to Management. After all, the Chan family remains the biggest shareholder of HLG, and through it, this Company.

In the coming months, there will be other changes to the Board. Mr. Dominic Ho, a long-serving Independent Non-Executive Director (INED), has notified us of his desire to retire from the Board at our next AGM in April. Now living on the other side of the globe has made physically attending meetings increasingly difficult. After all, none of us is getting any younger. Dominic was once the chair of KPMG's China practice. His business mind is one of the sharpest I know, not to mention his professional expertise and knowledge of China, where he once lived and worked since 1984. His contribution to the Company has been invaluable. On behalf of the Board, I thank him most sincerely.

On the advice of the Nomination and Remuneration Committee, the Board has today invited Ms. Holly Li to join as an INED, and she has accepted. Growing up in China and having developed a highly successful career there in mass retail, Holly's expertise is complementary to the Board. I believe that our shareholders would welcome her presence. She should be able to join our March Board meeting. I look forward to introducing her to shareholders at our April AGM.

Ronnie C. Chan
Chair
Hong Kong, January 30, 2024